NO. 1204-001 JUNE 30, 2005

Financial Accounting Series

EXPOSURE DRAFT

Proposed Statement of Financial Accounting Standards

Business Combinations

a replacement of FASB Statement No. 141

This Exposure Draft of a proposed Statement of Financial Accounting Standards is issued by the Board for public comment. Written comments should be addressed to:

Technical Director
File Reference No. 1204-001

Comment Deadline: October 28, 2005

Financial Accounting Standards Board
of the Financial Accounting Foundation

Responses from interested parties wishing to comment on the Exposure Draft must be *received* in writing by October 28, 2005. Interested parties should submit their comments by email to director@fasb.org, File Reference 1204-001. Those without email may send their comments to the "Technical Director File Reference 1204-001" at the address at the bottom of this page. Responses should *not* be sent by fax. Please send only one comment letter to either the FASB or the International Accounting Standards Board (IASB). The FASB and the IASB will share and consider jointly all comment letters received.

All comments received are considered public information. Those comments will be posted to the FASB's website and will be included in the project's public record.

Any individual or organization may obtain one copy of this Exposure Draft without charge until October 28, 2005, on written request only. Please ask for our Product Code No. E181. For information on applicable prices for additional copies and copies requested after October 28, 2005, contact:

Order Department
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Copyright © 2005 by Financial Accounting Standards Board. All rights reserved. Permission is granted to make copies of this work provided that such copies are for personal or intraorganizational use only and are not sold or disseminated and provided further that each copy bears the following credit line: "Copyright © 2005 by Financial Accounting Standards Board. All rights reserved. Used by permission."

Financial Accounting Standards Board
of the Financial Accounting Foundation
401 Merritt 7, P.O. Box 5116, Norwalk, Connecticut 06856-5116

Proposed Statement of Financial Accounting Standards

Business Combinations

a replacement of FASB Statement No. 141

June 30, 2005

CONTENTS

Notice for Recipients of This Exposure Draft .... page iii
Summary .... paragraphs I–XIII
Background .... III–V
Reasons for Issuing This Proposed Statement .... VI–VII
Main Features of This Proposed Statement VIII
Significant Changes to Statement 141 IX
Benefits and Costs .... X–XII
Effective Date XIII
Objective 1
Scope 2
Key Terms 3
Identifying a Business Combination 4–7
The Acquisition Method 8–70
Identifying the Acquirer 10–16
Determining the Acquisition Date 17–18
Measuring the Fair Value of the Acquiree 19–27
Consideration Transferred 21–26
Contingent Consideration 25–26
Costs Incurred in Connection with a Business Combination 27
Measuring and Recognizing the Assets Acquired and the Liabilities Assumed 28–51
Guidance for Measuring and Recognizing Particular Assets Acquired and Liabilities Assumed 33–41
Valuation Allowances 34
Contingencies That Meet the Definition of Assets or Liabilities 35–36
Liabilities Associated with Restructuring or Exit Activities 37
Leases 38–39
Intangible Assets 40–41
Assets Acquired and Liabilities Assumed That Are Not Recognized at Fair Value as of the Acquisition Date 42–51
Assets Held for Sale 43
Deferred Taxes 44–46
Operating Leases 47

Paragraph Numbers

Employee Benefit Plans....48
Goodwill....49–51
Additional Guidance for Applying the Acquisition Method to Particular Types of Business Combinations....52–61
Business Combinations Involving Only Mutual Entities....53
Business Combinations Achieved by Contract Alone....54
Business Combinations Achieved in Stages....55–57
Business Combinations in Which the Acquirer Holds Less Than 100 Percent of the Equity Interests in the Acquiree at the Acquisition Date....58
Business Combinations in Which the Consideration Transferred for the Acquirer's Interest in the Acquiree Is Less Than the Fair Value of That Interest....59–61
Measurement Period....62–68
Assessing What Is Part of the Exchange for the Acquiree....69–70
Disclosures....71–81
Effective Date and Transition....82–87
Subsequent Recognition of Acquired Deferred Tax Benefits....86
Not Used....87
Withdrawal of Other Pronouncements....88
Appendix A: Implementation Guidance....A1–A136
Appendix B: Background Information, Basis for Conclusions, and Alternative Views....B1–B212
Appendix C: Continuing Authoritative Guidance....C1–C31
Appendix D: Amendments to Existing Pronouncements....D1–D42
Appendix E: Impact on Related Authoritative Literature....E1–E6
Appendix F: Differences between the IASB's and the FASB's Exposure Drafts....F1–F3

Notice for Recipients of This Exposure Draft

The International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) (the Boards) invite comments on all matters in this Exposure Draft, particularly on the questions set out below. Comments are most helpful if they:

a. Comment on the questions as stated
b. Indicate the specific paragraph or paragraphs to which the comments relate
c. Contain a clear rationale
d. Include any alternative the Boards should consider.

Respondents need not comment on all of the questions presented and are encouraged to comment on additional issues as well.

Respondents should submit one comment letter to either the IASB or the FASB. The Boards will share and consider jointly all comment letters received. Respondents must submit comments in writing by October 28, 2005.

Until a final Statement based on this Exposure Draft becomes effective, FASB Statement No. 141, *Business Combinations,* remains effective.

Question 1—Objective, Definition, and Scope

The proposed objective of this Exposure Draft is:

> . . . that all business combinations be accounted for by applying the acquisition method. A business combination is a transaction or other event in which an acquirer obtains control of one or more businesses (the acquiree). In accordance with the acquisition method, the acquirer measures and recognizes the acquiree, as a whole, and the assets acquired and liabilities assumed at their fair values as of the acquisition date. [paragraph 1]

That objective provides the basic elements of the acquisition method of accounting for a business combination (formerly called the purchase method) by describing:

a. What is to be measured and recognized. An acquiring entity would measure and recognize the acquired business at its fair value, regardless of the percentage of the equity interests of the acquiree it holds at the acquisition date. That objective also provides the foundation for determining whether specific assets acquired or liabilities assumed are part of an acquiree and would be accounted for as part of the business combination.
b. When to measure and recognize the acquiree. Recognition and measurement of a business combination would be as of the acquisition date, that is, the date the acquirer obtains control of the acquiree.

c. The measurement attribute as fair value, rather than as cost accumulation and allocation. The acquiree and the assets acquired and liabilities assumed would be measured at fair value as of the acquisition date, with limited exceptions. Consequently, the consideration transferred in exchange for the acquiree, including contingent consideration, would also be measured at fair value as of the acquisition date.

That objective and definition of a business combination would apply to all business combinations in the scope of this Statement, including business combinations:

a. Involving only mutual entities
b. Achieved by contract alone
c. Achieved in stages (commonly called step acquisitions)
d. In which the acquirer holds less than 100 percent of the equity interests in the acquiree at the acquisition date
e. In which the primary beneficiary initially consolidates a variable interest entity that is a business.

(See paragraphs 52–58 and paragraphs B19–B30 and B45–B47 of the basis for conclusions.)

Question 1—Are the objective and the definition of a business combination appropriate for accounting for all business combinations? If not, for which business combinations are they not appropriate, why would you make an exception, and what alternative do you suggest?

Question 2—Definition of a Business

This Exposure Draft proposes to define a *business* as follows:

> A business is an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing either:
>
> (1) A return to investors
> (2) Dividends, lower costs, or other economic benefits directly and proportionately to owners, members, or participants. [paragraph 3(d)]

Paragraphs A2–A7 of Appendix A provide additional guidance for applying this definition. This Exposure Draft would nullify the definition of a business in EITF Issue No. 98-3, "Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business," and in FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities.* (See paragraphs B32–B40.)

Question 2—Are the definition of a business and the additional guidance appropriate and sufficient for determining whether the assets acquired and the liabilities assumed constitute a business? If not, how would you propose to modify or clarify the definition or additional guidance?

Questions 3–7—Measuring the Fair Value of the Acquiree

This Exposure Draft proposes that in a business combination that is an exchange of equal values, the acquirer should measure and recognize 100 percent of the fair value of the acquiree as of the acquisition date. This applies even in business combinations in which the acquirer holds less than 100 percent of the equity interests in the acquiree at that date. In those business combinations, the acquirer would measure and recognize the noncontrolling interest as the sum of the noncontrolling interest's proportional interest in the acquisition-date values of the identifiable assets acquired and liabilities assumed plus the goodwill attributable to the noncontrolling interest. (See paragraphs 19 and 58 and paragraphs B154–B155.)

Question 3—In a business combination in which the acquirer holds less than 100 percent of the equity interests of the acquiree at the acquisition date, is it appropriate to recognize 100 percent of the acquisition-date fair value of the acquiree, including 100 percent of the values of identifiable assets acquired, liabilities assumed, and goodwill, which would include the goodwill attributable to the noncontrolling interest? If not, what alternative do you propose and why?

This Exposure Draft proposes that a business combination is usually an arm's-length transaction in which knowledgeable, unrelated willing parties are presumed to exchange equal values. In such transactions, the fair value of the consideration transferred by the acquirer on the acquisition date is the best evidence of the fair value of the acquirer's interest in the acquiree, in the absence of evidence to the contrary. Accordingly, in most business combinations, the fair value of the consideration transferred by the acquirer would be used as the basis for measuring the acquisition-date fair value of the acquirer's interest in the acquiree. However, in some business combinations, either no consideration is transferred on the acquisition date or the evidence indicates that the consideration transferred is not the best basis for measuring the acquisition-date fair value of the acquirer's interest in the acquiree. In those business combinations, the acquirer would measure the acquisition-date fair value of its interest in the acquiree and the acquisition-date fair value of the acquiree using other valuation techniques. (See paragraphs 19 and 20, paragraphs A8–A26, and paragraphs B56–B99.)

Question 4—Do paragraphs A8–A26 provide sufficient guidance for measuring the fair value of an acquiree? If not, what additional guidance is needed?

This Exposure Draft proposes a presumption that the best evidence of the fair value of the acquirer's interest in the acquiree would be the fair values of all items of consideration transferred by the acquirer in exchange for that interest measured as of the acquisition date, including:

a. Contingent consideration
b. Equity interests issued by the acquirer
c. Any noncontrolling equity investment in the acquiree that the acquirer owned immediately before the acquisition date.

(See paragraphs 20–25 and paragraphs B23, and B60–B64.)

Question 5—Is the acquisition-date fair value of the consideration transferred in exchange for the acquirer's interest in the acquiree the best evidence of the fair value of that interest? If not, which forms of consideration should be measured on a date other than the acquisition date, when should they be measured, and why?

This Exposure Draft proposes that after initial recognition, contingent consideration classified as:

a. Equity would not be remeasured
b. Liabilities would be remeasured with changes in fair value recognized in income unless those liabilities are in the scope of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities.* Those liabilities would be accounted for after the acquisition date in accordance with that Statement.

(See paragraph 26 and paragraphs B74–B86.)

Question 6—Is the accounting for contingent consideration after the acquisition date appropriate? If not, what alternative do you propose and why?

This Exposure Draft proposes that the costs that the acquirer incurs in connection with a business combination (also called acquisition-related costs) should be excluded from the measurement of the consideration transferred for the acquiree because those costs are not part of the fair value of the acquiree and are not assets. Such costs include finder's fees; advisory, legal, accounting, valuation, other professional or consulting fees; the cost of issuing debt and equity instrument; and general administrative costs, including the costs of maintaining an internal acquisitions department. The acquirer would account for those costs separately from the business combination accounting. (See paragraph 27 and paragraphs B93–B99.)

Question 7—Do you agree that the costs that the acquirer incurs in connection with a business combination are not assets and should be excluded from the measurement of the consideration transferred for the acquiree? If not, why?

Questions 8 and 9—Measuring and Recognizing the Assets Acquired and the Liabilities Assumed

This Exposure Draft proposes that an acquirer measure and recognize as of the acquisition date the fair value of the assets acquired and liabilities assumed as part of the business combination, with limited exceptions. (See paragraphs 28–41 and paragraphs B100–B142.) That requirement would result in the following significant changes to accounting for business combinations:

a. Receivables (including loans) acquired in a business combination would be measured at fair value. Therefore, the acquirer would not recognize a separate valuation allowance for uncollectible amounts as of the acquisition date.

b. This Statement would amend FASB Statement No. 5, *Accounting for Contingencies,* to exclude from its scope assets or liabilities arising from contingencies acquired or assumed in a business combination. Assets and liabilities arising from contingencies that are acquired or assumed as part of a business combination would be measured and recognized at fair value at the acquisition date if the contingency meets the definition of an asset or a liability in FASB Concepts Statement No. 6, *Elements of Financial Statements,* even if it does not meet the recognition criteria in Statement 5. After initial recognition, contingencies would be accounted for in accordance with applicable generally accepted accounting principles, except for those that would be accounted for in accordance with Statement 5 if they were acquired or incurred in an event other than a business combination. Those contingencies would continue to be measured at fair value with changes in fair value recognized in income in each reporting period.

c. Costs associated with restructuring or exit activities that do not meet the recognition criteria in FASB Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities,* as of the acquisition date are not liabilities at the acquisition date. Therefore, the acquirer would recognize those costs as expenses of the combined entity in the postcombination period in which they are incurred.

d. Particular research and development assets acquired in a business combination that previously were required to be written off in accordance with FASB Interpretation No. 4, *Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method,* would be recognized and measured at fair value.

Question 8—Do you believe that these proposed changes to the accounting for business combinations are appropriate? If not, which changes do you believe are inappropriate, why, and what alternatives do you propose?

This Exposure Draft proposes limited exceptions to the fair value measurement principle. Therefore, some assets acquired and liabilities assumed (for example, those related to deferred taxes, assets held for sale, or employee benefits) would continue to be measured and recognized in accordance with other generally accepted accounting principles rather than at fair value. (See paragraphs 42–51 and paragraphs B143–B155.)

Question 9—Do you believe that these exceptions to the fair value measurement principle are appropriate? Are there any exceptions you would eliminate or add? If so, which ones and why?

Questions 10–12—Additional Guidance for Applying the Acquisition Method to Particular Types of Business Combinations

This Exposure Draft proposes that for purposes of applying the acquisition method, the fair value of the consideration transferred by the acquirer would include the acquisition-date fair value of the acquirer's noncontrolling equity investment in the acquiree that the acquirer owned immediately before the acquisition date. Accordingly, in a business combination achieved in stages (step acquisition), the acquirer would remeasure its noncontrolling equity investment in the acquiree at fair value as of the acquisition date and recognize any gain or loss in income. If, before the business

combination, the acquirer recognized changes in the value of its noncontrolling equity investment in other comprehensive income (for example, the investment was designated as available-for-sale), the amount that was recognized in other comprehensive income would be reclassified and included in the calculation of any gain or loss as of the acquisition date. (See paragraphs 55 and 56 and paragraphs B156–B160.)

Question 10—Is it appropriate for the acquirer to recognize in income any gain or loss on previously acquired noncontrolling equity investments on the date it obtains control of the acquiree? If not, what alternative do you propose and why?

This Exposure Draft proposes that in a business combination in which the consideration transferred for the acquirer's interest in the acquiree is less than the fair value of that interest (referred to as a bargain purchase), any excess of the fair value of the acquirer's interest in the acquiree over the fair value of the consideration transferred for that interest would reduce goodwill until the goodwill related to that business combination is reduced to zero, and any remaining excess would be recognized in income on the acquisition date. (See paragraphs 59–61 and paragraphs B168–B182.) However, this Exposure Draft would not permit the acquirer to recognize a loss at the acquisition date if the acquirer is able to determine that a portion of the consideration transferred represents an overpayment for the acquiree. The Boards acknowledge that an acquirer might overpay to acquire a business, but they concluded that it is not possible to measure such an overpayment reliably at the acquisition date. (See paragraph B183.)

Question 11—Do you agree with the proposed accounting for business combinations in which the consideration transferred for the acquirer's interest in the acquiree is less than the fair value of that interest? If not, what alternative do you propose and why?

Question 12—Do you believe that there are circumstances in which the amount of an overpayment could be measured reliably at the acquisition date? If so, in what circumstances?

Question 13—Measurement Period

This Exposure Draft proposes that an acquirer recognize adjustments made during the measurement period to the provisional values of the assets acquired and liabilities assumed as if the accounting for the business combination had been completed at the acquisition date. Thus, comparative information for prior periods presented in financial statements would be adjusted, including any change in depreciation, amortization, or other income effect recognized as a result of completing the initial accounting. (See paragraphs 62–68 and paragraphs B161–B167.)

Question 13—Do you agree that comparative information for prior periods presented in financial statements should be adjusted for the effects of measurement period adjustments? If not, what alternative do you propose and why?

Question 14—Assessing What Is Part of the Exchange for the Acquiree

This Exposure Draft proposes that an acquirer assess whether any portion of the transaction price (payments or other arrangements) and any assets acquired or liabilities assumed or incurred are not part of the exchange for the acquiree. Only the consideration transferred by the acquirer and the assets acquired or liabilities assumed or incurred that are part of the exchange for the acquiree would be included in the business combination accounting. (See paragraphs 69 and 70, paragraphs A87–A109, and paragraphs B111–B117.)

Question 14—Do you believe that the guidance provided is sufficient for making the assessment of whether any portion of the transaction price or any assets acquired and liabilities assumed or incurred are not part of the exchange for the acquiree? If not, what other guidance is needed?

Question 15—Disclosures

This Exposure Draft proposes broad disclosure objectives that are intended to ensure that users of financial statements are provided with adequate information to enable them to evaluate the nature and financial effects of business combinations. Those objectives are supplemented by specific minimum disclosure requirements. In most instances, the objectives would be met by the minimum disclosure requirements that follow each of the broad objectives. However, in some circumstances, an acquirer might be required to disclose additional information necessary to meet the disclosure objectives. (See paragraphs 71–81 and paragraphs B184–B191.)

Question 15—Do you agree with the disclosure objectives and the minimum disclosure requirements? If not, how would you propose amending the objectives or what disclosure requirements would you propose adding or deleting, and why?

Questions 16–18—The IASB's and the FASB's Convergence Decisions

This Exposure Draft is the result of the Boards' projects to improve the accounting for business combinations. The first phase of those projects led to the issue of IFRS 3 and FASB Statement 141. In 2002, the FASB and the IASB agreed to reconsider jointly their guidance for applying the purchase method of accounting, which this Exposure Draft calls the acquisition method, for business combinations. An objective of the joint effort is to develop a common and comprehensive standard for the accounting for business combinations that could be used for both domestic and cross-border financial reporting. Although the Boards reached the same conclusions on the fundamental issues addressed in this Exposure Draft, they reached different conclusions on only a few limited matters. Therefore, the IASB's version and the FASB's version of this Exposure Draft provide different guidance on those few limited matters. Appendix F provides a comparison, by paragraph, of the different guidance provided by each Board. Most of the differences arise because each Board decided to provide business combinations guidance that is consistent with its other existing standards. Even though those differences are candidates for future

convergence projects, the Boards do not plan to eliminate those differences before final standards on business combinations are issued.

This joint Exposure Draft would resolve a difference between IFRS 3 and Statement 141 relating to the criteria for recognizing an intangible asset separately from goodwill. Both Boards concluded that an intangible asset must be identifiable (that is, arising from contractual-legal rights or separable) to be recognized separately from goodwill. In its deliberations that led to Statement 141, the FASB concluded that, when acquired in a business combination, all intangible assets (except for an assembled workforce) that are identifiable can be measured with sufficient reliability to warrant recognition separately from goodwill. In addition to the identifiability criterion, IFRS 3 and IAS 38 required that an intangible asset acquired in a business combination be reliably measurable to be recognized separately from goodwill. Paragraphs 35–41 of IAS 38 provide guidance for determining whether an intangible asset acquired in a business combination is reliably measurable. IAS 38 presumes that the fair value of an intangible asset with a finite useful life can be measured reliably. Therefore, a difference between IFRS 3 and Statement 141 would arise only if the intangible asset has an indefinite life. The IASB decided to converge with the FASB in this Exposure Draft by (a) eliminating the requirement that an intangible asset be reliably measurable to be recognized separately from goodwill and (b) precluding the recognition of an assembled workforce acquired in a business combination as an intangible asset separately from goodwill. (See paragraph 40.)

Question 16—Do you believe that an intangible asset that is identifiable can always be measured with sufficient reliability to be recognized separately from goodwill? If not, why? Do you have any examples of an intangible asset that arises from legal or contractual rights and has both of the following characteristics:

a. The intangible asset cannot be sold, transferred, licensed, rented, or exchanged individually or in combination with a related contract, asset, or liability
b. Cash flows that the intangible asset generates are inextricably linked with the cash flows that the business generates as a whole?

For the joint Exposure Draft, the Boards considered the provisions of IAS 12 *Income Taxes* and FASB Statement No. 109, *Accounting for Income Taxes,* relating to an acquirer's deferred tax benefits that become recognizable because of a business combination. IAS 12 requires the acquirer to recognize separately from the business combination accounting any changes in its deferred tax assets that become recognizable because of the business combination. Such changes are recognized in postcombination profit and loss or equity. On the other hand, Statement 109 requires any recognition of an acquirer's deferred tax benefits (through the reduction of the acquirer's valuation allowance) that results from a business combination to be accounted for as part of the business combination, generally as a reduction of goodwill. The FASB decided to amend Statement 109 to require the recognition of any changes in the acquirer's deferred tax benefits (through a change in the acquirer's previously recognized valuation allowance) as a transaction separately from the business combination. As amended, Statement 109 would require such changes in deferred tax benefits to be recognized either in income from continuing operations in the period of the combination or directly to contributed capital, depending on the circumstances. Both Boards decided to require disclosure of the

amount of such acquisition-date changes in the acquirer's deferred tax benefits in the notes to the financial statements. (See paragraphs D18 and paragraphs B145–B150.)

Question 17—Do you agree that any changes in acquirer's deferred tax benefits that become recognizable because of the business combination are not part of the fair value of the acquiree and should be accounted for separately from the business combination? If not, why?

The Boards reconsidered disclosure requirements in IFRS 3 and Statement 141 for purposes of convergence. For some of the disclosures, the Boards decided to converge. However, divergence continues to exist for some disclosures as described in Appendix F. The Boards concluded that some of this divergence stems from differences that are broader than the business combinations project.

Question 18—Do you believe it is appropriate for the IASB and the FASB to retain those disclosure differences? If not, which of the differences should be eliminated, if any, and how should this be achieved?

Question 19—Style of This Exposure Draft

This Exposure Draft was prepared in a style similar to the style used by the IASB in its standards whereby paragraphs in **"bold type"** state the main principles. All paragraphs have equal authority.

Question 19—Do you find stating the principles in bold type helpful? If not, why? Are there any paragraphs you believe should be in bold type, but are in plain type, or vice versa?

Public Roundtable Meetings

The Boards plan to hold public roundtable meetings with constituents to discuss issues related to this Exposure Draft and the Exposure Draft, *Consolidated Financial Statements, Including Accounting and Reporting of Noncontrolling Interests in Subsidiaries*. Those roundtable meetings are scheduled to be held on October 27, 2005 in Norwalk, Connecticut, and on November 9, 2005 in London, England. The Boards would like those who participate in the meetings to be drawn from a wide variety of constituents, including investors, preparers of financial statements, auditors, valuation experts, analysts and others. If you wish to participate in the roundtable meetings, you must notify the Boards by September 15, 2005 by sending an email to **director@fasb.org.** You must specify the location of the roundtable meeting you would prefer to attend. Each roundtable can accommodate a limited number of participants. The Boards may not be able to accommodate all requests to participate. You will be notified about whether you were selected to participate by September 30, 2005.

Proposed FASB Statement No. 141, *Business Combinations* (revised 200X) (proposed Statement) is set out in paragraphs 1–88 and Appendices A and C–E. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Terms defined in paragraph 3 are underlined the first time they appear in the proposed Statement.

Summary

I. A business combination is a transaction or other event in which an acquirer obtains control of one or more businesses (the acquiree). The objective of this proposed Statement is that all business combinations be accounted for by applying the acquisition method. In accordance with the acquisition method, the acquirer measures and recognizes the acquiree, as a whole, and the assets acquired and liabilities assumed at their fair values as of the acquisition date.

II. This proposed Statement would replace FASB Statement No. 141, *Business Combinations*. In addition, this proposed Statement would be required to be applied at the same time as Proposed Statement of Financial Accounting Standards, *Consolidated Financial Statements, Including Accounting and Reporting of Noncontrolling Interests in Subsidiaries.*

Background

III. This proposed Statement is being issued as part of a joint effort by the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) (referred to as the "Boards") to improve financial reporting while promoting the international convergence of accounting standards. The Boards believe that developing a common set of high-quality financial accounting standards improves the comparability of financial information around the world and simplifies the accounting for entities that issue financial statements in accordance with international accounting standards and U.S. generally accepted accounting principles or reconcile from one set of standards to the other.

IV. The Boards each decided to address the financial accounting for business combinations in two phases. The IASB and the FASB deliberated the first phase separately. The FASB concluded the first phase in June 2001 by issuing Statement 141. The IASB concluded the first phase in March 2004 by issuing IFRS 3 *Business Combinations.* The Boards' primary conclusion in the first phase was that virtually all business combinations are acquisitions. Accordingly, the Boards decided to require the use of one method of accounting for business combinations—the purchase method (called the *acquisition method* in this proposed Statement).

V. The second phase of the project addresses the guidance for applying the acquisition method. The IASB and the FASB began deliberating the second phase of their projects at about the same time. The Boards decided that a significant improvement could be made to financial reporting if they had similar standards for accounting for business combinations. Thus, they decided to conduct the second phase of the project as a joint effort with the objective of reaching the same conclusions.

Reasons for Issuing This Proposed Statement

VI. This proposed Statement seeks to improve financial reporting by requiring the acquisition method be applied to more business combinations, including those involving only mutual entities and those achieved by contract alone. The Boards believe that

applying a single method of accounting to all business combinations will result in more comparable and transparent financial statements.

VII. This proposed Statement would require an acquirer to recognize an acquired business at its fair value at the acquisition date rather than at its cost. It also would require the acquirer to measure and recognize the individual assets acquired and liabilities assumed at their fair values at the acquisition date, with limited exceptions. The Boards concluded that requiring the recognition of the acquiree and the assets acquired and liabilities assumed at fair value as of the acquisition date improves the relevance and reliability of financial information. This is true even in business combinations in which the acquirer obtains control of a business by acquiring less than 100 percent of the equity interests in the acquiree or in business combinations achieved in stages (step acquisitions). Relevance and reliability are characteristics that make financial information more useful to users.

Main Features of This Proposed Statement

VIII. This proposed Statement would retain the fundamental requirements in Statement 141 that require the acquisition method of accounting for all business combinations and for an acquirer to be identified for every business combination. It also would retain the guidance in Statement 141 for identifying and recognizing intangible assets separately from goodwill. Additionally, this proposed Statement would require:

a. The acquirer to measure the fair value of the acquiree, as a whole, as of the acquisition date.
b. For purposes of applying the acquisition method, the consideration transferred by the acquirer in exchange for the acquiree to be measured at its fair value as of the acquisition date calculated as the sum of:
   (1) The assets transferred by the acquirer, liabilities incurred by the acquirer, and equity interests issued by the acquirer, including contingent consideration, and
   (2) Any noncontrolling equity investment in the acquiree owned by the acquirer immediately before the acquisition date.
c. The acquirer to assess whether any portion of the transaction price paid and any assets acquired or liabilities assumed or incurred are not part of the exchange for the acquiree. Only the consideration transferred or the assets acquired or liabilities assumed or incurred that are part of the exchange for the acquiree would be accounted for as part of the business combination accounting.
d. The acquirer to account for acquisition-related costs incurred in connection with the business combination separately from the business combination (generally as expenses).
e. The acquirer to measure and recognize the acquisition-date fair value of the assets acquired and liabilities assumed as part of the business combination, with limited exceptions. Those exceptions are:
   (1) Goodwill would be measured and recognized as the excess of the fair value of the acquiree, as a whole, over the net amount of the recognized identifiable assets acquired and liabilities assumed. If the acquirer owns less than 100

percent of the equity interests in the acquiree at the acquisition date, goodwill attributable to the noncontrolling interest would be recognized.

(2) Long-lived assets (or disposal group) classified as held for sale, deferred tax assets or liabilities, and particular assets or liabilities related to the acquiree's employee benefit plans would be measured in accordance with other generally accepted accounting principles.

(3) If the acquiree is a lessee to an operating lease, no asset or related liability would be recognized if the lease is at market terms.

f. The acquirer to recognize separately from goodwill an acquiree's intangible assets that are identifiable (that is, arise from contractual-legal rights or are separable), including research and development assets acquired in a business combination. This Statement would supersede FASB Interpretation No. 4, *Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method,* which required research and development assets acquired in a business combination that have no alternative future use to be measured at their fair value and expensed at the acquisition date.

g. The acquirer to exclude from the accounting for a business combination any changes in the amount of its deferred tax benefits that are recognizable (through the increase or reduction of the acquirer's valuation allowance) as a result of that business combination. Statement 109 would be amended to require such changes in deferred tax benefits to be recognized either in income from continuing operations in the period of the combination or directly to contributed capital, depending on the circumstances.

h. In a business combination in which the acquisition-date fair value of the acquirer's interest in the acquiree exceeds the fair value of the consideration transferred for that interest (referred to as a bargain purchase), the acquirer to account for that excess by reducing goodwill until the goodwill related to that business combination is reduced to zero and then by recognizing any remaining excess in income.

i. The acquirer to recognize any adjustments made during the measurement period to the provisional values of the assets acquired and liabilities assumed as if the accounting for the business combination had been completed at the acquisition date. Thus, comparative information for prior periods presented in financial statements would be adjusted.

Significant Changes to Statement 141

IX. The main changes between this proposed Statement and Statement 141 are described below:

Scope

a. The requirements of this proposed Statement would be applicable to business combinations involving only mutual entities, business combinations achieved by contract alone, and the initial consolidation of variable interest entities that are businesses.

Definition of a Business Combination

b. This proposed Statement would amend the definition of a *business combination* provided in Statement 141. This proposed Statement defines a *business combination* as "a transaction or other event in which an acquirer obtains control of one or more businesses."

Definition of a Business

c. This proposed Statement would provide a definition of a *business* and additional guidance for identifying when a group of assets constitutes a business. This proposed Statement would nullify the definitions provided in EITF Issue No. 98-3, "Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business," and FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities*.

Measuring the Fair Value of the Acquiree

d. This proposed Statement would require business combinations to be measured and recognized as of the acquisition date at the fair value of the acquiree, even if the business combination is achieved in stages or if less than 100 percent of the equity interests in the acquiree are owned at the acquisition date. Statement 141 required that a business combination be measured and recognized on the basis of the accumulated cost of the combination.

e. This proposed Statement would require the costs the acquirer incurs in connection with the business combination to be accounted for separately from the business combination accounting. Statement 141 required direct costs of the business combination to be included in the cost of the acquiree.

f. This proposed Statement would require all items of consideration transferred by the acquirer to be measured and recognized at fair value at the acquisition date. Therefore, this proposed Statement would require the acquirer to recognize contingent consideration arrangements at fair value as of the acquisition date. Subsequent changes in the fair value of contingent consideration classified as liabilities would be recognized in income, unless those liabilities are in the scope of, and therefore accounted for, in accordance with, FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*.

g. This proposed Statement would require the acquirer in a business combination in which the acquisition-date fair value of the acquirer's interest in the acquiree exceeds the fair value of the consideration transferred for that interest (referred to as a bargain purchase) to account for that excess by first reducing the goodwill related to that business combination to zero, and then by recognizing any excess in income. Statement 141 requires that excess to be allocated as a pro rata reduction of the amounts that would have been assigned to particular assets acquired.

Measuring and Recognizing the Assets Acquired and the Liabilities Assumed

h. This proposed Statement would require the assets acquired and liabilities assumed to be measured and recognized at their fair values as of the acquisition date, with limited exceptions. Statement 141 required the cost of an acquisition to be allocated to the individual assets acquired and liabilities assumed based on their estimated fair values. However, Statement 141 also provided guidance for measuring some assets and liabilities that was inconsistent with fair value measurement objectives. Thus, those assets or liabilities may not have been recognized at fair value as of the acquisition date in accordance with Statement 141.

i. This proposed Statement would amend FASB Statement No. 5, *Accounting for Contingencies,* to exclude from its scope assets or liabilities arising from contingencies acquired or assumed in a business combination. This proposed Statement would require assets and liabilities arising from contingencies that are acquired or assumed as part of a business combination to be measured and recognized at their fair value at the acquisition date if the contingency meets the definition of an asset or a liability in FASB Concepts Statement No. 6, *Elements of Financial Statements,* even if it does not meet the recognition criteria in Statement 5. After initial recognition, contingencies would be accounted for in accordance with applicable generally accepted accounting principles, except for those that would be accounted for in accordance with Statement 5 if they were acquired or incurred in an event other than a business combination. Those contingencies would continue to be measured at fair value with changes in fair value recognized in income in each reporting period. Statement 141 permitted deferral of the recognition of preacquisition contingencies until the Statement 5 recognition criteria were met and subsequent changes were recognized as adjustments to goodwill.

j. This proposed Statement would prohibit costs associated with restructuring or exit activities that do not meet the recognition criteria in FASB Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities,* as of the acquisition date from being recognized as liabilities assumed. Rather, they would be recognized as postcombination expenses of the combined entity when incurred. Previously, EITF Issue No. 95-3, "Recognition of Liabilities in Connection with a Purchase Business Combination," permitted costs that would result from a plan to exit an activity of an acquiree to be recognized as liabilities assumed at the acquisition date if specific criteria were met.

k. This proposed Statement would require the acquirer in business combinations in which the acquirer holds less than 100 percent of the equity interests in the acquiree at the acquisition date, to recognize the identifiable assets and liabilities at the full amount of their fair values, with limited exceptions, and goodwill as the difference between the fair value of the acquiree, as a whole, and the fair value of the identifiable assets acquired and liabilities assumed. Statement 141 did not change the accounting for a step acquisition described in AICPA Accounting Interpretation 2, "Goodwill in a Step Acquisition," of APB Opinion No. 17, *Intangible Assets*. That Interpretation stated that when an entity acquires another entity in a series of purchases, the entity should identify the cost of each investment, the fair value of the underlying assets acquired, and the goodwill for each step

acquisition. Statement 141 did not provide guidance for measuring the noncontrolling interests' share of the consolidated subsidiary's assets and liabilities at the acquisition date.

l. Acquisitions of additional noncontrolling equity interests after the business combination would not be permitted to be accounted for using the acquisition method. In accordance with Proposed Statement, *Consolidated Financial Statements, Including Accounting and Reporting of Noncontrolling Interests in Subsidiaries,* acquisitions (or dispositions) of noncontrolling equity interests after the business combination would be accounted for as equity transactions.

m. The acquirer would be required to recognize separately from goodwill the acquisition-date fair value of research and development assets acquired in a business combination. This Statement supersedes Interpretation 4, which required research and development assets acquired in a business combination that have no alternative future use to be measured at their fair value and expensed at the acquisition date.

n. The acquirer would be required to account for any changes in the amount of its deferred tax benefits that are recognizable (through the increase or reduction of the acquirer's valuation allowance on its previously existing deferred tax assets) as a result of a business combination separately from that business combination. This Statement would amend Statement 109 to require such changes in the amount of the deferred tax benefits to be recognized either in income from continuing operations in the period of the combination or directly to contributed capital, depending on the circumstances. Statement 109 had required that a reduction of the acquirer's valuation allowance as a result of a business combination be recognized through a corresponding reduction to goodwill or certain noncurrent assets or an increase in negative goodwill.

Benefits and Costs

X. The Boards have striven to issue a proposed Statement with common requirements that will fill a significant need and for which the costs imposed to apply it, as compared with other alternatives, are justified in relation to the overall benefits of the resulting information. The Boards concluded that this proposed Statement would, for the reasons previously noted, make several improvements to financial reporting that would benefit investors, creditors, and other users of financial statements.

XI. The Boards sought to reduce the costs of applying this proposed Statement. This proposed Statement would (a) require particular assets and liabilities (for example, those related to deferred taxes, assets held for sale, and employee benefits) to continue to be measured and recognized in accordance with existing generally accepted accounting principles rather than at fair value and (b) require its provisions to be applied prospectively rather than retrospectively. The Boards acknowledged that those two steps may diminish some benefits of improved reporting provided by this proposed Statement. However, the Boards concluded that the complexities and related costs that would result from imposing a fair value measurement requirement at this time to all assets acquired and liabilities assumed in a business combination and requiring retrospective application of the provisions of this proposed Statement are not justified.

XII. In addition, improving the consistency of the procedures used in accounting for business combinations, including international consistency, should help alleviate concerns that an entity's competitive position as a potential bidder is affected by differences in accounting for business combinations. Consistency in the accounting procedures also can reduce the costs to prepare financial statements, especially for entities with global operations. Moreover, such consistency also will enhance comparability of information among entities, which can lead to a better understanding of the resulting financial information and reduce the costs to users of analyzing that information.

Effective Date

XIII. This proposed Statement would apply prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual period beginning on or after December 15, 2006. Earlier application would be encouraged. However, this proposed Statement would be applied only at the beginning of an annual period that begins on or after the date on which this proposed Statement is issued. If this proposed Statement is applied before its effective date, that fact would be disclosed and Proposed Statement, *Consolidated Financial Statements, Including Accounting and Reporting of Noncontrolling Interests in Subsidiaries,* would be applied at the same time.

Proposed Statement of Financial Accounting Standards

Business Combinations

a replacement of FASB Statement No. 141

June 30, 2005

OBJECTIVE

1. This Statement requires that all business combinations be accounted for by applying the acquisition method. A business combination is a transaction or other event in which an acquirer obtains control of one or more businesses (the acquiree). In accordance with the acquisition method, the acquirer measures and recognizes the acquiree, as a whole, and the assets acquired and liabilities assumed at their fair values as of the acquisition date.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

SCOPE

2. An entity shall apply this Statement when accounting for business combinations. However, this Statement does not apply to:

a. Formations of joint ventures
b. Combinations involving only entities or businesses under common control (see paragraphs C25–C31 of Appendix C)
c. Combinations between not-for-profit organizations or the acquisition of a for-profit business by a not-for-profit organization.

KEY TERMS

3. The following terms are used with specific meanings and are integral to understanding and applying this Statement.

a. The acquiree is the business or businesses the acquirer obtains control of in a business combination.
b. The acquirer is the entity that obtains control of the acquiree.
c. The acquisition date is the date the acquirer obtains control of the acquiree.
d. A business is an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing either:
   (1) A return to investors
   (2) Dividends, lower costs, or other economic benefits directly and proportionately to owners, members, or participants.

e. A business combination is a transaction or other event in which an acquirer obtains control of one or more businesses.
f. Control has the meaning of *controlling financial interest* in paragraph 7 of Proposed Statement of Financial Accounting Standards, *Consolidated Financial Statements, Including Accounting and Reporting of Noncontrolling Interests in Subsidiaries*.
g. Contingencies is defined in paragraph 1 of FASB Statement No. 5, *Accounting for Contingencies*.
h. For purposes of this Statement, the term equity interests is used broadly to mean ownership interests of investor-owned entities and owner, member, or participant interests of mutual entities.
i. Fair value is used with the same meaning as in Proposed Statement of Financial Accounting Standards, *Fair Value Measurements*. That proposed Statement defines fair value as "the price at which an asset or liability could be exchanged in a current transaction between knowledgeable, unrelated willing parties."[1]
j. Goodwill is the future economic benefits arising from assets that are not individually identified and separately recognized.
k. An asset is identifiable if it either:
   (1) Is separable, that is, capable of being separated or divided from the entity and sold, transferred, licensed, rented, or exchanged, either individually or together with a related contract, asset, or liability, regardless of whether the entity intends to do so
   (2) Arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.
l. Impracticable is used with the same meaning as *impracticability* in paragraph 11 of FASB Statement No. 154, *Accounting Changes and Error Corrections.*
m. A mutual entity is an entity other than an investor-owned entity that provides dividends, lower costs, or other economic benefits directly and proportionately to its owners, members, or participants.
n. For purposes of this Statement, the term owners is used broadly to include holders of equity interests of investor-owned entities and owners, members, or participants of mutual entities.
o. Noncontrolling interest is used with the same meaning as in paragraph 5(e) of Proposed Statement, *Consolidated Financial Statements, Including Accounting and Reporting of Noncontrolling Interests in Subsidiaries*.

