EITF ABSTRACTS

Issue No. 95-3

Title: Recognition of Liabilities in Connection with a Purchase Business Combination

[Nullified by FAS 141(R)]

Dates Discussed: January 19, 1995; March 23, 1995; May 18-19, 1995; July 20-21, 1995

References:
- FASB Statement No. 5, Accounting for Contingencies
- FASB Statement No. 38, Accounting for Preacquisition Contingencies of Purchased Enterprises
- FASB Statement No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of
- FASB Statement No. 141, Business Combinations
- FASB Statement No. 141 (revised 2007), Business Combinations
- FASB Statement No. 142, Goodwill and Other Intangible Assets
- FASB Statement No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets
- FASB Technical Bulletin No. 85-5, Issues Relating to Accounting for Business Combinations
- FASB Concepts Statement No. 6, Elements of Financial Statements
- APB Opinion No. 16, Business Combinations
- APB Opinion No. 30, Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions
- AICPA Accounting Interpretation 33, Costs of Maintaining an “Acquisitions” Department, of APB Opinion No. 16
- AICPA Accounting Interpretation 1, Illustration of the Application of APB Opinion No. 30
- SEC Staff Accounting Bulletin No. 92, Accounting and Disclosures Relating to Loss Contingencies

ISSUE

Company A acquires Company B in a business combination accounted for as a purchase.

In connection with the acquisition, Company A intends to incur costs to exit activities at both Company A and Company B. Furthermore, in order to combine the operations of the two companies, Company A plans to incur integration costs, such as training Company B personnel, relocating Company A and Company B personnel, upgrading
Company B’s computer system, consolidating and restructuring certain functions, and severance and other expenses relating to personnel performing duplicative functions.

The accounting issues are what types of direct, integration, or exit costs should be accrued as liabilities in a purchase business combination in accordance with Opinion 16 and when to recognize those costs.

**EITF DISCUSSION**

The Task Force reached consensuses, described below, that the costs of a plan to (1) exit an activity of an acquired company, (2) involuntarily terminate employees of an acquired company, or (3) relocate employees of an acquired company should be recognized as liabilities assumed in a purchase business combination and included in the allocation of the acquisition cost in accordance with Opinion 16 if specified conditions are met. [Note: This consensus has been nullified by Statement 141(R). See STATUS section.]

**Costs to Exit an Activity of an Acquired Company**

The Task Force reached a consensus that a plan to exit an activity of an acquired company exists if all of the following conditions are met:

1. As of the consummation date of the acquisition, management having the appropriate level of authority begins to assess and formulate a plan to exit an activity of the acquired company.
2. As soon as possible after the consummation date, management having the appropriate level of authority completes the assessment of which activities of the acquired company to exit and approves and commits the combined company to the plan. Although the time required will vary with the circumstances, the finalization of the plan cannot occur beyond one year from the consummation date of the acquisition.
3. The plan specifically identifies all significant actions to be taken to complete the plan, activities of the acquired company that will not be continued, including the method of disposition and location of those activities, and the plan’s expected date of completion.
4. Actions required by the plan will begin as soon as possible after the plan is finalized, and the period of time to complete the plan indicates that significant changes to the plan are not likely.
The Task Force reached a consensus that a cost resulting from a plan to exit an activity of an acquired company should be recognized as a liability assumed as of the consummation date of the acquisition only if the cost is not associated with or is not incurred to generate revenues of the combined entity after the consummation date and it meets either of the following criteria:

1. The cost has no future economic benefit to the combined company, is incremental to other costs incurred by either the acquired company or the acquiring company in the conduct of activities prior to the consummation date, and will be incurred as a direct result of the plan to exit an activity of the acquired company. The notion of incremental does not contemplate a diminished future economic benefit to be derived from the cost but, rather, the absence of the cost in either company’s activities immediately prior to the consummation date.

2. The cost represents an amount to be incurred by the combined company under a contractual obligation of the acquired company that existed prior to the consummation date and will either continue after the plan is completed with no economic benefit to the combined company or be a penalty incurred by the combined company to cancel that contractual obligation.

