

FASB Interpretation No. 4

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Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method

an interpretation of FASB Statement No. 2

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Financial Accounting Standards Board
of the Financial Accounting Foundation
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FIN 4: Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method

an interpretation of FASB Statement No. 2

INTRODUCTION

1. The FASB has been asked to explain the applicability of *FASB Statement No. 2*, "Accounting for Research and Development Costs," to the cost of tangible and intangible assets to be used in research and development activities of an enterprise when those assets are acquired in a business combination accounted for by the purchase method.
2. Broad guidelines about the activities to be classified as research and development and the elements of costs to be identified with those activities are set forth in paragraphs 8-11 of *Statement No. 2*. Paragraph 12 of that Statement provides that research and development costs shall be charged to expense when incurred. However, some costs associated with research and development activities shall be capitalized if the item has alternative future uses in research and development or otherwise (see paragraphs 11(a) and 11(c) of *Statement No. 2*). The cost of materials consumed, the depreciation of equipment and facilities used, and the amortization of intangibles used in research and development activities are research and development costs.
3. *Statement No. 2* amends *APB Opinion No. 17*, "Intangible Assets," to exclude from the scope of that Opinion those research and development costs encompassed by the Statement but does not amend *APB Opinion No. 16*, "Business Combinations." Paragraph 34 of the Statement indicates that paragraph 11(c) is not intended to alter the conclusions in paragraphs 87-88 of *APB Opinion No. 16* regarding allocation of cost to assets acquired in a business combination accounted for by the purchase method.

INTERPRETATION

4. The intent of paragraph 34 of *Statement No. 2* is that the allocation of cost to the identifiable assets of an acquired enterprise shall be made in accordance with the provisions of

APB Opinion No. 16. Therefore, costs shall be assigned to all identifiable tangible and intangible assets, including any *resulting from* research and development activities of the acquired enterprise or to be *used in* research and development activities of the combined enterprise. Identifiable assets *resulting from* research and development activities of the acquired enterprise might include, for example, patents received or applied for, blueprints, formulas, and specifications or designs for new products or processes. Identifiable assets to be *used in* research and development activities of the combined enterprise might include, for example, materials and supplies, equipment and facilities, and perhaps even a specific research project in process. In either case, the costs to be assigned under *APB Opinion No. 16* are determined from the amount paid by the acquiring enterprise and *not* from the original cost to the acquired enterprise.

5. The subsequent accounting by the combined enterprise for the costs allocated to assets ¹ *to be used in* research and development activities shall be determined by reference to *Statement No. 2*. Paragraph 12 of *Statement No. 2* requires that costs identified with research and development activities shall be charged to expense when incurred unless the test of alternative future use in paragraph 11(a) or 11(c) is met. That requirement also applies in a business combination accounted for by the purchase method. Accordingly, costs assigned to assets to be used in a particular research and development project and that have no alternative future use shall be charged to expense at the date of consummation of the combination. Therefore, the accounting for the cost of an item to be used in research and development activities is the same under paragraphs 11 and 12 of *Statement No. 2*, whether the item is purchased singly, or as part of a group of assets, or as part of an entire enterprise in a business combination accounted for by the purchase method.

EFFECTIVE DATE AND TRANSITION

6. Because there have been varying interpretations of *Statement No. 2* with respect to the accounting for the cost of tangible and intangible assets covered by this Interpretation, the Board has concluded that it shall be effective as follows:

- a. Application of this Interpretation to business combinations accounted for by the purchase method that are initiated ² after March 31, 1975 is required.
- b. Application of this Interpretation to business combinations accounted for by the purchase method that are initiated prior to April 1, 1975 and consummated after March 31, 1975 is encouraged but is not required. It may be applied selectively to those combinations.
- c. Application of this Interpretation to business combinations accounted for by the purchase method that were initiated and consummated prior to April 1, 1975 is encouraged but is not required. If an enterprise chooses to apply this Interpretation to those combinations, it shall be applied retroactively as described in paragraphs 15 and 16 of *Statement No. 2* to *all* business combinations accounted for by the purchase method that were consummated prior to April 1, 1975.

7. This Interpretation shall not be applied prior to the initial application of *Statement No. 2*.

This Interpretation was adopted by the unanimous vote of the seven members of the Financial Accounting Standards Board following submission to the members of the Financial Accounting Standards Advisory Council.

Marshall S. Armstrong, *Chairman*

Oscar S. Gellein

Donald J. Kirk

Arthur L. Litke

Robert E. Mays

Walter Schuetze

Robert T. Sprouse

Footnotes

FIN4, Footnote 1--In this regard, paragraph 69 of *APB Opinion No. 16* states in part that: "The nature of an asset and not the manner of its acquisition determines an acquirer's subsequent accounting for the cost of that asset."

FIN4, Footnote 2--See paragraph 46(a) of *APB Opinion No. 16* for the definition of "initiated."