IDENTIFYING A BUSINESS COMBINATION

4. **A business combination is a transaction or other event in which an acquirer obtains control of one or more businesses.**

5. A transaction or other event is accounted for as a business combination only if the assets acquired and liabilities assumed constitute a business (an acquiree). Paragraphs A2–

[1]The FASB plans to issue a final Statement on fair value measurements in the fourth quarter of 2005. The definition of fair value may change in that final Statement.

A7 of Appendix A provide guidance for identifying whether the assets acquired and liabilities assumed constitute a business. If the assets acquired and liabilities assumed do not constitute a business, the acquirer shall account for the transaction as an asset acquisition. The accounting for an asset acquisition is set out in paragraphs C2–C7.

6. In a business combination, an acquirer might:

a. Acquire the equity interests of a business
b. Acquire some or all of an entity's assets (net assets) that constitute a business
c. Assume some or all of the liabilities of an acquiree.

An acquirer might obtain control of an acquiree:

d. By transferring cash, cash equivalents, or other assets (including net assets that constitute a business)
e. By issuing equity interests
f. By providing more than one type of consideration
g. By contract alone (see paragraph 54)
h. Without transferring any consideration
i. Without a transaction involving the acquirer. One example is a business combination that occurs when an entity (the acquiree) repurchases its own shares and, as a result, an existing investor (the acquirer) obtains control of that entity. Another example is a business combination that occurs when an acquirer obtains control of an acquiree through the lapse of minority veto rights that previously kept the acquirer from controlling the acquiree even though the acquirer held the majority voting interest in the acquiree.

7. A business combination may be structured in a variety of ways for legal, taxation, or other reasons. Accordingly, the provisions of this Statement apply equally to business combinations in which:

a. One or more businesses are merged with or become subsidiaries of an acquirer
b. One entity transfers net assets or its owners transfer their equity interests to another entity or the owners of another entity
c. All entities transfer net assets or the owners of those entities transfer their equity interests to a newly formed entity (some of which are referred to as roll-up or put-together transactions).

All those transactions are business combinations regardless of:

d. Whether the acquiree is incorporated
e. The form of consideration transferred in exchange for the acquiree
f. Whether a group of former owners of one of the combining entities retains or receives a majority of the voting rights of the combined entity.

THE ACQUISITION METHOD

8. **All business combinations shall be accounted for by applying the acquisition method.**

9. The acquisition method has four steps:

a. Identifying the acquirer
b. Determining the acquisition date
c. Measuring the fair value of the acquiree
d. Measuring and recognizing the assets acquired and the liabilities assumed.

Identifying the Acquirer

10. **An acquirer shall be identified for all business combinations.**

11. The guidance in Proposed Statement, *Consolidated Financial Statements, Including Accounting and Reporting of Noncontrolling Interest in Subsidiaries,* and FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities,* as amended by paragraph D28 of this Statement, shall be used to identify the acquirer, which is the entity that obtains control of the acquiree. If an acquirer cannot be determined based solely on the guidance in Proposed Statement, *Consolidated Financial Statements, Including Accounting and Reporting of Noncontrolling Interests in Subsidiaries,* paragraphs 12–16 shall be considered in making that determination. However, the primary beneficiary of a variable interest entity is always the acquirer for purposes of this Statement. The determination of which party, if any, is the primary beneficiary of a variable interest entity shall be made only in accordance with Interpretation 46(R), not on the basis of the guidance in paragraphs 12–16.

12. The form of the consideration transferred may provide evidence about which entity is the acquirer. For example:

a. In a business combination effected solely through the transfer of cash or other assets or by incurring liabilities, the entity that transfers the cash or other assets or incurs the liabilities is likely to be the acquirer.
b. In a business combination effected through an exchange of cash or other assets for voting equity interests, the entity that gives up the cash or other assets is likely to be the acquirer.
c. In a business combination effected through an exchange of equity interests, the entity that issues the equity interests is normally the acquirer. However, in some business combinations, commonly called reverse acquisitions, the issuing entity is the acquiree. Paragraphs A111–A136 provide guidance for accounting for reverse acquisitions. Commonly in an exchange of equity interests, the acquirer is the larger entity; however, the facts and circumstances surrounding a combination sometimes indicate that a smaller entity acquires a larger entity. Therefore, in identifying the

acquirer in a business combination effected through an exchange of equity interests, all pertinent facts and circumstances shall be considered, in particular:

(1) *The relative voting rights in the combined entity after the business combination*—All else being equal, the acquirer is the combining entity whose owners as a group retained or received the largest portion of the voting rights in the combined entity. In determining which group of owners retained or received the largest portion of the voting rights, consideration shall be given to the existence of any unusual or special voting arrangements and options, warrants, or convertible securities.

(2) *The existence of a large minority voting interest in the combined entity when no other owner or organized group of owners has a significant voting interest*—All else being equal, the acquirer is the combining entity whose single owner or organized group of owners holds the largest minority voting interest in the combined entity.

(3) *The composition of the governing body of the combined entity*—All else being equal, the acquirer is the combining entity whose owners or governing body has the ability to elect or appoint a voting majority of the governing body of the combined entity.

(4) *The terms of the exchange of equity interests*—All else being equal, the acquirer is the combining entity that pays a premium over the precombination market value of the equity securities of the other combining entity or entities.

13. If the fair value of one of the combining entities is significantly greater than that of the other combining entity or entities, the entity with the greatest fair value is likely to be the acquirer.

14. If the business combination results in the management of one of the combining entities being able to dominate the selection of the management team of the resulting combined entity, the entity whose management is able to dominate is likely to be the acquirer.

15. In a business combination involving more than two entities, determining the acquirer shall include a consideration of, among other things, which of the combining entities initiated the combination and whether the assets, revenues, or income of one of the combining entities significantly exceeds those of the others.

16. If a new entity is formed to issue equity interests to effect a business combination, one of the combining entities that existed before the business combination shall be identified as the acquirer based on the evidence available. The guidance in paragraphs 11–15 shall be used to identify the acquirer.

Determining the Acquisition Date

17. **The acquisition date is the date the acquirer obtains control of the acquiree.**

18. The acquirer generally obtains control of the acquiree on the closing date, which is the date that the acquirer transfers the consideration, acquires the assets, and assumes the liabilities of the acquiree. In some cases, the acquisition date may precede the closing date of the business combination or the date the business combination is finalized in law. All pertinent facts and circumstances surrounding a business combination shall be considered in assessing when the acquirer has obtained control of the acquiree. For example, the acquisition date may precede the closing date if a written agreement provides that the acquirer obtains control of the acquiree on a date before the closing date.

Measuring the Fair Value of the Acquiree

19. **The acquirer shall measure the fair value of the acquiree, as a whole, as of the acquisition date.**

20. Business combinations are usually arm's-length exchange transactions in which knowledgeable, unrelated willing parties exchange equal values. Therefore, in the absence of evidence to the contrary, the exchange price (referred to as the consideration transferred in this Statement) paid by the acquirer on the acquisition date is presumed to be the best evidence of the acquisition-date fair value of the acquirer's interest in the acquiree. In some business combinations, either no consideration is transferred on the acquisition date or the evidence indicates that the consideration transferred is not the best basis for measuring the acquisition-date fair value of the acquirer's interest in the acquiree. In those business combinations, the acquirer should measure the acquisition-date fair value of its interest in the acquiree using other valuation techniques. Paragraphs A8–A26 provide additional guidance for performing the fair value measurement described in this paragraph.

Consideration Transferred

21. For the purpose of applying the acquisition method, the fair value of the consideration transferred in exchange for the acquirer's interest in the acquiree is calculated as the sum of:

a. The acquisition-date fair values of the assets transferred by the acquirer, liabilities assumed or incurred by the acquirer, and equity interests issued by the acquirer. Examples include cash, other assets, contingent consideration (see paragraph 25), a business or a subsidiary of the acquirer, common or preferred equity instruments, options, warrants, and member interests of mutual entities; and
b. The acquisition-date fair value of any noncontrolling equity investment in the acquiree that the acquirer owned immediately before the acquisition date (see paragraph 56).

22. The consideration transferred may include assets or liabilities of the acquirer that have carrying amounts that differ from their fair values at the acquisition date (for example, nonmonetary assets or a business of the acquirer). In that case, the acquirer shall remeasure those transferred assets or liabilities to their fair values as of the acquisition date and recognize any gains or losses in income. However, if those assets or liabilities are transferred to the acquiree and, therefore, remain within the combined entity after the business combination, the acquirer shall eliminate any gains or losses on those transferred assets or liabilities in the consolidated financial statements.

23. If the information necessary to measure the fair value of some or all of the consideration transferred is not available at the acquisition date, the measurement period guidance in paragraphs 62–68 applies.

24. The acquirer shall assess whether any portion of the transaction price includes payments or other arrangements that are not consideration transferred in exchange for the acquiree. Paragraphs 69 and 70 provide guidance for making that assessment. Only the consideration transferred in exchange for the acquiree shall be accounted for as part of the business combination.

Contingent Consideration

25. As described in paragraph 21(a), the fair value of the consideration transferred in exchange for the acquiree includes the acquisition-date fair value of any obligations of the acquirer to transfer additional assets or equity interests if specified future events occur or conditions are met (commonly called contingent consideration). For example, the acquirer may agree to transfer additional equity interests, cash, or other assets to the former owners of the acquiree after the acquisition date if the acquiree meets specified financial or nonfinancial targets in the future. The acquirer shall measure and recognize the fair value of such contingent consideration as of the acquisition date and shall classify that obligation as either a liability or equity on the basis of other generally accepted accounting principles. An arrangement to transfer additional assets or equity interests if specified events or conditions occur may be incorporated in an acquirer's share-based payment awards exchanged for awards held by the acquiree's employees. The acquirer shall measure the portion of such awards included in consideration transferred for the acquiree in accordance with paragraphs A102–A109.

26. After initial recognition, the acquirer shall account for changes in the fair value of contingent consideration that do not qualify as measurement period adjustments (see paragraphs 62–68) as follows:

a. Contingent consideration classified as equity shall not be remeasured.
b. Contingent consideration classified as liabilities that:
    (1) Are financial instruments and within the scope of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities,* as amended by paragraph D21 of this Statement, shall be accounted for in accordance with that Statement.

(2) Are not within the scope of Statement 133 shall be measured at fair value with changes in the fair value recognized in income in each reporting period.

Costs Incurred in Connection with a Business Combination

27. Costs the acquirer incurs in connection with a business combination (also called acquisition-related costs) are not part of the consideration transferred in exchange for the acquiree. For example, such costs include finder's fees, advisory, legal, accounting, valuation, other professional or consulting fees, general administrative costs, including the costs of maintaining an internal acquisitions department, and costs of registering and issuing debt and equity securities. The acquirer shall not include such costs in the measure of the fair value of the acquiree or the assets acquired or liabilities assumed as part of the business combination. The acquirer shall account for acquisition-related costs, separately from the business combination, in accordance with generally accepted accounting principles.

Measuring and Recognizing the Assets Acquired and the Liabilities Assumed

28. **The acquirer shall measure and recognize as of the acquisition date the assets acquired and liabilities assumed as part of the business combination. Except as provided in paragraphs 42–51, the identifiable assets acquired and liabilities assumed shall be measured at fair value and recognized separately from goodwill.**

29. As part of the business combination accounting, the acquirer recognizes assets acquired or liabilities assumed that are part of the exchange for the acquiree and meet the definition of assets and liabilities in FASB Concepts Statement No. 6, *Elements of Financial Statements*. The assets and liabilities the acquirer recognizes as part of the business combination may include assets and liabilities the acquiree had not recognized previously in its financial statements. For example, the acquirer often recognizes the acquired identifiable intangible assets that were internally developed by the acquiree and did not meet the criteria for recognition in the acquiree's financial statements. The acquirer does not recognize any assets or liabilities other than the assets acquired or the liabilities assumed as part of the business combination.

30. A business combination does not affect the measurement of the acquirer's assets and liabilities, except for those assets or liabilities that are not recognized at fair value by the acquirer before the business combination and are part of the consideration transferred in exchange for the acquiree (see paragraph 22).

31. If the information necessary to measure the fair value of some or all of the assets acquired or liabilities assumed is not available at the acquisition date, the measurement period guidance in paragraphs 62–68 applies.

32. The acquirer shall assess whether any of the assets acquired or liabilities assumed or incurred are not part of the exchange for the acquiree (that is, not included in the business combination accounting). Paragraphs 69 and 70 provide guidance for making that assessment.

Guidance for Measuring and Recognizing Particular Assets Acquired and Liabilities Assumed

33. Paragraphs 34–41 provide guidance for measuring and recognizing particular assets acquired and liabilities assumed at fair value as of the acquisition date.

Valuation Allowances

34. The acquirer shall not recognize a separate valuation allowance as of the acquisition date for assets required to be recognized at fair value in accordance with this Statement. For example, an acquirer would recognize receivables (including loans) acquired in a business combination at fair value as of the acquisition date and would not recognize a separate valuation allowance for uncollectible receivables at that date. Uncertainty about collections and future cash flows is included in the fair value measure.-

Contingencies That Meet the Definition of Assets or Liabilities

35. The acquirer shall recognize, separately from goodwill, the acquisition-date fair value of assets and liabilities arising from contingencies that were acquired or assumed as part of the business combination. Therefore, the acquirer shall recognize as of the acquisition date an asset or a liability for a contingency acquired in a business combination if it meets the definition of an asset or a liability in Concepts Statement 6 even if that contingency does not meet the recognition criteria in Statement 5, as amended by this Statement.

36. After initial recognition, contingencies shall be accounted for as follows:

a. A contingency that would be accounted for in accordance with Statement 5 if it were acquired or incurred in an event other than a business combination shall continue to be measured at fair value with any changes in fair value recognized in income in each reporting period.
b. All other contingencies shall be accounted for in accordance with generally accepted accounting principles. For example:
   (1) A contingency that is a financial instrument shall be accounted for in accordance with applicable financial instrument guidance.
   (2) A contingency that is an asset or liability arising from an insurance contract shall be accounted for in accordance with FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises,* as amended (including the intangible asset, if any, recognized for the difference between the amounts recognized on the acquisition date at fair value and the amounts that would be recognized in accordance with Statement 60).

Liabilities Associated with Restructuring or Exit Activities

37. The acquirer shall recognize, separately from goodwill, the acquisition-date fair value of liabilities for restructuring or exit activities acquired in a business combination only if they meet the recognition criteria in FASB Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities,* as of the acquisition date. Costs

associated with restructuring or exit activities that do not meet the recognition criteria in Statement 146 as of the acquisition date are not liabilities at the acquisition date and, therefore, are recognized separately from the business combination, generally as postcombination expenses of the combined entity when incurred. For example, costs the acquirer expects to incur in the future pursuant to its plan to exit an activity of an acquiree, involuntarily terminate the employment of an acquiree's employees, or relocate employees of an acquiree are not assumed liabilities of the acquiree and, therefore, are not accounted for as part of the business combination.

Leases

38. In accordance with FASB Statement No. 13, *Accounting for Leases,* as interpreted by FASB Interpretation No. 21, *Accounting for Leases in a Business Combination,* as amended by paragraph D27 of this Statement, a lease of the acquiree (regardless of whether the acquiree is the lessee or lessor) retains the lease classification determined by the acquiree at the lease inception, unless the provisions of a lease are modified as a result of the business combination in a way that would require the acquirer to consider the revised agreement a new lease agreement in accordance with paragraph 9 of Statement 13. In that circumstance, the acquirer would classify the new lease according to the criteria set forth in Statement 13 on the basis of the conditions of the modified lease.

39. The acquirer shall account for the acquiree's operating leases in which the acquiree is the lessee in accordance with paragraph 47. For all other leases, the acquirer shall measure and recognize separately the asset and any related liability embodied in a lease at their acquisition-date fair values. After initial recognition, assets and liabilities related to leases shall be accounted for in accordance with other generally accepted accounting principles.

Intangible Assets

40. The acquirer shall recognize, separately from goodwill, the acquisition-date fair value of intangible assets acquired in a business combination that are identifiable. For purposes of this Statement, an assembled workforce shall not be recognized as an intangible asset separately from goodwill. Paragraphs A27–A61 provide additional guidance about measuring and recognizing intangible assets acquired in a business combination.

41. As part of a business combination, an acquirer may reacquire a right that it had previously granted to the acquiree to use the acquirer's recognized or unrecognized intangible assets (such as a right to use the acquirer's trade name under a franchise agreement or a right to use the acquirer's technology under a technology licensing agreement). Such a right is an identifiable intangible asset that shall be recognized separately from goodwill as part of the business combination accounting. If the contract giving rise to the reacquired right includes pricing terms that are favorable or unfavorable when compared with pricing for current market transactions for the same or similar items, the acquirer shall recognize a settlement gain or loss. Paragraph A92 provides guidance for measuring that settlement gain or loss. After initial recognition, reacquired rights shall

be amortized over the remaining contractual period of the precombination contract that granted those rights.

Assets Acquired and Liabilities Assumed That Are Not Recognized at Fair Value as of the Acquisition Date

42. The following assets acquired and liabilities assumed shall be measured and recognized as of the acquisition date as follows.

Assets Held for Sale

43. The acquirer shall measure and recognize, separately from goodwill, an acquired long-lived asset (or disposal group) that is classified as held for sale as of the acquisition date in accordance with paragraphs 30–32 of FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,* at fair value less cost to sell in accordance with paragraphs 34 and 35 of that Statement.

Deferred Taxes

44. The acquirer shall measure and recognize, separately from goodwill, a deferred tax asset or liability in accordance with FASB Statement No. 109, *Accounting for Income Taxes,* as amended by paragraph D17 of this Statement.

45. Statement 109, as amended by this Statement, sets out the subsequent accounting for deferred tax assets (including valuation allowances) and liabilities that were acquired in a business combination.

46. The acquirer shall account for the potential tax effects of temporary differences and carryforwards of an acquiree that exist at the acquisition date and income tax uncertainties related to the acquisition (for example, an uncertainty related to the tax basis of an acquired asset that ultimately will be agreed to by the taxing authority or positions taken in prior tax returns of the acquiree) in accordance with the provisions of Statement 109, as amended.

Operating Leases

47. If the acquiree is the lessee to an operating lease, the acquirer shall not recognize separately the asset and related liability embodied in the lease. If the acquiree is the lessor to an operating lease, the acquirer shall measure and recognize the asset subject to the operating lease at its acquisition-date fair value in accordance with paragraph 39. The acquirer also shall assess whether each of the acquiree's operating leases are at market terms as of the acquisition date, regardless of whether the acquiree is the lessee or lessor. If an operating lease is not at market terms as of the acquisition date, the acquirer shall recognize:

a. An intangible asset if the terms of the operating lease are favorable relative to market terms.

b. A liability if the terms of the operating lease are unfavorable relative to market terms.

Employee Benefit Plans

48. The acquirer shall measure and recognize, separately from goodwill, any asset or liability related to the acquiree's employee benefit plans that is within the scope of FASB Statement No. 87, *Employers' Accounting for Pensions,* as amended by paragraph D15 of this Statement, or No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions,* as amended by paragraph D16 of this Statement, in accordance with paragraph 74 of Statement 87 or paragraphs 86–88 of Statement 106.

Goodwill

49. Except as provided by paragraph 61, the acquirer shall measure and recognize goodwill as of the acquisition date as the excess of the fair value of the acquiree, as a whole, over the net amount of the recognized identifiable assets acquired and liabilities assumed. This requirement applies even if the acquirer owns less than 100 percent of the equity interests in the acquiree at the acquisition date (that is, even if a noncontrolling interest in the acquiree exists at the acquisition date).

50. The amount recognized as goodwill includes synergies and other benefits that are expected from combining the activities of the acquirer and acquiree. Because goodwill is measured as a residual, the amount recognized as goodwill also includes (a) intangible assets that do not meet the criteria in paragraph 40 for recognition separately from goodwill and (b) any difference between the fair values of the assets acquired and liabilities assumed and the amount recognized in accordance with paragraphs 42–48.

51. After initial recognition, the acquirer shall measure goodwill at the amount recognized as of the acquisition date less any accumulated impairment losses. Goodwill shall not be amortized. The acquirer shall test goodwill for impairment in accordance with FASB Statement No. 142, *Goodwill and Other Intangible Assets,* as amended by paragraph D22 of this Statement.

Additional Guidance for Applying the Acquisition Method to Particular Types of Business Combinations

52. Paragraphs 53–61 provide additional guidance for applying the acquisition method to the following types of business combinations:

a. Business combinations involving only mutual entities
b. Business combinations achieved by contract alone
c. Business combinations achieved in stages
d. Business combinations in which the acquirer holds less than 100 percent of the equity interests in the acquiree at the acquisition date
e. Business combinations in which the consideration transferred for the acquirer's interest in the acquiree is less than the fair value of that interest.

Business Combinations Involving Only Mutual Entities

53. In a business combination involving only mutual entities in which the only consideration exchanged is the member interests of the acquiree for the member interests of the acquirer (or the member interests of the newly combined entity), the amount equal to the fair value of the acquiree shall be recognized as a direct addition to capital or equity, not retained earnings.

Business Combinations Achieved by Contract Alone

54. In rare circumstances, an acquirer (a) obtains control of an acquiree by contract (b) transfers no consideration for control of the acquiree or for the net assets of the acquiree, and (c) obtains no equity interests in the acquiree, either on the acquisition date or previously. An example of such a business combination is one in which two businesses are brought together to form a dual listed corporation. This type of business combination is referred to as a business combination achieved by contract alone in this Statement. In such a business combination, the fair value of the acquiree shall be attributed to the noncontrolling interests of the acquiree (that is, the equity holders of the acquiree) in the consolidated financial statements of the acquirer.

Business Combinations Achieved in Stages

55. A business combination in which an acquirer holds a noncontrolling equity investment in the acquiree immediately before obtaining control of that acquiree is a business combination achieved in stages. This type of business combination is also commonly called a step acquisition.

56. As described in paragraph 21(b), for purposes of applying the acquisition method, the fair value of the consideration transferred by the acquirer includes the acquisition-date fair value of any noncontrolling equity investment in the acquiree that the acquirer owned immediately before the acquisition date. In a business combination achieved in stages, the acquirer shall remeasure its noncontrolling equity investment in the acquiree at fair value as of the acquisition date and recognize any gain or loss in income. If, before the business combination, the acquirer recognized changes in the value of its noncontrolling equity investment in other comprehensive income (for example, the investment was classified as available-for-sale), the amount that was recognized in other comprehensive income shall be reclassified and included in the calculation of any gain or loss as of the acquisition date.

57. Once an acquirer has obtained control of an acquiree, subsequent acquisitions (or dispositions) of any noncontrolling interests in the acquiree shall be accounted for as equity transactions in accordance with Proposed Statement, *Consolidated Financial Statements, Including Accounting and Reporting of Noncontrolling Interests in Subsidiaries*.

Business Combinations in Which the Acquirer Holds Less Than 100 Percent of the Equity Interests in the Acquiree at the Acquisition Date

58. In a business combination in which the acquirer holds less than 100 percent of the equity interests in the acquiree at the acquisition date, the acquirer shall:

a. Recognize identifiable assets acquired and liabilities assumed at their acquisition date values measured in accordance with paragraphs 28–48.
b. Recognize goodwill at the amount measured in accordance with paragraph 49.
c. Allocate the amount of goodwill determined in accordance with paragraph 49 to the acquirer and the noncontrolling interest. Paragraphs A62 and A63 provide additional guidance for allocating goodwill between the acquirer and the noncontrolling interest.
d. Measure and recognize the noncontrolling interest as the sum of the noncontrolling interest's proportional interest in the identifiable assets acquired and liabilities assumed plus the noncontrolling interest's share of goodwill, if any.

Business Combinations in Which the Consideration Transferred for the Acquirer's Interest in the Acquiree Is Less Than the Fair Value of That Interest

59. In rare circumstances, the acquisition-date fair value of the acquirer's interest in the acquiree exceeds the fair value of the consideration transferred for that interest (as might be the case, for example, in a business combination that is a forced sale in which the seller is acting under compulsion). This type of business combination is referred to as a bargain purchase in this Statement. However, this type of business combination may occur also because of the requirements in paragraphs 43–48 to measure and recognize particular assets acquired or liabilities assumed in accordance with other generally accepted accounting principles rather than at fair value.

60. If the fair value of the acquirer's interest in the acquiree initially is determined to exceed the fair value of the consideration transferred for that interest, the acquirer shall assess whether it has correctly identified all assets acquired and liabilities assumed and shall review the procedures used to measure and remeasure, if necessary, all of the following:

a. The acquisition-date fair value of the acquiree
b. The acquisition-date fair value of the acquirer's interest in the acquiree
c. The acquisition-date fair value of the consideration transferred
d. The acquisition-date values of the identifiable assets acquired and liabilities assumed recognized in accordance with the requirements of this Statement.

The objective of this review is to ensure that appropriate consideration has been given to all available information in performing the measurements.

61. If, after performing any remeasurements required by paragraph 60, the fair value of the acquirer's interest in the acquiree still exceeds the fair value of the consideration transferred for that interest, the acquirer shall account for that excess by reducing the

amount of goodwill that otherwise would be recognized in accordance with paragraph 49. If the goodwill related to that business combination is reduced to zero, any remaining excess shall be recognized as a gain attributable to the acquirer on the acquisition date. Paragraphs A64–A70 provide additional guidance and examples for applying this requirement.

Measurement Period

62. **The measurement period is the period after the acquisition date during which the acquirer may adjust the provisional amounts recognized at the acquisition date in accounting for a business combination. The measurement period provides the acquirer a reasonable time to obtain the information necessary to identify and measure the following:**

a. The acquisition-date fair value of the acquiree
b. The acquisition-date fair value of the acquirer's interest in the acquiree
c. The acquisition-date fair value of the consideration transferred for the acquiree
d. The acquisition-date values of the assets acquired and liabilities assumed recognized in accordance with the requirements of this Statement.

63. If any of those measurements can be determined only provisionally by the end of the reporting period in which the business combination occurs, the acquirer shall report those provisional amounts in its financial statements.

64. During the measurement period, the acquirer shall adjust the provisional amounts recognized at the acquisition date to reflect any new information obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the measurement of the amounts recognized as of that date. During the measurement period, the acquirer also shall recognize additional assets or liabilities if new information is obtained about facts and circumstances that existed as of the acquisition date and, if known, would have resulted in the recognition of those assets and liabilities as of that date.

65. The measurement period ends as soon as the acquirer receives the necessary information about facts and circumstances that existed as of the acquisition date or learns the information is not obtainable. However, the measurement period shall not exceed one year from the acquisition date.

66. Generally, adjustments to the provisional amounts recognized for identifiable assets and liabilities during the measurement period are recognized through an offsetting adjustment to goodwill. However, the offsetting adjustment (or part of the offsetting adjustment) may be to an asset or liability other than goodwill. For example, assume that an acquirer's contingent consideration obligation is directly related to the value of an acquired intangible asset and, during the measurement period, the acquirer obtains new information about the fair value of that intangible asset as of the acquisition date. In this case, the adjustment to the provisional amount recognized for that asset may be offset (or

partially offset) by a corresponding adjustment to the provisional amount recognized for the contingent consideration liability.

67. The acquirer shall recognize any adjustments to the provisional values during the measurement period as if the accounting for the business combination had been completed at the acquisition date. Thus, comparative information for prior periods presented in financial statements shall be adjusted, including any change in depreciation, amortization, or other income effect recognized as a result of completing the initial accounting. Paragraphs A71–A86 provide additional guidance and illustrative examples for applying the measurement period requirements.

68. After the end of the measurement period, the accounting for a business combination shall be restated only to correct an error in accordance with Statement 154.

Assessing What Is Part of the Exchange for the Acquiree

69. **The acquirer shall assess whether any portion of the transaction price (payments or other arrangements) and any assets acquired or liabilities assumed or incurred are not part of the exchange for the acquiree. Only the consideration transferred and the assets acquired or liabilities assumed or incurred that are part of the exchange for the acquiree shall be included in the business combination accounting. Any portion of the transaction price or any assets acquired or liabilities assumed or incurred that are not part of the exchange for the acquiree shall be accounted for separately from the business combination.**

70. Examples of payments or other arrangements that are not part of the exchange for the acquiree include:

a. Payments that effectively settle preexisting relationships between the acquirer and acquiree (see paragraphs A91–A97)
b. Payments to compensate employees or former owners of the acquiree for future services (see paragraphs A98–A101)
c. Payments to reimburse the acquiree or its former owners for paying the acquirer's costs incurred in connection with the business combination.

Paragraphs A87–A109 provide guidance for assessing whether a portion of the transaction price and any assets and liabilities are not part of the exchange for the acquiree.

DISCLOSURES

71. **The acquirer shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of business combinations that occur:**

a. During the reporting period
b. After the balance sheet date but before the financial statements are issued.

72. To meet the objective in paragraph 71, the acquirer shall disclose the following information for each material business combination that occurs during the reporting period:

a. The name and a description of the acquiree.
b. The acquisition date.
c. The percentage of voting equity instruments acquired.
d. The primary reasons for the business combination, including a description of the factors that contributed to the recognition of goodwill.
e. The acquisition-date fair value of the acquiree and the basis for measuring that value.
f. The acquisition-date fair value of the consideration transferred, including the fair value of each major class of consideration, such as:
   (1) Cash
   (2) Other tangible or intangible assets, including a business or subsidiary of the acquirer
   (3) Contingent consideration
   (4) Debt instruments
   (5) Equity or member interests of the acquirer, including the number of instruments or interests issued or issuable, and the method of determining the fair value of those instruments or interests
   (6) The acquirer's previously acquired noncontrolling equity investment in the acquiree in a business combination achieved in stages.
g. The amounts recognized as of the acquisition date for each major class of assets acquired and liabilities assumed in the form of a condensed balance sheet (see paragraph A110).
h. The maximum potential amount of future payments (undiscounted) the acquirer could be required to make under the terms of the acquisition agreement. If there is no limitation on the maximum potential amount of future payments, that fact shall be disclosed.
i. In a business combination in which the consideration transferred for the acquiree is less than fair value, the amount of any gain recognized in accordance with paragraph 61, the line item in the income statement in which the gain is recognized, and a description of the reasons why the acquirer was able to achieve a gain.
j. In a business combination achieved in stages, the amount of any gain or loss recognized in accordance with paragraph 56 and the line item in the income statement in which that gain or loss is recognized.
k. In a business combination in which the acquirer and acquiree have a preexisting relationship:
   (1) The nature of the preexisting relationship
   (2) The measurement of the settlement amount of the preexisting relationship, if any, and the valuation method used to determine the settlement amount
   (3) The amount of any settlement gain or loss recognized and the line item in the income statement in which that gain or loss is recognized.
l. The amount of costs incurred in connection with the business combination, the amount recognized as an expense and the line item or items in the income statement in which those expenses are recognized.

73. The acquirer also shall disclose the information required by:

a. Paragraphs 72(e)–(l) in aggregate for individually immaterial business combinations that are material collectively.
b. Paragraph 72 if a material business combination is completed after the balance sheet date but before the financial statements are issued unless disclosure of any of the information is impracticable. If disclosure of any of the information required by paragraph 72 is impracticable, that fact and the reasons shall be disclosed.

74. An acquirer that is a public business enterprise, as described in paragraph 9 of FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information,* shall also disclose the following information for each material business combination that occurs during the reporting period or in the aggregate for individually immaterial business combinations that are material collectively and occur during the reporting period.

a. The amounts of revenue and net income of the acquiree since the acquisition date included in the consolidated income statement for the reporting period.
b. The following supplemental pro forma information:
   (1) The *results of operations*[2] of the combined entity for the current reporting period as though the acquisition date for all business combinations that occurred during the year had been as of the beginning of the annual reporting period.
   (2) If comparative financial statements are presented, the *results of operations* of the combined entity for the comparable prior reporting period as though the acquisition date for all business combinations that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period.

If disclosure of any of the information required by this paragraph is impracticable, that fact and the reasons shall be disclosed.

75. **The acquirer shall disclose information that enables users of its financial statements to evaluate the financial effects of adjustments recognized in the current reporting period relating to business combinations that were effected in the current or previous reporting periods.**

---

[2]For this disclosure, *results of operations* means revenue, income before extraordinary items and the cumulative effect of accounting changes, net income, and earnings per share. In determining the pro forma amounts, income taxes, interest expense, preferred share dividends, and depreciation and amortization of assets shall be adjusted to the accounting base recognized for each in recording the combination. Pro forma information related to results of operations of periods prior to the combination shall be limited to the results of operations for the immediately preceding period. Disclosure also shall be made of the nature and amount of any material, nonrecurring items included in the reported pro forma results of operations.

76. To meet the objective in paragraph 75, the acquirer shall disclose the following information for each material business combination or in the aggregate for individually immaterial business combinations that are material collectively:

a. If the amounts recognized in the financial statements for the business combination have been determined only provisionally:
   (1) The reasons why the initial accounting for the business combination is not complete.
   (2) The assets acquired or the liabilities assumed for which the measurement period is still open.
   (3) The nature and amount of any measurement period adjustments recognized during the reporting period.
b. A reconciliation of the beginning and ending balances of liabilities for contingent consideration and contingencies that are required to be remeasured to fair value after initial recognition in accordance with paragraphs 26(b)(2) and 36, showing separately the changes in fair value during the reporting period and amounts paid or otherwise settled.
c. A description of the discrete event or circumstance that occurred after the acquisition date that resulted in deferred tax assets acquired as part of the business combination being recognized as income within 12 months after the acquisition date (see paragraph 86).
d. Paragraph not used.

77. **The acquirer shall disclose information that enables users of its financial statements to evaluate changes in the carrying amount of goodwill during the reporting period.**

78. To meet the objective in paragraph 77, if the total amount of goodwill is significant in relation to the fair value of the acquiree, the acquirer shall disclose the following information for each material business combination that occurs during the reporting period:

a. The total amount of goodwill and the amount that is expected to be deductible for tax purposes
b. The amount of goodwill by reportable segment, if the combined entity is required to disclose segment information in accordance with Statement 131, unless such disclosure is impracticable. For example, if the assignment of goodwill to reporting units as required by Statement 142 has not been completed as of the date the financial statements are issued, disclosure of this information would be impracticable.

79. The acquirer also shall disclose the information required by paragraph 78:

a. In aggregate for individually immaterial business combinations that are material collectively.
b. If a material business combination is completed after the balance sheet date but before the financial statements are issued unless such disclosure is impracticable. If

disclosure of any of the information required by paragraph 78 is impracticable, that fact and the reasons shall be disclosed.

80. The acquirer shall disclose a reconciliation of the carrying amount of goodwill at the beginning and end of the reporting period as required by Statement 142, as amended.

81. If the specific disclosures required by this and other Statements do not meet the objectives set out in paragraphs 71, 75, or 77, the acquirer shall disclose any additional information necessary to meet those objectives.

EFFECTIVE DATE AND TRANSITION

82. This Statement shall apply prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual period beginning on or after December 15, 2006. Earlier application is encouraged. However, this Statement shall be applied only at the beginning of an annual period that begins on or after this Statement is issued. If this Statement is applied before the effective date, that fact shall be disclosed and Proposed Statement, *Consolidated Financial Statements, Including Accounting and Reporting of Noncontrolling Interests in Subsidiaries,* shall be applied at the same time.

83. Except as provided in paragraph 86, assets and liabilities that arose from business combinations whose acquisition dates preceded the application of this Statement shall not be adjusted upon application of this Statement.

84. Entities that have not applied Statement 142 in its entirety shall apply that Statement in its entirety at the same time that they apply this Statement.

85. Entities, such as mutual entities, that have not applied Statement 141 and FASB Statement No. 147, *Acquisitions of Certain Financial Institutions,* and have had one or more business combinations that were accounted for using the purchase method shall apply the transition provisions in paragraphs C13–C24.

Subsequent Recognition of Acquired Deferred Tax Benefits

86. For business combinations in which the acquisition date was before this Statement is applied:

a. The acquirer shall apply the requirements of Statement 109, as amended by paragraph D17 of this Statement, prospectively. Therefore, the acquirer shall not adjust the accounting for prior business combinations for the subsequent recognition of acquired deferred tax benefits (that is, by elimination of that valuation allowance) unless the rebuttable presumption in paragraph 30 of Statement 109, as amended by this Statement, applies in the current period.
b. The acquirer shall recognize, as a reduction to income tax expense (or credited directly to contributed capital in accordance with paragraph 26 of Statement 109), tax benefits that are recognized more than one year after the acquisition date (that is, by elimination of that valuation allowance).

87. Paragraph not used.

WITHDRAWAL OF OTHER PRONOUNCEMENTS

88. This Statement replaces Statement 141.

The provisions of this Statement need not be applied to immaterial items.

Appendix A

IMPLEMENTATION GUIDANCE

CONTENTS

Paragraph Numbers

Introduction A1
Definition of a Business (Application of Paragraph 3(d)) A2–A7
Measuring the Fair Value of the Acquiree (Application of Paragraphs 19–27) ... A8–A26
Measuring the Fair Value of the Acquiree Using the Consideration Transferred A9–A17
Example 1: Acquisition of Less Than 100 Percent of the Equity Interests of an Acquiree A12–A13
Example 2: Acquisition of Less Than 100 Percent of the Equity Interests of an Acquiree in a Business Combination Achieved in Stages A14
Example 3: Acquisition of Less Than 100 Percent of the Equity Interests of an Acquiree with Evidence of a Control Premium A15–A17
Measuring the Fair Value of the Acquiree Using Valuation Techniques A18–A26
Market Approach A20–A21
Income Approach A22–A23
Special Considerations in Applying the Market and Income Approaches to Mutual Entities A24–A26
Intangible Assets (Application of Paragraphs 40 and 41) A27–A61
Research and Development Assets A27
Recognition of Intangible Assets Separately from Goodwill A28–A34
Examples of Intangible Assets That Are Identifiable A35–A61
Marketing-Related Intangible Assets A37–A41
Trademarks, Trade Names, Service Marks, Collective Marks, and Certification Marks A38–A40
Internet Domain Names A41
Customer-Related Intangible Assets A42–A49
Customer Lists A43
Order or Production Backlog A44
Customer Contracts and the Related Customer Relationships A45–A47
Noncontractual Customer Relationships A48
Examples Illustrating Customer Contract and Customer Relationship Intangible Assets Acquired in a Business Combination A49
Artistic-Related Intangible Assets A50–A51
Contract-Based Intangible Assets A52–A55
Servicing Contracts such as Mortgage Servicing Contracts A53–A54
Employment Contracts A55
Technology-Based Intangible Assets A56–A61
Computer Software and Mask Works A57–A58
Databases, Including Title Plants A59–A60

Paragraph
Numbers

Trade Secrets Such as Secret Formulas, Processes, or Recipes................A61
Initial Calculation and Allocation of Goodwill in a Business Combination in Which the Acquirer Holds Less Than 100 Percent of the Equity Interests in an Acquiree at the Acquisition Date (Application of Paragraph 58)...........A62–A63
Example 4: Initial Calculation and Allocation of Goodwill to the Acquirer and Noncontrolling Interests in the Acquiree......................................A63
Business Combinations in Which the Consideration Transferred for the Acquirer's Interest in the Acquiree Is Less Than the Fair Value of That Interest (Application of Paragraphs 59–61) A64–A70
Example 5: Business Combinations in Which the Consideration Transferred for 100 Percent of the Equity Interests in the Acquiree Is Less Than the Fair Value A64–A66
Example 6: Business Combinations in Which the Consideration Transferred for Less Than 100 Percent of the Equity Interests in the Acquiree Is Less Than the Fair Value..A67–A70
Measurement Period (Application of Paragraphs 62–68 and 76(a)) A71–A86
Example 7: Lawsuit A72–A74
Example 8: Disposal of an Asset during the Measurement Period..............A75–A76
Consideration Transferred and Contingent Consideration A77–A83
Example 9: Contingent Payout Based on Future Earnings.....................A78–A80
Example 10: Contingent Payout Based on the Outcome of a Lawsuit...A81–A83
Example 11: Illustration of Paragraphs 64 and 76(a)—Incomplete Appraisal...A84–A86
Assessing What Is Part of the Exchange for the Acquiree (Application of Paragraphs 69 and 70)...A87–A109
Example 12: Regulatory Asset Acquired That Is Included in the Business Combination Accounting...A89–A90
Effective Settlement of Preexisting Relationships between the Acquirer and Acquiree in a Business Combination A91–A97
Example 13: Effective Settlement of a Supply Contract as a Result of a Business Combination A94–A96
Example 14: Effective Settlement of a Contract between the Acquirer and Acquiree in Which the Acquirer Had Recognized a Liability before the Business Combination..A97
Arrangements to Pay for Employee Services A98–A101
Example 15: Arrangement That Is Part of the Exchange for the Acquiree..A100–A101
Acquirer Share-Based Payment Awards Exchanged for Awards Held by the Employees of the Acquiree A102–A109

Paragraph Numbers

Example 16: Acquirer Replacement Awards, for Which No Services Are Required after the Acquisition Date, Are Exchanged for Awards of the Acquiree, for Which the Required Services Were Rendered before the Acquisition Date A105
Example 17: Acquirer Replacement Awards, for Which Services Are Required after the Acquisition Date, Are Exchanged for Awards of the Acquiree, for Which the Required Services Were Rendered before the Acquisition Date A106
Example 18: Acquirer Replacement Awards, for Which Services Are Required After the Acquisition Date, Are Exchanged for Awards of the Acquiree, for Which the Requisite Service Period Was Not Completed before the Acquisition Date A107–A108
Example 19: Acquirer Replacement Awards, for Which No Services Are Required after the Acquisition Date, Are Exchanged for Awards of the Acquiree, for Which the Requisite Service Period Was Not Completed before the Acquisition Date A109
Illustration of Disclosure Requirements (Application of Paragraphs 71 and 72) A110
Reverse Acquisitions (Application of Paragraph 12(c)) A111–A136
Fair Value of the Acquiree A113–A115
Preparation and Presentation of Consolidated Financial Statements A116–A118
Noncontrolling Interest A119–A120
Earnings per Share A121–A124
Example 20: Reverse Acquisition A125–A136
Calculating the Fair Value of the Acquiree A128
Measuring Goodwill A129
Consolidated Balance Sheet at September 30, 20X6 .... A130–A131
Earnings per Share A132–A133
Noncontrolling Interest A134–A136

Appendix A

IMPLEMENTATION GUIDANCE

This appendix is an integral part of the Statement.

