REVISED MINUTES

Financial Accounting Standards Board

To:	Board Members
From:	Business Combinations: Applying the Acquisition Method Team (Bennett, Ext. 229; Rhine, Ext. 296)
Subject:	Revised Minutes of the July 19, 2006 Board Meeting
Date:	August 14, 2006
cc:	FASB: Bielstein, Smith, MacDonald, Bossio, Tamulis, Posta, Vessels, Bennett, Rhine, Todorova, Glotzer, Lapolla, Polley, Gabriele, Sutay, Carney, Allen, FASB Intranet; IASB: Leisenring, Upton, Hickey, Teixeira, Buschhueter, Quiring

The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue a final Statement or Interpretation.

Topics:	Identifying the Components of a Business Combination; Accounting for Restructuring Costs in a Business Combination; and Measurement Date for Equity Instruments Issued as Consideration
Basis for Discussion:	Board Memorandums No. 21–23
Length of Discussion:	8:00 to 8:50 a.m.

Attendance:

Board members present:	Batavick, Crooch, Herz, Linsmeier, Seidman, Trott, and Young
Staff in charge of topic:	Teixeira and Vessels
Other staff at Board table:	Bielstein, Rhine, and Bennett
IASB participants:	Buschhueter and Quiring (by phone)

Summary of Decisions Reached:

The Board continued redeliberations of its June 2005 Exposure Draft, *Business Combinations.* The Board discussed the principles and related guidance for identifying the components of a business combination, the accounting for restructuring costs in a business combination, and the measurement date for equity instruments issued as consideration.

1. The Board supported the following general principles and related guidance for assessing whether a business combination includes any transactions that are separate from the acquisition of assets and assumption of liabilities that make up the acquiree:

    a. The acquirer should assess whether a business combination includes any transactions that are substantively separate from the acquisition of assets and assumption of liabilities that make up the acquiree. Only the consideration transferred and the assets acquired or liabilities assumed that make up the acquiree should be accounted for using the acquisition method. Other transactions should be accounted for separately in accordance with other IFRS/U.S. GAAP.

    b. A transaction is substantively separate from a business combination if it was arranged by or on behalf of the acquirer and/or initiated primarily for the economic benefit of the acquirer or the combined entity (rather than for the benefit of the acquiree or its former owners prior to the business combination).

    c. The acquirer should consider the following factors, which are neither mutually exclusive nor individually conclusive, to determine whether a transaction or event is initiated primarily for the economic benefit of the acquirer or combined entity, rather than for the acquiree or its former owners prior to the business combination:

        (1) The reasons for the transaction or event

        (2) Who initiated the transaction or event

        (3) The timing of the transaction or event.

    The Board instructed the staff to continue to clarify and improve those principles and related guidance as it drafts the final Statement.

2. The Board affirmed that an acquirer should recognize restructuring or exit costs as liabilities assumed in a business combination **only if** those costs

meet the recognition criteria in FASB Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities,* **and** those liabilities are deemed a liability of the acquiree assumed as part of the business combination. Restructuring or exit costs that do not meet the criteria for recognition in Statement 146 or that arise from transactions or events substantively separate from the business combination should be recognized as separate transactions when the costs are incurred in the postcombination period.

3. The Board affirmed that the fair value of equity instruments issued as consideration in a business combination should be measured at the **acquisition date.**

Objectives of Meeting:

The objectives of the meeting were for the Board to discuss the following topics as a part of the redeliberations of the FASB's and the IASB's joint business combinations Exposure Draft:

1. Identifying the components of a business combination
2. Accounting for restructuring costs in a business combination
3. Measurement date for equity instruments issued as consideration.

Those objectives were met.

Matters Discussed and Decisions Reached:

TOPIC 1: IDENTIFYING THE COMPONENTS OF A BUSINESS COMBINATION

1. Ms. Vessels stated that a business combination might be comprised of several substantively separate yet related transactions or events (referred to as **components** of a business combination in this discussion). For example, in exchange for the total consideration transferred as part of the business combination, an acquirer might have received services to assist with the completion of the acquisition, in addition to acquiring the assets and assuming the liabilities that comprise the acquiree.

