FTB 85-5 Status Page

Issues Relating to Accounting for Business Combinations, Including

- Costs of Closing Duplicate Facilities of an Acquirer
- Stock Transactions between Companies under Common Control
- Downstream Mergers
- Identical Common Shares for a Pooling of Interests
- Pooling of Interests by Mutual and Cooperative Enterprises

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COSTS OF CLOSING DUPLICATE FACILITIES OF AN ACQUIRER

Reference:

APB Opinion No. 16, Business Combinations, paragraphs 76 and 88

Question 1

1. Are the costs incurred to close duplicate facilities of an acquiring company recognized as part of the cost of acquisition in a business combination accounted for by the purchase method?

Response

2. No. Only the direct costs of an acquisition should be included in the cost of a purchased company in a business combination accounted for by the purchase method. Indirect expenses of an acquiring company, including costs incurred when the acquiring company closes some of its facilities because they duplicate facilities acquired in a purchase business combination, should be charged to expense in determining net income. Therefore, the disposition of the acquiring company's assets do not affect the accounting for assets acquired and liabilities assumed of the acquired company, and any gain or loss on disposal or other cost associated with the disposition of an existing asset of the acquiring company should be charged to income.
Background

3. Paragraph 76 of Opinion 16 states that:

   The cost of a company acquired in a business combination accounted for by the purchase method includes the direct costs of acquisition. . . indirect and general expenses related to acquisitions are deducted as incurred in determining net income.

Costs incurred by an acquiring company to dispose of its assets are not direct costs of the acquisition and therefore are not to be considered in determining the amounts to be assigned to the assets acquired and liabilities assumed.

4. The treatment of the acquiring company's assets and those of the acquired company is different in a business combination. The acquiring company measures the cost of an acquisition at the fair value of the consideration paid to the selling parties and other direct costs of acquisition, whether that consideration involves assets, liabilities, or equity interests. In recording the acquisition, that cost is allocated to the individual assets acquired and liabilities assumed. No adjustments are made to the acquiring company's assets and liabilities because of a business combination other than to reflect the consideration paid by the acquiring company to the selling parties. Paragraph 88 of Opinion 16 provides guidance for allocating the cost of the acquisition by the acquiring company. Paragraph 88(i) states that "commitments and plant closing expense incident to the acquisition" are among factors that should be considered in allocating the purchase price. Plant closing expense is not part of the cost of the acquisition; it is one factor to be considered in allocating the cost of the acquired company to the individual assets acquired and liabilities assumed. Therefore, the reference to plant closing expense in paragraph 88(i) pertains only to the facilities of the acquired company. The cost of closing a facility of the acquiring company should not be similarly treated because the cost of the acquisition is not allocated to assets and liabilities of the acquiring company.

STOCK TRANSACTIONS BETWEEN COMPANIES UNDER COMMON CONTROL

References:

APB Opinion No. 16, Business Combinations, paragraphs 5 and 43
AICPA Accounting Interpretation 26, "Acquisition of Minority Interest," of Opinion 16
AICPA Accounting Interpretation 39, "Transfers and Exchanges between Companies under Common Control," of Opinion 16
Question 2

5. How should a parent company account for minority interest in an exchange of stock between two of its subsidiaries if one or both of the subsidiaries are partially owned?

Response

6. The accounting depends on whether the minority shareholders are party to the exchange of shares. If some or all of the shares owned by minority shareholders are exchanged for shares of ownership in another subsidiary of the parent (or a new subsidiary formed by combining two or more subsidiaries of the parent), then the transaction is recognized by the parent company as the acquisition of shares from the minority interest, which according to paragraph 43 of Opinion 16 should be accounted for by the purchase method, that is, based on fair value. The original minority interest effectively is purchased, and a new minority interest in a different subsidiary is created. However, if the exchange lacks substance, it is not a purchase event and should be accounted for based on existing carrying amounts. That is, if the minority interest does not change and if in substance the only assets of the combined entity after the exchange are those of the partially owned subsidiary prior to the exchange, a change in ownership has not taken place, and the exchange should be accounted for based on the carrying amounts of the partially owned subsidiary's assets and liabilities.

7. If, however, minority shareholders are not party to an exchange of shares between two subsidiaries of the same parent (a partially owned subsidiary issues its shares in exchange for shares of another subsidiary previously owned by the same parent), the minority interest in the issuing subsidiary remains outstanding, and the transaction is an exchange of stock between companies under common control. In contrast to the acquisition of a minority interest, this transaction leaves all of the issuing subsidiary's minority interest outstanding, although the minority stockholders' interest in the net assets has changed in each case. Accounting Interpretation 39 of Opinion 16 indicates that the assets and liabilities transferred in such an exchange of shares should be accounted for at existing carrying amounts.

Background

8. In some circumstances, the transaction described in paragraph 10 may result in ownership interests of the parent and the minority shareholders that are similar or identical to the ownership interests that result from the transaction described in paragraph 11. Accounting Interpretations 26 and 39 (which interpret paragraphs 43 and 5 of Opinion 16) prescribe different accounting treatment for these transactions; however, the similarity of results of the transactions has led to many questions and inconsistency in practice.