Introduction

A1. This appendix discusses generalized situations and provides examples that incorporate simplified assumptions to illustrate how to apply some of the provisions of this Statement.

Definition of a Business (Application of Paragraph 3(d))

A2. A *business* is defined as an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing either (a) a return to investors or (b) dividends, lower costs, or other economic benefits directly and proportionately to owners, members, or participants (paragraph 3(d)). A business consists of inputs and processes applied to those inputs that have the ability to create outputs. Although businesses usually have outputs, outputs are not required for an integrated set to qualify as a business. The three elements of a business are defined as follows:

a. *Input:* Any economic resource that creates, or has the ability to create, outputs when one or more processes are applied to it. Examples include long-lived assets (including intangible assets or rights to use long-lived assets), intellectual property, ability to obtain access to necessary materials or rights, and employees.
b. *Process:* Any system, standard, protocol, convention, or rule that when applied to an input, or inputs, creates or has the ability to create outputs. Examples include strategic management processes, operational processes, and resource management processes. These processes typically are documented; however, an organized workforce having the necessary skills and experience following rules and conventions may provide the necessary processes that are capable of being applied to inputs to create outputs. (Accounting, billing, payroll, and other administrative systems typically are not processes that are used to create outputs.)
c. *Output:* The result of inputs and processes applied to those inputs that provide or have the ability to provide a return to investors or dividends, lower costs, or other economic benefits directly and proportionately to owners, members, or participants.

A3. To be capable of being conducted and managed for the purposes defined, an integrated set of activities and assets requires two essential elements—inputs and processes applied to those inputs, which together are or will be used to create outputs. However, a business need not include all of the inputs or processes that the seller used in operating that business if a *willing party* is capable of acquiring the business and continuing to produce outputs, for example, by integrating the business with its own inputs and processes. Paragraph 5 of Proposed FASB Statement, *Fair Value Measurements,* states that *willing parties* are "presumed to be marketplace participants representing unrelated buyers and sellers that are (a) knowledgeable, having a common

level of understanding about factors relevant to the asset or liability and the transaction, and (b) willing and able to transact in the same market(s), having the legal and financial ability to do so."

A4. The nature of the elements of a business varies by industry and by the structure of an entity's operations (activities), including the entity's stage of development. Established businesses often have many, and different, kinds of inputs, processes, and outputs, whereas new businesses often have few inputs and processes, and sometimes only a single output (product). Nearly all businesses also have liabilities, but a business need not have any liabilities.

A5. An integrated set of activities and assets in the development stage may not have outputs. In that case, other factors should be assessed to determine whether the set is a business. Those factors would include whether the set:

a. Has begun planned principal activities
b. Has employees, intellectual property, and other inputs and processes that could be applied to those inputs
c. Is pursuing a plan to produce outputs
d. Has the ability to obtain access to customers that will purchase the outputs.

A6. The determination of whether a particular set of assets and activities is a business should be based on whether the integrated set is capable of being conducted and managed as a business by a willing acquirer. Thus, in evaluating whether a particular set is a business, it is not relevant whether a seller operated the set as a business or whether the acquirer intends to operate the set as a business.

A7. If goodwill is present in a particular set of assets and activities then, in the absence of evidence to the contrary, the set shall be presumed to be a business. However, a business need not have goodwill.

Measuring the Fair Value of the Acquiree (Application of Paragraphs 19–27)

A8. As noted in paragraph 19, the acquirer is required to measure the fair value of the acquiree, as a whole, as of the acquisition date. The objective of measuring the fair value of the acquiree is to estimate the price at which 100 percent of the acquiree could be exchanged in a current transaction between knowledgeable, unrelated willing parties when neither party is acting under compulsion.

Measuring the Fair Value of the Acquiree Using the Consideration Transferred

A9. In the absence of evidence to the contrary, the acquisition-date fair value of the consideration transferred is presumed to be the best basis for measuring the fair value of the acquirer's interest in the acquiree on that date.

A10. In a business combination between willing parties in which the acquirer purchases 100 percent of the equity interests or net assets that constitute a business (an acquiree), the fair value of the consideration transferred usually is more clearly evident and reliably

measurable than the fair value of the acquiree in the absence of evidence to the contrary. Therefore, the acquirer usually should use the acquisition-date fair value of the consideration transferred in exchange for the acquiree to measure the fair value of the acquiree on that date.

A11. If the acquirer purchases less than 100 percent of the equity interests of an acquiree on the acquisition date (either in a single transaction or multiple transactions), the acquisition-date fair value of the consideration transferred is usually the best basis for measuring the fair value of the acquirer's interest in the acquiree on that date. However, the consideration transferred by itself most likely is not representative of the fair value of the acquiree as a whole. The following examples illustrate how the fair value of consideration transferred for less than 100 percent of the equity interests of an acquiree, together with other available information, might be used to estimate the fair value of the acquiree as a whole.

Example 1: Acquisition of Less Than 100 Percent of the Equity Interests of an Acquiree

A12. Acquirer Company (AC) offers to purchase all of the 10 million outstanding shares of Target Company (TC) for CU10.00 per share, provided that at least 80 percent of TC's shares are tendered. Shares of TC are publicly traded and widely dispersed. On the acquisition date, 90 percent of TC's shares are tendered and acquired by AC for CU90 million. In the week before the announcement of the offer, TC's shares were trading at CU8.85–CU9.15 per share. During the first week after the acquisition date, the remaining 1 million outstanding shares of TC continue to trade with significantly lower volume and greater volatility (at prices ranging from CU8.50 to CU13.00 per share).

A13. In this example, the consideration transferred by AC for 90 percent of the equity interests of TC is determined to be the best basis for estimating the fair value of TC as CU100 million (10 million shares × CU10.00). First, there is no evidence to suggest that the price of CU10.00 per-share exchanged for the 90 percent interest is not representative of the price that knowledgeable, unrelated willing parties would pay at the acquisition date in exchange for a 100 percent ownership interest in TC. In fact, AC offered to pay CU10.00 for all of the outstanding shares. Second, because the shares were widely dispersed, there is no evidence that it would be necessary to pay an amount other than CU 10.00 per share to obtain 100 percent of the shares.

Example 2: Acquisition of Less Than 100 Percent of the Equity Interests of an Acquiree in a Business Combination Achieved in Stages

A14. Assume the same facts as in paragraph A12, except that AC owns 100,000 shares (1 percent) of TC that it originally purchased at CU8.50 per share. The shares are classified as available-for-sale securities and carried at fair value. For the reasons described in paragraph A13, the amount paid (CU10.00 per share) to obtain a 90 percent interest (an additional 8.9 million shares) continues to be the best basis for measuring the fair value of TC as CU100 million. However, in accordance with the provisions of paragraph 56, AC recognizes a gain of CU150,000 [(CU10.00 – CU8.50) × 100,000 shares] on its original 1 percent noncontrolling equity investment in income. The

carrying amount of CU1 million for that 1 percent investment, like the CU89 million investment for the 8.9 million shares acquired, is eliminated in consolidation.

Example 3: Acquisition of Less Than 100 Percent of the Equity Interests of an Acquiree with Evidence of a Control Premium

A15. Assume that a single Founding Shareholder (FS) owns 60 percent of TC's shares, and the remaining 40 percent of TC's 10 million shares are widely dispersed and have been publicly trading in the CU9.85–CU10.15 range. Also assume that FS desires to sell its controlling 60 percent interest in TC, and, on the basis of its knowledge of the industry, FS identifies AC as the highest bidder if FS was interested in making TC available for sale to all potential buyers. Following private negotiations, AC buys all of FS's holdings in TC for CU81 million (CU13.50 per share), a premium of about CU3.50 per share over the market price of the publicly traded noncontrolling shares on the acquisition date. During the first week following the acquisition, the noncontrolling shares of TC traded in a range of CU8.50–CU13.00. AC willingly paid a premium over the market price of the publicly traded shares on the basis of its assessment that:

a. TC, as a whole, would be worth between CU110 million and CU130 million to other marketplace participants (based on market comparisons of companies similar to TC and its best estimate as to the likely synergies that those marketplace participants might be able to achieve).
b. AC can extract synergies similar to those of other marketplace participants, as well as generate additional savings by making proprietary technology available to TC.

A16. At issue is whether the consideration transferred by AC for the less than 100 percent equity interest, by itself, can be presumed to provide the best basis for measuring the fair value of TC (that is, the fair value that knowledgeable, unrelated willing parties would exchange for a 100 percent equity interest in TC).

A17. In this example, AC has information that suggests that CU135 million is not necessarily representative of the amount that other knowledgeable, unrelated willing parties would pay for TC as a whole. Moreover, the market prices for the noncontrolling shares at the acquisition date (CU9.85 – CU10.15 per share) and during the first week following the acquisition (CU8.50 – CU13.00) suggest that CU13.50 per share is not representative of the fair value of TC, as a whole. In this case, the fair value of TC may be estimated on a preliminary basis to be CU121 million based on (a) the CU81 million paid for the controlling 60 percent interest plus CU40 million for the value of the noncontrolling shares ([4 million × CU10.00]) and (b) the fact that CU121 million falls within the CU110 million–CU130 million range used in AC's preliminary assessments of the value of TC. However, before AC concludes that CU121 million is its best estimate of the fair value of TC, consistently with the objective of measuring the fair value for 100 percent of the equity interests in the acquiree and with the guidance in Proposed Statement, *Fair Value Measurements,* AC should refine its initial estimate of fair value using other relevant valuation techniques, as appropriate. Thus, AC might refine its preliminary assessment of the fair value of TC using, for example, the market and income approaches discussed in paragraphs A20–A23.

Measuring the Fair Value of the Acquiree Using Valuation Techniques

A18. In some circumstances, the measurement of the fair value of the acquiree should not be based on the consideration transferred. These circumstances include the following:

a. The acquirer does not transfer any consideration on the acquisition date (for example, a business combination in which an entity (the acquiree) repurchases its own shares and, as a result, an existing investor (the acquirer) obtains control of that entity).
b. There is evidence that the transaction is not an exchange of equal values by willing parties (for example, a business combination in which the seller is acting under duress).
c. The fair value of the total consideration transferred is not more reliably measurable than the fair value of the acquiree (for example, a business combination in which two private business entities or two mutual entities combine through an exchange of equity or member interests and the fair value of the acquiree is more clearly evident and, thus, more reliably measurable than the fair value of the equity or member interests transferred by the acquirer).

A19. When the measurement of the fair value of the acquiree is not based on the consideration transferred, that measurement should be based on observable prices for a business that is similar to the acquiree, if such information is available. Otherwise, fair value should be estimated using multiple techniques that are relevant and for which reliable data are available. The results of the multiple techniques would then be evaluated considering the relevance and reliability of the inputs used to estimate the fair value of the acquiree. The techniques applied and evaluated might be the market approach, the income approach, or several variations of each on the basis of the relevance of the approach and the extent of the available data.

Market Approach

A20. In applying the market approach, the basic steps are (a) define and assess the available marketplace data (and adjust, if necessary) to derive one or more valuation ratios and (b) apply the appropriate valuation ratios to the acquiree. As applied to measuring the fair value of a business for the purposes of applying this Statement, the market approach typically is based on prices of publicly traded equity shares or prices in other business combinations involving comparable businesses for which the terms of the arrangements are disclosed. Identifying comparable businesses requires judgments about the degree to which operational, market, financial, and nonfinancial factors are similar between the acquiree and comparable businesses. Factors to be considered in making this assessment might include products and services (operational factors); markets served, competitors, and position within the industry (market factors); capital structure and historical and forecast financial performance (financial factors); and the depth of management, the expertise of personnel, and the maturity of the business (nonfinancial factors). Other factors might be considered, depending on the nature of the business being valued.

A21. Ideally, marketplace data are based on other entities within the same industry. In the absence of that information, marketplace data might be based on economically similar businesses. Thus, the degree of comparability between other businesses and the acquiree varies and it may be necessary to adjust the valuation ratios to reflect differences. Such adjustments should be consistent with the objective of measuring fair value.

Income Approach

A22. In applying an income approach, the basic steps involve estimating the value of future cash flows or other income-related valuation measures such as residual income. Paragraph 7(b) of Proposed FASB Statement, *Fair Value Measurements,* summarizes key aspects of the income approach and states:

> The income approach uses valuation techniques to convert future amounts (for example, cash flows or earnings) to a single present amount (discounted). The estimate of fair value is based on the value indicated by marketplace expectations about those future amounts.

A23. Appendix A of that proposed Statement discusses the use of present value techniques to estimate fair value.

Special Considerations in Applying the Market and Income Approaches to Mutual Entities

A24. When two mutual entities combine, the fair value of the acquiree may be more reliably measurable than the fair value of member interests transferred by the acquirer. In a business combination involving only mutual entities in which the only consideration is an exchange of the acquirer's member interests for the acquiree's member interests, the fair value of the acquiree and the fair value of the member interests exchanged as consideration are presumed to be equal.

A25. Mutual entities, although similar in many ways to other businesses, have distinct characteristics that arise primarily because the members of a mutual entity are both customers and owners. Members of mutual entities generally expect to receive benefits for their membership, often in the form of reduced fees charged for goods and services or patronage dividends. The portion of patronage dividends allocated to each member is often based on the amount of business the member did with the mutual entity during the year.

A26. A fair value measurement of a mutual entity should include the assumptions that marketplace participants would make about future member benefits as well as any other relevant assumptions marketplace participants would make about the mutual entity. For example, in determining the fair value of a mutual entity, an estimated cash flow model may be used. In that case, the cash flows should be based on the expected cash flows of the mutual entity, which are likely to include adjustments for member benefits, such as the cost of reduced fees charged for goods and services.

Intangible Assets (Application of Paragraphs 40 and 41)

Research and Development Assets

A27. An acquirer recognizes and measures the acquisition-date fair value of all identifiable intangible and tangible assets acquired in a business combination that are used in research and development activities regardless of whether there is an alternative future use for those assets. After initial recognition, the provisions of Statement 142, as amended by paragraph D22 of this Statement, and FASB Statement No. 2, *Accounting for Research and Development Costs,* as amended by paragraph D9 of this Statement, apply.

Recognition of Intangible Assets Separately from Goodwill

A28. In accordance with paragraph 40, the acquirer recognizes separately from goodwill the acquisition-date fair value of intangible assets acquired in a business combination that are identifiable. An intangible asset is identifiable if it arises from contractual or other legal rights (the contractual-legal criterion) or is separable (separability criterion). Intangible assets that meet the contractual-legal criterion are identifiable even if the asset is not transferable or separable from the acquiree or from other rights and obligations. For example:

a. An acquiree leases a manufacturing facility under an operating lease that has terms that are favorable relative to market prices. The lease terms explicitly prohibit transfer of the lease (through either sale or sublease). The amount by which the lease terms are favorable relative to market prices is an intangible asset that meets the contractual-legal criterion for recognition separately from goodwill, even though the lease contract cannot be sold or otherwise transferred.
b. An acquiree owns and operates a nuclear power plant. The license to operate that power plant is an intangible asset that meets the contractual-legal criterion for recognition separately from goodwill, even if it cannot be sold or transferred apart from the acquired power plant. An acquirer may recognize the fair value of the operating license and the fair value of the power plant as a single asset for financial reporting purposes if the useful lives of those assets are similar.
c. An acquiree owns a technology patent. It has licensed that patent to others for their exclusive use outside the United States in exchange for which the acquired business receives a specified percentage of future non-U.S. revenue. Both the technology patent and the related license agreement meet the contractual-legal criterion for recognition separately from goodwill even if selling or exchanging the patent and the related license agreement apart from one another would not be practical.

A29. The separability criterion means that the acquired intangible asset is capable of being separated or divided from the acquiree and sold, transferred, licensed, rented, or exchanged, either individually or together with a related contract, asset, or liability. Exchange transactions provide evidence that an intangible asset is separable from the acquiree and might provide information that can be used to estimate its fair value. An acquired intangible asset meets the separability criterion if there is evidence of exchange transactions for that type of asset or an asset of a similar type (even if those exchange

transactions are infrequent and regardless of whether the acquirer is involved in them). For example, customer and subscriber lists are frequently licensed and thus meet the separability criterion. Even if an acquiree believes its customer lists have different characteristics from other customer lists, the fact that customer lists are frequently licensed generally means that the acquired customer list meets the separability criterion.

A30. An intangible asset that meets the separability criterion should be recognized separately from goodwill even if the acquirer does not intend to sell, license, or otherwise exchange that asset. The separability criterion is met because the asset is *capable* of being separated from the acquiree or combined entity and sold, transferred, licensed, rented, or otherwise exchanged for something else of value. For example, because an acquired customer list is generally capable of being licensed, it meets the separability criterion regardless of whether the acquirer intends to license it.

A31. An intangible asset that is not separable from the acquiree or combined entity individually meets the separability criterion if it is separable in combination with a related contract, asset, or liability. For example:

a. Deposit liabilities and related depositor relationship intangible assets are exchanged in observable exchange transactions. Therefore, the depositor relationship intangible asset should be recognized separately from goodwill.
b. An acquiree owns a registered trademark, a related secret formula, and unpatented technical expertise used to manufacture the trademarked product. To transfer ownership of a trademark, the owner is also required to transfer everything else necessary for the new owner to produce a product or service indistinguishable from that produced by the former owner. Because the unpatented technical expertise must be separated from the acquiree or combined entity and sold if the related trademark is sold, it meets the separability criterion.

A32. An acquirer subsumes into goodwill the value of any acquired intangible asset that is not identifiable as of the acquisition date. For example, an acquirer may attribute value to the potential contracts the acquiree is negotiating with prospective new customers at the acquisition date. Because those potential contracts are not identifiable intangible assets at the acquisition date, they are not recognized separately from goodwill. The value of those contracts should not be reclassified from goodwill for events that occur after the acquisition date. However, the acquirer should assess the facts and circumstances surrounding events occurring shortly after the acquisition to determine whether a separately recognizable intangible asset existed at the acquisition date.

A33. After initial recognition, intangible assets acquired in a business combination are accounted for in accordance with the provisions of Statement 142. However, as described in paragraph 8 of Statement 142, the accounting for some acquired intangible assets after initial recognition is prescribed by other Statements.

A34. The identifiability criterion is used to determine whether an intangible asset should be recognized separately from goodwill. It does not provide guidance for measuring the fair value of an intangible asset. That criterion does not restrict the assumptions used in

estimating the fair value of an intangible asset. For example, assumptions that marketplace participants would consider, such as expectations of future contract renewals, are considered in arriving at a fair value measurement even though those renewals do not meet the identifiability criterion. EITF Issue No. 02-7, "Unit of Accounting for Testing Impairment of Indefinite-Lived Intangible Assets," provides guidance for determining whether indefinite-lived intangible assets should be combined into a single unit of accounting for purposes of testing for impairment if they are operated as a single asset and, as such, essentially are inseparable from one another. That guidance also is relevant for determining the unit of accounting when estimating the fair values of intangible assets acquired in a business combination.

Examples of Intangible Assets That Are Identifiable

A35. The following are examples of identifiable intangible assets acquired in a business combination. Some of the examples may have characteristics of assets other than intangible assets. Accordingly, those assets should be accounted for on the basis of their substance. These examples are not intended to be all-inclusive.

A36. Intangible assets designated with the symbol # are those that arise from contractual or other legal rights. Those designated with the symbol * do not arise from contractual or other legal rights but are separable. Intangible assets designated with the symbol # might also be separable; however, separability is not a necessary condition for the asset to meet the contractual-legal criterion.

Marketing-Related Intangible Assets

A37. Marketing-related intangible assets are those assets that are primarily used in the marketing or promotion of products or services. Examples of marketing-related intangible assets are:

a. Trademarks, trade names, service marks, collective marks, certification marks #
b. Trade dress (unique color, shape, or package design) #
c. Newspaper mastheads #
d. Internet domain names #
e. Noncompetition agreements. #

Trademarks, trade names, service marks, collective marks, and certification marks #

A38. Trademarks are words, names, symbols, or other devices used in trade to indicate the source of a product and to distinguish it from the products of others. A service mark identifies and distinguishes the source of a service rather than a product. Collective marks are used to identify the goods or services of members of a group. Certification marks are used to certify the geographical origin or other characteristics of a good or service.

A39. Trademarks, trade names, service marks, collective marks, and certification marks may be protected legally through registration with governmental agencies, continuous use in commerce, or by other means. Provided it is protected legally through registration or other means, a trademark or other mark acquired in a business combination is an

intangible asset that meets the contractual-legal criterion. Otherwise, a trademark or other mark acquired in a business combination can be recognized separately from goodwill provided the separability criterion is met, which would normally be the case.

A40. The terms brand and brand name are often used as synonyms for trademarks and other marks. However, the former are general marketing terms that are typically used to refer to a group of complementary assets such as a trademark (or service mark) and its related trade name, formulas, recipes, and technological expertise. An entity is not precluded from recognizing, as a single asset apart from goodwill, a group of complementary intangible assets commonly referred to as a brand if the assets that make up that group have similar useful lives.

Internet domain names #

A41. An Internet domain name is a unique alphanumeric name that is used to identify a particular numeric Internet address. Registration of a domain name creates an association between that name and a designated computer on the Internet for the period of the registration. Those registrations are renewable. A registered domain name acquired in a business combination meets the contractual-legal criterion.

Customer-Related Intangible Assets

A42. Examples of customer-related intangible assets are:

a. Customer lists *
b. Order or production backlog #
c. Customer contracts and related customer relationships #
d. Noncontractual customer relationships. *

Customer lists *

A43. A customer list consists of information about customers, such as their names and contact information. A customer list also may be in the form of a database that includes other information about the customers, such as their order histories and demographic information. A customer list does not generally arise from contractual or other legal rights. However, customer lists are frequently leased or exchanged. Therefore, a customer list acquired in a business combination normally meets the separability criterion. However, a customer list acquired in a business combination would not meet the separability criterion if the terms of confidentiality or other agreements prohibit an entity from selling, leasing, or otherwise exchanging information about its customers.

Order or production backlog #

A44. An order or production backlog arises from contracts such as purchase or sales orders. An order or production backlog acquired in a business combination meets the contractual-legal criterion, even if the purchase or sales orders are cancelable.

Customer contracts and the related customer relationships #

A45. If an entity establishes relationships with its customers through contracts, those customer relationships arise from contractual rights. Therefore, customer contracts and the related customer relationships acquired in a business combination meet the contractual-legal criterion. This will be the case even if confidentiality or other contractual terms prohibit the sale or transfer of a contract separately from the acquiree.

A46. A customer contract intangible asset and the related customer relationship intangible asset may represent two distinct intangible assets. Both the useful lives and the pattern in which the economic benefits of the two assets are consumed may differ.

A47. A customer relationship exists between an entity and its customer if (a) the entity has information about the customer and has regular contact with the customer and (b) the customer has the ability to make direct contact with the entity. Customer relationships meet the contractual-legal criterion when an entity has a practice of establishing contracts with its customers, regardless of whether a contract exists at the acquisition date. Customer relationships also may arise through means other than contracts, such as through regular contact by sales or service representatives. As noted in paragraph A44, an order or a production backlog arises from contracts such as purchase or sales orders, and therefore is also considered a contractual right. Consequently, if an entity has customer relationships with its customers through these types of contracts, the customer relationships also arise from contractual rights and, therefore, meet the contractual-legal criterion.

Noncontractual customer relationships *

A48. If a customer relationship acquired in a business combination does not arise from a contract, the relationship may be separable. Exchange transactions for the same asset or a similar asset provide evidence of separability of a noncontractual customer relationship and might also provide information about exchange prices that should be considered when estimating fair value.

Examples illustrating customer contract and customer relationship intangible assets acquired in a business combination

A49. The following examples illustrate the recognition of customer contract and customer relationship intangible assets acquired in a business combination.

a. AC acquires TC in a business combination on December 31, 20X5. TC has a five-year agreement to supply goods to Customer. Both TC and AC believe that Customer will renew the supply agreement at the end of the current contract. The supply agreement is not separable. The supply agreement, whether cancelable or not, meets the contractual-legal criterion. Additionally, because TC establishes its relationship with Customer through a contract, the customer relationship with Customer meets the contractual-legal criterion. In determining the fair value of the customer relationship, AC considers assumptions such as the expected renewal of the supply agreement.

b. AC acquires TC in a business combination on December 31, 20X5. TC manufactures goods in two distinct lines of business: sporting goods and electronics. Customer purchases both sporting goods and electronics from TC. TC has a contract with Customer to be its exclusive provider of sporting goods. However, there is no contract for the supply of electronics to Customer. Both TC and AC believe only one overall customer relationship exists between TC and Customer.

   The contract to be Customer's exclusive supplier of sporting goods, whether cancelable or not, meets the contractual-legal criterion. Additionally, because TC establishes its relationship with Customer through a contract, the customer relationship with Customer meets the contractual-legal criterion. Because there is only one customer relationship with Customer, the fair value of that relationship incorporates assumptions regarding TC's relationship with Customer related to both sporting goods and electronics. However, if both AC and TC believe there were separate customer relationships with Customer—one for sporting goods and another for electronics—the customer relationship with respect to electronics would be assessed by AC to determine whether it meets the separability criterion for identification as an intangible asset.

c. AC acquires TC in a business combination on December 31, 20X5. TC does business with its customers solely through purchase and sales orders. At December 31, 20X5, TC has a backlog of customer purchase orders from 60 percent of its customers, all of whom are recurring customers. The other 40 percent of TC's customers also are recurring customers. However, as of December 31, 20X5, TC does not have any open purchase orders or other contracts with those customers.

   The purchase orders from 60 percent of TC's customers, whether cancelable or not, meet the contractual-legal criterion. Additionally, because TC has established its relationship with 60 percent of its customers through contracts, those customer relationships meet the contractual-legal criterion. Because TC has a practice of establishing contracts with the remaining 40 percent of its customers, its relationship with those customers also arises through contractual rights and, therefore, meets the contractual-legal criterion, even though TC does not have contracts with those customers at December 31, 20X5.

d. AC acquires TC, an insurer, in a business combination on December 31, 20X5. TC has a portfolio of one-year motor insurance contracts that are cancelable by policyholders. Annual renewal rates are reasonably predictable. Because TC establishes its relationships with policyholders through insurance contracts, the customer relationship with policyholders meets the contractual-legal criterion. In determining the fair value of the customer relationship intangible asset, AC considers estimates of renewals and cross-selling. Statement 142 applies to the customer relationship intangible asset.

   In determining the fair value of the liability relating to the portfolio of insurance contracts, AC considers estimates of cancellations by policyholders. Statement 60*,*

as amended by paragraph D13 of this Statement, requires an expanded presentation that splits the fair value of acquired insurance contracts into two components:

(1) A liability measured in accordance with the insurer's accounting policies for insurance contracts that it issues
(2) An intangible asset, representing the fair value of the contractual rights and obligations acquired, to the extent that the liability does not reflect that fair value. This intangible asset is excluded from the scope of Statement 142 and FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. After the business combination, AC is required to measure that intangible asset on a basis consistent with the measurement of the related insurance liability.

Artistic-Related Intangible Assets

A50. Examples of artistic-related intangible assets are:

a. Plays, operas, ballets #
b. Books, magazines, newspapers, other literary works #
c. Musical works such as compositions, song lyrics, advertising jingles #
d. Pictures, photographs #
e. Video and audiovisual material, including motion pictures or films, music videos, television programs. #

A51. Artistic-related assets acquired in a business combination meet the identifiability criterion if they arise from contractual or legal rights such as those provided by copyright. Copyrights can be transferred either in whole through assignments or in part through licensing agreements. In determining the fair value of an intangible asset protected by copyright, consideration is given to the existence of any assignments or licenses of the acquired copyrights. An acquirer is not precluded from recognizing a copyright intangible asset and any related assignments or license agreements as a single asset, provided they have similar useful lives.

Contract-Based Intangible Assets

A52. Contract-based intangible assets represent the value of rights that arise from contractual arrangements. Customer contracts are one particular type of contract-based intangible asset. If the terms of a contract give rise to a liability (which might be the case if the terms of an operating lease or customer contract are unfavorable relative to market prices), that liability is recognized as a liability assumed. Examples of contract-based intangible assets are:

a. Licensing, royalty, standstill agreements #
b. Advertising, construction, management, service or supply contracts #
c. Lease agreements (whether the acquiree is the lessee or lessor) #
d. Construction permits #
e. Franchise agreements #
f. Operating and broadcast rights #
g. Servicing contracts such as mortgage servicing contracts #

h. Employment contracts #
i. Use rights such as drilling, water, air, mineral, timber cutting, and route authorities. #[3]

Servicing contracts such as mortgage servicing contracts #

A53. Contracts to service financial assets are one type of contract-based intangible asset. Although servicing is inherent in all financial assets, it becomes a distinct asset by one of the following:

a. When contractually separated from the underlying financial asset by sale or securitization of the assets with servicing retained
b. Through the separate purchase and assumption of the servicing.

A54. If mortgage loans, credit card receivables, or other financial assets are acquired in a business combination with servicing retained, the inherent servicing rights are not a separate intangible asset because the fair value of those servicing rights is included in the measurement of the fair value of the acquired financial asset.

Employment contracts #

A55. Employment contracts that are beneficial contracts from the perspective of the employer are one type of contract-based intangible asset because the pricing of those contracts is favorable relative to market prices.

Technology-Based Intangible Assets

A56. Examples of technology-based intangible assets are:

a. Patented technology #
b. Computer software and mask works #
c. Unpatented technology *
d. Databases, including title plants *
e. Trade secrets, such as secret formulas, processes, recipes. #

[3]Certain use rights may have characteristics of assets other than intangible assets. For example, certain mineral rights are considered tangible assets based on the consensus in EITF Issue No. 04-2, "Whether Mineral Rights Are Tangible or Intangible Assets." Accordingly, use rights should be accounted for based on their substance.

Computer software and mask works #

A57. If computer software and program formats acquired in a business combination are protected legally, such as by patent or copyright, they meet the contractual-legal criterion for identification as intangible assets.

A58. Mask works are software permanently stored on a read-only memory chip as a series of stencils or integrated circuitry. Mask works may have legal protection. Mask works with legal protection that are acquired in a business combination meet the contractual-legal criterion for identification as intangible assets.

Databases, including title plants *

A59. Databases are collections of information, often stored in electronic form (such as on computer disks or files). A database that includes original works of authorship may be entitled to copyright protection. If a database acquired in a business combination is protected by copyright, it meets the contractual-legal criterion. However, a database typically includes information created as a consequence of an entity's normal operations, such as customer lists, or specialized information such as scientific data or credit information. Databases that are not protected by copyright can be, and often are, exchanged, licensed, or leased to others in their entirety or in part. Therefore, even if the future economic benefits from a database do not arise from legal rights, a database acquired in a business combination meets the separability criterion.

A60. Title plants constitute a historical record of all matters affecting title to parcels of land in a particular geographical area. Title plant assets are bought and sold in exchange transactions (either in whole or in part) or are licensed. Therefore, title plant assets acquired in a business combination meet the separability criterion.

Trade secrets such as secret formulas, processes, recipes #

A61. A trade secret is "information, including a formula, pattern, recipe, compilation, program, device, method, technique, or process that (1) derives independent economic value, actual or potential, from not being generally known and (2) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy."[4] If the future economic benefits from a trade secret acquired in a business combination are legally protected, that asset meets the contractual-legal criterion. Otherwise, trade secrets acquired in a business combination are identifiable only if the separability criterion is met, which is likely to be the case.

---

[4]Melvin, Simensky, and Lanning Bryer, *The New Role of Intellectual Property in Commercial Transactions* (New York: John Wiley & Sons, 1998), page 293.

Initial Calculation and Allocation of Goodwill in a Business Combination in Which the Acquirer Holds Less Than 100 Percent of the Equity Interests in an Acquiree at the Acquisition Date (Application of Paragraph 58)

A62. In accordance with paragraph 58, in a business combination in which the acquirer holds less than 100 percent of the equity interests in the acquiree at the acquisition date, the acquirer allocates the amount of goodwill determined in accordance with paragraph 49 to the acquirer and the noncontrolling interests. The amount of goodwill allocated to the acquirer shall be measured as the difference between the acquisition-date fair value of the acquirer's equity interest in the acquiree and the acquirer's share in the acquisition-date fair value of the separately recognized assets acquired and liabilities assumed. The remainder of the goodwill shall be allocated to the noncontrolling interests. The goodwill allocated to the acquirer shall not exceed the total goodwill calculated in accordance with paragraph 49. The acquisition-date fair value of the acquirer's equity interest in the acquiree includes the fair value of any equity interests the acquirer owned immediately before the acquisition date. The following example illustrates those requirements.

Example 4: Initial Calculation and Allocation of Goodwill to the Acquirer and Noncontrolling Interests in the Acquiree

A63. On January 1, 20X5, AC acquires 80 percent of the equity interests in TC for CU160. There is no evidence to suggest that this transaction is not an exchange of equal values. Therefore, the consideration transferred of CU160 is presumed to be the fair value of the 80 percent interest acquired by AC. Through valuation techniques, the fair value of TC as a whole is determined to be CU195. As of the acquisition date, the fair value of the separately recognizable identifiable assets acquired is CU210 and the fair value of the liabilities assumed is CU60. On the basis of those facts, the amount of goodwill is measured as follows:

	CU
Fair value of TC	195
Less: net amount of the fair values of the separately recognized identifiable assets acquired and liabilities assumed [CU210 – CU60]	(150)
Goodwill	45

As described in paragraph A62, the amount of goodwill allocated to AC and to the noncontrolling interests of TC is calculated as follows:

	CU
Fair value of AC's 80 percent interest in TC	160
Less: AC's share of the fair value of the identifiable net assets acquired (80 percent × [CU210 – CU60])	(120)
Goodwill allocated to AC	40
Goodwill allocated to the noncontrolling interests in TC [CU45 – CU40]	5

Business Combinations in Which the Consideration Transferred for the Acquirer's Interest in the Acquiree Is Less Than the Fair Value of That Interest (Application of Paragraphs 59–61)

Example 5: Business Combinations in Which the Consideration Transferred for 100 Percent of the Equity Interests in the Acquiree Is Less Than the Fair Value

A64. On January 1, 20X5, AC acquires 100 percent of the equity interests of TC in exchange for AC's shares with a value of CU190. Because of a regulatory requirement, the former owner of TC did not have sufficient time to market TC to multiple potential buyers. The management of AC initially measures the acquisition-date fair value of the separately recognizable identifiable assets acquired at CU250 and the fair value of the liabilities assumed at CU50. Management of AC estimates the fair value of TC to be between CU215–CU230. Because the fair value of TC exceeds the fair value of the consideration transferred, AC reviews the procedures it used to identify and measure the assets acquired and liabilities assumed and to measure the fair values of both the consideration transferred and TC on the acquisition date and decides that they were appropriate. Nonetheless, management of AC also engages an independent valuation firm to review its estimates. That firm, using multiple valuation techniques, determines that the fair value of TC as a whole is CU225 because of economies of scale that any likely acquirer could achieve in TC's operations. On the basis of those facts, the amount of goodwill and the gain on the bargain purchase are measured as follows:

	CU
Fair value of TC	225
Less: net amount of the fair values of the separately recognized identifiable assets acquired and liabilities assumed [CU250 – 50]	(200)
Goodwill that tentatively would be recognized under paragraph 49	25
Fair value of TC	225
Less: fair value of the consideration transferred for TC	(190)
Excess of the fair value of TC over the fair value of the consideration transferred for TC	35
Less: reduction of tentative goodwill (to zero)	(25)
Adjusted "gain" on bargain purchase for any excess remaining after reducing goodwill to zero	10

A65. Alternatively, because the fair value of the consideration transferred for TC of CU190 is less than the fair value of the separately recognized identifiable assets acquired and liabilities assumed of CU200 [CU250 – 50], the amount of the gain may be calculated as follows:

	CU
Fair value of the consideration transferred for TC	190
Less: net amount of the fair values of the separately recognized identifiable assets acquired and liabilities assumed [CU250 – 50]	(200)
Gain on bargain purchase	10

A66. AC would record its acquisition of TC in its consolidated financial statements as follows:

Identifiable assets acquired (at fair value)	CU250	
Goodwill	0	
Liabilities assumed (at fair value)		CU50
Equity (for issuing shares of AC)		190
Gain on the bargain purchase		10

Example 6: Business Combinations in Which the Consideration Transferred for Less Than 100 Percent of the Equity Interests in the Acquiree Is Less Than the Fair Value

A67. Consider the same facts as in the previous example, except that AC acquires 80 percent of the equity interests in TC for CU152 in AC's shares. If the goodwill measured in accordance with paragraph 49 is reduced to zero, any remaining excess is recognized as a gain attributable to the acquirer on the acquisition date. No gain is attributable to the noncontrolling interest. On the basis of those facts, the amount of goodwill and the gain on bargain purchase are measured as follows:

	TC, as a Whole CU	AC's Interest CU	Noncon-trolling Interest CU
Fair value of TC (and related 80 percent controlling and 20 percent noncontrolling interests)	225	180	45
Less: net amount of the fair values of the separately recognized identifiable assets acquired and liabilities assumed [CU250 – 50]	(200)	(160)	(40)
Goodwill that tentatively would be recognized under paragraph 49 (and tentative allocations)[5]	25	20	5
Fair value of AC's 80 percent interest in TC [CU225 × .80]		180	
Less: fair value of the consideration transferred for AC's interest		(152)	
Excess of the fair value of AC's interest in TC over the consideration exchanged for that interest		28	
Less: adjustment to reduce goodwill that tentatively would have been recognized under paragraph 49 [CU25 × .80]		(20)	
Adjusted "gain" for the 80 percent interest acquired in a bargain purchase after reducing goodwill to zero		8	

[5]In a business combination in which the consideration transferred for a less than 100 percent equity interest in the acquiree is less than the fair value of that interest, goodwill measured in accordance with paragraph 49 is allocable to the acquirer and noncontrolling interests based on their relative equity interests since presumably the acquirer did not pay a control premium to obtain its interest.