2. Ms. Vessels noted that it is important to identify the components of the business combination so that each component is accounted for appropriately. This objective will provide users with relevant information about the financial effects of transactions and events entered into by the acquirer. The component that involves acquiring the assets and assuming the liabilities that comprise the acquiree is accounted for using the acquisition method. The other components, such as the incurrence of acquisition related costs, should be accounted for separately in accordance with other U.S. GAAP.

3. Ms. Vessels stated that the guidance in the Exposure Draft focused on assessing whether the assets acquired or the liabilities assumed or any portion of the consideration transferred was not part of the exchange for the acquiree. She informed the Board that respondents had mixed views on that proposed guidance. Respondents generally agreed that acquirers should assess whether any portion of the transaction price and any assets acquired or liabilities assumed or incurred should be included in the initial business combination accounting or should be accounted for as transactions separate from the business combination accounting. Some respondents stated that the proposed guidance was sufficient, while others thought the proposed guidance lacked a clear principle. She noted that most respondents' comments related to the specific guidance proposed for preexisting relationships, payments to employees, and exchanges of share-based payment awards. The staff plans to address those comments and issues at a future Board meeting.

4. Ms. Vessels stated that the staff carefully considered constituents' comments and recommended that the following principles be included in the final Statement:

> The acquirer should assess whether a business combination includes any transactions that are substantively separate from the acquisition of assets and assumption of liabilities that comprise the acquiree. Only the consideration transferred and the assets acquired or liabilities assumed that comprise the acquiree shall be accounted for using the acquisition

method. Other transactions should be accounted for separately in accordance with other IFRS/U.S. GAAP.

> A transaction or event arranged by or on behalf of the acquirer and/or initiated primarily for the economic benefit of the acquirer or the combined entity (rather than for the benefit of the acquiree or its former owners **prior to** the business combination) is a substantively separate transaction.

In addition, the staff recommended that the following guidance proposed in the Exposure Draft be included in the final Statement to assist constituents in assessing whether a transaction is substantively separate from the acquisition of assets and assumption of liabilities that comprise the acquiree:

> The acquirer should consider the following factors, which are neither mutually exclusive nor individually conclusive, to determine whether a transaction or event is initiated primarily for the economic benefit of the acquirer or combined entity, rather than for the acquiree or its former owners prior to the business combination:
>
> a. The reasons for the transaction or event
>
> b. Who initiated the transaction or event
>
> c. The timing of the transaction or event.

5. The Board generally supported the revised principles and related guidance recommended by the staff. Some Board members suggested that the staff consider additional clarifications and improvements as it drafts the final Statement. For example, Mr. Young suggested that an additional factor that should be considered is whether an activity would have occurred absent a business combination. Several Board members agreed that the staff should consider alternative ways of expressing the principles and guidance when drafting the final Statement.

TOPIC 2: ACCOUNTING FOR RESTRUCTURING COSTS IN A BUSINESS COMBINATION

6. Ms. Vessels stated that the Exposure Draft proposed that acquirers recognize the acquisition date fair value of liabilities for restructuring or exit activities only if they meet the recognition criteria in Statement 146. This is consistent with the recognition principle that the Board agreed to at the March 2006 Board meeting.

7. Ms. Vessels noted that most respondents that commented on the proposed accounting for restructuring costs apply U.S. GAAP and disagreed with the proposal for the following reasons:

a. Acquirers factor restructuring costs into the amount they are willing to pay for an acquiree. As a result, those costs should be included in the initial business combination accounting.

b. The proposal is inconsistent with the Board's decisions regarding contingencies in a business combination.

c. Capitalizing restructuring costs as part of the business combination is consistent with the guidance for other assets in which the amount capitalized is equal to the amount paid to acquire and place the asset in service.