9. Paragraph 43 of Opinion 16 states:
The acquisition . . . of some or all of the stock held by minority stockholders of a subsidiary—whether acquired by the parent, the subsidiary itself, or another affiliate—should be accounted for by the purchase method rather than by the pooling of interests method.

10. Accounting Interpretation 26 of Opinion 16 gives several examples of transactions that are, in substance, the acquisition of a minority interest. It states for one of those examples:

Thus, purchase accounting applies when . . . (c) another subsidiary of the parent exchanges its common stock or assets or debt for common stock held by the minority shareholders of an affiliated subsidiary.

11. Accounting Interpretation 39 of Opinion 16 clarifies how an exchange of stock between two subsidiaries of a parent would be recorded:

Also, a parent may exchange its ownership or the net assets of a wholly owned subsidiary for additional shares issued by the parent's partially owned subsidiary, thereby increasing the parent's percentage of ownership in the partially owned subsidiary but leaving all of the existing minority interest outstanding.

None of the above transfers or exchanges is covered by APB Opinion No. 16. The assets and liabilities so transferred would be accounted for at historical cost in a manner similar to that in pooling of interests accounting.

12. Some transactions involve both an effective acquisition of a minority interest and an exchange of stock between companies under common control, which usually are accounted for differently. In those cases, the accounting depends on whether the minority shareholders are party to the exchange of shares. In transactions described in Accounting Interpretation 26 of Opinion 16, an exchange takes place involving the minority shareholders. In transactions described in Accounting Interpretation 39 of Opinion 16, an effective change in the equity interest of the minority shareholders arises, but no exchange takes place. The accounting for the above types of transactions depends on the nature of the exchange that takes place, not the apparent similarity of the results of different transactions.

**DOWNSTREAM MERGERS**

**References:**

APB Opinion No. 16, *Business Combinations*, paragraphs 5 and 43
AICPA Accounting Interpretation 26, "Acquisition of Minority Interest," of Opinion 16
AICPA Accounting Interpretation 39, "Transfers and Exchanges between Companies under Common Control," of Opinion 16
Question 3

13. Are there circumstances in which an exchange by a partially owned subsidiary of its common stock for the outstanding voting common stock of its parent (a "downstream merger") can be accounted for like a pooling of interests?

Response

14. No. Accounting for this transaction is specifically addressed in Accounting Interpretation 26 of Opinion 16.

... Pooling is precluded in the exchange by a subsidiary of its common stock for the outstanding voting common stock of its parent (usually referred to as a "downstream merger"). Instead, purchase accounting applies and the transaction should be accounted for as if the parent had exchanged its common stock for common stock held by minority shareholders of its subsidiary. (Whether a parent acquires the minority or a subsidiary acquires its parent, the end result is a single shareholder group, including the former minority shareholders, owning the consolidated net assets.) The same would be true if a new corporation exchanged its common stock for the common stock of the parent and the common stock of the subsidiary held by minority shareholders.

Background

15. Some have observed that a downstream merger is a transaction between companies under common control. They cite Accounting Interpretation 39 of Opinion 16 to support accounting for a downstream merger like a pooling of interests. However, although a downstream merger is a transaction involving companies under common control, the accounting for that transaction is explicitly described in Accounting Interpretation 26 of Opinion 16.

IDENTICAL COMMON SHARES FOR A POOLING OF INTERESTS

References:

APB Opinion No. 16, *Business Combinations*, paragraphs 47(b) and 48(a)
AICPA Accounting Interpretation 11, "Use of Restricted Stock to Effect a Business Combination," of Opinion 16
AICPA Accounting Interpretation 13, "Two-Class Common for Pooling," of Opinion 16
16. Does the issuance in a business combination of common shares that are identical to other outstanding common shares, except that the issuer retains a right of first refusal to repurchase the shares issued in certain specific circumstances, preclude the issuer from accounting for the business combination as a pooling of interests?

17. Yes. Paragraph 47(b) of Opinion 16 states that the shares that are issued by a combining company to effect a business combination must have "rights identical to those of the majority of its outstanding voting common stock" in order for the combination to meet the requirements for pooling.

18. Accounting Interpretation 13 of Opinion 16 includes guidance on the meaning of identical rights. 

   Interpretation—Paragraph 47-b does not prohibit designating the common stock issued as a different class if it has rights identical to those of the majority class of outstanding voting common stock. Thus, the different class must have the same voting, dividend, liquidation, preemptive, etc., rights as the majority class with the stipulation that these rights cannot be changed unless a corresponding change is made in the rights of the majority class.