A68. In this case, goodwill of CU25 that otherwise would be attributable to AC and the noncontrolling interest is reduced to zero.

A69. Alternatively, because the fair value of the consideration transferred for AC's 80 percent interest in TC of CU152 is less than the fair value of AC's 80 percent interest in the separately recognized identifiable assets acquired and liabilities assumed of CU160 [(CU250 – 50) × .80], the amount of the gain on AC's purchase of the 80 percent interest may be calculated as follows:

	CU
Fair value of the consideration transferred for AC's 80 percent interest in TC	152
Less: net amount of the fair values of the separately recognized identifiable assets acquired and liabilities assumed [(CU250 – 50) × .80]	(160)
Gain on bargain purchase of 80 percent interest	8

A70. AC would record its acquisition of TC in its consolidated financial statements as follows:

Identifiable assets acquired (at fair value)	CU250	
Goodwill	0	
Liabilities assumed (at fair value)		CU50
Equity (for issuing shares of AC)		152
Gain on the bargain purchase		8
Equity—noncontrolling interest [(CU250 – CU50) × .20]		40

Measurement Period (Application of Paragraphs 62–68 and 76(a))

A71. During the measurement period, the acquirer adjusts the provisional amounts recognized at the acquisition date or recognizes additional assets or liabilities to reflect any new information obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the measurement or recognition of the amounts as of that date. Some factors to consider in determining whether new information should result in a measurement period adjustment to the provisional amounts recognized are:

a. *The timing of the receipt of subsequent information.* Generally, new information that is obtained shortly after the acquisition date is more likely to reflect circumstances that existed at the acquisition date.
b. *The type of subsequent information.* An actual exchange with a third party generally provides the best evidence of fair value.
c. *The size of the adjustment and the ability to identify the reason for the adjustment.* Significant gains and losses that do not have identifiable causes and that are recognized shortly after the acquisition date may be an indication of circumstances that existed at the acquisition date.

Example 7: Lawsuit

A72. AC acquires TC on December 31, 20X5. One of the liabilities assumed in the business combination is a liability for a lawsuit against TC. At the acquisition date, AC initially measures the fair value of the liability on the basis of the information obtained during the due diligence procedures and recognizes a provisional fair value for the liability of CU95,000. Within the measurement period, AC discovers information about the lawsuit against TC. AC determines that the information relates to facts that existed as of the acquisition date, and AC revises its fair value measure of the liability as of the acquisition date to CU80,000.

A73. In this example, the adjustment to the fair value of the liability (CU15,000 reduction) would be accounted for as part of completing the initial accounting in the business combination because the new information (a) is obtained within the measurement period and (b) relates to facts and circumstances that existed as of the acquisition date. The adjustment would result in an offsetting adjustment to goodwill.

A74. In contrast, instead assume that a lawsuit is settled late in the measurement period for an amount that is different from the initial estimate. After assessing all of the facts and circumstances causing the difference, AC determines there is no new information about facts that existed at the acquisition date. In that case, the difference would not be an adjustment to the initial accounting for the business combination, but instead would be recognized as an adjustment to income of the postcombination period.

Example 8: Disposal of an Asset during the Measurement Period

A75. AC acquires TC on September 15, 20X5. AC measures and recognizes a provisional fair value of CU1,000 for TC's specialized (nonwasting) Asset A. AC also seeks an independent appraisal of the fair value of Asset A. On December 15, 20X5, AC sells Asset A to Third Party Co. for CU1,750. The sale provides information about the fair value of Asset A. Depending on the circumstances, the adjustment or adjustments to the provisional fair value of Asset A (CU750 increase) would be accounted for as part of completing the initial accounting for the business combination, as current-period income or, perhaps, partly as each. That determination would depend on whether the sale at CU1,750 is indicative of the fair value that existed at the acquisition date or indicative of an increase in value that resulted from events and circumstances that occurred after the acquisition date.

A76. In this example, also assume that before agreeing to sell Asset A to Third Party Co., AC receives the independent appraisal indicating a fair value of Asset A of CU1,500 as of the acquisition date. In these circumstances, AC would adjust the fair value of Asset A to the appraised value of CU1,500 as of the acquisition date. The CU500 adjustment to Asset A would result in an offsetting adjustment to goodwill. The incremental CU250 would be recognized as a gain on the sale of Asset A.

Consideration Transferred and Contingent Consideration

A77. The measurement period guidance also applies to the consideration transferred, including contingent consideration. The objective of the measurement period in relation to the consideration transferred is the same, that is, to provide the acquirer a reasonable time to obtain the information necessary to measure the items of consideration transferred on the basis of facts and circumstances that existed at the acquisition date. Subsequent changes in the fair value of consideration transferred, especially contingent consideration, usually result from events and changes in circumstances that occur after the acquisition date and, therefore, should not be recognized as measurement period adjustments.

Example 9: Contingent Payout Based on Future Earnings

A78. AC acquires TC on December 31, 20X5, for cash and contingent consideration. The contingent consideration arrangement provides that if TC's 20X6 earnings exceed CU100,000, TC's former owners will receive CU10,000 on March 31, 20X7.

A79. At the acquisition date, AC had obtained information about the historical profitability of TC and projected its future cash flows and profitability on the basis of AC's assessment of economic conditions, TC's prospects, and its plans for TC. On the basis of that information, AC recognizes a provisional fair value of its liability for the contingent consideration of CU3,700. Three months after the acquisition, TC unexpectedly obtains a profitable contract from a new customer, and first quarter 20X6 earnings are substantially greater than AC's projections for TC as of the acquisition date. AC determines that the fair value of its liability is now CU7,000.

A80. In this example, the increase in the liability for the contingent consideration should be recognized in income in the first quarter 20X6. AC had the information necessary to measure the liability as of the acquisition date on the basis of the circumstances that existed at that time. In this case, the change in projections (and the increased likelihood of the contingent consideration payment) is identifiable with an event that occurred after the acquisition date.

Example 10: Contingent Payout Based on the Outcome of a Lawsuit

A81. AC acquires TC on December 31, 20X5, for cash and contingent consideration. The fair value of the contingent consideration liability depends on assessments about the outcome of a lawsuit against TC that AC assumes in the combination. The values of the liabilities for the lawsuit and for the contingent consideration are directly related. A decrease in the fair value of the liability for the lawsuit leads to an equal increase in the fair value of the liability for the contingent consideration. However, if the lawsuit results in a judgment or settlement of CU200,000 or more, TC's former owners will receive no additional consideration.

A82. At the acquisition date, AC measures and recognizes a provisional fair value of the liability for the lawsuit at CU95,000 and a provisional fair value of the liability for the contingent consideration at CU3,000 on the basis of the information obtained during the

due diligence procedures. After the acquisition date and during the measurement period, AC discovers information in the records about the lawsuit that relates to facts that existed as of the acquisition date. On the basis of that information, AC revises its estimates of the fair value of the liability for the lawsuit to CU93,000 and the fair value of the liability for the contingent consideration to CU5,000.

A83. In this example, the adjustments to the liabilities should be accounted for as part of completing the initial accounting for the business combination because the new information was (a) obtained during the measurement period and (b) related to facts and circumstances that existed as of the acquisition date. The adjustments equally affect the fair values of the contingent consideration and the liability for the lawsuit. Therefore, in this example the offsetting adjustments result in no change to the amount recognized for goodwill.

Example 11: Illustration of Paragraphs 64 and 76(a)—Incomplete Appraisal

A84. AC acquires TC on September 30, 20X5. AC seeks an independent appraisal for an item of property, plant, and equipment acquired in the combination. However, the appraisal was not completed by the time AC completed its 20X5 annual financial statements. AC recognized in its 20X5 annual financial statements a provisional fair value for the asset of CU30,000. The item of property, plant, and equipment had a remaining useful life at the acquisition date of five years. Four months after the acquisition date, AC received the independent appraisal, which estimated the asset's fair value at the acquisition date at CU40,000.

A85. As described in paragraph 64, AC is required to recognize any adjustments to provisional values as a result of completing the initial accounting for the business combination as if the initial accounting for the business combination had been completed at the acquisition date. In its 20X6 financial statements, AC presents a current period balance sheet and a two year comparative income statement. Therefore, in the 20X6 financial statements, an adjustment is made to the opening carrying amount of the item of property, plant, and equipment. That adjustment is measured as the fair value adjustment at the acquisition date of CU10,000 less the additional depreciation that would have been recognized had the asset's fair value at the acquisition date been recognized from that date (CU500 for three months' depreciation). The carrying amount of goodwill also is adjusted for the reduction in value at the acquisition date of CU10,000, and the 20X5 comparative information is adjusted to include additional depreciation of CU500.

A86. In accordance with paragraph 76(a), AC discloses:

a. In its 20X5 financial statements, that the initial accounting for the business combination has not been completed, and explains why this is the case.
b. In its 20X6 financial statements, the amounts and explanations of the adjustments to the provisional values recognized during the current reporting period. Therefore, AC discloses that the fair value of the item of property, plant, and equipment at the acquisition date has been increased by CU10,000 with a corresponding decrease in

goodwill. The 20X5 comparative information is adjusted to include additional depreciation of CU500.

Assessing What Is Part of the Exchange for the Acquiree (Application of Paragraphs 69 and 70)

A87. In accordance with paragraph 69, the acquirer assesses whether any portion of the transaction price and any assets acquired or liabilities assumed or incurred are not part of the exchange for the acquiree. Because only the consideration transferred and the assets acquired or liabilities assumed or incurred that are part of the exchange for the acquiree are included in the business combination accounting any portion that is not part of the exchange for the acquiree is accounted for separately from the business combination.

A88. Judgment is required to determine whether a portion of the transaction price paid, or the assets acquired and liabilities assumed or incurred, are part of the exchange for the acquiree. A transaction or event arranged primarily for the economic benefit of the acquirer or the combined entity is not part of the exchange for the acquiree and is accounted for separately from the business combination. One arranged primarily for the benefit of the acquiree or its former owners generally is part of the exchange and is included in the business combination accounting. The acquirer should consider the following factors, which are neither mutually exclusive nor individually conclusive, to determine whether a transaction or event is arranged primarily for the economic benefit of the acquirer or combined entity, rather than for the acquiree or its former owners.

a. *The reasons for the transaction or event*—Understanding the reasons why the parties to the combination (the acquirer, the acquiree, and their owners, directors, managers, and their agents) entered into a particular transaction or arrangement may provide insight into whether it should be accounted for as part of the exchange for the acquiree. For example, if a transaction is arranged primarily for the economic benefit of the acquirer or combined entity with little or no benefit received by the acquiree or its former owners, that portion of the transaction price paid (and any related assets or liabilities) is unlikely to be part of the exchange for the acquiree and would be accounted for separately from the business combination.
b. *Who initiated the transaction or event*—Understanding who initiated the transaction or event may also provide insight into whether it should be accounted for as part of the exchange for the acquiree. For example, a transaction or other event that is initiated by the acquirer may be entered into for the purpose of providing future economic benefits to the acquirer or combined entity with little or no benefit received by the acquiree or its former owners. On the other hand, a transaction or arrangement initiated by the owners of the acquiree is unlikely to be for the benefit of the acquirer or combined entity.
c. *The timing of the transaction or event*—The timing of the transaction or event may also provide insight into whether it should be accounted for as part of the exchange for the acquiree. For example, a transaction between the acquirer and the acquiree that take place during the negotiations of the terms of a business combination may be entered into in contemplation of the business combination for the purpose of

providing future economic benefits to the acquirer or combined entity with little or no benefit received by the acquiree or its former owners.

Example 12: Regulatory Asset Acquired That Is Included in the Business Combination Accounting

A89. To induce the acquisition of WB (Weak Bank) by SB (Strong Bank), as a condition of the combination between WB and SB, a regulatory authority agrees to provide financial assistance in the form of cash, a receivable, or guarantees. That assistance is transferred to SB (the combined entity) upon the closing of the combination agreement. The regulatory authority, as part of its mission and public purpose, has an interest in supporting the soundness of financial institutions, which includes protecting the interests of the depositors of WB. From the perspective of the regulatory body, the assistance provided to induce WB and SB to combine is in the furtherance of its mission.

A90. In this case, the transaction was not arranged primarily to achieve economic benefits favorable to the acquirer or combined entity. If SB did not receive the financial assistance, it might not have acquired WB or would have paid less to acquire WB (presumably by an amount equal to the financial assistance). Thus, SB is indifferent whether it pays less to acquire WB or if it pays more to acquire WB and also receives the financial assistance. Thus, that assistance would be an asset acquired at the acquisition date that is recognized as part of accounting for the business combination. The portion of the consideration transferred for the financial assistance is also accounted for as part of the business combination accounting even though it is transferred to the former owners of WB not to the regulator that provided it.

Effective Settlement of Preexisting Relationships between the Acquirer and Acquiree in a Business Combination

A91. The acquirer and acquiree may have a relationship that existed before the business combination was contemplated. For purposes of this Statement, those relationships are called *preexisting relationships*. A preexisting relationship between the acquirer and acquiree may be contractual (for example, vendor and customer or licensor and licensee), or noncontractual (for example, plaintiff and defendant).

A92. In general, the effective settlement of a preexisting relationship between the acquirer and acquiree should be accounted for in the same way whether it is settled as part of a business combination or separately from a business combination. Therefore, if the business combination results in the effective settlement of a preexisting relationship, the acquirer recognizes a gain or loss and measures it as follows:

a. A noncontractual preexisting relationship (such as a lawsuit) should be measured at fair value.
b. A contractual preexisting relationship should be measured as the lesser of the following:
   (1) The amount by which the contract is favorable or unfavorable from the perspective of the acquirer when compared with pricing for current market transactions for the same or similar items.

(2) Any stated settlement provisions in the contract available to the counterparty to whom the contract is unfavorable.

To the extent that (2) is less than (1), the difference should be included as part of the business combination accounting. Also, an unfavorable contract is not necessarily a loss contract for the acquirer.

A93. A preexisting relationship may be a contract between the acquirer and the acquiree in which the acquirer had previously granted to the acquiree the right to use the acquirer's recognized or unrecognized intangible assets (for example, a right to use the acquirer's trade name under a franchise agreement). In that case, paragraph 41 requires that the acquirer recognize an intangible asset for that right separately from goodwill as part of the business combination accounting. However, if the contract includes terms that are favorable or unfavorable when compared with pricing for current market transactions for the same or similar items, the acquirer should recognize a gain or loss separately from the business combination for the effective settlement of the contract. The gain or loss is measured in accordance with paragraph A92.

Example 13: Effective Settlement of a Supply Contract as a Result of a Business Combination

A94. AC purchases electronic components from TC under a five-year supply contract at fixed rates. Currently, the fixed rates are higher than rates at which AC could purchase similar electronic components from another supplier. The supply contract includes provisions that AC can terminate the contract before the end of the initial 5-year term only by paying a CU6 million penalty. With 3 years remaining under the supply contract, AC pays CU50 million to acquire TC, which is the fair value of TC based on what other marketplace participants would be willing to pay.

A95. Included in the total fair value of TC is CU8 million related to the fair value of the supply contract with AC. The CU8 million represents a CU3 million component that is "at-market" because the pricing is comparable to pricing for current market transactions for the same or similar items (selling effort, customer relationships, and so forth) and a CU5 million component for pricing that is unfavorable to AC. TC has no other identifiable assets or liabilities related to the supply contract, and AC has not recognized any assets or liabilities related to the supply contract before the business combination.

A96. In this example, AC recognizes separately from the business combination a settlement loss of CU5 million (the lesser of the stated settlement amount and the amount by which the contract is unfavorable to the acquirer).

Example 14: Effective Settlement of a Contract between the Acquirer and Acquiree in Which the Acquirer Had Recognized a Liability before the Business Combination

A97. The amount recognized by AC as a gain or loss for the effective settlement of the preexisting relationship will be affected if AC had previously recognized an amount in its financial statements related to that preexisting relationship. Assume the same facts as in Example 13 except that before the business combination AC had recognized a CU6 million liability on the supply contract. AC recognizes a CU1 million settlement gain on

that contract at the acquisition date (the CU5 million measured loss on the contract less the CU6 million loss previously recognized) in income.

Arrangements to Pay for Employee Services

A98. Judgment is often required to determine whether arrangements to pay for employee services (compensation arrangements) should be accounted for as part of the exchange for the acquiree or separately from the business combination. To assist in that determination, it is important to understand whether the transaction includes payments or other arrangements for the economic benefit of the acquirer or combined entity with little or no benefit received by the acquiree or its former owners. To the extent that it is, that portion of the transaction price (and any related liabilities) should be accounted for separately from the business combination. As described in paragraph A88, understanding the reasons for the arrangement, who initiated the arrangement, and when the arrangement was entered into may also assist in determining whether the arrangement should be accounted for as part of the business combination accounting or separately.

A99. If it is not clear whether an arrangement to pay for employee services should be accounted for as part of the exchange for the acquiree or separately from the business combination, the following indicators also should be considered:

a. *Continuing employment*—If future payments are automatically forfeited if employment ends, the arrangement may be compensation for postcombination services that will benefit the combined entity and should be accounted for separately from the business combination. In contrast, if future payments are not affected by employment termination, the arrangement may be part of the consideration transferred for the acquiree.
b. *Duration of continuing employment*—An employment agreement with an employment period coinciding with or longer than the future payment period may indicate that the arrangement is compensation for postcombination services that will benefit the combined entity and should be accounted for separately from the business combination accounting.
c. *Level of payment*—Reduced payments to owners who do not become employees may indicate that the incremental payments to selling owners who become employees are payments for postcombination services that will benefit the combined entity and should be accounted for separately from the business combination accounting. In contrast, payments in excess of reasonable levels paid to employees with similar responsibilities may indicate that the payment is part of the consideration transferred for the acquiree.
d. *Formula for determining consideration*—Contingent payments that are based on multiples of future earnings, future cash flows, or other similar performance measures may indicate that the formula is intended to verify the fair value of the acquiree and, therefore, should be accounted for as part of the business combination. In contrast, contingent payments based on percentages of earnings may indicate a profit-sharing arrangement that should be accounted for separately from the business combination.

Example 15: Arrangement That Is Part of the Exchange for the Acquiree

A100. TC hired a candidate as its new CEO under a 10-year contract. The contract required TC to pay the candidate CU5 million in the event that TC is acquired before (a) the contract expires or (b) the termination of CEO's employment for specified causes within the control of TC. AC acquires TC eight years later. CEO remained an employee of TC through the acquisition date and, thus, will receive the additional payment under the existing contract.

A101. AC is required to assess whether a portion of the consideration transferred and the related liability incurred—required payment of CU5 million—is part of the exchange for the acquiree that should be included in the business combination accounting. The employment agreement was entered into by TC to secure the employment of CEO and by CEO to secure payment and security. The employment agreement was also entered into before the negotiations of the combination began. Thus, there is no reason to believe that the agreement was arranged primarily to achieve economic benefits for AC. Therefore, the consideration transferred and the related liability for the payment to CEO should be regarded as part of the exchange for the acquiree and included in the business combination accounting.

Acquirer Share-Based Payment Awards Exchanged for Awards Held by the Employees of the Acquiree

A102. In a business combination, an acquirer may exchange its share-based payment awards (replacement awards) for awards held by employees of the acquiree. Exchanges of share options or other equity instruments in conjunction with a business combination are modifications of share-based payment awards for the purposes of FASB Statement No. 123 (revised 2004), *Share-Based Payment*. If the acquirer is obligated to replace the acquiree's awards, all or a portion of the acquirer's replacement awards shall be included in the measurement of the consideration transferred by the acquirer in the business combination, as explained in the following paragraph.

A103. For the purpose of determining the portion of a replacement award that is part of the consideration exchanged for the acquiree, the share-based payment awards issued by the acquirer and acquiree shall be measured using the fair value-based measurement method of Statement 123(R). The portion of the replacement award that is part of the consideration transferred in exchange for the acquiree shall be determined as follows:

a. On the acquisition date, the acquirer recognizes an expense in postcombination income for any excess of (1) the fair value-based measure of the acquirer's replacement award over (2) the fair value-based measure of the replaced acquiree awards.
b. The remaining fair value-based measure of the acquirer's replacement award is the amount that remains after deducting the excess, if any, recognized in postcombination consolidated net income under (a). Of this amount, the portion attributable to past services is regarded as part of the consideration transferred in exchange for the acquiree. The portion, if any, attributable to future services is not

part of the consideration transferred and is an expense to be recognized in postcombination income. The guidance in (c) and (d) shall be followed to determine the portion of the remaining fair value-based measure of the replacement award attributable to past and future services. Depending on the circumstances, the acquirer recognizes the replacement award as a liability or an equity instrument, as required in accordance with Statement 123(R).

c. Of the remaining fair value-based measure of the replacement award, the portion attributable to past services is equal to the remaining fair value-based measure of the replacement award (or settlement) multiplied by the ratio of the past service period to the total service period. The total service period is the period that begins with the service inception date for the award of the acquiree and ends with the service completion date for the replacement award. The past service period ends and the future service period begins on the acquisition date. (The amount, if any, which represents compensation expense to be recognized in postcombination consolidated net income is the remaining fair value-based measure of the replacement award (or settlement) multiplied by the ratio of the future service period to the total service period.)
d. The requisite service period of awards issued by the acquirer shall reflect any explicit, implicit, and derived service periods (consistent with the requirements of Statement 123(R)).

A104. The following examples illustrate the application of these provisions in circumstances in which AC issues replacement awards of CU100 (fair value-based measure) at the acquisition date for TC awards of CU100 (fair value-based measure) at the acquisition date. Because the fair value-based measure of replacement awards equals the fair value-based measure of the replaced awards, there is no excess value recognized as acquisition date expense in accordance with paragraph A103(a). Therefore, in accordance with paragraph A103(b), the remaining fair value-based measure of the replacement awards is CU100.

Example 16: Acquirer Replacement Awards, for Which No Services Are Required after the Acquisition Date, Are Exchanged for Awards of the Acquiree, for Which the Required Services Were Rendered before the Acquisition Date

A105. AC exchanges replacement awards for which no services are required after the acquisition of TC for share-based payment awards of TC, for which the required services were rendered before the business combination. When originally granted, the share-based payment awards of TC had a requisite service period of four years. The required services were rendered before the business combination. Because no future service is required for AC's replacement award, the AC replacement award represents part of the consideration transferred by AC in the business combination. Thus, 100 percent of the award is regarded as equity interest in the acquiree, and the CU100 replacement award is included as part of the consideration transferred by AC.

Example 17: Acquirer Replacement Awards, for Which Services Are Required after the Acquisition Date, Are Exchanged for Awards of the Acquiree, for Which the Required Services Were Rendered before the Acquisition Date

A106. AC exchanges replacement awards that require three years of future service for share-based payment awards of TC, for which the requisite service period was completed before the business combination. When originally granted, the share-based payment awards of TC had a requisite service period of four years. The TC employees had rendered a total of seven years of service as of the acquisition date. Because all requisite service was rendered, the TC awards represent an equity interest. However, because the replacement awards require three years of future services, a portion of the replacement award is to be attributed to compensation cost in accordance with the provisions of paragraph A103(b). In this case, the total service period is 10 years—the period that begins with the service inception date for the acquiree's award and ends with the service completion date for the replacement award. The portion attributable to past services is equal to the remaining fair value-based measure of the replacement award (CU100) multiplied by the ratio of the past service period (seven years) to the total service period (10 years). Thus, CU70 would be attributable to the past service period and CU30 to the future service period.

Example 18: Acquirer Replacement Awards, for Which Services Are Required after the Acquisition Date, Are Exchanged for Awards of the Acquiree, for Which the Requisite Service Period Was Not Completed before the Acquisition Date

A107. AC exchanges replacement awards that require one year of future service for share-based payment awards of TC, for which the requisite service period was not completed before the business combination. When originally granted, the awards of TC had a requisite service period of four years. As of the acquisition date the TC employees had rendered a total of two years' service; thus, two years of service after the acquisition date would be required. Because all required service has not been rendered, the TC awards represent an equity interest in part (50 percent, two of the required four years of service rendered as of the acquisition date).

A108. The replacement awards require only one year of future service. Thus, because two years of service have been rendered, the total requisite service period is three years. Normally, the portion attributable to past services would be equal to the remaining fair value of the replacement award (CU100) multiplied by the ratio of the past requisite service period (two years) to the total requisite service period (three years). Thus, CU67 would be attributable to the past services (and therefore, would be part of the consideration transferred for the acquiree) and CU33 to the future services. However, in accordance with paragraph A103(b), because the amount of the acquirer's replacement award attributable to past services (CU67) exceeds the amount of the replaced acquirer's awards attributable to those services (CU50, or CU100 × 2 ÷ 4 years), the excess (CU17) is not part of the consideration transferred. Rather, that excess is an expense to be recognized in postcombination financial statements. Thus, CU50 would be attributable to past services (and included as part of the consideration transferred for the acquiree) and CU50 to future services.

Example 19: Acquirer Replacement Awards, for Which No Services Are Required after the Acquisition Date, Are Exchanged for Awards of the Acquiree, for Which the Requisite Service Period Was Not Completed before the Acquisition Date

A109. Assume the same facts as in the previous example except that AC exchanges replacement awards that require no service after the business combination. Like the previous example, the portion that could be attributable to past services cannot exceed the amount of the replaced TC awards attributable to those services. Thus, CU50 (which is calculated as CU100 × 2 ÷ 4 years) is attributable to the past services and is part of the consideration transferred for the acquiree, and CU50 is expense to be recognized in postcombination financial statements. Because this replacement award has no requisite service period associated with it, the entire CU50 would be recognised as an expense immediately.

Illustration of Disclosure Requirements (Application of Paragraphs 71 and 72)

A110. The following example of some of the disclosure requirements of this Statement is presented for illustrative purposes only, and, therefore, may not be representative of actual transactions.

Footnote X: Acquisitions

On June 30, 20X2, Alpha acquired 100 percent of the outstanding common shares of Beta. Beta is a provider of data networking products and services in Canada and Mexico. As a result of the acquisition, Alpha is expected to be the leading provider of data networking products and services in those markets. It also expects to reduce costs through economies of scale.

The fair value of Beta on June 30, 20X2, was CU9,400, determined on the basis of the consideration paid. Alpha's consideration included CU6,000 of cash, 100,000 common shares valued at CU2,400, and a contingent future payment arrangement with a fair value of CU1,000 at the acquisition date. The fair value of the 100,000 common shares issued was determined on the basis of the closing market price of Alpha's common shares at the acquisition date. The future payment arrangement is contingent on the levels of revenue that Omega, an unconsolidated equity investment owned by Beta, achieves over the 12-month period following the acquisition. The maximum potential undiscounted amount of all future payments that Alpha could be required to make under the future payment arrangement is CU2,000.

Alpha incurred CU500 of third-party expenses related to the acquisition of Beta. Those expenses are included in the selling, general, and administrative expenses in Alpha's consolidated statement of income.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the acquisition date.

At June 30, 20X2

	CU
Current assets	2,400
Property, plant, and equipment	1,500
Intangible assets subject to amortization	2,500
Intangible assets not subject to amortization	2,400
Goodwill	2,200
Total assets acquired	11,000
Current liabilities	(1,100)
Long-term debt	(500)
Total liabilities assumed	(1,600)
Net assets acquired	9,400

Reverse Acquisitions (Application of Paragraph 12(c))

A111. In some business combinations, commonly called *reverse acquisitions,* the acquirer is the entity whose equity interests have been acquired and the issuing entity is the acquiree. For example, a private entity might initiate a combination and arrange to have itself "acquired" by a smaller public entity as a means of obtaining a stock exchange listing. Although the public entity that issues equity interests is regarded as the legal parent and the private entity is regarded as the legal subsidiary, the private entity that initiated and arranged the combination is the acquirer if it is determined to have obtained control of the public entity in accordance with the requirements of paragraphs 11–16. Therefore, for financial reporting purposes in a reverse acquisition, the legal parent is the acquiree and the legal subsidiary is the acquirer.

A112. The requirement in this Statement that for an acquirer to measure and recognize the fair value of the acquiree and the values of the assets acquired and liabilities assumed on the acquisition date applies to reverse acquisition accounting. In a reverse acquisition, the legal subsidiary is the acquirer that measures and recognizes the legal parent, which is the acquiree. Paragraphs A113–A136 provide guidance for applying the acquisition method to reverse acquisitions.

Fair Value of the Acquiree

A113. In accordance with paragraph 20 of this Statement, the acquisition-date fair value of the consideration transferred by the acquirer is presumed to be the best basis for measuring the fair value of the acquirer's interest in the acquiree on that date, in the absence of evidence to the contrary. If the consideration transferred by the acquirer is not the best evidence of the fair value of the acquiree, the acquirer should use other valuation techniques to measure directly the fair value of the acquiree (see paragraphs A18–A26). When equity interests are issued as part of the consideration transferred in a business combination, the fair value of those equity interests is measured as of the acquisition date.

A114. In a reverse acquisition, the consideration is deemed to have been transferred by the legal subsidiary (that is, the acquirer for financial reporting purposes) in the form of equity interests issued to the owners of the legal parent (that is, the acquiree for financial reporting purposes). If the fair value of the equity interests of the legal subsidiary (acquirer) is used to determine the fair value of the consideration transferred for the acquiree, a method of calculating the fair value of the consideration is to determine the number of equity interests the legal subsidiary (acquirer) would have had to issue to provide the same percentage equity interest of the combined entity to the owners of the legal parent (acquiree) as they have in the combined entity as a result of the reverse acquisition. The fair value of the number of equity interests so calculated can be used as the fair value of consideration transferred for the acquiree in the combination.

A115. If the fair value of the consideration transferred by the acquirer (that is, the fair value of the equity interests of the legal subsidiary) is not the best basis for measuring the fair value of the acquiree (legal parent), the acquirer should use other valuation techniques. In a reverse acquisition, the fair value of the issued equity interests of the legal parent (acquiree) as of the acquisition date, based on prices of the legal parent's publicly traded equity shares, may provide the best basis for measuring the fair value of the legal parent (acquiree).

Preparation and Presentation of Consolidated Financial Statements

A116. Consolidated financial statements prepared following a reverse acquisition are issued under the name of the legal parent, but described in the notes as a continuation of the financial statements of the legal subsidiary (that is, the acquirer for financial reporting purposes). Because such consolidated financial statements represent a continuation of the financial statements of the legal subsidiary:

a. The assets and liabilities of the legal subsidiary (acquirer) are measured and recognized in those consolidated financial statements at their precombination carrying amounts.
b. The retained earnings and other equity balances recognized in those consolidated financial statements are the retained earnings and other equity balances of the legal subsidiary (acquirer) immediately before the business combination.
c. The amount recognized as issued equity interests in those consolidated financial statements shall be determined by adding the issued equity of the legal subsidiary (acquirer) immediately before the business combination to the fair value of the legal parent (acquiree) determined in accordance with paragraphs A113–A115. However, the equity structure appearing in those consolidated financial statements (that is, the number and type of equity interests issued) reflects the equity structure of the legal parent (acquiree), including the equity interests issued by the legal parent to effect the combination.
d. Comparative information presented in those consolidated financial statements is that of the legal subsidiary (acquirer).

A117. Reverse acquisition accounting applies only in the consolidated financial statements, and not in the separate financial statements.

A118. Consolidated financial statements prepared following a reverse acquisition reflect the values measured in accordance with this Statement for the assets and liabilities of the legal parent (that is, the acquiree for financial reporting purposes). Therefore, the fair value of the assets and liabilities of the legal parent are recognized in accordance with paragraphs 28–51 of this Statement.

Noncontrolling Interest

A119. In a reverse acquisition, some of the owners of the legal subsidiary (acquirer) may not exchange their equity interests for equity interests of the legal parent (acquiree). Although the entity in which those owners hold equity interests (the legal subsidiary) acquired another entity (the legal parent), those owners are treated as a noncontrolling interest in the consolidated financial statements prepared after the reverse acquisition. This is because the owners of the legal subsidiary that do not exchange their equity interests for equity interests of the legal parent have an interest only in the results and net assets of the legal subsidiary, and not in the results and net assets of the combined entity. Conversely, the owners of the legal parent, notwithstanding that the legal parent is the acquiree for financial reporting purposes, have an interest in the results and net assets of the combined entity.

A120. Because the assets and liabilities of the legal subsidiary are measured and recognized in the consolidated financial statements at their precombination carrying amounts, the noncontrolling interest reflects the noncontrolling shareholders' proportionate interest in the precombination carrying amounts of the legal subsidiary's net assets. This is unique to a reverse acquisition.

Earnings per Share

A121. As noted in paragraph A116(c), the equity structure appearing in the consolidated financial statements prepared following a reverse acquisition reflects the equity structure of the legal parent (acquiree), including the equity interests issued by the legal parent to effect the business combination.

A122. For the purpose of calculating the weighted-average number of common shares outstanding (the denominator) during the period in which the reverse acquisition occurs:

a. The number of common shares outstanding from the beginning of that period to the acquisition date shall be deemed to be the number of common shares issued by the legal parent (acquiree) to the owners of the legal subsidiary (acquirer)
b. The number of common shares outstanding from the acquisition date to the end of that period shall be the actual number of common shares of the legal parent (acquiree) outstanding during that period.

A123. The basic earnings per share disclosed for each comparative period before the acquisition date that is presented in the consolidated financial statements following a reverse acquisition shall be calculated by dividing the income of the legal subsidiary attributable to common shareholders in each of those periods by the number of common

shares issued by the legal parent to the owners of the legal subsidiary in the reverse acquisition.

A124. The calculations outlined in paragraphs A132 and A133 assume that there were no changes in the number of the legal subsidiary's issued common shares during the comparative periods and during the period from the beginning of the period in which the reverse acquisition occurred to the acquisition date. The calculation of earnings per share shall be appropriately adjusted to take into account the effect of a change in the number of the legal subsidiary's issued common shares during those periods.

Example 20: Reverse Acquisition

A125. This example illustrates the accounting for a reverse acquisition in which Entity A, the entity issuing equity instruments and, therefore, the legal parent, is acquired in a reverse acquisition by Entity B, the legal subsidiary, on September 30, 20X6. This example ignores the accounting for any income tax effects.

A126. The following are the balance sheets of Entity A and Entity B immediately before the business combination:

	Entity A (Legal Parent, Acquiree) CU	**Entity B (Legal Subsidiary, Acquirer) CU**
Current assets	500	700
Noncurrent assets	1,300	3,000
Total assets	1,800	3,700
Current liabilities	300	600
Noncurrent liabilities	400	1,100
Total liabilities	700	1,700
Owners' equity		
Retained earnings	800	1,400
Issued equity		
100 common shares	300	—
60 common shares	—	600
Total owners' equity	1,100	2,000
Total liabilities and owners' equity	1,800	3,700

A127. The following is other information used in this example:

a. On September 30, 20X6, Entity A issues 2½ shares in exchange for each common share of Entity B. All of Entity B's shareholders exchange their shares in Entity B. Therefore, Entity A issues 150 common shares in exchange for all 60 common shares of Entity B.

b. The fair value of each common share of Entity B at September 30, 20X6, is CU40. The quoted market price of Entity A's common shares at that date is CU16.
c. The fair values of Entity A's identifiable assets and liabilities at September 30, 20X6, are the same as their carrying amounts, except that the fair value of Entity A's noncurrent assets at September 30, 20X6, is CU1,500.

Calculating the Fair Value of the Acquiree

A128. As a result of the issue of 150 common shares by Entity A (legal parent, acquiree), Entity B's shareholders own 60 percent of the issued shares of the combined entity (that is, 150 of 250 issued shares). The remaining 40 percent are owned by Entity A's shareholders. If the business combination had taken the form of Entity B issuing additional common shares to Entity A's shareholders in exchange for their common shares in Entity A, Entity B would have had to issue 40 shares for the ratio of ownership interest in the combined entity to be the same. Entity B's shareholders would then own 60 of the 100 issued shares of Entity B and, therefore, 60 percent of the combined entity. As a result, the fair value of the consideration transferred by Entity B and the fair value of the Entity A is CU1,600 (that is, 40 shares each with a fair value of CU40). If the fair value of the consideration transferred by Entity B is determined not to be the best evidence of the fair value of Entity A, then other valuation techniques should be used to measure the fair value of Entity A directly. The fair value of Entity A could be measured directly based on the fair value of Entity A's shares outstanding.

Measuring Goodwill

A129. Goodwill is measured as the excess of the fair value of the acquiree, Entity A, over the net amount of Entity A's recognized identifiable assets and liabilities. Therefore, goodwill is measured as follows:

	CU	CU
Fair value of Entity A (legal parent, acquiree)		1,600
Net recognized values of Entity A's identifiable assets and liabilities		
Current assets	500	
Noncurrent assets	1,500	
Current liabilities	(300)	
Noncurrent liabilities	(400)	(1,300)
Goodwill		300

Consolidated Balance Sheet at September 30, 20X6

A130. The following is the consolidated balance sheet immediately after the business combination:

	CU
Current assets [CU700 + CU500]	1,200
Noncurrent assets [CU3,000 + CU1,500]	4,500
Goodwill	300
Total assets	6,000
Current liabilities [CU600 + CU300]	900
Noncurrent liabilities [CU1,100 + CU400]	1,500
Total liabilities	2,400
Owners' equity	
Retained earnings	1,400
Issued equity	
250 common shares [CU600 + CU1,600]	2,200
Total owners' equity	3,600
Total liabilities and owners' equity	6,000

A131. In accordance with paragraph A116(c), the amount recognized as issued equity interests in the consolidated financial statements (CU2,200) is determined by adding the issued equity of the legal subsidiary immediately before the business combination (CU600) and the fair value of the legal parent (acquiree) measured in accordance with paragraph A113–A115 (CU1,600). However, the equity structure appearing in the consolidated financial statements (that is, the number and type of equity interests issued) must reflect the equity structure of the legal parent, including the equity interests issued by the legal parent to effect the combination.

Earnings per Share

A132. Assume that Entity B's net income for the annual period ending December 31, 20X5, was CU600, and that the consolidated net income for the annual period ending December 31, 20X6, is CU800. Assume also that there was no change in the number of common shares issued by Entity B during the annual period ending December 31, 20X5, and during the period from January 1, 20X6, to the date of the reverse acquisition on September 30, 20X6. Earnings per share for the annual period ended December 31, 20X6, is calculated as follows:

Number of shares deemed to be outstanding for the period from January 1, 20X6, to the acquisition date (that is, the number of common shares issued by Entity A (legal parent, acquiree) in the reverse acquisition)	150
Number of shares outstanding from the acquisition date to December 31, 20X6	250
Weighted-average number of common shares outstanding [(150 × 9 ÷ 12) + (250 × 3 ÷12)]	175
Earnings per share [800 ÷ 175]	CU4.57

A133. Restated earnings per share for the annual period ending December 31, 20X5, is CU4.00 (that is, the net income of Entity B of 600 divided by the number of common shares issued by Entity A in the reverse acquisition).