8. Ms. Vessels stated that the staff agrees that an acquirer would factor a variety of costs into its decision to purchase a business; however, the acquirer does not pay the owner of the acquiree for anticipated costs or activities and the acquirer's plans to undertake those activities do not give rise to an obligation at the acquisition date. The acquirer usually incurs the liability associated with such costs after it gains control of the business. In the second argument, the staff believes that the proposals for restructuring costs are consistent with the Board's decisions for contingencies because, in both cases, an entity recognizes a liability when an obligation arises from either a contingency or restructuring activity that meets the definition of a liability at the acquisition date. Finally, the staff believes that some constituents might be confusing anticipated costs with actual costs incurred. Restructuring costs that meet the criteria for capitalization

under U.S. GAAP should be capitalized when the costs are incurred in the postcombination period. As a result of the staff's analysis, Ms. Vessels recommended that the Board affirm the proposal in the Exposure Draft.

9. The Board affirmed that an acquirer should recognize restructuring or exit costs as liabilities assumed in a business combination **only if** those costs meet the recognition criteria in Statement 146 at the acquisition date, **and** those liabilities are deemed a liability of the acquiree assumed as part of the business combination. Restructuring or exit costs that do not meet the criteria for recognition in Statement 146 or that arise from transactions or events substantively separate from the business combination should be recognized as separate transactions when the costs are incurred in the postcombination period. Therefore, those costs would be recognized as separate transactions when the costs are incurred in the postcombination period (all Board members agreed).

10. Mr. Batavick stated that the acquirer does not pay the owner of the acquiree for the anticipated restructuring or exit costs, and the acquirer's plan to undertake those activities does not give rise to an obligation and associated liability at the acquisition date. The liability associated with such costs is usually incurred by the acquirer after it gains control of the business.

11. Mr. Young suggested that the staff consider including a disclosure requirement for restructuring activities. That disclosure information would be useful for projecting future cash flows. Mr. Herz added that the user community would also be interested in a disclosure that provides information about all the costs associated with the business combination. Those costs would include restructuring and exit costs, payments to third parties, and transaction expenses.

TOPIC 3: MEASUREMENT DATE FOR EQUITY INSTRUMENTS ISSUED AS CONSIDERATION

12. Mr. Teixeira stated that the Exposure Draft requires that consideration transferred in a business combination be measured at its fair value on the date control is achieved (the acquisition date). Therefore, the fair value of any equity

securities issued as consideration in a business combination should be measured at the acquisition date and not at the agreement or closing date.

13. Mr. Teixeira noted that FASB Statement No. 141, *Business Combinations,* and IFRS 3, *Business Combinations,* currently diverge on the measurement date for equity securities issued as consideration in a business combination. While IFRS 3 requires measuring equity instruments issued by the acquirer at the date of exchange, current U.S. guidance is contradictory. Paragraph 22 of Statement 141 states that the market price for a reasonable period before and after the date the terms of the acquisition are agreed to and announced should be considered in determining the fair value of the securities issued. However, paragraph 49 of Statement 141 states that the cost of an acquired entity could be determined at the acquisition date.

14. Mr. Teixeira informed the Board that respondents had mixed views on the measurement date for equity securities issued as consideration in a business combination. Those respondents who supported the proposal stated that it makes sense to measure all forms of consideration and the assets and liabilities on the same date. Other respondents disagreed with the proposals for the following reasons:

a. There is a direct alignment between the fair value of consideration transferred and the fair value of the acquirer's interest in the acquiree at the agreement date.

b. Subsequent changes in the fair value of the acquirer's equity instruments between the agreement date and the acquisition date could be due to factors unrelated to the business combination and should not affect the fair value of the acquirer's interest in the acquiree.

c. Subsequent changes in the fair value of the acquirer's equity instruments between the agreement date and the acquisition date lead inappropriately to either bargain purchase or overpayment situations.

