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The Scope of Accounting Requirements for Decreases in Ownership of a Subsidiary

Requirements for recognizing a decrease in the ownership of a subsidiary would explicitly apply to all subsidiaries and groups of assets that are businesses or nonprofit activities, but would not apply to in-substance sales of real estate, under a new FASB proposal that would modify the scope provisions that became GAAP with the passage of Statement 160 on noncontrolling interests.¹ The proposal would clarify that the Statement 160 decrease-in-ownership requirements would apply to transfers of a subsidiary that is a business or nonprofit activity to an equity-method investee or joint venture and to exchanges of a group of assets that constitute a business or nonprofit activity for a noncontrolling interest in another entity. It would also expand required disclosures about the fair-value measurements in accounting for a change in ownership of a subsidiary.

Comments on the proposal are due by September 28, 2009.

Statement 160's decrease-in-ownership provisions require an entity that ceases to have a controlling interest in a subsidiary to deconsolidate that subsidiary, recognizing a gain or loss on the transaction and remeasuring any retained investment in the former subsidiary at fair value. A decrease in the ownership interest in a subsidiary that does not result in deconsolidation must be accounted for as an equity transaction with no gain or loss recognized for any difference between the portion of the subsidiary that is sold and the consideration received from the buyer.

The Scope Definition

Current GAAP requirements for recognizing a decrease in the ownership of a subsidiary generally apply only to subsidiaries that are legal entities, including unincorporated entities,

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¹ Proposed Accounting Standards Update, Accounting and Reporting for Decreases in Ownership of a Subsidiary—a Scope Clarification, and FASB Statement No. 160, Noncontrolling Interests in Consolidated Financial Statements, both available at www.fasb.org. Statement 160's requirements are included in FASB ASC 810, Consolidation, available at www.fasb.org.

such as partnerships or trusts. The requirements currently do not apply to groups of assets that do not meet the GAAP definition of a legal entity, even if they meet the GAAP definition of a business.² The FASB's proposal would include within the scope of the decrease-in-ownership accounting requirements subsidiaries that are businesses or nonprofit activities and groups of assets that constitute businesses or nonprofit activities even when those assets are not within a separate legal entity. This explicitly includes subsidiaries that are transferred to an equity-method investee or joint venture and exchanges of groups of assets that are businesses or nonprofit activities for a noncontrolling interest in an entity, including an equity-method investee or joint venture. Accounting for subsidiaries that are in-substance real estate would continue to be governed by the requirements that originated in Statement 66 on accounting for sales of real estate.³

The proposed requirements would not change accounting for transactions that increase an ownership interest in a controlled subsidiary, regardless of whether that subsidiary is a business, nonprofit activity, or in-substance real estate.

The change in applicability would align the accounting for both business combinations achieved in stages and dispositions by recognizing any preacquisition or retained interest at its fair value. A consequence, the Board pointed out, would be to limit structuring opportunities — for example, transferring assets to a legal entity and thereby avoiding other GAAP requirements, such as the requirements on transfers of interests in financial assets, including the guidance on whether such transfers represent sales or secured borrowings.⁴

Subsidiary Transferred to an Equity-Method Investee or Joint Venture

The revisions to the scope of the decrease-in-ownership requirements would resolve questions from constituents about accounting for transactions in which an entity transfers an interest in a subsidiary to an equity-method investee that results in losing control of the subsidiary. For example, assume a parent company transfers a wholly owned subsidiary to that parent's equity-method investee. The parent owns a 30% interest in the investee. Under equity-method accounting requirements, the gain or loss on the portion of the interest in the subsidiary retained through ownership of the equity-method investee would not be recognized until the gain or loss has been realized through transactions outside the group.⁵ Under the proposed decrease-in-ownership scope change, the entire gain or loss would be recognized because the transfer led to the parent company's loss of control, which in turn led to the deconsolidation of the subsidiary.

Questions had also been raised about accounting for transfers of a controlling interest in a subsidiary in exchange for a joint-venture interest. Such investments in joint ventures are now generally accounted for at the historical carrying value of the transferred interest in the subsidiary (although some gain may be recognized in limited circumstances). Under the proposed decrease-in-ownership scope change, the transfer of the interest in the subsidiary to a joint venture would result in deconsolidation with gain or loss recognized in earnings, and the residual joint-venture interest would be measured at fair value.

² FASB ASC 805, Business Combinations (FASB Statement No. 141 (revised 2007), Business Combinations), available at www.fasb.org.

³ FASB Statement No. 66, Accounting for Sales of Real Estate, available at www.fasb.org. The applicable requirements are now in FASB ASC 360-20, Real Estate Sales, and 976-605, Real-Estate-Retail Land-Revenue Recognition, both of which are available at www.fasb.org.