Noncontrolling Interest

A134. Assume the same facts as above, except that only 56 of Entity B's 60 common shares are exchanged. Because Entity A issues 2½ shares in exchange for each common share of Entity B, Entity A issues only 140 (rather than 150) shares. As a result, Entity B's shareholders own 58.3 percent of the issued shares of the combined entity (that is, 140 shares of 240 issued shares). The fair value of the consideration transferred for Entity A, the acquiree, is calculated by assuming that the combination had taken place in the form of Entity B issuing additional common shares to the shareholders of Entity A in exchange for their common shares in Entity A. In calculating the number of shares that would have to be issued by Entity B, the noncontrolling interest is ignored. The majority shareholders own 56 shares of Entity B. For this to represent a 58.3 percent equity interest, Entity B would have had to issue an additional 40 shares. The majority shareholders would then own 56 out of the 96 issued shares of Entity B and, therefore, 58.3 percent of the combined entity. As a result, the fair value of the consideration transferred for Entity A, the acquiree, is CU1,600 (that is, 40 shares each with a fair value of CU40). This is the same amount as when all 60 of Entity B's common shares are tendered for exchange. The fair value of Entity A, the acquiree, does not change if some of Entity B's shareholders do not participate in the exchange.

A135. The noncontrolling interest is represented by the four shares of the total 60 shares of Entity B that are not exchanged for shares of Entity A. Therefore, the noncontrolling interest is 6.7 percent. The noncontrolling interest reflects the noncontrolling shareholders' proportionate interests in the precombination carrying amounts of the net assets of Entity B, the legal subsidiary. Therefore, the consolidated balance sheet is adjusted to show a noncontrolling interest of 6.7 percent of the precombination carrying amounts of Entity B's net assets (that is, CU134 or 6.7 percent of CU2,000).

A136. The consolidated balance sheet at September 30, 20X6, reflecting the noncontrolling interest is as follows:

	CU
Current assets [CU700 + CU500]	1,200
Noncurrent assets [CU3,000 + CU1,500]	4,500
Goodwill	300
Total assets	6,000
Current liabilities [CU600 + CU300]	900
Noncurrent liabilities [CU1,100 + CU400]	1,500
Total liabilities	2,400
Owners' equity	
Retained earnings [CU1,400 × 93.3 percent]	1,306
Issued equity	
240 common shares [CU560 + CU1,600]	2,160
Noncontrolling interest	134
Total owners' equity	3,600
Total liabilities and owners' equity	6,000

Appendix B

BACKGROUND INFORMATION, BASIS FOR CONCLUSIONS, AND ALTERNATIVE VIEW

CONTENTS

Paragraph Numbers

Introduction B1–B2
Background Information B3–B17
  Statements 141 and 142—Objectives and Significant Steps B4–B6
  Statement 141(R)—Objectives and Significant Steps B7–B17
    Second Phase—Guidance for Applying the Acquisition Method B8–B12
    Third Phase—Combinations Involving Only Mutual Entities B13–B17
Basis for Conclusions B18–B203
  Fundamental Principles B19–B25
  Definition of a Business Combination B26–B31
    Change in Terminology B31
  Definition of a Business B32–B40
  Scope B41–B43
    Joint Ventures and Combinations between Entities under Common Control B42
    Not-for-Profit Organizations B43
  Methods of Accounting for Business Combinations B44–B47
    Methods of Accounting for Business Combinations Involving Only Mutual Entities B45–B47
  Application of the Acquisition Method B48–B183
    Identifying the Acquirer B49–B52
      Convergence and Clarification of Statements 141's Guidance for Identifying the Acquirer B50
      Identifying the Acquirer in Business Combinations Involving Only Mutual Entities B51–B52
    Determining the Acquisition Date and Documentation Requirement B53–B55
    Measuring the Fair Value of the Acquiree B56–B99
      Consideration of Basic Principles of Accounting for Acquisitions of Assets B57–B59
      Using the Fair Value of Consideration to Measure the Fair Value of the Acquiree B60–B64
      Using Other Valuation Techniques to Measure the Fair Value of the Acquiree B65–B69
      Measuring Specific Items and Determining Whether They Are Part of the Consideration Transferred for the Acquiree B70–B99
        Measurement Date for Equity Securities B71–B73
        Contingent Consideration, Including Subsequent Accounting B74–B86

Paragraph Numbers

Equity Shares or Member Interests of the Acquirer Issued as Consideration B87–B90
Share-Based Compensation Replacement Awards of the Acquirer B91–B92
Costs Incurred in Connection with a Business Combination B93–B99
Measuring and Recognizing the Assets Acquired and the Liabilities Assumed B100–B155
Principle for Measuring and Recognizing Assets Acquired and Liabilities Assumed B101–B105
Guidance for Recognizing the Assets Acquired and Liabilities Assumed B106–B117
An Item that Is an Asset or a Liability at the Acquisition Date B107–B110
Determining Whether Assets Acquired and Liabilities Assumed Are Part of the Exchange for the Acquiree B111–B117
Guidance for Particular Assets Acquired and Liabilities Assumed B118–B142
Valuation Allowances B119–B121
Contingencies That Meet the Definitions of Assets or Liabilities B122–B134
Subsequent Measurement of Contingencies B135–B141
Recognition of Research and Development Assets B142
Exceptions to the Fair Value Measurement Principle B143–B155
Assets Held for Sale B144
Deferred Taxes B145–B150
Operating Leases B151–B152
Employee Benefit Plans B153
Goodwill B154–B155
Recognizing Gains or Losses on Noncontrolling Equity Investments B156–B160
Measurement Period B161–B167
Business Combinations in Which the Consideration Transferred for the Acquirer's Interest in the Acquiree Is Less Than the Fair Value of That Interest (Bargain Purchases) B168–B182
Distinguishing a Bargain Purchase from Measurement Errors B172–B177
Distinguishing a Bargain Purchase from a "Negative Goodwill Result" B178–B182
Business Combinations in Which the Consideration Transferred for the Acquirer's Interest in the Acquiree Is More Than the Fair Value of That Interest (Overpayments) B183
Disclosures B184–B191
Disclosure of Information about Postcombination Revenue and Net Income of Acquiree B187–B191
Effective Date and Transition B192–B196

Paragraph Numbers

Effective Date and Transition for Combinations Involving Only Mutual Entities B194–B196
Benefits and Costs B197–B203
Alternative View B204–B212
Required Use of Fair Value to Measure and Remeasure Particular Items B205–B209
Separate Display of Remeasurement Gains and Losses B210–B211
Use of the Acquisition Method for Particular Combinations Involving Mutual Entities B212

Appendix B

BACKGROUND INFORMATION, BASIS FOR CONCLUSIONS, AND ALTERNATIVE VIEW

Introduction

B1. This basis for conclusions summarizes the FASB Board's considerations in reaching the conclusions in this Statement (Statement 141(R)). It includes the reasons why the Board accepted particular approaches and rejected others. Individual Board members gave greater weight to some factors than to others. The IASB's considerations and conclusions on the issues addressed jointly by the FASB and the IASB, which are similar in most but not necessarily all respects, are summarized in the basis for conclusions to [draft] IFRS 3 *Business Combinations* (revised 200X).

B2. This Statement carries forward without reconsideration the primary conclusions reached in FASB Statement No. 141, *Business Combinations*. They include the requirements to use the *purchase method* of accounting (which this Statement now refers to as the *acquisition method*), to identify an acquirer for all business combinations, and the criteria for recognizing an intangible asset separately from goodwill. Thus, the sections of Statement 141 that discuss the basis for those conclusions remain relevant but because the Board is not redeliberating or seeking comments on those conclusions, this Statement does not repeat those sections of Statement 141.

Background Information

B3. The Board added the project on accounting for business combinations to its agenda in August 1996. Its overall objective was to improve the transparency of accounting and reporting of business combinations, including the accounting for goodwill and other intangible assets. In 1999, the Board decided to conduct the project in phases. Since then, separate phases of the project have progressively focused on specific objectives within that overall objective:

a. The first phase was completed in June 2001 with the concurrent issuance of Statement 141 and FASB Statement No. 142, *Goodwill and Other Intangible Assets*. (The second and third phases commenced immediately after the issuance of Statements 141 and 142.)
b. The second and third phases address issues related to the application of the acquisition method, including how that method should be applied to combinations involving only mutual entities and business combinations achieved in stages (step acquisitions). This Statement is a result of the Board's deliberations on those issues and revises Statement 141 to incorporate the decisions reached on those issues.
c. The fourth phase addresses the accounting for combinations involving not-for-profit organizations, which is expected to result in the issuance of an Exposure Draft in the second half of 2005 that will seek comments on the proposed accounting for those combinations.

Statements 141 and 142—Objectives and Significant Steps

B4. Paragraphs B5–B7 of Statement 141 noted several of the specific reasons for undertaking the business combination project. Those reasons are (paraphrased):

a. *Merger and acquisition activity increased*. The increase in merger and acquisition activity brought greater attention to the fact that two transactions that are economically similar may be accounted for by different methods (either the pooling-of-interests [pooling] method or the purchase method). Those methods could produce dramatically different financial statement results and impair the representational faithfulness and the comparability of financial statements.
b. *The differences in the pooling and purchase methods affected competition in markets for mergers and acquisitions*. Entities that could not meet all of the conditions for applying the pooling method believed that they faced an uneven playing field in competing for acquisitions with entities that could apply that method. That perception and the resulting attempts to expand the application of the pooling method placed considerable tension on the interpretation and application of the provisions of APB Opinion No. 16, *Business Combinations*. The volume of inquiries fielded by the staffs of the FASB and the Securities and Exchange Commission (SEC) and the auditing profession was evidence of that tension.
c. *Cross-border differences in accounting standards for business combinations and the rapidly accelerating movement of capital flows globally heightened the need for accounting standards to be comparable internationally.* Promoting international convergence in accounting standards is part of the Board's mission, and many members of the Financial Accounting Standards Advisory Council (FASAC) cited the opportunity to promote greater international comparability in the standards for business combinations as a reason for adding this project to the Board's agenda. (FASAC had consistently ranked a possible project on business combinations as a high priority for a number of years.)

B5. The Canadian Accounting Standards Board conducted a business combinations project concurrently with the first phase of the FASB's project. The goal of that concurrent effort was to establish common standards on business combinations and intangible assets. In 2001, the Canadian Accounting Standards Board concurrently adopted their standards and issued new Handbook Sections 1581, *Business Combinations,* and 3062, *Goodwill and Other Intangible Assets,* which are consistent with Statements 141 and 142.

B6. The fundamental issues included in Statement 141 focused on (a) eliminating the alternative methods of accounting for business combinations, (b) providing guidance for identifying the acquirer, and (c) providing criteria and guidance for recognizing intangible assets acquired in a business combination. Statement 142 addresses the accounting for acquired goodwill and other intangible assets, including their subsequent measurement. Paragraphs B10–B17 of Statement 141 discussed the significant steps undertaken in conducting the first phase of the project on accounting for business combinations.

Statement 141(R)—Objectives and Significant Steps

B7. Paragraphs B8–B17 discuss the objectives and significant steps during the Board's conduct of the second and third phases of its project that led to Statement 141(R).

Second Phase—Guidance for Applying the Acquisition Method

B8. At its outset, the objective of the second phase of the project was to consider the existing guidance on the application of the acquisition method of accounting with the objective of improving the completeness, relevance, and comparability of financial information about business combinations provided in financial statements. Shortly after commencing this phase, the FASB and the IASB agreed to reconsider jointly their guidance for applying the acquisition method of accounting for business combinations. Thus, consistent with the objective of this phase, the Board conducted this phase of the project jointly with the IASB with the goal of developing a single high-quality accounting standard that could be used for both international and domestic financial reporting.

B9. In the second phase of the project, the Board considered the purchase method procedures that Statement 141 carried forward, without reconsideration, from Opinion 16 and FASB Statement No. 38, *Accounting for Preacquisition Contingencies of Purchased Enterprises*. The Board also addressed other related issues that it did not consider during its deliberations in the first phase. They include accounting for business combinations through means other than a purchase of its net assets or equity interests and business combinations achieved in stages (step acquisitions). The Board's deliberations related to business combinations achieved in stages led to the Board comprehensively reconsidering the accounting and reporting of noncontrolling interests and the issuance of FASB Statement No. 1XX, *Consolidated Financial Statements, Including Accounting and Reporting of Noncontrolling Interests in Subsidiaries,* which was issued concurrently with this Statement. The Board also considered disclosure requirements consistent with its objective of improving the relevance of information reported to investors, creditors, and other users of financial statements.

B10. The two Boards shared staff and other resources and coordinated their deliberations of issues; however, for the most part, the Boards separately deliberated the issues within this joint project. The FASB deliberated the issues at 43 public decision-making meetings. In addition, the Board met jointly with the IASB at public meetings held in September 2002, October 2003, and April 2004.

B11. The IASB also has been conducting its project on business combinations in multiple phases. The first phase of its project resulted in the issuance of IFRS 3 in March 2004 and revisions to IAS 36 *Impairment of Assets* and IAS 38 *Intangible Assets.* The scope of the IASB's first phase was similar to Statements 141 and 142 and reached similar conclusions on the major issues. The second phase of the IASB's project is addressing issues not addressed in their first phase. Those include issues related to the:

a. Application of the acquisition method
b. Accounting for combinations involving two or more mutual entities, and entities brought together by contract alone without purchasing net assets or equity interests.

In April 2002, the IASB commenced part (a) of its second phase and, as discussed in paragraph B8, agreed to conduct that part as a joint project with the FASB. (In 2004, the IASB decided to also include part (b) in the scope of the joint project, thus, further aligning its scope with that of Statement 141(R).) A forthcoming phase of the IASB's project on business combinations will address issues about the accounting for circumstances in which separate entities or businesses are brought together to form a joint venture, and combinations involving entities under common control.

B12. Throughout the project, the Boards and their staff received technical support from members of the FASB's business combinations resource group comprising individuals with accounting, auditing, valuation, and related financial reporting expertise in business combinations. In 2003, the FASB expanded the resource group to gain additional council from financial analysts and other users of financial statements. The Board and some IASB members held educational meetings with resource group members in April and August 2003. In addition, throughout the project, the Board held educational meetings with FASAC and other constituents and industry groups to benefit from their insight and expertise on specific project and industry-related issues. To gain additional information about the benefits and costs of this Statement, in September and October 2004, the Board also conducted field visits with five companies that recently completed a business combination.

Third Phase—Combinations Involving Only Mutual Entities

B13. Another objective of the FASB's project was to consider and develop guidance on the application of the acquisition method for combinations involving only mutual entities. During its deliberations leading to Statement 141, the Board concluded that those combinations should be accounted for using the acquisition method. However, as noted in paragraphs 60 and B217 of Statement 141 and paragraphs 48(c) and 52 of Statement 142, the Board decided to defer the effective date of those Statements for combinations involving only mutual entities until it issued interpretative guidance about how mutual entities should apply the acquisition method. At its outset, the Board conducted this third phase of the project jointly with the Canadian Accounting Standards Board. The Board (and the Canadian Accounting Standards Board) decided to use a "differences-based" approach for addressing the issues in this phase and for identifying circumstances particular to mutual entities that may require additional guidance. That approach presumed that the provisions and guidance of Statements 141 and 142 would apply to combinations involving only mutual entities, unless the economic conditions or other circumstances of the combination were found to be so different to warrant a different accounting treatment or further guidance.

B14. In October 2001, the Board held a roundtable discussion meeting with representatives of different types of mutual entities to discuss the characteristics of mutual

entities and how they differ from other business entities and the present accounting for business combinations. The Board learned that mutual entities have many common characteristics to other business entities and some distinguishing characteristics. The Board also learned that the economic motivations driving combinations involving only mutual entities, such as, to provide constituents with a broader range of or access to services and cost savings through economies of scale, are similar to those driving combinations between other business entities. In particular, the Board learned that:

a. Although mutual entities generally do not have shareholders in the traditional sense of investor-owners, they are effectively "owned" by their members and are in business to serve their members or other stakeholders. Like other businesses, mutual entities strive to provide their members with a financial return or benefits; however, a mutual entity generally does that by focusing on providing its members with its products and services at lower prices. For example, in the case of credit unions, the benefit may be a lower interest rate on a borrowing than might be obtainable through an investor-owned financial institution. In a wholesale buying cooperative, the benefit might be realized in lower net costs, after consideration of patronage dividends.
b. Although the interests of members of a mutual entity generally are not transferable as are most investor-ownership interests, like other ownership interests they usually include a right to share in the net assets of the mutual entity in the event of its liquidation or conversion.
c. Although a higher percentage of combinations among mutual entities happen without an exchange of cash or other readily measurable consideration, that circumstance is not unique to mutual entities. Business combinations without an exchange of cash or other readily measurable consideration also happen between other entities, particularly combinations of private companies.

B15. Following that October 2001 meeting, the Board deliberated the related issues about combinations involving only mutual entities at eight of its public decision-making meetings. Among the more significant of the identified differences considered and deliberated are:

a. The existence of members or other stakeholders rather than shareholders (equity investors in the traditional sense) and
b. The higher percentage of business combinations involving only mutual entities in which there is no exchange of cash or other readily measurable consideration that could provide evidence for measuring the fair value of the acquiree.

B16. After considering those differences and the related issues, the Board concluded that combinations between mutual entities are economically similar to combinations between other business entities and that there is no need to issue separate application guidance for those business combinations. As a result, in December 2003, the Board:

a. Affirmed its decision that the fair value of an acquired mutual entity and the calculation of the related goodwill should be consistent with decisions reached in the second phase of the project

b. Decided to provide broadly applicable guidance for determining the fair value of an acquiree that would apply to all entities and some specific guidance for considering benefits to members when measuring the fair value of an acquired mutual entity
c. Decided to include in this Statement the results of its deliberations and conclusions on both the second and third phases of the project on business combinations. Thus, Statement 141(R) provides accounting standards and interpretive guidance that is applicable for business combinations between business and mutual entities.

B17. In January 2004, the Board held a meeting with representatives of organizations of cooperative and other mutual entities to discuss its tentative conclusions and specific concerns raised about the benefits and costs of implementing this Statement, including regulatory and other public policy concerns. To gain additional information about the benefits and costs of this Statement, in September and October 2004, the Board also conducted field visits with three mutual entities (a credit union, a mutual bank, and a cooperative) that recently merged with a similar entity. Each of those combinations was accomplished without an exchange of cash or other readily measurable consideration.

Basis for Conclusions

B18. The FASB and IASB concurrently deliberated each of the fundamental issues considered in the second phase of the project and reached the same conclusions on all of those fundamental issues.[6] The application of some provisions of this Statement may differ, however, because of differences in:

a. Other accounting standards of the Boards to which this Statement refers. For example, recognition and measurement requirements for a few particular assets acquired (for example, a deferred tax asset) and liabilities assumed (for example, an employee benefit obligation) refer to existing generally accepted accounting principles (GAAP) rather than fair value measures.
b. Disclosure practices of the Boards. For example, the FASB requires particular unaudited supplementary information or particular disclosures of public companies only. The IASB has no similar requirements for unaudited information and does not distinguish between public and nonpublic entities.
c. Particular transition provisions for changes to past accounting practices of U.S. and non-U.S. companies that previously differed.

Appendix F describes the substantive differences that remain.

---

[6]The FASB worked concurrently with the Canadian Accounting Standards Board in considering the issues in applying the acquisition method to combinations between mutual entities and they reached the same conclusions on those issues. The IASB considered and deliberated those issues in 2004 and also reached the same conclusions.

Fundamental Principles

B19. This Statement carries forward without reconsideration the primary provisions of Statement 141, including its requirement that all business combinations be accounted for by applying the acquisition method.

B20. In developing this Statement, the Board examined the inconsistencies that have resulted from applying existing guidance to account for acquisitions of businesses. The Board observed that those practices were based on a process that involves accumulating and allocating costs as if a business combination was one transaction in a series of investments. The use of that process for acquisitions that occur in different ways was a primary cause of many inconsistencies in the measurement of assets acquired and liabilities assumed. If a business combination was achieved in stages (a step acquisition), that process involved accumulating the costs or carrying amounts of earlier purchases of interests in an entity, which may have occurred years or decades ago. Those amounts were added to the current costs to purchase incremental interests in the acquiree on the acquisition date. The accumulated amounts of those purchases were then allocated to the assets acquired and liabilities assumed.[7] Allocating the accumulated amounts generally resulted in recognizing the identifiable assets and liabilities of the acquiree at a mixture of some current exchange prices and some carryforward book values for each earlier purchase rather than the fair values of those assets and liabilities on the acquisition date.

B21. Those practices have long been criticized by users of financial statements as resulting in information that lacks consistency, understandability, and usefulness.[8] The Board agreed that no useful purpose is served by reporting the assets or liabilities of a newly acquired business using a mixture of their fair values at the date acquired and the acquirer's historical costs or carrying amounts. The Board concluded that those amounts that relate to transactions and events occurring before the business is included in the consolidated financial statements of the acquirer are not relevant to those who use the financial statements of the acquirer.

---

[7]AICPA Accounting Interpretation 2, "Goodwill in a Step Acquisition," of APB Opinion No. 17, *Intangible Assets,* had required that when an entity acquires another entity through a series of purchases (step acquisition), the acquiring entity should identify the cost of each investment, the fair value of the underlying assets acquired, and the goodwill for each step acquisition. That guidance was inconsistent with the conclusion in paragraph 9 of Statement 141 that "a *business combination* occurs when an entity acquires net assets that constitute a business or acquires equity interests of one or more other entities *and obtains control over that entity or entities*" (footnotes omitted and emphasis added). It also is inconsistent with this Statement's principle that "the identifiable assets acquired and liabilities assumed in a business combination should be recognized at their fair values on the date control is obtained" (see paragraph B23(b)).

[8]In response to a September 1991 FASB Discussion Memorandum, *Consolidation Policy and Procedures,* an organization representing lending officers said:

> [We believe] that the assets and liabilities of the [acquiree] subsidiary reported in the consolidation should reflect the full values established by the exchange transaction in which they were purchased. . . . [We believe] the current practice of reporting individual assets and liabilities at a mixture of some current exchange prices and some carryforward book values is *dangerously misleading*. [Emphasis added.]

B22. The Board also observed the criticisms of the information resulting from the application of that cost accumulation and allocation process to acquisitions of businesses that resulted in ownership of less than all of the equity interests in the acquiree. In those circumstances, the application of the cost accumulation and allocation process also resulted in identifiable assets and liabilities being assigned amounts that generally were other than their acquisition-date fair values.[9] In addition, generally only a partial interest in the goodwill asset was recognized.[10] If, on the other hand, all of the interests in the business were acquired in a single purchase, the process of assigning that current purchase price (which typically would be equal to the fair value of the acquiree) generally resulted in the assets and liabilities being measured and recognized at their acquisition-date fair values.

B23. The Board also agreed with constituents that said the principles underlying standards should strive to reflect the underlying economics of transactions and events. The Board concluded that financial reporting and the relevance of information it provides for all business combinations could be significantly improved by developing and consistently applying fundamental principles that focus on the underlying economic circumstances that exist on the date a business is acquired. Thus, the decisions in this Statement are guided by the Board's decision to apply the following fundamental principles in recognizing all business combinations.

a. *The acquirer obtains control of the acquiree at the acquisition date and, therefore, becomes responsible and accountable for all of the acquiree's assets, liabilities, and activities, regardless of the percentage of its ownership in the acquiree.* The Board concluded that obtaining control of a business is a remeasurement event regardless of how control is obtained. Thus, to provide information that is both relevant and reliable, the acquirer's accounting for those assets, liabilities, and activities begins at the acquisition date and if the acquirer held a noncontrolling equity investment in the acquired entity, its accounting for that investment comes to an end.
b. *The identifiable assets acquired and liabilities assumed in a business combination should be recognized at their fair values on the date control is obtained.* The Board concluded that that faithfully reflects the underlying economic circumstances at that date and, thus, improves the relevance and comparability of the information reported.

---

[9]In its 1993 Position Paper, *Financial Reporting in the 1990s and Beyond,* the Association for Investment Management and Research (AIMR) said:

> An even more difficult situation arises when Firm B acquires less than total ownership of Firm A. Under current practice, only the proportionate share of Firm A's assets and liabilities owned by Firm B are revalued, but all of Firm A's assets and liabilities—partially revalued, partially not—are consolidated with those of Firm B, none of whose assets and liabilities have been revalued. What a mélange! *The result is a combination of historic and current values that only a mystic could sort out with precision.* [Page 28, emphasis added.]

[10]In his 1927 text, *Accounting: Its Principles and Problems,* Henry Rand Hatfield notes that "although the [acquirer] has only a fractional interest therein, it seems needlessly inconsistent in regard to the single asset goodwill to show only [the acquirer's] part of its value and to neglect entirely that portion representing the equity of the outstanding [minority] stockholders" (New York: D. Appleton and Company, page 448).

c. *The total amount to be recognized for the acquiree should be the fair value of the acquiree as a whole.* The Board concluded that that faithfully and consistently reflects the underlying economic value of the acquiree, regardless of the ownership interest in the acquiree at the acquisition date or whether control was achieved in stages (involving two or more purchases of equity interests in the acquiree), or without a purchase on the acquisition date and, thus, improves the relevance and comparability of the information reported.

d. *Business combinations generally are exchange transactions in which knowledgeable, unrelated willing parties are presumed to exchange equal values.* Therefore, the Board concluded that "in the absence of evidence to the contrary, the exchange price (referred to as the consideration transferred in this Statement) paid by the acquirer on the acquisition date is presumed to be the best evidence of the acquisition-date fair value of the acquirer's interest in the acquiree" (paragraph 20) and should be used as a basis for measuring the fair value of the acquiree.

B24. The Board concluded that by focusing on those principles this Statement will result in significant improvements in financial reporting without imposing undue costs. In particular, the Board believes this Statement's emphasis on accounting for business combinations at the acquisition date (rather than on a basis of tracking and accumulating past costs) is consistent with its commitment to develop neutral standards that result in accounting for similar transactions and circumstances similarly. In the past, the accounting and reporting for the underlying assets and liabilities of the acquiree (and for the acquiree's subsequent activities) differed significantly depending merely on whether some or all of the equity interests in the acquiree was purchased, or how the acquisition was achieved, for example, through a series of purchases of equity interests ultimately leading to control, a single purchase of equity interests resulting in control, or a change in control on the acquisition date without a purchase of equity interests. In accordance with this Statement, the underlying assets and liabilities of all businesses that are acquired through a change in control will be measured and recognized similarly—based on the underlying economic circumstances surrounding that business and its assets and liabilities at the acquisition date.

B25. In its consideration of the benefits and costs of any new standard, the Board is mindful that its standards should emphasize fundamental principles and strive to avoid exceptions, particularly exceptions that add undue complexities and costs. The Board concluded that this Statement's focus on the fundamental principles in paragraph B23 accomplishes that objective. It also believes that the exceptions to those principles have been appropriately limited to those that are necessary, at this time, to avoid undue complexities and costs and to bring about this Statement's significant improvements in a way that minimizes disruptions to the continuity of reporting practice.

Definition of a Business Combination

B26. This Statement reflects the Board's decision to broaden the definition of a business combination to include all transactions and events in which control of a business is obtained. Paragraph 3(e) defines a business combination as "a transaction *or other event*

in which an acquirer obtains control of one or more businesses" (emphasis added). Previously, paragraph 9 of Statement 141 said:

> For purposes of applying this Statement, a *business combination* occurs when an entity acquires net assets that constitute a business or acquires equity interest of one or more other entities and obtains control over that entity or entities. This Statement does not address transactions in which control is obtained through means other than an acquisition of net assets or equity interest. . . . [Footnote references omitted.]

Paragraph B23 of Statement 141 explained that at that time:

> The Board affirmed the decision it made in developing the 1999 Exposure Draft that [Statement 141] would not address transactions, events, or circumstances that result in one entity obtaining control over another entity through means other than the acquisition of net assets or equity interests. Therefore, [Statement 141 did] not change current accounting practice with respect to those transactions. For example, if a previously unconsolidated majority-owned entity is consolidated as a result of control being obtained by the lapse or elimination of participating veto rights that were held by minority stockholders, a new basis for the investment's total carrying amount is not recognized under current practice. Instead, only the display of the majority-owned investment in the consolidated financial statements is changed. The majority-owned entity is consolidated rather than reported as a single investment accounted for by the equity method. *That treatment is consistent with the practice for accounting for step acquisitions, in which a parent obtains control of a subsidiary through two or more purchases of the investee-subsidiary's stock.* . . . [Emphasis added.]

B27. An objective of the second phase of its project leading to this Statement was to reconsider whether the accounting for a change in control resulting in the acquisition of a business should differ based on the means in which control is obtained. Although business combinations typically occur when an acquirer purchases the net assets or controlling equity interest of one or more businesses, the Board acknowledged, as it did in Statement 141, that control of a business may be obtained in several ways. One of those ways is a business combination in which an acquirer obtains control upon an event that does not involve a current purchase of equity interests in that business. Paragraph 6 of this Statement notes a specific example: a change in control through the lapse of minority veto rights that previously kept the acquirer from controlling the acquiree even though the acquirer held the majority voting interest in the acquiree. Paragraph 6 of this Statement notes another example: a change in control that occurs upon an entity (the acquiree) repurchasing some of its own shares and, as a result, an existing investor (the acquirer) obtains control of that entity.

B28. The Board concluded that all changes of control in which an entity acquires a business are economically similar transactions or events. Consistent with the first

fundamental principle noted in paragraph B23, the Board decided that to improve the consistency of accounting guidance and the relevance, completeness, and comparability of the resulting information about the assets, liabilities, and activities of that business, the definition of a business combination in Statement 141 should be expanded to make it applicable to all transactions or other events that result in an entity obtaining control of a business.

B29. The FASB considered several suggestions for improving the definition of a business. Those suggestions included whether to adopt the definition of a business combination in IFRS 3, which the IASB issued in March 2004. IFRS 3 defined a business combination as "the bringing together of separate entities or businesses into one reporting entity." That definition is sufficiently broad to encompass all transactions or other events in the scope of this Statement. As noted in paragraphs BC47 and BC49 of IFRS 3, at that time the IASB:

> . . . decided that it should not, in the first phase of its Business Combinations project, rule out the possibility of a combination occurring (other than a combination involving the formation of a joint venture) in which one of the combining entities does not obtain control of the other combining entity or entities. Such combinations are sometimes referred to as 'true mergers' or 'mergers of equals'.
>
> . . . concluded that the IFRS arising from the first phase of the project should require all business combinations to be accounted for by applying the purchase method. However, . . . the Board committed itself to exploring in a future phase of its Business Combinations project whether the 'fresh start' method might be applied to some combinations.

B30. The FASB observed, however, that the definition of a business combination in IFRS 3 was too broad for its purposes and inconsistent with the conclusions reached at the time it issued Statement 141. That is because it would allow for the inclusion of one or more businesses without the reporting entity (acquirer) obtaining control of the business. Paragraph B84 of Statement 141 explained that in cases that might be defined as transactions in which an acquirer cannot be identified:

> The Board concluded that the advantages of using the fresh-start method . . . (primarily enhanced representational faithfulness) were outweighed by the disadvantages of having two methods of accounting (particularly the potential for accounting arbitrage but also the difficulties of drawing unambiguous and nonarbitrary boundaries between the methods). The Board further concluded that an alternative to the purchase method of accounting for those combinations was not needed because it is possible to apply the purchase method to them.

The Board affirmed that decision and decided against adopting the broader definition of a business combination in IFRS 3 in part because that would be inconsistent with that decision and could raise false expectations on the part of FASB's constituents that the Board would reconsider the fresh-start alternative as part of this project. In December

2004, the IASB also reconsidered its definition of a business combination and decided to adopt the definition used in this Statement.

Change in Terminology

B31. Because the Board decided to broaden the definition of a business combination beyond purchases of net assets or equity interests, a business combination could occur in the absence of a purchase. Accordingly, the Board decided to replace the term *purchase method,* which was previously used to describe the method of accounting for business combinations, with the term *acquisition method*.

Definition of a Business

B32. Paragraph 5 of this Statement notes that "a transaction or other event is accounted for as a business combination only if the assets acquired and liabilities assumed constitute a business (an acquiree)." Paragraph 3(d) of this Statement defines a *business* as:

> . . . [A]n integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing either:
>
> (1) A return to investors
> (2) Dividends, lower costs, or other economic benefits directly and proportionately to owners, members, or participants.

B33. Previously, EITF Issue No. 98-3, "Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business," contained the guidance for identifying whether a group of net assets constitutes a business. Some constituents, including some FASB resource group members, noted that particular aspects of the definition and related guidance in Issue 98-3 seemed unnecessarily restrictive and open to misinterpretations. They suggested that the Board reconsider that definition and guidance as part of this phase of the project. The Board agreed. In addition to considering how its definition and guidance might be improved, the FASB and the IASB jointly decided that they should consider whether to adopt the same definition.

B34. The Board began by asking resource group members and other constituents to identify problems in applying the existing definition in Issue 98-3. Resource group members noted that the EITF framework generally is functioning well for purposes of distinguishing between acquisitions of integrated groups of assets that are mature businesses and those groups of assets that are not businesses. They noted, however, that Issue 98-3 sometimes is interpreted inconsistently and perceived to be overly restrictive, especially when applied to businesses in the early stages of development.

B35. The Board then considered the suitability of the existing definition and guidance. In its deliberations, the Board considered the guidance in paragraph 6 of Issue 98-3 and the EITF's consensus, which said:

> A business is a *self-sustaining* integrated set of activities and assets conducted and managed for the purpose of providing a return to investors.

> A business consists of (a) inputs, (b) processes applied to those inputs, and (c) resulting outputs that are used to generate revenues. For a transferred set of activities and assets to be a business, *it must contain all of the inputs and processes necessary for it to continue to conduct normal operations after the transferred set is separated from the transferor, which includes the ability to sustain a revenue stream by providing its outputs to customers.* [Emphasis added.]

B36. The Board observed that the term *self-sustaining* in the existing definition and the requirement in the quoted italicized sentence were leading to unnecessarily restrictive interpretations about whether an integrated group of assets constitutes a business. It also concluded that other aspects of the EITF guidance required clarification, in particular the parts of paragraph 6 of Issue 98-3 that said:

> A transferred set of activities and assets fails the definition of a business if it excludes one or more of the above items [inputs, processes, and outputs] such that it is not possible for the set to continue normal operations and sustain a revenue stream by providing its products and/or services to customers. However, if the excluded item or items are only minor (based on the degree of difficulty and the level of investment necessary to obtain access to or to acquire the missing item(s)), then the transferred set is capable of continuing normal operations and is a business. The assessment of whether excluded items are only minor should be made without regard to the attributes of the transferee and should consider such factors as the uniqueness or scarcity of the missing element, the time frame, the level of effort, and the cost required to obtain the missing element. If goodwill is present in a transferred set of activities and assets, it should be presumed that the excluded items are minor and that the transferred set is a business. . . .
>
> The level of working capital or the adequacy of financing necessary to conduct normal operations in the transferred set is not an indicator either way as to whether the set meets the definition of a business. Likewise, if the planned principal operations of the transferred set have commenced, the presence and/or expectation of continued operating losses while the set seeks to achieve the level of market share necessary to attain profitability is not an indicator of whether or not the set is a business. However, *if the transferred set is in the development stage and has not commenced planned principal operations, the set is presumed not to be a business.* [Emphasis added.]

B37. To address the perceived deficiencies and misinterpretations, the FASB decided to modify the existing definition of a business and clarify the related guidance. The more significant modifications to the guidance of Issue 98-3 were to:

a. Replace *self-sustaining* in the definition with the notion that the integrated set of activities and assets must be *capable of being conducted and managed for the purpose of either providing a return to investors, or dividends, lower costs, or other*

economic benefits directly and proportionately to owners, members, or participants. The Board concluded that focusing on the capability to achieve the purposes of the business helps avoid the overly restrictive interpretations that existed in accordance with the former guidance.

b. Clarify the meanings of the terms *inputs, processes,* and *outputs*. The Board concluded that clarifying the meanings of those key terms, together with other modifications, helps eliminate the need for extensive detailed guidance and the kinds of misinterpretations that sometimes stem from such guidance.

c. Clarify that inputs and processes applied to those inputs are essential and that although the resulting outputs normally are present, resulting outputs need not be present. Therefore, an integrated set of assets could qualify as a business if the integrated set of activities and assets is capable of being conducted and managed to produce the resulting outputs. The Board concluded that, together with item (a), clarifying that outputs need not be present for an integrated set to be a business helps avoid the overly restrictive interpretations that existed in accordance with the former guidance. The Board believes that this clarification also helps eliminate the need for extensive detailed guidance and assessments about whether a missing input, process, or output is minor.

d. Clarify that a business need not include all of the inputs or processes that the seller used in operating that business if a willing acquirer is capable of continuing to produce outputs, for example, by integrating the business with its own inputs and processes. The Board believes that this clarification also helps avoid the need for extensive detailed guidance and assessments about whether a missing input or process is minor.

e. Eliminate the presumption that an integrated set in the development stage is not a business merely because it has not yet commenced its planned principal operations, focusing instead on the definition of a business and whether the integrated set is capable of being conducted and managed to produce the resulting outputs. The Board concluded that elimination of this presumption is consistent with focusing on assessing the capability to achieve the purposes of the business (item (a)) and helps avoid the overly restrictive interpretations that existed with the former guidance.

f. Eliminate the guidance for assessing whether a missing input or process is minor. The Board concluded that as a result of the improvements to the definition of a business and clarifications to its related guidance, there no longer is a need for this part of the former guidance.

B38. The Board also considered whether to retain guidance similar to the presumption in Issue 98-3 that an asset group is a business if goodwill is present. Some of the FASB resource group members suggested that that presumption results in circular logic that is not especially useful guidance in practice. Some Board members agreed and indicated that they would prefer to eliminate that presumption. Other Board members noted that such a presumption could be useful in avoiding restrictive interpretations of the definition of a business that would hinder their stated intent of applying this Statement's guidance to economically similar transactions. FASB members also observed that members of the IASB prefer to retain the goodwill presumption, and, thus, to further convergence, the

Board concluded that this Statement's implementation guidance also should retain that presumption.[11]

B39. Some Board members indicated that they believe that the guidance in this Statement is appropriate for all asset acquisition transactions and expressed a preference for expanding the scope of this Statement to acquisitions of asset groups. They noted that doing so would avoid the need to distinguish between those groups that are businesses and those that are not. However, other Board members noted that broadening the scope of this Statement beyond acquisitions of businesses would require further research and deliberation of additional issues and delay the implementation of this Statement's improvements to practice. The Board agreed and decided not to extend the scope of this Statement to acquisitions of all asset groups.

B40. Consistent with the decision to apply this Statement to all acquisitions of asset groups that are businesses and the objective of improving the consistency of the procedures applied to all business combinations, the Board decided to amend FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities,* to clarify that the initial consolidation of a variable interest entity that is a *business* is a business combination that is to be accounted for in accordance with the provisions of this Statement.

Scope

B41. This Statement, like Statement 141, excludes from its scope the formation of a joint venture, combinations involving businesses under common control, combinations between not-for-profit organizations, and acquisitions of a for-profit business by a not-for-profit organization.

Joint Ventures and Combinations between Entities under Common Control

B42. The Board, like the IASB, decided to continue to exclude from the scope of this Statement and its definition of a business combination (a) the formation of a joint venture and (b) combinations involving entities or businesses that are under common control. The Board is not aware of developments since the issuance of Statement 141 that suggest that issues surrounding the accounting for those events, which do not involve an acquirer obtaining control of an acquiree, need to be addressed prior to issuing this Statement. Rather, the Board continues to believe that those issues should be addressed in future projects that address whether, and, if so, when to apply a new basis of accounting.

---

[11]The FASB and the IASB considered the definition of a business and related guidance concurrently. Before issuing IFRS 3 in March 2004, the IASB did not have a definition of a business or guidance similar to that in Issue 98-3. Consistent with the suggestions of respondents to its Exposure Draft that led to IFRS 3, the IASB decided to adopt a definition of a business and limited guidance when it issued IFRS 3 that was based on the deliberations of the Boards as of March 2004. The definition and guidance in IFRS 3, although similar to that in this Statement, was modified based on the further deliberations and joint decisions of the Boards after the issue of IFRS 3 in March 2004.