15. Mr. Teixeira stated that in March 2006, the Board affirmed the following fair value measurement principle for applying the acquisition method: *in a business combination, the acquirer measures each recognized asset acquired*

and each liability assumed at its acquisition date fair value. At the May 2006 Board meeting, the Board discussed the reasons for making exceptions to the fair value measurement principle and agreed that only in narrowly defined circumstances should it depart from that principle. The staff does not believe that there are any exceptional reasons or arguments to warrant a departure from that principle in this case. Hence, the staff believes that the equity instruments issued as consideration should be measured on the acquisition date.

16. The Board affirmed that the fair value of equity instruments issued as consideration in a business combination should be measured at the date the acquirer achieves control (the acquisition date) (six Board members agreed; one did not (LFS)). Mr. Trott stated that measuring equity instruments issued as consideration in a business combination on the acquisition date is preferable conceptually and practicably because the Board is not creating an exception to the measurement principle that the Board had agreed to in March 2006. Messrs. Herz and Linsmeier stated that while they both agree with using the acquisition date for practical purposes, especially when no renegotiations have taken place, they believe that the agreement date is a better measurement of the fair value of the acquiree as a whole.

17. Mr. Linsmeier asked the staff whether the concept underlying this measurement issue is to measure the fair market value of the assets given up or the fair market value of the assets received. He questioned the consistency between the Board's decision and other types of acquisition transactions outside of business combinations. He stated that the concept in measuring equity instruments at the acquisition date potentially conflicts with the measurement of options in FASB Statement No. 123 (revised 2004), *Share-Based Payment,* which measures stock options at the date of grant. He further stated that in circumstances in which an acquirer and an acquiree agreed to a transaction price consisting of cash and stock; if the economics underlying that agreement significantly change between the agreement date and the acquisition date, either party might have the ability to renegotiate the contract. Therefore, this further

proves that the value of the acquiree is determined at the agreement date because the only time the parties are allowed to reconsider the amount of the transaction price is when the amount materially differs between the agreement and acquisition dates. He noted that the staff should consider a core concept that could be applied in both the measurement of equity instruments in a business combination and in other situations. That would provide consistency across U.S. GAAP.

18. Ms. Seidman stated that in a 100 percent acquisition, the fair value of the consideration transferred is generally the best evidence of the fair value of the acquiree as a whole at the agreement date. She noted her objections to the Boards' decisions for full goodwill and bargain purchases at the March 2006 Board meeting. At that Board meeting, Ms. Seidman stated that she prefers the partial goodwill method because she believes that method links the Day One measurement as closely as possible to the consideration paid, and it avoids extrapolating a value to the goodwill attributable to the piece of the entity that was not acquired. In addition, she also disagreed that an acquirer should recognize a gain on the acquisition date for a bargain purchase because recognizing a gain on a bargain purchase is inconsistent and potentially conflicts with the transaction price presumption (that is, the price paid is presumptively the fair value of the arrangement). Ms. Seidman stated that in a business combination in which the acquirer issues equity securities as consideration, if the only factor that changed between the agreement date and the acquisition date is a decrease in the value of the acquirer's stock, the acquirer would have paid less for the acquiree on the acquisition date, which would potentially create a bargain purchase situation. Based on the Board's previous decisions for bargain purchases, the acquirer might recognize a gain on the business combination at the acquisition date. Ms. Seidman believes that recognizing a gain on a business combination due to the decrease of one's own stock distorts the financial reporting of the acquiring entity. Therefore, consistent with her support of the partial goodwill method and her views for bargain purchases, she believes that the agreement date is a better indicator of the fair value of the arrangement

(that is, the fair value of equity instruments issued as consideration in a business combination should be measured at the agreement date).

19. Mr. Herz and Ms. Seidman indicated that the Board's decision to use the acquisition date has implications on the measurement of goodwill, especially the noncontrolling interest's portion of goodwill. Mr. Teixeira informed the Board that the staff plans to discuss the measurement of noncontrolling interests and the implications on the measurement goodwill at the joint FASB-IASB meeting in October 2006.

Follow-Up Items:

None.

General Announcements:

None.