19. Opinion 16 and Accounting Interpretations 11 and 13 of Opinion 16 specifically use the term identical to describe the type of shares to be issued in a pooling of interests. A restriction imposed by the issuing corporation upon the sale of stock is discussed in Accounting Interpretation 11 of Opinion 16:

   However, a restriction imposed by the issuing corporation upon the sale of the stock in the absence of a governmental regulation would probably create different rights between previously outstanding and newly issued stock. Such a restriction might also indicate the previously separate stockholder groups would not be sharing the same risks in the business combination (see paragraph 45 and introductory statements in paragraphs 46 and 47). Likewise, a restriction upon the sale of the stock to anyone other than the issuing corporation or an affiliate would not meet the "absence of planned transactions" condition specified in paragraph 48-a. [Emphasis added.]

20. Accounting Interpretation 11 of Opinion 16 describes one specific exception to the
requirement that shares issued be identical. Temporary restrictions imposed by government regulations on the sale of the shares to the public does not cause the shares to be regarded as different for purposes of determining whether a business combination may be accounted for as a pooling of interests. That type of restriction is different from the type of restriction described in paragraph 17 of this Bulletin.

**POOLING OF INTERESTS BY MUTUAL AND COOPERATIVE ENTERPRISES**

**Reference:**

APB Opinion No. 16, *Business Combinations*, paragraphs 5 and 47(c)

**Question 5**

21. Does the conversion of a mutual or cooperative enterprise to stock ownership within two years before a plan of combination is initiated or between the dates a combination is initiated and consummated preclude accounting for the combination as a pooling of interests?

**Response**

22. No. The changes in the equity interests of the combining companies that are proscribed in a pooling of interests are those that might be used to circumvent the intent of Opinion 16—that the combination is effected through an exchange of voting interests. In the case of a conversion from mutual ownership to stock ownership, the change to stock ownership may be a necessary step to effect a combination, in which case it should not preclude accounting for a combination as a pooling.

**Background**

23. Paragraph 47(c) of Opinion 16 states that as a condition for pooling:

   c. None of the combining companies changes the equity interest of the voting common stock in contemplation of effecting the combination either within two years before the plan of combination is initiated or between the dates the combination is initiated and consummated; changes in contemplation of effecting the combination may include distributions to stockholders and additional issuances, exchanges, and retirements of securities.

24. Combinations of mutuals and cooperative enterprises were not specifically addressed in
Opinion 16, although paragraph 5 indicates that Opinion 16 should be applied to a combination of two or more unincorporated businesses. The requirements of paragraph 47(c) of Opinion 16 were included to ensure that other provisions of Opinion 16 would not be circumvented. In the special case of a mutual or cooperative enterprise that converts to stock ownership for purposes of effecting a business combination, the conversion is not a shift of equity ownership from one group of equity owners to another. It is a shift from a form of organization that has no substantive equity ownership to one that has. This would not preclude accounting for the transaction as a pooling of interests. This exception to paragraph 47(c) of Opinion 16 applies exclusively to mutual and cooperative enterprises, which must meet all of the other requirements of Opinion 16 to qualify for a pooling of interests.

Consideration of Comments Received on the Proposed Technical Bulletin

25. A proposed Technical Bulletin, Issues Relating to Accounting for Business Combinations, Including Costs of Settling Employee Stock Options and Awards, Costs of Closing Duplicate Facilities of an Acquirer, Stock Transactions between Companies under Common Control, Downstream Mergers, Identical Common Shares for a Pooling of Interests, and Pooling of Interests by Mutual and Cooperative Enterprises, was released for comment on June 28, 1985. Forty-one letters of comment were received on the proposed Technical Bulletin. Certain of the comments received and consideration of them are discussed in the following paragraphs.

26. The proposed Technical Bulletin addressed the issue of whether costs incurred by a purchased company to settle an earlier award of stock or to settle a grant of option to an employee are part of the purchase price in a business combination accounted for by the purchase method. Some of the comments received on this issue indicated that the question and related response were not clear as to how they should apply in various circumstances. Because addressing all circumstances would significantly delay issuance of the final Technical Bulletin, it was decided that the issue should be referred to the FASB’s Emerging Issues Task Force for further consideration. The issue is not included in this Technical Bulletin.

27. Several respondents questioned the significance of the June 5, 1985 effective date for the provisions of paragraph 2 (response to question 1). June 5, 1985 was the date the proposed Technical Bulletin was discussed at a public Board meeting, and that conclusion was publicly announced.

EFFECTIVE DATE AND TRANSITION

28. The provisions of paragraph 2 of this Technical Bulletin (response to question 1) are effective for transactions consummated after June 5, 1985. Other provisions of this Technical Bulletin are effective for business combinations initiated after December 31, 1985. Earlier application to transactions occurring in periods for which financial statements have not been issued is encouraged.
The Financial Accounting Standards Board has authorized its staff to prepare FASB Technical Bulletins to provide guidance on certain financial accounting and reporting problems on a timely basis, pursuant to the procedures described in FASB Technical Bulletin No. 79-1 (Revised), *Purpose and Scope of FASB Technical Bulletins and Procedures for Issuance*. The provisions of Technical Bulletins need not be applied to immaterial items.