Not-for-Profit Organizations

B43. The Board also decided to exclude from the scope of this Statement business combinations between not-for-profit organizations or acquisitions of for-profit businesses by not-for-profit organizations. The Board observed that one of the fundamental principles (paragraph B23(d)) underlying decisions reached in this Statement does not apply in combinations involving not-for-profit colleges, universities, hospitals, religious organizations, and other charitable organizations. That is, it cannot be presumed that combinations involving organizations that serve a public interest are necessarily exchange transactions in which willing parties are presumed to exchange equal values. Thus, the Board is addressing the accounting for combinations involving not-for-profit organizations in a separate project. It plans to issue an Exposure Draft in the second half of 2005 that will address and seek comments on the proposed accounting for those combinations. The IASB does not have a separate project addressing business combinations between not-for-profit organizations because standards of the IASB do not address not-for-profit organizations.

Methods of Accounting for Business Combinations

B44. In Statement 141, the Board adopted a single-method approach for accounting for business combinations in Statement 141, which is fundamentally different from the approaches that existed under Opinion 16. The single-method approach required by Statement 141 reflects the Board's conclusion that virtually all business combinations are acquisitions and, thus, all business combinations should be accounted for in the same fundamental way that other asset acquisitions are accounted for—based on the values exchanged. This Statement carries forward that conclusion. Paragraphs B25–B85 of Statement 141 discussed the basis for that conclusion, including the reasons for requiring the acquisition method and rejecting the pooling method and the fresh-start method. The IASB addressed the accounting for business combinations and issued IFRS 3 in March 2004. That IFRS, like Statement 141, requires the use of a single method in accounting for business combinations.

Methods of Accounting for Business Combinations Involving Only Mutual Entities

B45. As discussed in paragraphs B13–B17, during its deliberations leading to Statement 141, the Board considered and concluded that combinations involving only mutual entities also should be accounted for using the acquisition method but decided not to mandate its use until the Board considered particular implementation questions raised about the application of that method. During the Board's deliberations leading to this Statement, some representatives of mutual entities reiterated concerns expressed during the development of Statement 141 about requiring all combinations of mutual entities to be accounted for using the acquisition method. Many of those constituents reiterated public policy concerns similar to those discussed in paragraphs B69–B76 of Statement 141. For example, some said that eliminating the pooling method could impede desirable combinations and reduce the amount of capital flowing into their industries. They suggested, for example, that the requirement to identify an acquirer could impede

mergers of neighboring mutual entities when both the fact and appearance of a merger of equals are of paramount importance to their directors, members, and communities.

B46. Others expressed concern that combinations of credit unions could be impeded because of particular laws and regulatory requirements. They noted that regulatory agencies currently evaluate the financial soundness of credit unions on the basis of their accumulated *retained earnings* rather than their total equity capitalization. In accordance with the pooling method, the recorded amount of the retained earnings of each of the combining credit unions is carried forward and, thus, becomes the aggregate retained earnings of the combined entity. In accordance with the acquisition method, however, when an acquirer issues equity shares or member interest for those of the acquiree, the retained earnings (and any other capital) of the acquiree is reflected as an increase to the equity of the acquiring credit union but not as part of its retained earnings. The Board acknowledges those concerns. However, despite that information, the Board retained its view that, as noted in paragraph B76 of Statement 141, "its public policy goal is to issue accounting standards that result in neutral and representationally faithful financial information and that eliminating the pooling method is consistent with that goal."

B47. During its deliberations leading to this Statement, the Board met with representatives of mutual banks, credit unions, cooperatives, and other mutual entities in October 2001 and January 2004. On both occasions, a few of the participants suggested a preference for the fresh-start method as an alternative to the acquisition method for particular mergers, particularly those mergers for which it is especially difficult to identify the acquirer. On both occasions, however, those participants acknowledged the costs and practical difficulties that a fresh-start alternative would impose, especially on entities with recurring combinations. For the reasons noted in paragraphs B80–B85 of Statement 141, the Board affirmed the conclusion reached in Statement 141 that the disadvantages of two methods of accounting for business combinations outweigh the advantages of the fresh-start method as an alternative for particular mergers. Accordingly, this Statement carries forward the provision of Statement 141 that requires that all business combinations, including mergers of mutual entities, be accounted for as acquisitions.

Application of the Acquisition Method

B48. Paragraph 9 of this Statement identifies four steps in applying the acquisition method of accounting for a business combination. They are:

a. Identifying the acquirer
b. Determining the acquisition date
c. Measuring the fair value of the acquiree
d. Measuring and recognizing the assets acquired and the liabilities assumed.

Identifying the Acquirer

B49. Paragraph 10 of this Statement carries forward without reconsideration the provision in Statement 141 that requires identification of an acquirer in every business combination. Paragraphs B88–B96 of Statement 141 discussed the considerations and deliberations

leading to the Board's conclusions and guidance in Statement 141 for identifying the acquirer.

Convergence and clarification of Statement 141's guidance for identifying the acquirer

B50. IFRS 3 and Statement 141 included similar but not identical guidance for identifying the acquirer; however, because the guidance is worded differently, the Boards were concerned that differences in identifying the acquirer could arise. Therefore, as part of the effort to develop a common standard on accounting for business combinations, the Boards decided to develop common guidance for identifying the acquirer that could be applied internationally. For example, the FASB and the IASB decided to include in paragraph 11 of this Statement an explicit reference to its other Statements and Interpretations that provide guidance for identifying the acquirer. That guidance, although previously implicit, was not in Statement 141. The intent of the Boards is to conform and clarify their guidance but not change the substance of the provisions for identifying an acquirer previously provided in IFRS 3 and Statement 141.

Identifying the acquirer in business combinations involving only mutual entities

B51. The Board considered whether differences between mutual entities and investor-owned entities or differences between combinations of mutual entities and combinations of investor-owned entities justify different or additional guidance for identifying the acquirer in combinations of mutual entities. The Board did not note any such differences. As a result, the Board affirmed that the provision of Statement 141 that requires the identification of an acquirer should apply to all business combinations, including those involving only mutual entities.

B52. The Board also concluded that the indicators for identifying the acquirer in a business combination are applicable to mutual entities and that no additional indicators are needed to identify the acquirer in those combinations. The Board acknowledged that difficulties may arise in identifying the acquirer in combinations of two virtually equal mutual entities but observed that those difficulties also arise in combinations of two virtually equal investor-owned entities. Based on its field visits, the Board concluded that those difficulties, which are not unique to mutual entities, can be resolved in practice.

Determining the Acquisition Date and Documentation Requirement

B53. The Board decided to make three modifications to Statement 141's acquisition date guidance. First, this Statement carries forward and clarifies the acquisition-date guidance to make explicit that the acquisition date is the date that the acquirer obtains control of the acquiree. Second, as part of the FASB's and the IASB's efforts to develop a common standard for business combinations, the acquisition-date documentation requirements for purposes of assigning goodwill to reporting units in accordance with the provisions of Statement 142 that previously were included in Statement 141 have been moved to Statement 142 through an amendment of that Statement (paragraph D22(h)).

B54. Third, the Board also decided to eliminate the "convenience" exception that Statement 141 carried forward from Opinion 16 and the reporting alternative permitted by

Accounting Research Bulletin No. 51, *Consolidated Financial Statements*. Previously an acquirer could designate "an effective date other than the date assets or equity interests are transferred or liabilities are assumed or incurred [which required] adjusting the cost of an acquired entity and net income otherwise reported to compensate for recognizing income before consideration is transferred" (Statement 141, paragraph 48). Paragraph 11 of ARB 51 said:

> When a subsidiary is purchased during the year, there are alternative ways of dealing with the results of its operations in the consolidated income statement. One method . . . is to include the subsidiary in the consolidation as though it had been acquired at the beginning of the year, and to deduct at the bottom of the consolidated income statement the preacquisition earnings. . . . Another method of prorating income is to include in the consolidated statement only the subsidiary's revenue and expenses subsequent to the date of acquisition.

B55. The Board concluded that to faithfully represent an acquirer's financial position and results of operations, the acquirer should account for all business combinations at the acquisition date. That is, its financial position should reflect the assets acquired and liabilities assumed at the acquisition date—not before they are obtained or assumed. Moreover, the acquirer's financial statements for the period should include only the cash inflows and outflows, revenues and expenses, and other effects of the acquiree's operations after the acquisition date.

Measuring the Fair Value of the Acquiree

B56. Paragraph 19 of this Statement requires that the acquirer in a business combination "measure the fair value of the acquiree, as a whole, as of the acquisition date." Like Statement 141, this Statement reflects the Board's conclusion in Statement 141 that virtually all business combinations are acquisitions. Thus, like Statement 141, this Statement reflects the Board's belief that, in concept, all acquisitions of assets and groups of assets or net assets should be accounted for similarly. Acquisitions of businesses, therefore, should be accounted for in the same way as acquisitions of other assets—based on the values exchanged at the acquisition date—regardless of the manner in which the business is acquired.

Consideration of basic principles of accounting for acquisitions of assets

B57. As discussed in paragraph B87 of Statement 141, it is a longstanding basic principle of accounting that "an asset acquisition should be measured on the basis of the values exchanged and that measurement of the values exchanged should be based on the fair value of the consideration given or the fair value of the net assets acquired, whichever is more reliably measurable." Paragraphs 4–6 of Statement 141 described the general concepts for initial recognition and measurement (that had been included in paragraph 67 of Opinion 16 (1970)):

> *Initial recognition*. Assets are commonly acquired in exchange transactions that trigger the initial recognition of the assets acquired and

> any liabilities assumed. If the consideration given in exchange for the asset (or net assets) acquired is in the form of assets surrendered (such as cash), the assets surrendered are derecognized at the date of acquisition. If the consideration given is in the form of liabilities incurred or equity interests issued, the liabilities incurred and equity interests issued are initially recognized at the date of acquisition (Opinion 16, paragraph 67).
>
> *Initial measurement*. Like other exchange transactions generally, *acquisitions are measured on the basis of the fair values exchanged*. In exchange transactions, the fair values of the net assets acquired and the consideration paid are assumed to be equal, absent evidence to the contrary. Thus, the "cost"[2] of an acquisition to the acquiring entity is equal to the fair values exchanged and no gain or loss is generally recognized. Exceptions to that general condition include (a) the gain or loss that is recognized if the fair value of noncash assets given as consideration differs from their carrying amounts on the acquiring entity's books and (b) the extraordinary gain that is sometimes recognized by the acquiring entity if the fair value of the net assets acquired in a business combination exceeds the cost of the acquired entity. . . (Opinion 16, paragraph 67).
>
> Exchange transactions in which the consideration given is cash are measured by the amount of cash paid. However, if the consideration given is not in the form of cash (that is, in the form of noncash assets, liabilities incurred, or equity interests issued), measurement is based on the fair value of the consideration given or the fair value of the asset (or net assets) acquired, whichever is more clearly evident and, thus, more reliably measurable (Opinion 16, paragraph 67). [Emphasis added.]
>
> ---
>
> [2]Cost is a term that is often used to refer to the amount at which an entity initially recognizes an asset at the date it is acquired, whatever the manner of acquisition. [Emphasis added.]

B58. The Board observed that those basic principles also are consistent with the general concepts acknowledged in APB Opinion No. 29, *Accounting for Nonmonetary Transactions*. Paragraph 18 of Opinion 29 states that:

> . . . in general accounting for nonmonetary transactions should be based on the fair values of the assets (or services) involved which is the same basis as that used in monetary transactions. Thus, the cost [initial basis] of a nonmonetary asset acquired in exchange for another nonmonetary asset is the fair value of the asset surrendered to obtain it, and a gain or loss should be recognized on the exchange. *The fair value of the asset received should be used to measure the cost [initial basis] if it is more clearly evident than the fair value of the asset surrendered. Similarly, a nonmonetary asset received in a nonreciprocal transfer should be recorded at the fair value of the asset received.* [Emphasis added; footnote reference omitted.]

The Board concluded that this Statement's objective of measuring the business received at its fair value is consistent with those general concepts for acquisitions of assets.

Moreover, the Board concluded that measurement principle—that is, measuring the business at its fair value—should apply whether the business is acquired in an exchange transaction or through other means. Thus, this Statement rejects the past practice of measuring the acquiree in part at current exchange prices and in part at historical costs or carrying amounts that had been a primary cause of the inconsistencies discussed in paragraphs B20–B22.

B59. The Board acknowledges, however, that applying high-level principles without sufficient guidance sometimes results in difficulties in practice and that those application difficulties could lead to undue implementation costs. For example, applying the principle that the fair value of the acquiree, as a whole, should be based on the fair value of the consideration transferred *or* the fair value of the business (net assets) acquired, whichever is more reliably measurable, could lead to difficulties in judging which is more reliably measurable and inconsistencies in making such judgments. Moreover, strict application of that principle could impose unnecessary cost to independently determine the fair values of both the consideration transferred and the acquiree for purposes of judging which is more reliably measurable. Thus, to help reduce the costs of implementing this Statement and to promote greater consistency in the measurement techniques used in measuring the fair value of an acquiree, the Board decided that this Statement should provide guidance for applying its fair value measurement principle.

Using the fair value of consideration to measure the fair value of the acquiree

B60. As noted in paragraph 20, the Board observed that "business combinations are usually arm's length exchange transactions in which knowledgeable, unrelated willing parties exchange equal values." Therefore, the Board believes that, similar to present practice for acquisitions of 100 percent of the equity interests in a business, in most cases indirectly measuring the fair value of a business based on evidence of the fair value of the consideration transferred remains a useful, if not preferable, measurement technique. The Board concluded and paragraph 20 of this Statement specifies that "in the absence of evidence to the contrary, the exchange price (. . . consideration transferred . . .) paid by the acquirer on the acquisition date is presumed to be the best evidence of the acquisition-date fair value of the acquirer's interest in the acquiree." Thus, the fair value of that consideration is presumed to be the fair value of the acquiree as a whole in an acquisition of 100 percent of the equity interest in an acquiree, in the absence of evidence to the contrary.

B61. The Board also concluded that in acquisitions of less than 100 percent of the equity interests of the acquiree, it often is appropriate for the acquirer to measure the fair value of the acquiree, as a whole, based on the fair value of the cash or other consideration transferred for its interest together with other available information. The Board observed that in the United States, perhaps because of desired tax consequences, such acquisitions often involve purchases in excess of 80 percent and sometimes more than 90 percent of ownership interest in the acquiree. In those circumstances, the Board believes that collectively the fair values of cash, other assets, and contingent consideration exchanged by the acquirer for an acquisition of a partial ownership interest provide presumptive evidence of the fair value of that partial interest acquired and that in the absence of

evidence to the contrary, that evidence, together with other available information, should be the basis for estimating the fair value of the acquiree as a whole.

B62. The Board acknowledges, however, that an acquirer may obtain control of an acquiree through a transaction involving considerably smaller percentages of the acquiree's equity interest or, in some cases, through an event that results in control without a purchase of any equity interests on the acquisition date. Accordingly, this Statement acknowledges that in those circumstances measuring the fair value of the acquiree at the acquisition date will require the use of other valuation techniques.

B63. The Board believes that emphasizing the use of the fair value of the consideration as a basis for measuring the fair value of the acquiree is appropriate for several reasons. First, the Board observed that business combinations generally are exchange transactions in which knowledgeable, unrelated willing parties are presumed to exchange equal values. Thus, the Board believes that in the absence of evidence to the contrary it can be presumed that the fair value of the consideration transferred is representative of the fair value of the acquirer's interest in the business. Second, the Board believes that evidence of the fair value of discrete items of consideration transferred by the acquirer, such as cash, promissory notes, and nonmonetary assets, generally is readily available to the acquirer or obtainable at a lower cost and that the fair values of those items generally will be equally if not more reliably measurable than directly measuring the fair value of the business as a whole. The Board acknowledges that some companies, generally large companies with active acquisition programs, may have valuation professionals on their staffs who have the expertise and ability to reliably measure the fair value of a potential acquiree and that the cost to perform those measures may not be excessive for those particular companies. Nonetheless, the Board believes that presuming that in the absence of evidence to the contrary a reliable measure can be determined on the basis of the fair value of consideration transferred is a reasonable way to mitigate the costs to the many companies that do not have such resources.

B64. The Board also believes that emphasis on use of the consideration transferred as an appropriate basis for determining the fair value of the business as a whole often will avoid or minimize:

a. Unproductive disputes in practice about whether the consideration transferred or another valuation technique provides the best evidence and basis for estimating the fair value of the business in those close-call circumstances in which both measurement techniques provide sufficiently reliable estimates
b. Incremental costs, for example, to independently verify valuations of the business that were performed by the acquirer as part of its due diligence but are not necessarily audited.

Accordingly, to facilitate the implementation of this Statement in practice, the Board concluded that this Statement should (a) retain the presumptive attitude in present practice that the consideration transferred for the acquirer's interest in the acquiree generally provides the best basis for measuring that interest and (b) provide guidance illustrating how the fair value of the consideration transferred for less than 100 percent of the equity

interests of an acquiree, together with other available information, might be used to estimate the fair value of the acquiree as a whole (paragraphs A9–A17).

Using other valuation techniques to measure the fair value of the acquiree

B65. The Board observes, however, that this Statement's presumption and guidance, which emphasize the use of the consideration transferred, is not intended to override this Statement's principle and requirement to measure and recognize the fair value of the acquiree as a whole at the acquisition date. Moreover, paragraph 20 explicitly adds that "in some business combinations, either no consideration is transferred or the evidence indicates that consideration transferred is not the best basis for measuring the acquisition-date fair value of the acquirer's interest in the acquiree. In those business combinations, the acquirer should measure the acquisition-date fair value of its interest in the acquiree using other valuation techniques."

B66. The Board acknowledges that in circumstances in which readily measurable consideration is absent, the acquirer is likely to incur costs to determine its measure of the fair value of the acquiree as a whole and incremental cost to have that measure independently verified. The Board observed that in many of those circumstances companies already incur such costs as part of their due diligence procedures. For example, an acquisition of a privately held business by another privately held entity often is accomplished by an exchange of equity shares that do not have observable market prices. For purposes of determining the exchange ratio, those companies generally engage advisors and valuation experts to assist them in valuing the acquiree as well as the equity transferred by the acquirer in exchange for the shares of the acquiree. Similarly, a combination of two mutual entities often is accomplished by an exchange of member interests of the acquirer for all of the member interests of the acquiree. In many, but not necessarily all, of those cases the directors and managers of the entities also assess the relative fair values of the combining entities to ensure that the exchange of member interests is equitable to the members of both entities.

B67. The Board believes that the incremental measurement costs that this Statement may require are justified. The Board reached that conclusion based on its assessment of overall improvements in financial information. Those improvements include the increased relevance and understandability of information resulting from measuring all businesses acquired as a whole at their acquisition-date fair value, which is consistent with reflecting the change in economic circumstances that occurs at that date.

B68. The Board also concluded that, consistent with its objective of providing broadly applicable measurement guidance, this Statement should provide particular guidance for applying this Statement's fair value measurement requirement when no consideration is transferred or the consideration transferred is not the best evidence of or basis for determining the acquisition-date fair value of the acquiree. Paragraphs A18–A23 of this Statement provide that guidance and draw on guidance in Proposed Statement, *Fair Value Measurements,* which was issued in June 2004, including guidance for using the market approach and the income approach for measuring the fair value of an acquiree.

B69. Thus, this Statement, together with that proposed Statement, provides broadly applicable measurement guidance that is relevant and useful in measuring the fair value of an acquiree. However, Board members had some concerns that without some discussion of special considerations for measuring the fair value of mutual entities, some acquirers may neglect to consider relevant assumptions that marketplace participants would make about future member benefits when using a market or income approach. For example, consider an acquired cooperative entity that operates at breakeven because of discounts granted to its members. An entity acquiring such a cooperative entity should consider the value of the member discounts in its determination of the fair value of the acquired entity. Therefore, the Board also decided to provide specific guidance (paragraphs A24–A26) that discusses special considerations when measuring the fair value of mutual entities.

Measuring specific items and determining whether they are part of the consideration transferred for the acquiree

B70. Paragraphs B71–B99 discuss the Board's considerations and decisions related to issues raised about (a) the measurement of specific items of consideration that often are transferred by acquirers and (b) whether particular costs incurred by acquirers in connection with an acquisition are part of the consideration transferred for the acquiree. (Paragraphs B111–B117 discuss considerations related to determining whether particular assets acquired and liabilities assumed in connection with a business combination are part of the exchange for the acquiree.)

Measurement date for equity securities

B71. In its deliberations of the measurement date for equity securities issued as consideration in a business combination, the Board decided to resolve a longstanding contradiction in the existing business combinations guidance. Paragraph 22 of Statement 141, which was carried forward from Opinion 16, 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, which also was carried forward from Opinion 16, states that the cost of an acquired entity should be determined as of the acquisition date.

B72. In addressing this issue, the Board considered the reasons for the consensus reached in EITF Issue No. 99-12, "Determination of the Measurement Date for the Market Price of Acquirer Securities Issued in a Purchase Business Combination." That consensus states that the value of the acquirer's marketable equity securities issued to effect a business combination should be determined based on the market price of the securities over a reasonable period of time before and after the terms of the acquisition are agreed to and announced. The Board considered the arguments for the guidance developed by the EITF, which include that (a) the announcement of a transaction, and related agreements, normally binds the parties to the transaction such that the acquirer is obligated at that point to issue the equity securities at the closing and, thus, the arrangement has characteristics of an equity forward contract, and (b) if the parties are bound to the transaction at the announcement date, the value of the underlying securities on that date best reflects the value of the bargained exchange. The Board did not find those arguments compelling.

Rather, the Board observed that to make the announcement of a recommended transaction binding generally requires shareholders' authorization or another binding event, which also gives rise to the change in control of the acquiree. Thus, the Board decided on the acquisition date.

B73. Additionally, the Board noted that the EITF's consensus resulted in a "mixed" measurement basis, because it required measuring equity securities on the announcement date while all other forms of consideration transferred are measured at the acquisition date. The Board decided that all forms of consideration transferred should be valued on the same date and that date should be the date that the assets acquired and liabilities assumed are measured. The Board also noted that measuring the equity securities on the acquisition date avoids the complexities of the EITF guidance for those situations in which the number of shares or other consideration transferred could change between the announcement date and the acquisition date and that measuring equity securities on the acquisition date would converge with IFRS 3. Moreover, the Board also observed that negotiations between an acquirer and an acquiree typically provide for share adjustments in the event of material events and circumstances between the agreement date and acquisition date and that ongoing negotiations after announcements, which are not unusual, provide evidence of the nonbinding nature of announcements. Lastly, the Board also observed that the parties typically provide for cancellation options that they can use in the event the number of shares to be issued at the acquisition date would not reflect an exchange of relative fair values at that date.

Contingent consideration, including subsequent accounting

B74. Opinion 16 defined contingent consideration as "consideration that is issued or issuable at the expiration of the contingency period or that is held in escrow pending the outcome of the contingency." In accordance with the guidance in Statement 141, which was carried forward from Opinion 16 without reconsideration, obligations for the acquirer's agreement to make contingent payments usually were not recorded at the acquisition date. Rather, they usually were recorded when the contingency was resolved and consideration was issued or became issuable. In general, the issuance of additional securities or distribution of additional cash or other assets upon resolution of contingencies based on reaching particular earnings levels resulted in delayed recognition of an additional element of cost of an acquired entity. In contrast, the issuance of additional securities or distribution of additional assets at the resolution of contingencies based on security prices did not change the recorded cost of an acquiree.

B75. The Board concluded that the cost accumulation and delayed recognition approach to accounting for contingent consideration in Statement 141 and Opinion 16 is unacceptable because it ignored the fact that the acquirer's agreement to make contingent payments is the obligating event in a business combination transaction. That approach failed to recognize that upon promising to make contingent payments of cash or other assets, an acquirer incurred an obligation that meets the four fundamental recognition criteria identified in paragraph 63 of FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises.* That is:

a. The obligation meets the definition of a liability (unless it can be settled in the entity's own equity shares).
b. The obligation has a relevant attribute (fair value) that is measurable with sufficient reliability.
c. Information about the obligation is capable of making a difference in user decisions.
d. The information is representationally faithful, verifiable, and neutral.

The Board concluded that not recognizing the obligation of the acquirer at the acquisition date for such future contingent payments would not fairly represent the economic consideration exchanged at that date. The Board concluded that, consistent with the general principle for recording a business combination, obligations for contingent consideration should be measured and recognized at fair value on the acquisition date.

B76. The Board considered arguments of constituents that prefer to retain the guidance in Statement 141 because of difficulties in measuring the fair value of contingent consideration obligations at the acquisition date. Some constituents expressed concern about the increased subjectivity that they believe such measurements introduce in the financial statements and others argued that many or most contingent consideration arrangements cannot be reliably measured. The Board believes, however, that the notion that an entity's directors and managers enter into such arrangements without assessing and measuring the economic risk inherent in the agreement is inconsistent with prudent business practices, which typically is evident in the due diligence procedures.

B77. Moreover, a contingent consideration arrangement is inherently part of the economic considerations in the negotiations between the buyer and seller. Such arrangements commonly are used by buyers and sellers to reach an agreement by sharing particular specified economic risks related to uncertainties about future outcomes. Differences in the views of the buyer and seller about those uncertainties often are reconciled by their agreeing to share the risks in such ways that favorable future outcomes generally result in additional payments to the seller and that unfavorable outcomes result in no or lower payments. The Board observed that, often, the evidence surrounding those negotiations also provides information useful in estimating the fair value of the contingent obligation assumed by the acquirer.

B78. The Board acknowledges that measuring the fair values of some contingent payments may be difficult, but it concluded that to delay recognition of or otherwise ignore assets or liabilities that are difficult to measure would cause financial reporting to be incomplete. As noted in paragraphs 79 and 80 of FASB Concepts Statement No. 2, *Qualitative Characteristics of Accounting Information,* completeness affects the reliability and relevance of information and, within the bounds of feasibility, is necessary to both of those primary qualities. The Board concluded that excluding a measure of a liability (or asset) related to a contingent payment arrangement diminishes the usefulness of financial reporting and, perhaps worse, runs too high a risk of failing to faithfully represent the economics of the business combination transaction. Furthermore, as discussed in paragraph A28 of the proposed Statement on fair value measurement the Board noted that uncertainties in the amount and timing of future cash flows to settle an obligation is

incorporated directly in its fair value measurement, rather than its recognition, as required by FASB Statement No. 5, *Accounting for Contingencies*.

B79. The Board also noted that some contingent consideration arrangements obligate the acquirer to deliver its equity securities if specified future events occur. The Board concluded that the classification of these instruments either as equity or as a liability should be based on existing GAAP, such as FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity.*

B80. The Board also decided that this Statement would have to address the subsequent recognition and measurement of obligations for contingent payments of cash or other consideration. Consistent with the accounting for other obligations that require an entity to deliver its equity shares, the Board concluded that obligations for contingent payments that are classified as equity should not be remeasured after the acquisition date. The Board observed, however, that many of the obligations that are liabilities might not meet the threshold for recognition if Statement 5 was applied to those liabilities after the acquisition date. It noted that derecognition of those liabilities in accordance with Statement 5 would result in recognition of a gain immediately after the acquisition date. The Board concluded that that would not faithfully represent the economic position of the acquirer immediately following the acquisition date or the changes in its financial condition or performance and, thus, addressed the subsequent accounting for those liabilities.

B81. The Board observed that two types of obligations exist for contingent payments of cash or other consideration classified as liabilities: those that meet the definition of derivative instruments and those that do not meet that definition. The Board noted that many contingent consideration arrangements are similar or identical to contracts that are otherwise subject to the requirements of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities.* To improve transparency in reporting particular instruments, the Board believes that all contracts that would be in the scope of Statement 133 outside of a business combination should be subject to the requirements of that Statement. Therefore, the Board agreed to eliminate the provision in paragraph 11(c) of Statement 133 that excluded contingent consideration from the scope of that Statement.[12] Thus, in accordance with this Statement, liabilities for payments of contingent consideration that are subject to the requirements of Statement 133 would be remeasured, after the acquisition date, at fair value with changes in fair value reported in accordance with Statement 133.

B82. In considering the subsequent accounting for contingent payments that are liabilities but are not derivative instruments subject to Statement 133, as amended by this Statement, the Board concluded that in concept all liabilities for contingent payments should be accounted for similarly. Therefore, the Board decided that those liabilities for contingent

---

[12]As stated in paragraph 288 of Statement 133, at the time that Statement was issued the Board "decided that without further study it would be inappropriate to change the accounting for them [contingent consideration arrangements] by the entity that accounts for the business combination." That decision was made on the basis that the accounting for those arrangements would be reconsidered in the business combinations project.

payments that are not derivative instruments also should be remeasured at fair value after the acquisition date. The Board concluded that applying those provisions would faithfully represent the fair value of the liability for the contingent payment of consideration that remains a liability until settled.

B83. The Board also considered whether subsequent changes in the measurement of liabilities for contingent consideration should be reflected as an adjustment to the consideration transferred in the business combination (normally in goodwill). The Board noted that the measurement objective of a business combination is to record the fair value of the acquiree on the acquisition date and that measuring contingent consideration at its fair value at that date furthers that objective. The Board acknowledged that in limited circumstances in which particular information may not be available at the acquisition date, a conclusive determination of the fair value of any liability for contingent consideration may not be practicable. As discussed in paragraphs B161–B167, the Board decided that this Statement should provide for provisional measurement of the fair value of assets acquired or liabilities assumed, including liabilities for contingent payments, in those circumstances. Thus, this Statement provides for adjustments during the measurement period (after the acquisition date) to the provisional values of the assets acquired and liabilities assumed as if the accounting for the business combination had been completed at the acquisition date (paragraphs 62–68).

B84. Moreover, the Board concluded that except for adjustments to provisional estimates of fair values at the acquisition date, subsequent changes in the fair value of a liability for contingent consideration do not affect the acquisition-date fair value of the consideration transferred or the acquiree. Rather, the Board believes those subsequent changes in value *generally*[13] are directly related to postcombination events and changes in circumstances related to the combined entity. Thus, subsequent changes in value for postcombination events and circumstances should not affect the measurement of the consideration transferred or goodwill on the acquisition date.

B85. The Board also considered arguments that the approach agreed to by the Board will result in:

a. Recognizing gains in the income statement when the specified milestone or event requiring the contingent payment is not met (for example, the acquirer would record a gain on the reversal of the liability if an earnings target in an earnout arrangement is not met)
b. Subsequent changes in the value of many liabilities for contingent consideration that many constituents believe are directly attributable to changes in the value of the business acquired and, thus, should be capitalized as part of the acquired entity.

[13]The Board also acknowledges, however, that some changes in fair value might result from events and circumstances that in part may relate to a precombination period but the extent of the change is indistinguishable from that part related to the postcombination period. The Board concluded that in those limited circumstances the benefits in information that might result from making such fine distinctions in practice would not justify the costs that such a requirement would impose.

B86. The Board accepts the consequence that recognizing the fair value of a liability in a business combination for contingent payments of consideration is likely to subsequently result in a gain if smaller or no payments are required or in a loss if greater payments are required. The Board believes that this is a consequence of companies entering into contingent consideration arrangements whereby the underlying in the arrangement relates to future changes in the value of a specified asset or liability or net income of the acquiree after the acquisition date—that is, in the postcombination period of the acquirer (combined entity).[14]

Equity shares or member interests of the acquirer issued as consideration

B87. In considering the application of the acquisition method to mutual entities, the Board considered the accounting and reporting for an acquisition in which an acquirer issues equity shares or member interests as consideration in exchange for the equity shares or member interests of an acquiree. The Board observed that in a business combination between two investor-owned entities, if the acquirer issues equity shares as consideration for all of the equity shares of an acquiree, the fair value of the acquiree (its equity or net assets) is reported as an addition to equity of the acquirer—that is, generally as an increase to the acquirer's common stock (usually at par value) and paid-in capital (usually for the excess of fair value over the par value of the common stock issued). Thus, the equity (net assets) of the combined entity is increased from the acquisition of the acquiree (and the fair value of its net assets), but retained earnings of the acquirer are unaffected.

B88. Some representatives of mutual entities suggested that a similar acquisition of a mutual entity should be allowed to be reported as an increase in the retained earnings of the acquirer (combined entity) as had been the practice in accordance with the pooling method of accounting. The Board rejected that view. The Board believes that business combinations between two investor-owned entities are economically similar to those between two mutual entities in which the acquirer issues member interests for all the member interests of the acquiree. Thus, the Board concluded that those similar transactions should be similarly reported. Therefore, paragraph 53 of this Statement clarifies that "in a business combination involving only mutual entities in which the only consideration exchanged is the member interests of the acquiree for the member interests of the acquirer (or the member interests of the newly combined entity), the amount equal

---

[14]The Board also observed that liabilities for contingent payments may be related to contingencies surrounding an outcome for a particular asset or other liability. In those cases, the effects of changes in estimates of the fair value related to the liability for the contingent payment on income of the period may be offset by changes in the value of the asset or other liability. Assume, for example, that after an acquisition the combined entity reaches a very favorable settlement of pending litigation of the acquiree for which it had a contingent consideration arrangement. If the combined entity is thus required to make a contingent payment to the seller of the acquiree in an amount greater than the carrying amount (fair value) of the liability to the seller, the effect of the increase in that liability and charge to income may be offset in part by the reduction to the liability to the litigation claimant and the credit to income resulting from that favorable settlement. Similarly, assume the acquirer is not required to make a contingent payment to the seller because an acquired research and development project failed to materialize into a viable product. In that case, the gain resulting from the elimination of the liability may be offset, in whole or in part, by an impairment charge to the asset acquired.

to the fair value of the acquiree shall be recognized as a direct addition to capital or equity, not retained earnings."

B89. The Board also considered more specific concerns of representatives of credit unions about adverse economic consequences for those entities. Those representatives argued that requiring the application of the acquisition method would impede consolidation within that industry and, perhaps, misrepresent the financial soundness and regulatory capital of two credit unions that combine their operations. They noted that in the United States, applicable federal law defines net worth for credit unions as the "retained earnings balance of the credit union, as determined under generally accepted accounting principles." Because the regulatory definition of net worth is narrower than equity under GAAP, they expressed concern that the exclusion of the equity of an acquired credit union from retained earnings of the combined entity could misrepresent a financially sound combined entity as if it were not financially sound. Thus, they suggested that credit unions be permitted to continue to apply the pooling method of accounting for their combinations or be permitted to report the equity of an acquired mutual entity as an addition to retained earnings of the combined entity. The Board was not persuaded by those arguments. The Board believes that this Statement will not affect the ability of credit unions to restructure and combine with other credit unions.

B90. Additionally, the Board has been told that the number of combinations between credit unions in which the regulatory net worth calculation could be significantly impacted is relatively small in any given year. The Board also noted that this Statement applies to the general-purpose financial statements of all entities and that regulatory filings of credit unions and other entities and the needs of their regulators are separate matters beyond the purpose of those financial statements. Concepts Statement 2 states that a necessary and important characteristic of accounting information is neutrality. In the context of business combinations, neutrality means that the accounting standards should neither encourage nor discourage business combinations but, rather, provide information about those combinations that is fair and evenhanded. The Board concluded that its public policy goal is to issue accounting standards that result in neutral and representationally faithful financial information. The elimination of the pooling method for all entities by Statement 141 and the requirement that all entities, including mutual entities, report the resulting increase in equity as a direct addition to equity (not retained earnings) is consistent with the Board's public policy goal.

Share-based compensation replacement awards of the acquirer

B91. Paragraphs A102–A109 provide guidance for those circumstances in which an acquirer is obligated to exchange its share-based payment awards for those of an acquiree in connection with a business combination. The Board observed that replacement awards issued by an acquirer may be to benefit the employees of the acquiree for past services, future services, or both. For several reasons, the Board decided that this Statement should provide implementation guidance for these transactions. Those reasons include the following:

a. The difficulties in judging the extent to which replacement awards are for past services (and, thus, part of the consideration for the business) or future services (and, thus, not part of the consideration for the business)
b. The relative newness of both this Statement and FASB Statement No. 123 (revised 2004), *Share-Based Payment,* and implementation difficulties that might otherwise be encountered in practice.

The Board believes the guidance in this Statement is consistent with the objective that the measure of the consideration transferred for the business include those payments that are for the business and exclude those payments that are not. Compensation payments for future services to be rendered to the acquirer by former owners or officers and other employees are not payments for the business acquired (paragraph 70(b)).

B92. The Board also acknowledged that although the guidance in this Statement is consistent with the IASB's basic guidance, some details are different. As noted in paragraph A103(d) "the requisite service period of awards issued by the acquirer shall reflect any explicit, implicit, and derived service periods (consistent with the requirements of Statement 123(R))." That *requisite service period* often, but not always, will result in the same total service period as the IASB's requirement that uses the *total vesting period*. The Board decided to accept this divergence, since it stems from a difference in the Boards' other standards, which is a matter outside the scope of the joint project on business combinations.

Costs incurred in connection with a business combination

B93. The Board considered whether, for purposes of measuring the fair value of the acquiree, costs that an acquirer incurs in connection with a business combination are part of the consideration transferred in exchange for the acquiree. Those costs (commonly called acquisition-related costs) include an acquirer's costs incurred in connection with a business combination (a) for the services of lawyers, investment bankers, accountants, and other third parties and (b) for issuing debt or equity instruments used to effect the business combination (issue costs). Generally, acquisition-related costs are expensed. However, issue costs are an exception. Currently, the accounting for issue costs in practice is mixed. The Board is addressing issue costs in its project on liabilities and equity and has tentatively decided that those costs should also be expensed as incurred. While some Board members would have preferred to require that issue costs to effect a business combination be expensed, the Board decided that the business combinations project was not the place to make that decision. Therefore, the Board decided to allow mixed practices for accounting for issue costs to continue until the project on liabilities and equity resolves the issue broadly.

B94. The Board concluded that acquisition-related costs are not part of the fair value exchange between the buyer and seller for the business. Rather, they are separate transactions in which the buyer makes payments in exchange for services rendered. The Board also observed that those costs, whether for services performed by external parties or internal staff of the acquirer, generally do not represent assets of the acquirer at the acquisition date, since they are consumed as the services are rendered.

B95. Thus, this Statement specifies that the acquirer "shall not include such costs in the measure of the fair value of the acquiree or the assets acquired or liabilities assumed as part of the business combination [and] shall account for acquisition-related costs, separately from the business combination, in accordance with applicable accounting standards" (paragraph 27). As a result, this Statement resolves inconsistencies in accounting for acquisition-related costs in accordance with the cost accumulation approach that had been used in practice (and as required by paragraph 24 of Statement 141 and paragraph 76 of Opinion 16 and its related interpretation). In accordance with those past practices, the cost of an acquired entity included *direct* costs incurred for an acquisition of a business but excluded *indirect* costs. Those direct costs included out-of-pocket or incremental costs, for example, finder's fees and fees paid to outside consultants for accounting, legal, or valuation services for a successful acquisition, but direct costs incurred in unsuccessful negotiations were expensed as incurred. Indirect costs included recurring internal costs, such as maintaining an acquisition department, and although those costs also could be directly related to a successful acquisition, they were expensed as incurred.

B96. The Board's conclusion also reflects that whether a business is acquired in a single purchase, a series of purchases, or through other means, the objective of this Statement is to measure the acquiree at its acquisition-date fair value. That attribute is not cost. Moreover, those acquisition-related fees are not part of the cost of the acquiree; they are costs for the services the acquirer receives.

B97. Some constituents argued that acquisition-related costs, including costs of due diligence, are an unavoidable cost of the investment in a business. They suggested that like other investment costs, since the acquirer intends to recover its due diligence cost through the postacquisition operations of the business, that transaction cost is a cost that should be capitalized as part of the total investment in the business. Some also argued that the buyer specifically considers these costs in determining the amount that it is willing to pay for the acquiree. The Board rejected those arguments. The Board found no persuasive evidence indicating that the seller of a particular business is willing to accept less than fair value as consideration for its business merely because a particular buyer may or may not incur more (or less) acquisition-related costs than other potential buyers for that business. Further, the Board concluded that the intent of a particular buyer, including its plans to recover such costs, is a separate matter that is distinct from the fair value measurement objective for the acquiree.