Task Force members observed that the above criteria are essentially the same as the criteria in Issue No. 94-3, “Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring),” for the recognition of a liability for costs, other than employee termination benefits, that are directly associated with a plan to exit an activity. Task Force members noted that the examples in Exhibit 94-3A illustrating the application of the criteria in Issue 94-3 may be helpful in applying the criteria described above.
Involuntary Employee Termination Benefits and Relocation Costs

The Task Force reached a consensus that a cost resulting from a plan to involuntarily terminate or relocate employees of an acquired company should be recognized as a liability assumed as of the consummation date of the purchase business combination and included in the allocation of the acquisition cost if all of the following criteria are met:

1. As of the consummation date of the acquisition, management having the appropriate level of authority begins to assess and formulate a plan to involuntarily terminate (relocate) employees of the acquired company.

2. As soon as possible after the consummation date, management having the appropriate level of authority completes the assessment of which employees of the acquired company will be involuntarily terminated (relocated), approves and commits the combined company to the plan of termination (relocation), and communicates the termination (relocation) arrangement to the employees of the acquired company. The communication of the termination (relocation) arrangement should include sufficient detail to enable employees of the acquired company to determine the type and amount of benefits they will receive if they are terminated (relocated). Although the time required will vary with the circumstances, the finalization of the plan of termination (relocation) and the communication of the termination (relocation) arrangement cannot occur beyond one year from the consummation date of the acquisition.

3. The plan of termination (relocation) specifically identifies the number of employees of the acquired company to be terminated (relocated), their job classifications or functions, and their locations.

4. Actions required by the plan of termination (relocation) will begin as soon as possible after the plan is finalized, and the period of time to complete the plan indicates that significant changes to the plan are not likely.

[Note: This consensus has been nullified by Statement 141(R). See STATUS section.]

The Task Force agreed that costs related to activities or employees of the acquired company that do not meet the conditions described above are indirect and general expenses related to the acquisition as discussed in paragraph 76 of Opinion 16. [Note: This consensus has been nullified by Statement 141(R). See STATUS section under Business Combinations.] The Task Force also agreed that, with respect to exit plans and involuntary employee termination and relocation plans, initial or revised plan actions that result from events occurring after the consummation date do not result in an element of
cost of the acquired company. The costs described above are not recorded as part of the purchased entity and should be either expensed or capitalized when incurred based on the nature of the expenditure and the capitalization policy of the combined company.

The Task Force observed that costs related to activities or employees of the acquiring company are not considered in the purchase price allocation because the cost of the acquisition is not allocated to the assets and liabilities of the acquiring company as discussed in Technical Bulletin 85-5.

The Task Force also reached a consensus that when the ultimate amount of a cost expended is less than the amount recorded as a liability assumed in a purchase business combination as a result of applying the above consensuses, the excess should reduce the cost of the acquired company. [Note: This consensus has been nullified by Statement 141(R). See STATUS section.] The amount of a cost exceeding the amount recorded as a liability assumed in a purchase business combination should result in an additional element of cost of the acquired company if an adjustment to an original estimate is determined within one year of the acquisition date and, thereafter, should be included in the determination of net income in the period in which the adjustment is determined. The Task Force observed that costs related to plans to exit activities and involuntarily terminate or relocate employees that are recorded as part of the purchased entity under this Issue are not preacquisition contingencies accounted for under Statement 38. [Note: See STATUS section under Business Combinations.]

The Task Force discussed the financial reporting and disclosure requirements related to the above consensuses. The Task Force reached a consensus that the combined company should disclose the following information, in addition to the disclosures required by paragraphs 95 and 96 of Opinion 16. [Note: This consensus has been nullified by Statement 141(R). See STATUS section under Business Combinations.] The following
information should be disclosed only if the activities of the acquired company that will not be continued are significant to the combined company’s revenues or operating results or if the costs recognized under the consensuses as of the consummation date are material to the combined company.