⁴ FASB ASC 860, Transfers and Servicing (FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities), available at www.fasb.org.

⁵ FASB ASC 323, Investments-Equity Method and Joint Ventures (APB Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock), available at www.fasb.org.

Exchange of a Group of Assets for a Noncontrolling Interest

The FASB's proposal would mandate that accounting for a transfer of a group of assets that constitutes a business or nonprofit activity in exchange for a noncontrolling interest in another entity should be governed by the Statement 160 decrease-in-ownership requirements even if the group of assets is not transferred in the form of a separate legal entity. The guidance for such changes is currently limited to subsidiaries that are exchanged for a noncontrolling interest in another entity.⁶ The change responds to concerns expressed by constituents that accounting for exchanges of groups of assets that constitute businesses should be consistent whether the business being transferred is in the form of a group of assets or a legal entity.

In-substance Real Estate

The proposal would exclude transactions that are in substance the sale of real estate from the scope of the decrease-in-ownership accounting requirements even if the subsidiary involved is a business, thereby preserving the specific GAAP accounting requirements for sales of real estate.⁷ The unrevised Statement 160 requirements contain no scope exceptions for transactions with subsidiaries that are within the scope of the requirements on accounting for real estate, and the accounting outcomes from applying the decrease-in-ownership requirements can differ considerably.

To illustrate the potential differences, assume a parent entity owns a 100% interest in a subsidiary that in substance is an investment in real estate and sells a 30% interest to a third party. Gain or loss on the portion sold may qualify for recognition under the real-estate accounting requirements. Under the decrease-in-ownership requirements, no gain or loss would be recognized in income if the sale of the 30% interest did not lead to the subsidiary's deconsolidation. However, if the parent sold a 60% interest in the subsidiary to a third party and thereby gave up control, partial gain or loss may still be recognized under the real-estate accounting requirements, but the Statement 160 decrease-in-ownership requirements would currently require that the subsidiary be deconsolidated with a gain or loss recognized in income for both the portion sold and the fair value of the portion retained. The proposal would clarify that the real-estate accounting requirements, not the Statement 160 requirements, would apply to decreases in ownership of subsidiaries that are in-substance real estate.

Subsidiaries that Are Not Businesses or Nonprofit Activities

The proposal would eliminate decreases in ownership of subsidiaries that are not businesses or nonprofit activities from the scope of the Statement 160 requirements, but would provide no other guidance on accounting for the sale of a partial or entire interest in a subsidiary that is not a business or nonprofit activity. Entities would be required to evaluate the substance of the subsidiary and the transaction and apply other applicable GAAP. Other applicable GAAP would depend on the circumstances, but could include revenue recognition guidance for transfers of financial assets and for sales of real estate. The Board believes that the Codification's framework for applying accounting principles provides sufficient guidance for selecting the appropriate accounting principle in the absence of specific guidance from other GAAP.⁸

⁶ FASB ASC 845-10, Nonmonetary Transactions-Overall (EITF No. 01-2, Interpretations of APB Opinion No. 29), available at www.fasb.org.

⁷ FASB Statement No. 66, Accounting for Sales of Real Estate, available at www.fasb.org. The applicable requirements are now in FASB ASC 360-20, Real Estate Sales, and 976-605, Real-Estate-Retail Land-Revenue Recognition, both of which are available at www.fasb.org.

⁸ FASB ASC 105, Generally Accepted Accounting Principles, available at www.fasb.org.



Additional Disclosures

The FASB proposal would require three additional disclosures about the deconsolidation of a subsidiary or group of assets that constitute a business or nonprofit activity. The first is the valuation techniques used to measure the fair value of any direct or indirect retained investment in the former subsidiary and information that enables users of its financial statements to assess the inputs used to develop the measurement. The second is the nature of continuing involvement with the subsidiary after it has been deconsolidated. Finally, the reporting entity would have to disclose the valuation techniques used to measure an equity interest in an acquiree held by the entity immediately before the acquisition date in a business combination achieved in stages. All of the disclosures already required by GAAP when recognizing a decrease in the ownership of a subsidiary would continue to be required.

Effective Date and Transition

The proposed requirements would be effective beginning in the period that Statement 160 is adopted. Statement 160 applies to fiscal years, and interim periods within those fiscal years, beginning after December 15, 2008 (January 1, 2009 for calendar-year companies). If Statement 160 was adopted before the proposed requirements are issued, the proposed requirements would be effective beginning in the first interim or annual reporting period ending on or after December 15, 2009, and the requirements would have to be applied retrospectively to the first period that Statement 160 had been adopted.

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