B98. The Board acknowledges that in accordance with current GAAP cost-accumulation models would include some acquisition-related costs as part of the carrying amount of the asset acquired. The Board also acknowledges that asset acquisitions are similar transactions that in concept should be accounted for similarly, regardless of whether the asset acquired is a separate asset or a group of assets that may or may not meet the definition of a business. However, as noted in paragraph B39, the Board decided not to extend the scope of this Statement to acquisitions of all asset groups. Therefore, the Board accepts that, at this time, recognizing most acquisition-related costs as an expense as incurred for services received in connection with a business combination (that are not for the business acquired) differs from some accepted practices that allow particular

acquisition-related costs to be included in the cost of an asset acquisition. Board members agreed, however, that this Statement improves financial reporting by eliminating inconsistencies in accounting for acquisition-related costs in connection with a business combination and by applying the fair value measurement objective to all business combinations consistent with the Board's definition of fair value.

B99. The Board also considered concerns about the potential for abuse. Some constituents noted that if acquirers can no longer capitalize acquisition-related costs as part of the cost of the business acquired, they may use abusive practices to avoid recognizing those costs as expenses. For example, some assert that a buyer might ask a seller to make payments to the buyer's vendors on its behalf and that the seller, to facilitate the negotiations and sale of the business, might agree to make those payments provided that the "total agreed price" to be paid to the seller upon closing of the business combination includes an amount sufficient to reimburse the seller for payments it made on the buyer's behalf. If the disguised reimbursements were treated as part of the consideration transferred for the business, those expenses might not be recognized by the acquirer. Rather, the measure of the fair value of the business and the amount of goodwill recognized for that business might be overstated. To mitigate such concerns, the Board decided to clarify in this Statement that the portion of any payments to an acquiree (or its former owners) in connection with a business combination that are payments for goods or services that are not part of the acquired business should be assigned to those goods or services and accounted for as if separately acquired. As discussed in paragraphs B111–B117, the Board also decided that this Statement should specifically require an assessment to determine whether any portion of the payment amounts transferred by the acquirer are not part of the consideration transferred in exchange for the acquiree and the related assets acquired and liabilities assumed or incurred. Paragraphs 69 and 70 provide guidance for making that assessment.

Measuring and Recognizing the Assets Acquired and the Liabilities Assumed

B100. In developing this Statement, the Board considered the need for fundamental principles to resolve inconsistencies that resulted from the existing purchase price allocation process used by an acquirer in recognizing and assigning amounts to assets acquired and liabilities assumed in a business combination.

Principle for measuring and recognizing assets acquired and liabilities assumed

B101. This Statement reflects the Board's decisions to develop a standard (and related application guidance) for measuring and recognizing assets acquired and liabilities assumed in a business combination that:

a. Is consistent with the general principle of initially recognizing assets acquired and liabilities assumed at their acquisition-date fair values, thereby improving the relevance and comparability of the resulting information about the assets acquired and liabilities assumed (paragraph B23(b))
b. Eliminates inconsistencies and other deficiencies of the purchase price allocation process, including those in applying that process to acquisitions of businesses that

occur in stages in which the acquirer ultimately obtains the business without purchasing all or perhaps any of the acquiree's equity interest on the acquisition date
c. Can be applied in practice with a reasonably high degree of consistency and without imposing undue costs.

B102. To achieve those objectives, the Board decided that, *in principle,* an acquirer should be required to measure and recognize the assets and liabilities of the acquiree at their fair values at the acquisition date. Thus, this Statement eliminates:

a. The use of inconsistent measures for specified assets and liabilities that existed in Statement 141 and Opinion 16
b. The practice that existed in Statement 141 of reducing the initial fair value based estimates of particular assets acquired if the sum of those amounts assigned to assets acquired and liabilities assumed exceeds the cost of the acquired entity[15]
c. The inconsistencies and deficiencies of the past practice of measuring assets and liabilities of an acquiree that is not wholly owned at a mixture of some current exchange prices and some carryforward book values (as discussed in paragraphs B20–B24).

B103. Previously, the purchase price allocation process applied in accordance with Statement 141 had required that an acquirer allocate the cost (rather than the fair value) of an acquiree to the assets acquired and liabilities assumed. That allocation was generally based on the estimated fair values of those assets and liabilities on the acquisition date, but paragraph 37 of Statement 141 (Opinion 16, paragraph 88) required that particular assets and liabilities be measured at current replacement costs, at net realizable values, or in accordance with other GAAP. When it issued Statement 141, the Board acknowledged that some of the guidance for applying the purchase price allocation process conflicted with the general principle of recognizing assets acquired and liabilities assumed at their fair value. However, the Board decided that Statement 141 should carry forward, without reconsideration, the general guidance in paragraph 88 of Opinion 16 for assigning amounts to assets acquired and liabilities assumed. It explained:

> The Board recognizes that some of that guidance may be inconsistent with the term *fair value* as defined in [Statement 141]. For example, uncertainties about the collectibility of accounts or loans receivable would affect their fair value. If accounts or loans receivable were assigned an amount equal to their fair value, there would be no need to separately recognize an allowance for uncollectible accounts. . . . The Board decided, however, that it would consider those inconsistencies in a separate project on issues related to the application of the purchase method. [Statement 141, paragraph B100]

---

[15]More specifically, paragraph 44 of Statement 141 stated that the "excess shall be allocated as a pro rata reduction of the amounts that otherwise would have been assigned to all of the acquired assets except (a) financial assets other than investments accounted for by the equity method, (b) assets to be disposed of by sale, (c) deferred tax assets, (d) prepaid assets relating to pension or other postretirement benefit plans, and (e) any other current assets" (footnotes omitted).

In this Statement, the Board concluded that measuring assets acquired or liabilities assumed at amounts other than their fair values at the acquisition date does not faithfully represent their economic values or the acquirer's economic circumstances resulting from the business combination.

B104. The Board noted that the steps taken in this Statement toward consistent application of its recognition principle continue the process of improving the relevance and comparability of information provided about the assets acquired and liabilities assumed in a business combination. As in Statement 141, the Board observed that this Statement's recognition principle will give rise to the recognition of assets and liabilities by the acquirer that the acquiree may not have recognized in its financial statements before the combination. For example, an acquirer will recognize unrecorded assets of an acquiree for the future economic benefits embodied in internally generated intangible assets that Statement 141 and this Statement require to be recognized separate from goodwill. Additionally, in accordance with this Statement, the acquirer will recognize assets of the acquiree that are used in research and development projects and that have no alternative use. Although those assets met the definition of an asset, they previously did not qualify for recognition in accordance with paragraph 5 of FASB Interpretation No. 4, *Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method*. Examples of unrecorded liabilities of an acquiree that an acquirer would recognize include future sacrifices of economic benefits resulting from contingencies of the acquiree that previously did not qualify for recognition in accordance with the "probability threshold" criterion of Statement 5.

B105. The Board concluded that the consistent application of this Statement's principle for the recognition of assets acquired and liabilities assumed in a business combination will improve the completeness, representational faithfulness, and relevance of the information reported in an acquirer's financial statements. However, for cost-benefit reasons and to minimize disruptions to practice, the Board decided that this Statement should provide particular accommodations and clarifications about the application of its fair value measurement and recognition principles. More specifically, the Board decided that this Statement should:

a. Require that particular assets and liabilities continue to be measured in accordance with existing GAAP and that goodwill continue to be measured as a residual[16]
b. Clarify that separate recognition of assets and liabilities is not permitted for an acquiree's operating leases if the acquiree is the lessee (paragraph 47).

[16]Assets and liabilities that are to be measured in accordance with existing GAAP rather than at their fair values include (a) assets (disposal group) that qualify as assets held for sale, (b) deferred tax assets and liabilities, and (c) employee benefit obligations. In accordance with this Statement, goodwill would be measured as the excess of the fair value of the acquiree, as a whole, not its cost, over the net amount of the recognized identifiable assets acquired and liabilities assumed.

Guidance for recognizing the assets acquired and liabilities assumed

B106. The Board decided that to achieve a reasonably high degree of consistency in practice and to resolve existing inconsistencies, this Statement should provide guidance for applying its measurement and recognition principle. In this Statement, the Board decided that guidance should emphasize two fundamental conditions; that is, to measure and recognize an item as part of the acquirer's accounting for the business combination, the item acquired or assumed must be:

a. An asset or liability at the acquisition date
b. Part of the acquiree that the acquirer receives for the consideration transferred in exchange for that business. That is, the items are not other assets acquired or liabilities assumed as part of a substantively separate exchange transaction.

An item that is an asset or a liability at the acquisition date

B107. For purposes of determining whether an item is an asset or liability at the acquisition date, the Board decided that this Statement should use the definitions in FASB Concepts Statement No. 6, *Elements of Financial Statements.* Those definitions are:

> Assets are probable[18] future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.
>
> Liabilities are probable[21] future sacrifices of economic benefits arising from present obligations[22] of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.
>
> ---
>
> [18 and 21] *Probable* is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in FASB Statement No. 5, *Accounting for Contingencies,* par. 3), and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved (*Webster's New World Dictionary of the American Language,* 2d college ed. [New York Simon and Schuster 1982], p. 1132). Its inclusion in the definition is intended to acknowledge that business and other economic activities occur in an environment characterized by uncertainty in which few outcomes are certain (pars. 44–48).
>
> [22] *Obligations* in the definition is broader than *legal obligations*. It is used with its usual general meaning to refer to duties imposed legally or socially; to that which one is bound to do by contract, promise, moral responsibility, and so forth (*Webster's New World Dictionary*, p. 981). It includes equitable and constructive obligations as well as legal obligations (pars. 37–40). [paragraphs 25 and 35]

B108. The Board observed that in accordance with Statement 141, and its predecessor Opinion 16 and related interpretative guidance, particular items were being recognized in practice *as if* they were assets acquired or liabilities assumed at the acquisition date even though they did not meet the definition of an asset or a liability. That practice appears to stem from whether an item is viewed as part of the cost of (or investment in) the acquiree. For example, as discussed in paragraphs B94 and B95, in accordance with existing

practices particular expenses for services received in connection with a business combination were capitalized as part of the cost of the acquiree (and recognized as part of goodwill) *as if* they were an asset at the acquisition date. As discussed in the following paragraphs, the Board also observed that some future costs that an acquirer expected to incur often were viewed as a cost of the acquiree and recognized *as if* they were a liability at the acquisition date. The Board concluded that the representational faithfulness, consistency, and understandability of financial reporting would be improved by eliminating such practices.

B109. The Board specifically considered the guidance in EITF Issue No. 95-3, "Recognition of Liabilities in Connection with a Purchase Business Combination." In Issue 95-3, the Task Force reached consensuses that the costs of an acquirer's plan to (a) exit an activity of an acquired company, (b) involuntarily terminate employees of an acquired company, or (c) 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 if specified conditions were met. The Board concluded, however, as it did in FASB Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities,* that:

> Only present obligations to others are liabilities under the definition. An obligation becomes a present obligation when a transaction or event occurs that leaves an entity little or no discretion to avoid the future transfer or use of assets to settle the liability. *An exit or disposal plan, by itself, does not create a present obligation to others for costs expected to be incurred under the plan; thus, an entity's commitment to an exit or disposal plan, by itself, is not the requisite past transaction or event for recognition of a liability.* [Paragraph 4, emphasis added.]

B110. Consistent with that conclusion, this Statement now specifies the accounting for costs associated with restructuring or exit activities of a newly acquired business. Paragraph 37 specifies that "the acquirer shall recognize, separately from goodwill, the acquisition-date fair value of liabilities for restructuring or exit activities acquired in a business combination only if they meet the recognition criteria in [Statement 146] as of the acquisition date." It also clarifies that:

> Costs associated with restructuring or exit activities that do not meet the recognition criteria in Statement 146 as of the acquisition date are not liabilities at the acquisition date and, therefore, are recognized separately from the business combination, generally as postcombination expenses of the combined entity when incurred. For example, costs the acquirer expects to incur in the future pursuant to its plan to exit an activity of an acquiree, involuntarily terminate the employment of an acquiree's employees, or relocate employees of an acquiree are not assumed liabilities of the acquiree and, therefore, are not accounted for as part of the business combination.

Thus, this Statement nullifies the guidance in Issue 95-3.

Determining that assets acquired and liabilities assumed are part of the exchange for the acquiree

B111. To recognize an asset or liability as part of the acquirer's accounting for the business combination, the asset or liability must be part of the exchange for the acquiree. Paragraph 69 of this Statement states:

> The acquirer shall assess whether any portion of the transaction price (payments or other arrangements) and any assets acquired or liabilities assumed or incurred are not part of the exchange for the acquiree. Only the consideration transferred and the assets acquired or liabilities assumed or incurred that are part of the exchange for the acquiree shall be included in the business combination accounting. Any portion of the transaction price or any assets acquired or liabilities assumed or incurred that are not part of the exchange for the acquiree shall be accounted for separately from the business combination.

B112. An objective of that assessment is to distinguish consideration that an acquirer transfers for the acquiree from other increased (or reduced) payments made in connection with the business combination that are for other assets or purposes. To assist in meeting that objective, paragraph 70 of this Statement includes three specific examples of payments or other arrangements that are not part of the exchange for the acquiree, and Appendix A provides additional implementation guidance.

B113. The first example—the exclusion of payments that effectively settle preexisting relationships between the acquirer and acquiree—is consistent with guidance in EITF Issue No. 04-1, "Accounting for Preexisting Relationships between the Parties to a Business Combination." It is directed at ensuring that assets and liabilities related to preexisting relationships between the parties that are not transferred to or assumed by the acquirer are excluded from the accounting for the business combination. Assume, for example, a potential acquiree had an asset (receivable) for an unresolved claim against the potential acquirer and that acquirer and the acquiree's owner agree to settle that claim as part of an agreement to sell the acquiree to the acquirer. Consistent with Issue 04-1, the Board concluded that if the acquirer makes a lump-sum payment to the seller-owner, part of that payment is to settle the claim and is not part of the consideration transferred to acquire the business. Thus, the portion of the payment that relates to the claim settlement should be excluded from the accounting for the business combination and accounted for separately. In effect, the acquiree relinquished its claim (receivable) against the acquirer by transferring it (as a dividend) to the acquiree's owner. Thus, at the acquisition date the acquiree has no receivable (asset) to be acquired as part of the combination, and the acquirer would account for its settlement payment separately. Board members acknowledge that in practice the guidance in Issue 04-1 requires that amounts for all preexisting relationships be excluded from the accounting for the business combination. Although that guidance differs from the assessment and judgment approach of paragraph 69 of this Statement, the Board decided that the guidance in Issue 04-1 is reasonable. Accordingly, the Board decided that this Statement should codify the guidance in Issue 04-1.

B114. The second and third examples also are directed at ensuring that payments that are not part of the consideration transferred for the acquiree are excluded from the business combination accounting. The Board concluded that the payments for such transactions or arrangements should be accounted for separately in accordance with applicable GAAP for those transactions. Paragraph B99 also discusses the Board's specific considerations about potential abuses surrounding the third example—payments to reimburse the acquiree or its former owners for paying the acquirer's costs incurred in connection with the business combination.

B115. The Board also decided to provide further application guidance to help address concerns expressed about distinguishing between the elements of a business combination and other concurrent transactions. It was suggested that parties directly involved in the negotiations of an impending business combination could take on the characteristics of related parties. As a result, they may be willing to enter into other agreements or include conditions as part of the business combination agreement that were designed primarily to achieve favorable postcombination reporting outcomes. Because of those concerns, the Board decided to include factors that should be considered when assessing a particular transaction or arrangement entered into by the parties to the combination.

B116. The Board believes that if, in connection with a business combination, a transaction or arrangement is designed primarily for the economic benefit of the specific acquirer or the combined entity (rather than the acquiree or its former owners), that transaction or arrangement is not part of the exchange for the acquiree. The Board concluded that that transaction or arrangement should be accounted for separately from the business combination. The Board acknowledged, however, that judgment may be required to determine whether a portion of the transaction price paid, or the assets acquired and liabilities assumed, are not part of the exchange for the acquiree. The Board decided to include in paragraph A88 of this Statement's guidance three factors to be considered in assessing a business combination transaction: (a) the reason for the transaction or event, (b) who initiated the transaction or event, and (c) the timing of the transaction or event. The Board believes that although those factors are neither mutually exclusive nor individually conclusive, they can be helpful in considering whether a transaction or event is arranged primarily for the economic benefit of the acquirer or combined entity. Paragraph A88 expands on those factors, and paragraphs A89–A109 provide illustrative examples for assessing whether any portion of the consideration transferred or the assets acquired or liabilities assumed or incurred are not part of the exchange for the acquiree.

B117. The Board acknowledges that assessing the circumstances surrounding a business combination imposes costs. The Board concluded, however, that those costs are warranted. The Board believes the required assessment and related guidance will help achieve a reasonably high degree of consistency in applying this Statement's recognition principle and help ensure that a business combination is faithfully represented.

Guidance for particular assets acquired and liabilities assumed

B118. Paragraphs B119–B141 discuss the Board's considerations and conclusions about applying this Statement's principle for measuring and recognizing particular assets acquired and liabilities assumed. As previously noted, in accordance with that principle the acquirer measures and recognizes the assets acquired and liabilities assumed at their acquisition-date fair values. Paragraphs B143–B155 discuss the reasons for permitting particular exceptions to that principle.

Valuation allowances

B119. The Board considered whether an exception to this Statement's fair value measurement principle is necessary for assets required to be recognized at fair value, such as trade receivables and other short-term and long-term receivables acquired as part of a business combination. Although several of the Board's constituents suggested that an exception be permitted for practical reasons the Board concluded that there is no compelling reason for such an exception. Many of those constituents suggested retaining the requirements of Statement 141, which states that receivables are measured at "present values of amounts to be received determined at appropriate current interest rates, less allowances for uncollectibility and collection costs, if necessary" (paragraph 37(b)). The Board noted, however, that using an acquiree's carrying basis and including collection costs is inconsistent with this Statement's fair value measurement requirement and the principle that the acquirer's initial measurement, recognition, and classification of the assets acquired and liabilities assumed begins on the acquisition date—when the acquirer obtains control of the acquiree. The Board concluded that because uncertainty about collections and future cash flows is included in the fair value measure, the acquirer should not recognize a separate valuation allowance for assets required to be measured at fair value.

B120. The Board also observed that because uncertainties about future cash flows is included in a fair value measure, this Statement's fair value measurement approach differs from the SEC registrants' practice established in SEC Staff Accounting Bulletin Topic 2.A.5, *Adjustments to Allowances for Loan Losses in Connection With Business Combinations,* which states that generally the acquirer's estimation of the uncollectible portion of the acquiree's loans should not change from the acquiree's estimation prior to the acquisition. The Board also observed that the fair value measurement approach is consistent with relevant guidance in:

a. AICPA Statement of Position 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer,* which prohibits "carrying over" or creation of valuation allowances in the initial accounting of all loans acquired in transfers that are within the scope of this SOP, including purchase business combinations.
b. EITF Issue No. 98-1, "Valuation of Debt Assumed in a Purchase Business Combination," which applies to trade and other loan payables assumed in a business combination.

B121. The Board also understands that the fair value measurement approach has implications for the capital requirements for financial institutions, in particular banks. During the Board's deliberations, constituents stated that the elimination of the separate loan loss reserves of the acquiree upon initial recognition by the acquirer in a business combination would affect the Tier II capital requirements for regulatory reporting purposes. Constituents also told the Board, however, that this Statement's fair value measurement approach is supported by some banking regulatory agencies and some financial institution analysts. The Board noted, however, that regulatory reporting requirements are a separate matter beyond the scope of general-purpose financial reporting. The Board concluded that requiring all acquirers to measure assets acquired and liabilities assumed in the same way is consistent with the Board's policy goal of issuing accounting standards that result in neutral and representationally faithful financial information.

Contingencies that meet the definitions of assets or liabilities

B122. Paragraph 35 of this Statement specifies that acquirer recognizes, separately from goodwill, the acquisition-date fair value of assets and liabilities arising from contingencies that were acquired or assumed as part of the business combination if the contingency meets the definition of an asset or a liability in Concepts Statement 6 even if that contingency does not meet the recognition criteria in Statement 5. The Board concluded that to fairly represent the economic circumstances at the acquisition date, in principle, all assets acquired and liabilities assumed should be measured and recognized at their acquisition-date fair values, which includes assets and liabilities arising from contingencies of the acquiree at the acquisition date. That conclusion also applies in those circumstances in which the fair value of an acquiree's contingent gain or loss is offset in whole or in part by the fair value of an acquirer's related liability or asset for a contingent consideration arrangement.

B123. The Board also noted that, in principle, measuring contingencies at their fair value is consistent with using a fair value measure for the initial recognition of many other assets and liabilities that have inherent risks and uncertainties. Although there are various degrees of risk and uncertainties inherent in major classes of assets and liabilities, substantially all assets (perhaps other than cash) involve some uncertainty about their future economic benefit. For example, the future economic benefit of a note receivable includes an expectation of future payment but, to some degree, the future payment of any or all contractual amounts due is an uncertain event. Fair value incorporates uncertainty about the timing and amount of cash flows in the measurement of the asset or liability rather than its recognition.

B124. The Board also decided that this Statement should address two significant concerns about difficulties that are likely to be encountered in practice in measuring the fair values of contingencies at the acquisition date. The first is that information needed to measure the acquisition-date fair value of a contingency may not be available or of sufficient quality at that date. The second is that eliminating the Statement 5 approach is likely to require measuring at an earlier date contingencies that are significantly more difficult to measure and that change is likely to require measurement guidance.

B125. The Board decided to address the first concern by allowing acquirers to record provisional fair value estimates at the acquisition date followed by a measurement period during which the acquirer may adjust the provisional amounts recognized at the acquisition date (paragraphs 62–68). The measurement period is intended to provide the acquirer reasonable time to obtain the information necessary to identify and estimate acquisition-date fair values of assets and liabilities on the basis of the circumstances that existed at the acquisition date. The Board concluded that this Statement's measurement period is a reasonable way to accommodate concerns about the quality and availability of information at the acquisition date.

B126. The Board decided that it is best to address the second concern—measuring fair values of assets acquired and liabilities assumed—through the proposed Statement on fair value measurement. That Statement comprehensively addresses and discusses the fundamental issues surrounding fair value measurements and provides relevant guidance for measuring the fair values of assets and liabilities. The Board also believes that improving the understanding of what is meant by *reliably measurable* in relation to a fair value measurement is important to the Board's considerations in this Statement for measuring the assets and liabilities for contingencies.

B127. The Board notes that a reliable measurement of the fair value of a contingency does not mean that the acquirer must be able to determine, predict, or otherwise know the ultimate settlement amount of that contingency at the acquisition date or within the measurement period. Paragraph A28 of the proposed Statement on fair value measurement also clarifies how fair value measures differ from practice in Statement 5:

> For a liability measured at fair value, the guidance in FASB Statement No. 5, *Accounting for Contingencies,* and FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss,* does not apply. Both Statement 5 and a fair value measurement consider uncertainty inherent in future cash flows (amount and timing). However, Statement 5 considers uncertainty in the context of recognition, establishing a probability threshold for when to recognize a loss contingency. In contrast, a fair value measurement considers uncertainty in the context of measurement, incorporating uncertainty directly in the measurement.[19]
>
> ---
>
> [19]Paragraphs 55–61 of Concepts Statement 7 discuss the differences between recognition of a loss contingency under Statement 5 and measurement of a liability at fair value (using expected cash flows).

B128. Assumptions used in a fair value measurement are based on expectations at the time the measurement is made, and those expectations reflect the information that is available at the time of measurement. The fair value of the items measured will change over time as factors used to estimate their fair value change. Changes in the fair value of those items are a normal economic process to which any valuable resource is subject. Such changes do not indicate that the expectations on which previous fair value measurements were based were unreliable or incorrect. The fair value of those items at a

single point in time is not a forecast of what the estimated fair value of those items may be in the future.

B129. In its deliberations leading to this Statement, the Board considered but rejected two alternatives: (a) retaining existing practice based on Statement 38 and (b) adopting a similar approach based on Statement 5. To improve the accounting for acquisitions of businesses by acquirers, the Board concluded that it could not continue to allow the existing practice and related guidance that had permitted delayed measurement and recognition of contingencies. The accounting guidance for contingencies of an acquiree was specified in paragraphs 40 and 41 of Statement 141. Those requirements had been carried forward by Statement 141 from Statement 38. Statement 141 defined a preacquisition contingency as "a contingency of an entity that is acquired in a business combination that is in existence before the consummation of the combination" (paragraph F1). It added that a preacquisition contingency can be a *contingent asset,* a *contingent liability,*[17] or a contingent impairment of an asset.

B130. Statement 141 required that preacquisition contingencies (other than particular income tax contingencies) be included in the purchase price allocation. However, it did not require that accounting at the acquisition date. Rather, it permitted delayed recognition during the Statement 141 *allocation period*[18] based on amounts determined as follows:

(a) If the fair value of the preacquisition contingency can be determined during the allocation period, that preacquisition contingency shall be included in the allocation of the purchase price based on that fair value.

(b) If the fair value of the preacquisition contingency cannot be determined during the **allocation period,** that preacquisition contingency shall be included in the allocation of the purchase price based on an amount determined in accordance with the following criteria:

    (1) Information available prior to the end of the allocation period indicates that it is probable that an asset existed, a liability had been incurred, or an asset had been impaired at the consummation of the business combination. It is implicit in this condition that it must be probable that one or more future events will occur confirming the existence of the asset, liability, or impairment.

    (2) The amount of the asset or liability can be reasonably estimated.

    The criteria of this subparagraph shall be applied using the guidance provided in FASB Statement No. 5, *Accounting for Contingencies*, and related FASB Interpretation No. 14, *Reasonable Estimation of*

---

[17]The terms *contingent assets* and *contingent liabilities* sometimes are used in practice to refer to all contingencies, including items viewed as "possible assets" or "possible liabilities" that may not be assets or liabilities at the acquisition date. Thus, this Statement does not use those terms to avoid confusion.

[18]The *allocation period* in Statement 141 provided a period of time to identify and measure assets acquired and liabilities assumed in a business combination, which usually was not to exceed one year.

> *the Amount of a Loss,* for application of the similar criteria of paragraph 8 of Statement 5 (Statement 38, paragraph 5). [Paragraph 40; footnote references omitted.]

B131. The Board was told by members of its resource group and others that in practice assets acquired and liabilities assumed for contingencies of an acquiree often were not measured and recognized at their acquisition-date fair values. Instead, contingencies were recognized after the acquisition date at an amount determined at that later date because either (a) their amount was judged not *reasonably estimable* (in accordance with subparagraph (b)(2) of paragraph 40 of Statement 141) or (b) the contingency was determined not to meet the Statement 5 "probability" criterion for recognition. Although that delayed recognition generally occurred within the Statement 141 allocation period, the amount recognized seldom was the acquisition-date fair value. Rather, it often was the settlement amount or a best estimate of the expected settlement amount based on circumstances existing at that later date.

B132. The Board believes the objective of limiting the measurement period to a reasonable period following the acquisition date is to measure the assets acquired and liabilities assumed at their fair values as of the acquisition date. Therefore, it concluded that the only information that should be considered in recording assets acquired and liabilities assumed in a business combination is that information that pertains to their fair values as of the acquisition date. For example, information discovered after a business combination that suggests that an acquired asset requires an impairment (or other) adjustment would not be an adjustment to the initial accounting for the business combination if that information is about an event that occurred after the acquisition date; instead, it would result in a charge to earnings.

B133. The Board also considered whether a strict Statement 5 approach might be feasible for the initial measurement and recognition of all contingencies, which would mean contingencies that did not meet the Statement 5 "probability" criterion would be measured at zero (or a minimum amount that is probable). It was suggested that those initial amounts that are recognized also should be "frozen" until the contingency is settled (or sufficiently near settlement). Some constituents suggested that might be a practical way to reduce the costs and measurement difficulties that could be involved in obtaining the information and legal counsel needed to measure the fair value of numerous (in the ordinary course of business) contingencies that the acquiree had already assessed and judged not to qualify for recognition under Statement 5. They suggested that freezing the initial amounts recognized also could (a) minimize the costs of ongoing reassessments and (b) address concerns that reporting significant increases and decreases in fair value estimates during the periods before settlement could lead to considerable volatility in reported earnings and damage to the credibility of financial reporting.

B134. The Board noted that if a Statement 5 approach was to be applied as it is in practice, gain contingencies likely would not be recognized, including those for which all required information is available. That is, paragraph 17(a) of Statement 5 states that "contingencies that might result in gains usually are not reflected in the accounts since to do so might be to recognize revenue prior to its realization." The Board concluded that

would be a step backwards, since Statement 141 already required the recognition of all gain contingencies that qualify as intangible assets at the acquisition date and for which their fair value is determinable (paragraphs 39 and 40(a)). The Board also observed that in accordance with Statement 5 contingent losses that arise outside a business combination are not recognized unless there is a rather high likelihood of a future outflow of resources. The Board also observed that since goodwill is calculated as a residual, omitting an asset for an identifiable contingent gain also would result in overstating goodwill. Similarly, omitting a liability for a contingent loss would result in understating goodwill, and, in extreme cases, that omission could reduce a goodwill asset to zero or make it appear as if that asset had "negative" value. The Board decided to reject that Statement 5 approach, as well. However, the Board also noted that a project on business combinations is not the place to address broadly what some believe are deficiencies in Statement 5.

Subsequent measurement of contingencies

B135. The Board noted that its decision to measure and recognize assets acquired and liabilities assumed for contingencies of an acquiree at the acquisition date raises questions about how those items should be measured after the business combination. That is, without guidance from this Statement, questions would arise about whether those contingencies should continue to be measured at fair value or in accordance with other existing GAAP. Although this Statement is not directed at accounting for transactions and events after a business combination, the Board decided that to avoid misleading reporting consequences, this Statement must address that issue.

B136. The Board noted that if Statement 5 was applied in the postcombination period to a recognized liability (asset) for a contingency of an acquiree that did not meet the Statement 5 probability threshold at the acquisition date, in the absence of a change in circumstances, that liability (asset) would be derecognized and a gain (loss) would be reported in income of the postcombination period. The Board concluded that that would lead to financial reporting that does not faithfully represent the economic circumstances for that period. Thus, the Board decided that this Statement must address the subsequent measurement and recognition of contingencies that would be subject to Statement 5.

B137. The Board also noted that concerns about the potential for misleading reporting consequences do not exist for contingencies that are financial instruments. Contingencies that are financial instruments generally would continue to be measured at fair value in accordance with applicable GAAP because GAAP provides relevant guidance for how subsequent changes in fair value of financial instruments are to be reported in a statement of income and comprehensive income. The Board concluded that current GAAP provides appropriate guidance for the subsequent measurement of those contingencies.

B138. The Board considered four alternatives for subsequent measurement of nonfinancial contingencies of an acquiree:

Alternative 1—"Fresh-start" fair value approach

Alternative 2—Statement 5 "freeze" approach

Alternative 3—Interest allocation approach—which is similar to the model in FASB Statement No. 143, *Accounting for Asset Retirement Obligations*

Alternative 4—Deferred revenue approach—which would be applied only to those items that are revenue-generating activities.

B139. Paragraphs B122–B134 discuss the reasons for the Board's decision to require a fair value measurement approach for the initial measurement and recognition of an acquiree's contingencies and rejection of a Statement 5 approach. For many of those same reasons the Board concluded to require Alternative 1—a "fresh-start" fair value approach for their subsequent measurement and recognition—and rejected Alternative 2. Chief among those reasons are the Board's conclusion that fair value is the most relevant measurement attribute for contingencies and that the Statement 5 approach often fails to measure and recognize an existing asset or liability.

B140. The Board also rejected Alternative 3, the interest allocation approach. In accordance with that approach, the contingency would be remeasured using a convention similar to Statement 143 whereby interest rates are held constant for initial cash flow assumptions. It was noted that the reasons for selecting the interest allocation method in Statement 143, including concerns over income statement volatility, for rather long-term asset retirement obligations is not compelling for contingencies such as warranties and pending litigation that generally have shorter lives.

B141. The Board also rejected Alternative 4, the deferred revenue approach. In accordance with that approach, after the acquisition date, the recorded amount of the acquisition-date fair value established for a deferred revenue liability (performance obligation) would be amortized, similar to the approach for separately priced extended warranties and product maintenance contracts acquired outside a business combination. In addition, accruals would be added to the contingency for subsequent direct costs. The Board acknowledges that the costs to apply that measurement approach are lower than other measurement approaches. However, the Board concluded that the potential reduction in costs does not justify (a) creating inconsistencies in the subsequent accounting for particular classes of contingencies acquired or assumed in a business combination and (b) the diminished relevance of the resulting information.

Recognition of research and development assets

B142. The Board concluded that further improvements could be made by eliminating the requirement to measure and immediately write off in-process research and development assets acquired in a business combination. Board members believe that requirement results in information that is not representationally faithful. Accordingly, this Statement supersedes Interpretation 4. Board members also concluded that is a meaningful step toward fulfilling the Board's objective of promoting international convergence of accounting standards. Board members also considered whether further improvements could be achieved by extending this Statement's asset recognition to purchases of in-process research and development assets that are acquired outside a business combination. However, for the reasons discussed in paragraph B39, the Board decided not to extend the

scope of this Statement to acquisitions of assets that are not businesses. Additionally, the Board is considering in its short-term convergence project whether to address differences between U.S. GAAP and IFRS relating to the recognition of in-process research and development assets that are acquired outside of a business combination.

Exceptions to the fair value measurement principle

B143. Primarily because of cost-benefit or practicability concerns, the Board decided to allow particular exceptions to the application of this Statement's fair value measurement principle. The bases for allowing each exception are described in more detail in paragraphs B144–B155.

Assets held for sale

B144. The Board decided that long-lived assets (disposal group) acquired in a business combination that qualify as held for sale in accordance with FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,* should be measured at fair value less cost to sell in accordance with that Statement. The Board was concerned that if this Statement required those assets to be measured at fair value, a loss would be recognized immediately after the acquisition date, since Statement 144 would apply and require recognition of the costs to sell in accordance with that Statement. The Board concluded that assuming that there are no changes in events or other circumstances following the acquisition date, that reported loss would not fairly represent the activities of the acquirer during that period. Thus, the Board decided to require that long-lived assets (disposal group) that qualify as held for sale at the acquisition date be measured and recognized in accordance with the requirements of Statement 144.

Deferred taxes

B145. This Statement requires that deferred tax assets or liabilities be measured and recognized in accordance with FASB Statement No. 109, *Accounting for Income Taxes,* as amended, rather than at their acquisition-date fair values. In accordance with Statement 109, deferred tax assets or liabilities generally are measured and recognized at undiscounted amounts. The Board decided not to require deferred tax assets or liabilities acquired in a business combination to be measured at fair value because it observed that:

a. If those assets and liabilities were to be measured at their acquisition-date fair values, without any change in the underlying economic circumstances, their subsequent measurement in accordance with the provisions of Statement 109 would result in postcombination gains or losses in the period immediately following the acquisition. The Board concluded that would not faithfully represent the results of the postcombination period and would be inconsistent with the notion that a business combination that is a fair value exchange should not give rise to the recognition of immediate postcombination gains or losses.
b. To measure those assets and liabilities at their acquisition-date fair values and overcome the reporting problem noted in (a) would require a comprehensive consideration of whether and how to modify the requirements of Statement 109 for the subsequent measurement of deferred tax assets or liabilities acquired in a

business combination. The Board concluded that due to the complexities of Statement 109 and the added complexities that would be involved in tracking deferred tax assets acquired and liabilities assumed in a business combination, the benefits of applying this Statement's fair value measurement principle are not sufficient to warrant the costs or complexities that would cause.

B146. The Board decided to address three specific income tax accounting issues in connection with a business combination. They are the acquirer's accounting for (a) a change in its valuation allowance for its deferred tax asset that results from a business combination, (b) the reduction or elimination after the acquisition date of the valuation allowance that is established at the date of the acquisition for its deductible temporary differences or operating loss or tax credit carryforwards, and (c) tax benefits arising from tax deductible goodwill in excess of goodwill for financial reporting. The Board addressed these issues because retaining the existing requirements of Statement 109 are incompatible with this Statement, would negate some benefits of applying the provisions of this Statement, and the existing requirements of Statement 109 are different from the requirements in the international accounting income tax standard (IAS 12).

B147. On the first issue, the Board agreed that a change in the acquirer's valuation allowance for its deferred tax asset that results from a change in the acquirer's circumstances upon a business combination should be accounted for as a separate event and, thus, excluded from the business combination accounting. As a result, the acquirer would recognize the change in its valuation allowance as income or expense in the period of the business combination. The Board decided that it should consider this income tax accounting matter primarily for purposes of determining whether it might achieve convergence with international standards. Thus, the Board limited its consideration to the existing alternatives prescribed by Statement 109 and IAS 12. Presently, these changes in the acquirer's valuation allowance are included as part of the business combination accounting in accordance with Statement 109 but are accounted for separately in accordance with IAS 12.

B148. Board members observed that neither the Statement 109 alternative nor the IAS 12 alternative is entirely consistent with the requirements in paragraph 69 of this Statement because both alternatives remove the judgment that is required in assessing whether other assets and liabilities are part of the business combination. Some Board members prefer to exclude these changes in the acquirer's valuation allowance from the business combination accounting (the IAS 12 alternative) because the business combination model focuses on measuring and recognizing the fair value of the acquiree. They believe that the acquirer's deferred tax asset is an attribute of the *acquirer* rather than the *acquiree*. Other Board members prefer to include these changes in the acquirer's valuation allowance in the business combination accounting because they would emphasize consistency with the Statement 109 model. They view the business combination as the triggering event for the recognition of the change.

B149. Board members acknowledged that both alternatives are defensible on conceptual grounds. They also observed that retaining either of the alternatives, which do not allow for the judgment called for by this Statement, is acceptable for practical reasons. The

Board concluded that on balance the benefits of converging to the IAS 12 alternative—elimination of reconciling items and improvements in the comparability of information—outweigh the costs related to a change in the accounting in accordance with Statement 109. Board members also agreed to amend Statement 109 to require, consistent with the objective in paragraph 71 of this Statement, disclosure of the amount of the deferred tax benefit (or expense) recognized in income in the period of the acquisition for the reduction (or increase) of the acquirer's valuation allowance for its deferred tax asset that results from a business combination.

B150. On the second and third issues, the Board concluded that the fair value of other long-lived assets acquired in a business combination should no longer be reduced for changes after the acquisition date in the valuation allowance or in any excess amount of tax-deductible goodwill over the goodwill for financial reporting purposes (excess tax goodwill). This decision is consistent with the reasons for no longer reducing these assets in circumstances in which the cost of the combination exceeds the assets acquired and liabilities assumed. Additionally, from a conceptual standpoint, the excess tax goodwill meets the definition of a temporary difference, and not recognizing the tax benefit of that temporary difference at the date of the business combination is inappropriate and inconsistent with Statement 109. Thus, this Statement amends Statement 109 accordingly.

Operating leases

B151. In accordance with FASB Statement No. 13, *Accounting for Leases,* assets and liabilities are not separately recognized for rights and obligations of operating leases. The Board considered whether to require, for example, the separate recognition of an asset acquired for an acquiree's rights to use property for the specified period and related renewal options or other rights and a liability assumed for an acquiree's obligations to make required lease payments for an operating lease acquired in a business combination. The Board concluded that because it is not prepared at this time to address how the asset and the liability for an operating lease would be accounted for after the acquisition date, consistency in lease accounting should take primacy over consistency in the application of the fair value measurement requirement in this Statement. Therefore, consistent with current practice in accordance with Statement 141, the asset and the liability arising from an operating lease in which the acquiree is the lessee are recognized as a net amount.

B152. In addition, the Board decided to continue to require that acquirers recognize as part of the combination an intangible asset if the terms of the operating lease are favorable relative to market terms or a liability if the terms of the operating lease are unfavorable relative to market terms. That practice is consistent with current practice in accordance with Statement 141.