1. Notes to the financial statements of the combined company for the period in which a purchase business combination occurs should disclose the following:
   (a) If the acquiring company has not finalized a plan to exit an activity or involuntarily terminate (relocate) employees of the acquired company as of the balance sheet date, a description of unresolved issues, the types of additional liabilities that may result in an adjustment to the allocation of the acquisition cost for the business combination, and how any adjustments will be reported.
   (b) A description of the type and amount of liabilities assumed and included in the acquisition cost allocation for costs to exit an activity of the acquired company or to involuntarily terminate (relocate) employees of the acquired company.
   (c) A description of the major actions that comprise the plan to exit an activity or involuntarily terminate (relocate) employees of an acquired company, activities of the acquired company that will not be continued, including the method of disposition, and the anticipated date of completion and a description of employee group(s) to be terminated (relocated).

2. Notes to the financial statements of the combined company for all periods presented subsequent to the acquisition date in which a purchase business combination occurred, through and including the period in which all actions under a plan to exit an activity or involuntarily terminate (relocate) employees of the acquired company have been fully executed, should disclose the following:
   (a) A description of the type and amount of exit costs, involuntary employee termination costs, and relocation costs paid and charged against the liability.
   (b) The amount of any adjustment(s) to the liability account and whether the corresponding entry was an adjustment of the cost of the acquired company or included in the determination of net income for the period.

[Note: This consensus has been nullified by Statement 141(R). See STATUS section.]

Task Force members questioned the impact of the above consensuses on the consensus guidance in Issue No. 87-11, “Allocation of Purchase Price to Assets to Be Sold.” The FASB staff noted that the consensus guidance in Issue 87-11 as it relates to net assets held for sale that constitute a portion of a line of business currently is being evaluated as
The SEC Observer stated that the SEC staff expects that registrants will follow the requirements of SAB 92, with respect to unresolved preacquisition contingencies resulting from a business combination. The SEC Observer indicated that the SEC staff intends to closely monitor those disclosures, as well as disclosures related to the types of costs discussed in this Issue.

**STATUS**

In March 1995, the FASB issued Statement 121, which establishes accounting standards for the impairment of long-lived assets, certain identifiable intangibles, and goodwill related to those assets to be held and used and for long-lived assets and certain identifiable intangibles to be disposed of that are not covered by Opinion 30. Statement 121 supersedes the last question and interpretation of Accounting Interpretation 1 of Opinion 30 relating to net assets held for sale that constitute a portion of a line of business as defined in Accounting Interpretation 1 of Opinion 30.

In August 2001, the FASB issued Statement 144. Statement 144 establishes financial and reporting standards for the disposal of long-lived assets and components of an entity that are discontinued operations. Statement 144 does not address issues related to purchase accounting. However, Statement 144 supersedes Statement 121 and the provisions of Opinion 30 that address the disposal of a segment of a business. Accordingly, Statement 144 nullifies Issue 87-11 in its entirety.

**Business Combinations**

Statement 141, which superseded Opinion 16, was issued in June 2001. Statement 141 contained the guidance for costs of the business combination in paragraph 24, the
guidance for preacquisition contingencies in paragraphs 40 and 41, and the guidance for
disclosures in a business combination in paragraphs 51–58.

Statement 141(R), which was issued in December 2007, supersedes Opinion 16, replaces
Statement 141, and nullifies this Issue. However, this Issue still applies to mergers and
acquisitions by not-for-profit organizations, which will be further considered as part of a
separate FASB project that was exposed for comment in proposed Statements, *Not-for-
Profit Organizations: Mergers and Acquisitions*, and *Not-for-Profit Organizations: 
Goodwill and Other Intangible Assets Acquired in a Merger or Acquisition*. Statement
141(R) is effective for business combinations with an acquisition date on or after the
beginning of the first annual reporting period beginning on or after 12/15/08.

**Intangible Assets**

Statement 142, which supersedes Opinion 17, was issued in June 2001. Statement 142
amends Statement 121 to exclude from its scope goodwill and intangible assets that are
not amortized.

No further EITF discussion is planned.
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