Employee benefit plans

B153. The Board concluded that if, at this time, it were to consider requiring that employee benefit obligations assumed in a business combination be measured at their acquisition-date fair values, the Board also would need to either (a) comprehensively reconsider the relevant standards for those employee benefits, or (b) at minimum, determine whether accommodations would be required, for their subsequent measurement

following the acquisition date, or (c) both. At this time, the Board does not have an active project to comprehensively reconsider the relevant standards for employee benefits. Thus, due to the complexities in accounting for employee benefit obligations in accordance with FASB Statements No. 87, *Employers' Accounting for Pensions,* No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions,* and No. 112, *Employers' Accounting for Postemployment Benefits,* the Board decided that at this time those benefits should continue to be measured in accordance with their applicable standards.

Goodwill

B154. Consistent with Statement 141 and Opinion 16, this Statement requires that the acquirer measure goodwill as a residual and recognize it as an asset. In Statement 141, the Board concluded that direct measurement of goodwill is impracticable. The Board did not reconsider that conclusion as part of the second phase of the business combinations project. Paragraphs B101–B146 of Statement 141 provide the basis for the Board's decision that goodwill should be recognized as an asset but can be only measured as a residual. Consistent with the fundamental principles underlying this Statement, the Board decided, however, that all assets and liabilities should be measured at their full fair values (or in limited cases their full amounts determined in accordance with other GAAP), including those of an acquiree (subsidiary) that is not wholly owned.[19] Thus, this Statement eliminates the past practice of not recognizing the full amount of goodwill; that is, omitting the portion related to the noncontrolling interests in such subsidiaries. Because that is a change to present practice, the Board decided to provide guidance that clarifies and illustrates how the goodwill residual is to be determined and allocated between the controlling and noncontrolling interests for an acquiree that is not wholly owned (paragraphs A62 and A63).

The Board considered three alternatives for purposes of allocating goodwill between the controlling and noncontrolling interest in an acquisition of a less than wholly owned acquiree. They are:

a. Allocate a portion of goodwill to the controlling interest based on the difference between the fair value of the equity interest acquired (which includes any previous investment held in the acquiree) and the acquirer's share of the fair value of the net identifiable assets acquired and the remaining portion to the noncontrolling interests
b. Allocate goodwill to the controlling and noncontrolling interests based on their relative ownership interests in the fair value of the acquiree
c. Allocate a portion of goodwill first to a reporting unit of the controlling interest that is expected to benefit from synergies of the combination, and then allocate the remainder to the controlling and noncontrolling interests based on their relative ownership interests in the fair value of the acquiree.

B155. The Board decided that goodwill should be allocated based on the first of those alternatives. Thus, as noted in paragraph A66, the amount of goodwill allocated to the

---

[19]Paragraphs B168–B182 discuss the reasons for the Board's decision to reduce the full amount of goodwill in the event of a bargain purchase—an acquisition in which the fair value of the interest acquired in the acquiree is greater than the consideration transferred for that interest.

acquirer (controlling interest) is to be measured as "the difference between the acquisition-date fair value of the acquirer's equity interest in the acquiree and the acquirer's share in the acquisition-date fair value of the separately recognized assets acquired and liabilities assumed" and the remainder is to be allocated to the noncontrolling interests. The Board noted that each alternative has certain merits. It concluded that on balance the first alternative best reflects the assumption that any control premium that is paid by the acquirer for control rights that is included in the full amount of goodwill should be allocated to the acquirer's interests (and avoids allocating any of that amount to the noncontrolling interest). The Board noted that the second alternative would be simple to apply but would result in a portion of goodwill that is related to the acquirer's payment of a control premium being allocated to the noncontrolling interest. The Board noted that the third alternative might be desirable in that it would allocate goodwill to the reporting units based on expected benefits but concluded that might introduce more difficulties and costs to apply in practice.

Recognizing Gains or Losses on Noncontrolling Equity Investments

B156. In accordance with paragraph 56 of this Statement, in a business combination achieved in stages, an acquirer remeasures its noncontrolling equity investment at its acquisition-date fair value and recognizes any gains or losses in income. Consistent with its conclusion in paragraphs B30 and B31 of Proposed Statement, *Consolidated Financial Statements, Including Accounting and Reporting of Noncontrolling Interests in Subsidiaries,* that losing control of a business is a remeasurement event, the Board concluded that gaining control of a business also is a remeasurement event. Specifically, a change from holding a noncontrolling investment in an entity to obtaining control of that entity is a significant change in the nature of and economic circumstances surrounding that investment. That change warrants a change in the classification and measurement of that investment. Board members observed that the acquirer no longer is the owner of a noncontrolling investment asset in that entity when control of the underlying entity is obtained. As in present practice, the acquirer ceases its investment accounting as an owner of an investment asset and begins reporting the underlying assets, liabilities, and results of operations of the entity as part of its consolidated results. In effect, the acquirer exchanges its status as an owner of an investment asset in an entity for a controlling financial interest in all of the underlying assets and liabilities of that entity (acquiree) and the right to direct how the acquiree and its management use those assets in conducting its operations.

B157. Paragraph 21(b) of this Statement also provides that, for purposes of applying the acquisition method, the fair value of any noncontrolling equity investment is considered part of the fair value of the consideration transferred. Board members noted that measuring that investment asset at its acquisition-date fair value represents its economic value at that date. They also noted that measuring that investment asset at its fair value at the acquisition date—when that investment accounting ceases—is consistent with the longstanding concept that when an asset is exchanged for another asset, the transaction is accounted for based on the fair values of the assets involved (paragraphs B57 and B58).

B158. In August 2003, the Board held a roundtable meeting with resource group members and other constituents to discuss, among other things, the decision to require that an acquirer remeasure any noncontrolling equity investment in an acquiree at its acquisition-date fair value and recognize any gain or loss in income of the period. The users of financial statements indicated they did not have significant concerns with the change to present practice to remeasure any noncontrolling equity investment, as long as the amount of the gain or loss is clearly disclosed in the financial statements or in the notes. Paragraph 72(j) of this Statement requires that an acquirer in a business combination achieved in stages disclose "the amount of any gain or loss recognized . . . and the line item in the income statement in which that gain or loss is recognized." Board members rejected the view expressed by some constituents that the carrying basis of any preacquisition investment should be retained in the initial accounting for the cost of the business acquired. As noted in paragraphs B20–B22, the Board concluded that current cost-accumulation practices have led to many of the inconsistencies and deficiencies in accounting practices and financial reporting.

B159. Some constituents also expressed concern about allowing an opportunity for gain recognition on a "purchase transaction." The Board noted that the required remeasurement also could result in loss recognition. Moreover, the Board rejected the characterization that the resulting recognition of a gain or loss is from a *purchase*. Rather, under the mixed attribute accounting model that exists today, economic gains and losses are recognized as they occur for particular, but not all, financial instruments. If a noncontrolling equity interest in an entity is not required to be measured at its fair value, the Board noted that the recognition of a gain or loss at the acquisition date is merely a consequence of the mixed practice that permits the delayed recognition of the economic gain or loss that is present in that financial instrument. However, if an investment asset is being measured at fair value in accordance with GAAP, the gain or loss would be recognized as it occurs in accordance with that accounting, and remeasurement would result in no further gain or loss to be recognized in comprehensive income of the period.[20]

B160. This Statement affirms the Board's conclusion in Statement 133 that fair value is the most relevant measure for financial instruments. The Board acknowledges that current accounting requirements for particular financial instruments are inconsistent with that fundamental conclusion but concluded that addressing those inconsistencies is a matter outside the scope of this project.[21] The Board also noted its ongoing commitment to work toward resolving the conceptual and practical issues related to determining the fair values of financial instruments and portfolios of financial instruments. However, the Board also concluded that there is no compelling need to resolve those inconsistencies before proceeding with the conclusion reached in this Statement that upon a change in control, an

---

[20]Paragraph 56 provides that "if, before the business combination, the acquirer recognized changes in the value of its noncontrolling equity investment in other comprehensive income (for example, the investment was classified as available for sale), the amount that was recognized in other comprehensive income shall be reclassified and included in the calculation of any gain or loss as of the acquisition date."

[21]Currently, the Board's fair value option project is considering whether to permit entities a one-time election to report most financial instruments (or similar nonfinancial instruments) at fair value with the changes in fair value included in earnings. Refinements of the project's scope are expected as the Board deliberates these issues.

acquirer should remeasure its noncontrolling equity investment at its acquisition-date fair value and recognize any gains or losses in income.

Measurement Period

B161. The Board decided to provide for a *measurement period* after the acquisition date during which the acquirer adjusts any provisional amounts that were recognized at the acquisition date to their subsequently determined acquisition-date fair values. The measurement period provides the acquirer with reasonable time following the acquisition date to obtain information necessary to measure the acquisition-date fair values of the acquiree, acquirer's interest in that acquiree, consideration transferred for the acquiree, and assets acquired and liabilities assumed. The Board concluded that allowing adjustments during the measurement period should address concerns about the quality and availability of information at the acquisition date for measuring the acquisition-date fair values of particular items, especially including contingencies of the acquiree and contingent consideration arrangements of the acquirer, which often impact the valuation of the acquiree as well.

B162. The Board decided that acquirers should provide users of their financial statements with relevant information about the status of items that have been measured only provisionally. Thus, paragraph 76(a) requires that the acquirer disclose "if the amounts recognized in the financial statement for the business combination have been determined only provisionally, (1) the reasons why the initial accounting for the business combination is not complete, (2) the assets acquired or the liabilities assumed for which the measurement period is still open, and (3) the nature and amount of any measurement period adjustments recognized during the period."

B163. The Board decided to place constraints on the period of time for which it is deemed reasonable to be seeking necessary information. The Board concluded that that period should end "as soon as the acquirer receives the necessary information about facts and circumstances that existed as of the acquisition date or learns the information is not obtainable. However, the measurement period shall not exceed one year from the acquisition date" (paragraph 65).

B164. The Board acknowledged that some contingencies and similar matters may not "mature" within a one-year limit. It observed, however, that the objective of the measurement period is to provide time to obtain the information necessary to measure the fair value of the item *as of* the acquisition date. The objective is not directed at determining the ultimate settlement amount of a contingency or other item. As discussed in paragraph B123, uncertainties about future cash flows are part of the measure of the fair value of an asset or liability.

B165. The Board noted that the measurement period in this Statement differs in important ways from the allocation period guidance of Statement 141 and its cost allocation method. This Statement emphasizes the principle that assets acquired, liabilities assumed, and the acquiree should be measured at their fair values on the acquisition date. As discussed in paragraphs B130 and B131, the application of the

Statement 141 allocation period and its postcombination adjustments delayed the recognition of assets and liabilities and when those assets and liabilities were recognized, they were not measured at their acquisition-date fair values. Thus, the Board decided to abandon the Statement 141 term *allocation period* and its guidance.

B166. The Board also decided that to improve the quality of comparative information reported in financial statements and converge with the requirements of IFRS 3, this Statement should require that:

a. An acquirer recognize adjustments made during the measurement period to the provisional values of the assets acquired and liabilities assumed as if the accounting for the business combination had been completed at the acquisition date
b. Comparative information in previously issued financial statements be adjusted, including any change in depreciation, amortization, or other income effect recognized as a result of completing the initial accounting. (paragraph 67)

B167. The Board noted that Statement 141 was silent about whether adjustments during the Statement 141 allocation period are to be reported retrospectively but noted that in practice the effects of those adjustments typically were reported in the postcombination period—not retrospectively. Board members acknowledged concerns that retrospective adjustments and adjusting previously issued comparative information are more costly. Some Board members indicated that for cost-benefit reasons they would prefer not to require retrospective adjustments. Board members also noted, however, that applying measurement period adjustments retrospectively would result in at least two significant benefits: (a) improvements in comparative period information and (b) avoidance of divergent accounting between U.S. entities and others and the reduction of reconciling items and their attendant costs. The Board concluded that those overall benefits outweigh the potential costs of retrospective application.

Business Combinations in Which the Consideration Transferred for the Acquirer's Interest in the Acquiree Is Less Than the Fair Value of That Interest (Bargain Purchases)

B168. Paragraphs 59–61 of this Statement provide the accounting requirements for business combinations in which the fair value of the consideration transferred (paid) by the acquirer is less than the fair value of that interest in the acquiree. This type of business combination is referred to as a *bargain purchase* in this Statement. The Board believes that bargain purchases are anomalous transactions—that is, business entities and their owners generally do not knowingly and willingly sell assets or businesses at prices below their fair values. However, bargain purchases have occurred and are likely to continue to occur. They include a forced liquidation or distress sale (for example, death of founder or

key manager) in which owners need to sell a business and are acting under compulsion to sell at less than fair value.[22]

B169. The Board decided that because a bargain purchase is unlike a business combination in which willing parties exchange assets (net assets) of equal values, the presumption in paragraph 20 of this Statement would not apply to those transactions. That is, the Board agreed that this Statement's presumption that the amount paid by the acquirer is the best evidence of the acquisition-date fair value of the acquirer's interest and its related measurement guidance are not appropriate for circumstances in which the seller (transferor) of the business is known to be acting under compulsion. The Board concluded, however, that the objectives and other fundamental principles underlying this Statement are relevant and apply to a bargain purchase.

B170. The Board also observed that unlike a typical acquisition of an acquiree, an economic gain is inherent in a bargain purchase. That is, at the acquisition date, the acquirer is better off by the amount by which the fair value of the acquiree exceeds the fair value of the consideration transferred (paid). The Board believes that, in concept, that gain should be recognized by the acquirer at the acquisition date but (as discussed in paragraphs B171–B182) decided to place limits on the recognition of gains on a bargain purchase. Board members acknowledged that although the reasons for a forced liquidation or distress sale often are apparent, sometimes clear evidence might not exist; for example, if a seller uses a closed (private) process for the sale and to maintain its negotiating position is unwilling to reveal the main reason for the sale. Board members also agreed that because those transactions are expected to be rare, the *appearance* of a bargain purchase without evidence of the underlying reasons would raise concerns in practice about the existence of measurement errors.

B171. Constituents have expressed concerns about recognizing gains upon the acquisition of a business, particularly when it is difficult to determine whether a particular acquisition is in fact a bargain purchase. They also suggested that an initial determination of an excess of the fair value of the acquirer's interest in the acquiree over the fair value of the consideration transferred (paid) by the acquirer for that interest might arise from other factors, including:

a. Errors in measuring the fair values of the (1) acquirer's interest in the business, (2) assets acquired, or (3) liabilities assumed
b. Using measures under GAAP that are not fair value measurements.

[22]Like a bargain purchase, a donation of a business is another example of a business combination in which an acquirer obtains an acquiree that has a fair value that exceeds any consideration transferred by the acquirer. However, in those cases the acquirer commonly is a charitable or other not-for-profit organization. Accounting for business combinations among not-for-profit organizations is excluded from the scope of this Statement.

Distinguishing a bargain purchase from measurement errors

B172. Board members also acknowledged concerns raised by constituents that a requirement to recognize gains on a bargain purchase might provide an opportunity for inappropriate gain recognition from intentional errors resulting from:

a. Overstating the value attributed to its interest in the acquiree
b. Understating or failing to identify the value of items of consideration that it transferred
c. Overstating values attributed to particular assets acquired
d. Understating or failing to identify and recognize particular liabilities assumed.

B173. Board members believe that problems surrounding intentional measurement errors generally are best addressed by other means, such as strong internal control systems and the use of independent valuation experts and external auditors, rather than by setting standards that lack *neutrality*.[23] However, Board members share concerns about the potential for inappropriate gain recognition resulting from measurement bias or undetected measurement errors. Thus, the Board decided, as specified in paragraph 60, to require that:

> If the fair value of the acquirer's interest in the acquiree initially is determined to exceed the fair value of the consideration transferred for that interest, the acquirer shall assess whether it has correctly identified all assets acquired and liabilities assumed and shall review the procedures used to measure and remeasure, if necessary, all of the following:
>
> a. The acquisition-date fair value of the acquiree
> b. The acquisition-date fair value of the acquirer's interest in the acquiree
> c. The acquisition-date fair value of the consideration transferred
> d. The acquisition-date values of the identifiable assets acquired and liabilities assumed recognized in accordance with the requirements of this Statement.

The objective of that review is to ensure that appropriate consideration has been given to all available information in identifying the items to be measured and recognized and in

[23]Paragraphs 98–110 of Concepts Statement 2 discuss the relationship of neutrality to intentional bias introduced to attain a predetermined result or induce a particular mode of behavior. Paragraphs 77 and 78 of Concepts Statement 2 discuss the effects of both intentional and unintentional biases in accounting measures.

determining their fair values. That includes determining the appropriate *unit of account* and *valuation premise* for their measurement.[24] The Board believes that such remeasurement checks will mitigate if not eliminate undetected errors that might have existed in the initial measurements.

B174. The Board acknowledged, however, that those remeasurement checks may be insufficient for purposes of eliminating its concern about unintentional measurement bias or addressing constituents' concerns about abuse that stem from the opportunity for gain recognition. The Board decided to address its concern by limiting the extent of gain that can be recognized. Thus, paragraph 61 of this Statement provides that:

> If, after performing any remeasurements required by paragraph 60, the fair value of the acquirer's interest in the acquiree still exceeds the fair value of the consideration transferred for that interest, the acquirer shall account for that excess by reducing the amount of goodwill that otherwise would be recognized in accordance with paragraph 49. If the goodwill related to that business combination is reduced to zero, any remaining excess shall be recognized as a gain attributable to the acquirer on the acquisition date.

In addition, paragraph 72(i) requires that an acquirer disclose:

> . . . the amount of any gain recognized in accordance with paragraph 61, the line item in the income statement in which the gain is recognized, and a description of the reasons why the acquirer was able to achieve a gain.

B175. The primary objective of that limitation on gain recognition is to mitigate the potential for inappropriate gain recognition through measurement errors, particularly those that might result from unintended measurement bias. However, the disclosure requirement is to provide information that enables users of an acquirer's financial statements to evaluate the nature and financial effect of business combinations that occur during the period. Board members have been told by professional analysts and others that separately disclosing information about revenues, expenses, gains, and losses resulting from atypical events and circumstances, such as gains on a bargain purchase transaction, is particularly important in analyzing an entity's performance and developing trend

---

[24]As discussed in Proposed Statement, *Fair Value Measurements,* the *unit of account* defines the boundaries of what is being measured by reference to the level at which an asset or liability is aggregated (or disaggregated), that is, whether individually (for example, a single loan) or as part of a larger group (for example, a portfolio of loans). A *valuation premise* specifies the condition and location of many assets, including whether assets are installed or integrated with other assets (that is, configured for use by an entity). It provides additional information about the asset being measured and the assumptions that marketplace participants would use in their estimates of fair value. A going-concern or in-use valuation premise presumes that marketplace participants would continue to use (a) a business that is a going concern or (b) an asset that is configured for use by an entity. In those situations, a going-concern or in-use valuation premise is generally appropriate. Otherwise, an in-exchange valuation premise may be appropriate. An in-exchange valuation premise presumes that an asset is not configured for use by an entity and that marketplace participants would sell the asset.

information for purposes of assessing an entity's prospects for generating future earnings and cash flows. Board members acknowledged, however, that the limitation and disclosure requirements also may help mitigate constituents' concerns about potential abuse, although that is not their primary objective.

B176. Moreover, Board members believe that concerns about abuse resulting from the opportunity for gain recognition may be overstated. First, they noted that financial analysts and other users have often told the Board that they give little "weight" to one-time or unusual gains, such as those resulting from a bargain purchase transaction. Second, they noted that managers of entities generally have no incentive to overstate assets acquired or understate liabilities assumed in a business combination because that generally would result in higher postcombination expenses—when the assets are used or become impaired or liabilities are remeasured or settled.

B177. Some Board members expressed concern that placing a limit on gain recognition is not consistent with this Statement's fair value measurement principles and could lead to misrepresentations for bargain purchases that are free of measurement errors. Those Board members would prefer to allow for gain recognition without this Statement's limitation in those cases in which there is persuasive evidence (such as duress on a seller) that the transaction is, in fact, a bargain purchase. They acknowledge, however, that to apply this "persuasive evidence" distinction could lead to other difficulties in practice. On balance, the Board concluded that this Statement's limit on gain recognition is a practical way to address the problems and concerns raised about measurement errors.

Distinguishing a bargain purchase from a "negative goodwill result"

B178. The Board also acknowledged that a so-called negative goodwill result remains a remote possibility because, as discussed in paragraphs B143–B155, this Statement continues to require that particular assets acquired and liabilities assumed be measured at other than their acquisition-date fair value. The Board observed, however, that provisions of this Statement address most deficiencies in past GAAP that previously led to negative goodwill results—that is, a result that had the appearance but not the economic substance of a bargain purchase. For example, as discussed in paragraphs B122–B134, prior to this Statement, at the acquisition date a liability for a contingent loss of an acquiree may not have been recognized at all or may have been recognized at a minimum amount rather than at its fair value. The omission of such liabilities would result in an overstatement of the identifiable *net assets* acquired and, thus, an equivalent understatement of the residual calculation of goodwill. If the omitted liability exceeded the actual goodwill in the acquiree, that would result in a calculated negative goodwill. Similarly, a liability for contingent payment arrangements (for example, earnouts) often was not recognized at the acquisition date, which, in some cases, could lead to understating the consideration paid and creating the appearance of a bargain purchase. This Statement solves those problems by requiring the measurement and recognition of substantially all liabilities at their fair values on the acquisition date.

B179. Other changes made by this Statement also may reduce the instances of negative goodwill. Among them is the Board's decision, as discussed in paragraphs B146–B150,

to account for a change in the acquirer's valuation allowance for its deferred tax asset as a separate event rather than as part of the business combination accounting. Previously, in accordance with Statement 109 that change in the valuation allowance was included in the business combination accounting and that inclusion had the effect of reducing the amount of goodwill recognized. Another is the Board's decision to eliminate the immediate write-off to expense in-process research and development (IPR&D) assets acquired in a business combination. Some constituents believe that, in the past, the opportunity to immediately expense that asset led to overstatements of its measurement to achieve an equivalent understatement of goodwill as a means to avoid future expenses for goodwill impairments. Thus, Board members believe that this Statement's improvements in GAAP also help to mitigate the concerns raised about measurement errors that have, in the past, led to negative goodwill results.

B180. Lastly, the Board also considered concerns raised by some constituents that a buyer's expectations of future losses and its need to incur future costs to make a business viable might give rise to a negative goodwill result. That is, a buyer would only be willing to pay a seller an amount that is, in that view, *less than fair value* of the acquiree (or its identifiable net assets) because to make a fair return on the business the buyer would need to make further investments in that business to bring its condition to fair value. The Board disagreed with that view for the reasons noted in paragraphs B168–B179, as well as those that follow.

B181. The Board noted that the objective of a fair value measurement is to estimate an exchange price for the item being measured in its condition at the measurement date. The Board observed that a possible cause of a negative goodwill result that might remain after rechecking the procedures used in applying this Statement's provisions is a failure to correctly reflect the fair value of the acquiree's identifiable assets or liabilities in their current location and condition and their current level of performance. The Board also concurred with the conclusion reached by the IASB in paragraph BC149 of IFRS 3, that "although expectations of future losses and expenses have the effect of depressing the price that an acquirer is prepared to pay for the acquiree, the net fair value of the acquiree's identifiable assets or liabilities will be similarly affected." For example, if the price of a business is depressed because its manufacturing facilities and equipment are poorly configured and generating insufficient cash flows, the in-use fair value of those assets would be similarly depressed. That is, their fair value would reflect expectations of future losses and expenses based on their current in-use condition.

B182. Moreover, the Board noted that a fair value estimate is determined by reference to willing marketplace participants representing unrelated *buyers and sellers* that are knowledgeable and have a common level of understanding about factors relevant to the business and the transaction, and that also are willing and able to transact in the same market(s) and have the legal and financial ability to do so. In the absence of duress, the Board is not aware of any compelling reason to believe a seller of a business would willingly and knowingly sell a business for an amount less than its fair value. Thus, the Board concluded that careful application of this Statement's fair value measurement requirements in practice will mitigate concerns that a negative goodwill might result and might be misinterpreted as a bargain purchase transaction.

Business Combinations in Which the Consideration Transferred for the Acquirer's Interest in the Acquiree Is More Than the Fair Value of That Interest (Overpayments)

B183. The Board considered whether this Statement should include provisions to account for a business combination in which a buyer pays an amount that is in more than the fair value of its interest in the acquiree. The Board acknowledged that that circumstance is possible and, in concept, an overpayment should lead to recognition of an expense by the acquirer. However, the Board believes that in practice that circumstance, if it occurs, will not be detectable or known at the acquisition date. That is, the Board is not aware of instances in which a buyer knowingly overpays a seller to acquire a business or is otherwise compelled to make such an overpayment. Rather, the Board believes that an acquirer's overpayment, although rare, occurs unknowingly; generally as a result of misinformation at the acquisition date. Thus, the Board concluded that in practice it is not possible to identify and reliably measure an overpayment at the acquisition date. The Board concluded that the accounting for overpayments is best addressed through subsequent impairment testing when evidence of a potential overpayment first arises.

Disclosures

B184. This Statement carries forward those disclosure requirements from Statement 141 that remain relevant, eliminates those that do not, and modifies those that are affected by changes in the measurement or recognition provisions of Statement 141(R). Paragraphs B195–B213 of Statement 141 discussed the Board's considerations and decisions that led to the disclosures required by that Statement. (Because the Board is not redeliberating or seeking comments on those conclusions, this Statement does not repeat those sections of Statement 141.)

B185. Like the IASB, the Board decided that this Statement's disclosure requirements should include overall objectives for the disclosure of information that would be useful to investors, creditors, and others in evaluating the financial effects of a business combination. Those objectives are that the acquirer disclose information that enables users of its financial statements to evaluate:

a. The nature and financial effect of business combinations that occur (1) during the reporting period and (2) after the balance sheet date but before the financial statements are issued (paragraph 71)
b. The financial effects of adjustments to the amounts recognized in a business combination that occurs in the current reporting period or in previous reporting periods (paragraph 75)
c. Changes in the carrying amount of goodwill during the reporting period (paragraph 77).

In addition, the Board believes that it is not necessary (or possible) to identify in this Statement all of the specific information that may be necessary to meet those objectives for all business combinations. Rather, the Board concluded that this Statement should specify particular disclosures that generally are required to meet those objectives and specify that acquirers should disclose any additional information about the circumstances

surrounding their particular business combination that they believe is necessary to meet those objectives (paragraph 81).

B186. The Board also decided to organize within each of those objectives the specific Statement 141 disclosure requirements that this Statement carries forward or modifies and those developed during the Board's deliberations leading to this Statement. Changes to the Statement 141 requirements include the elimination of those disclosures that required amounts or information that was based on applying the Statement 141 cost-allocation (purchase price) method for assigning amounts to assets and liabilities that is replaced by this Statement's fair value measurement principle. Some of those disclosures are modified to retain the information but conform the amounts to be disclosed with this Statement's fair value measurement principle. The following are among the disclosure requirements that the Board decided to add, eliminate, or modify in developing this Statement, including references to related discussions in other parts of this basis for conclusions.

a. Added for public business entities disclosure of the revenue and net income of the acquiree, if practicable, for a minimum of the period from the acquisition date through the end of the current year. This disclosure would be required for the current year, the current interim period, and cumulative interim periods from the acquisition date through the end of the current year (paragraphs B187–B191).
b. Eliminated the disclosure of the period for which the results of operations of the acquiree are included in the income statement of the combined entity, which is replaced by disclosure of the acquisition date. This Statement no longer permits the alternative practice of reporting revenues and expenses of the acquiree as if the acquisition occurred as of the beginning of the year (or a designated date) with a reduction to eliminate the acquiree's preacquisition period earnings (paragraphs B54 and B55).
c. Added a required reconciliation of beginning and ending balances of contingencies for liabilities assumed and liabilities for contingent consideration arrangements and disclosure of the maximum potential amount of future payments for contingent consideration. The reconciliation would show changes in fair value estimates recorded in income, payments, and other changes or settlements (paragraphs B74–B86).
d. Added disclosure of the amount of acquisition-related costs, the amount expensed and the income statement line item in which that expense is reported (paragraph B93–B99).
e. Replaced the disclosure of *extraordinary gains* recognized for so-called "negative goodwill" in accordance with paragraph 45 of Statement 141 with this Statement's required disclosure of the amount of any gain recognized in the period for a *bargain purchase,* the line item in the income statement in which it is recognized, and a description of the reasons why the acquirer was able to achieve a gain (paragraphs B168–B182).
f. Eliminated the requirement to disclose the amount of in-process research and development acquired and had been measured and immediately written off to expense in accordance with Statement 141. This Statement no longer permits that past practice (paragraph B142).

Disclosure of Information about Postcombination Revenue and Net Income of Acquiree

B187. Paragraph 74(a) of this Statement requires that a public business enterprise disclose, for each material business combination (or for individually immaterial business combinations that are material collectively), the amounts of revenue and net income of the acquiree since the acquisition date included in the consolidated income statement for the period. At its August 2003 roundtable discussion meeting with users of financial statements, the Board discussed the potential usefulness of information about postcombination revenues and net income of an acquired business or businesses from other (organic) revenues of the acquirer. The Board also asked whether that information would be preferable to the existing pro forma supplemental disclosure that Statement 141 had carried forward from Opinion 16—that is, revenue and results of operations of the combined entity for the current period *as though* the acquisition date for all business combinations that occurred during the year had been as of the beginning of the annual reporting period (paragraph 74(b)(1)).

B188. The Board also questioned whether those disclosures are directed at similar objectives and, if so, whether one may be preferable. The Board observed that making postcombination distinctions might be too costly or impossible if the operations of the acquiree are integrated with those of the acquirer. Although users acknowledged that point, they indicated that information about actual postcombination revenues and net income is preferable to the pro forma disclosures and should be required whenever possible. Some also said that distinguishing acquired revenues from organic revenues is most important and suggested the acquirers be required to provide that information for a 12-month period following an acquisition rather than only through the end of the annual period.

B189. The Board agreed with users that the information about postcombination revenues and net income of the acquiree is useful. However, for practical reasons, the Board concluded that this Statement should provide an exception to that requirement (paragraph 74) if distinguishing the postcombination results of the operations of the acquiree from those of the combined entity is impracticable. The Board also decided that in those circumstances the acquirer should disclose the fact and the reasons why it is impracticable to provide the postcombination information. The Board also decided to limit the period for that disclosure to the end of the current annual period. The Board believes that the information needed to provide this disclosure during that period generally will be available because often a short period of time is required to fully integrate an acquiree's operations with those of the acquirer. The Board also observed that the usefulness of the separate information diminishes as the operations of the acquiree are integrated with the combined entity.

B190. Some Board members suggested that this disclosure of postcombination revenues and net income of an acquiree be expanded to all entities because the information would be valuable to any investor, not merely investors in public business entities. It was noted that that also would converge with the proposed requirements of the IASB. Other Board members expressed concern about imposing the additional costs on nonpublic entities because they believe the benefits to users of those entities would not be sufficient to

warrant imposing those costs. They also observed that the IASB has not completed its separate deliberations on its small- and medium-sized entities project and, thus, do not have an established practice of differential disclosure for those circumstances in which it is clear that the benefits would be sufficient for some entities but not so clear for all entities. Because of those cost-benefit concerns, the Board decided not to expand this disclosure requirement to all entities.

B191. Users expressed mixed views about the continued need for the pro forma disclosure. Some suggested that it provides some useful information in predicting trends, and others suggested it is of little or less value to them in predicting future growth. However, users also said that the Board should retain the pro forma disclosures, particularly for circumstances in which the postcombination disclosure is impracticable. The Board concluded, consistent with the reasons noted in paragraph B199 of Statement 141, that the pro forma disclosure requirements should be retained.[25]

Effective Date and Transition

B192. The Board decided that the provisions of this Statement should apply prospectively and that its effectiveness should coincide with the adoption of the proposed Statement on consolidated financial statements. Prospective application of this Statement is consistent with Statement 141. The Board acknowledges that, like Statement 141, this Statement could have been made effective upon its issuance, or shortly after. However, the Board's preference is that this Statement be adopted at the same time as the proposed Statement on consolidated financial statements and that that proposed Statement become effective as of the beginning of an annual period. The Board believes that particular provisions in that proposed Statement, which address the subsequent accounting for an acquiree in consolidated financial statements, are related to provisions in this Statement that address the initial accounting for an acquiree at the acquisition date. The Board believes that linking the timing of the changes in accounting required by these Statements will minimize disruptions to practice. As a result, both preparers and users of financial statements should benefit from such linkage.

B193. At the time the Exposure Drafts for this Statement and the proposed Statement on consolidated financial statements were issued, the Board estimated that those Statements would become effective no later than for annual periods beginning on or after December 15, 2006. The Board believes that a period of approximately three-six months following issuance is desirable. That period should provide sufficient time for entities and their

---

[25]Paragraph B199 of Statement 141 noted that during the deliberations leading to Statement 141:

> Respondents also expressed mixed views about the proposal to eliminate the pro forma sales and earnings disclosures required by Opinion 16. Many of the respondents supported elimination of those disclosure requirements. Those respondents said that the information provided has little value because it is based on hypothetical assumptions and mechanical computations. Respondents that favored retaining those disclosures said that the pro forma information is useful for measuring growth and in assessing whether the synergies expected to result from the combination have been achieved. After considering respondents' views, the Board concluded that the pro forma disclosure requirements in Opinion 16 should be retained in this Statement.

auditors to analyze, interpret, and prepare for implementation of the provisions of these Statements. It also allows time for coordinating the effective dates with the standards being issued by the IASB and accommodates the IASB's desire to allow sufficient time for countries to enact enabling legislation. The Board also decided to encourage early application of both Statements, as long as the provisions of both are applied at the same time. The Board saw no reason to delay or preclude the application of this Statement's improvements for any significant length of time for entities that want to apply the provisions of both Statements before their effective date.

Effective Date and Transition for Combinations Involving Only Mutual Entities

B194. Paragraph 60 of Statement 141 indicated that the provisions of that Statement are not effective for combinations involving only mutual entities until the Board issues interpretative guidance for the application of the purchase method to those transactions. This Statement provides that interpretative guidance. Thus, in the absence of any special effective date provisions provided by this Statement, the delayed application for combinations between mutual entities would end upon the issuance of this Statement. The Board observed that taken literally that could result in mutual entities making a two-step transition—transitioning to Statement 141 when the guidance in this Statement is issued and then transitioning to the provisions of this Statement when it becomes effective.

B195. The Board decided that it should take steps in this Statement to avoid the complexities and difficulties that a two-step transition might impose on both issuers of financial statements and the users of those financial statements. The Board concluded that it would be best to effect the Statement 141 change that precludes the use of the pooling method at the same time that this Statement's changes to the procedures for applying the acquisition method become effective. Therefore, the effective date for combinations between mutual entities is the same as the effective date for all other entities applying this Statement.

B196. The Board also decided that this Statement should carry forward the transition provisions of Statement 141 that are relevant for entities adopting the change in accounting from the pooling method to the purchase method. Therefore, the transition provisions that applied to entities that adopted Statement 141 will now also apply to combinations between mutual entities upon the effective date of this Statement. Those provisions are provided in paragraphs C9–C24 of this Statement.

Benefits and Costs

B197. The mission of the FASB is to establish and improve standards of financial accounting and reporting for the guidance and education of the public, including preparers, auditors, and users of financial information. In fulfilling that mission, the Board strives to determine that a proposed standard will fill a significant need and that the costs imposed to apply that standard, as compared with other alternatives, are justified in relation to the overall benefits of the resulting information. Although the costs to implement a new standard may not be borne evenly, investors and creditors—both present and potential—as well as others benefit from improvements to financial reporting. Those

improvements then facilitate the functioning of markets for capital and credit and the efficient allocation of resources in the economy.

B198. The Board believes that the requirements of this Statement will result in improved financial reporting in several ways. Foremost, by focusing on fundamental principles for recognizing and measuring all business combinations, this Statement will assist the Board in establishing principles-based standards that simplify GAAP whenever possible while improving the comparability and understanding of the resulting information. This Statement furthers that effort by requiring that all acquirers recognize the businesses they acquire at fair value. It also requires, with limited exceptions, that the assets acquired and liabilities assumed as part of the business combination be recognized and measured at their fair values, regardless of the ownership percentage acquired or the means used to acquire the business.

B199. The Board believes that this Statement improves the completeness, relevance, and comparability of information provided to investors, creditors, and other users of financial statements by requiring more assets and liabilities to be separately recognized and initially measured at fair value. For example, in accordance with this Statement, (a) contingencies that meet the definitions of assets or liabilities but not the previous criteria for recognition would be separately recognized at fair value rather than subsumed in goodwill, (b) research and development assets acquired in a business combination would be measured and recognized at their fair value rather than expensed at the acquisition date as previously required, and (c) assets and liabilities of acquired businesses that are not wholly owned generally would be recognized at the full amount of their fair values rather than measured in part at fair value, based on the percentage of ownership interest acquired in the business combination, and in part based on another basis.

B200. The Board also believes this Statement benefits issuers of financial statements and users of their financial statements by converging to a common set of high-quality financial accounting standards on an international basis. That improves the comparability of financial information around the world and simplifies and reduces the costs of accounting for entities that issue financial statements in accordance with both U.S. GAAP and international accounting standards.

B201. The Board believes that the guidance in this Statement is not overly complex. Indeed, it eliminates guidance that many have found to be complex, costly, and arbitrary and that has been the source of considerable uncertainties and costs in the marketplace. Moreover, this Statement does not introduce a new method of accounting but rather expands the use of the acquisition method of accounting that is familiar, has been widely used, and for which there is a substantial base of experience.

B202. This Statement also improves the comparability and usefulness of information provided by mutual entities by eliminating the permitted use of the pooling method by those entities in their accounting for acquisitions of other mutual entities. Statement 141 had allowed a delayed effective date for applying its provisions to business combinations between mutual entities. As discussed in Statement 141, the use of two methods that produce such dramatically different financial statement outcomes makes it difficult or

impossible for users to compare the financial statements of entities that have accounted for their business combinations by different methods.

B203. The Board sought to reduce the costs of applying this Statement. The Board believes that this Statement does that by (a) requiring that particular assets and liabilities (for example, those related to deferred taxes, pensions, and other postemployment benefits) continue to be measured in accordance with existing accounting standards rather than at fair value and (b) applying its provisions prospectively rather than retrospectively. The Board acknowledges that those two steps may result in some sacrifice to the benefits of improved financial reporting in accordance with this Statement. However, the Board believes that the complexities and related costs that result from imposing the fair value measurement requirement to all assets and liabilities, at this time, and requiring retrospective application are not justified.

Alternative View

B204. One Board member, for the reasons discussed in paragraphs B205–B212, has alternative views on the following proposals:

a. The requirements (1) to measure and recognize the fair value of nonfinancial contingent consideration obligations incurred in a business combination and contingencies acquired or assumed in a business combination at the acquisition date and (2) to subsequently remeasure to fair value nonfinancial contingent consideration liabilities and particular contingencies
b. The disclosure requirements that permit remeasurement gains and losses to be reported in notes to financial statements rather than requiring their separate display on the face of the income statement
c. The required use of the acquisition method for particular combinations involving mutual entities.

Required Use of Fair Value to Measure and Remeasure Particular Items

B205. This Statement proposes to replace the guidance contained in paragraph 37 of Statement 141 relating to assigning acquisition date amounts to specific types of assets acquired and liabilities assumed in a business combination. This Statement instead proposes a general requirement (subject to a few limited exceptions) to measure acquired assets and liabilities assumed at their fair values at the acquisition date. Among the items that initially would be measured and recognized at fair value at the acquisition date are (a) contingent consideration obligations and (b) assets and liabilities arising from contingencies. As proposed in this Statement, contingencies and contingent consideration liabilities that would be subject to Statement 5 if they were acquired, assumed, or incurred in an event other than a business combination would continue to be measured at fair value after the acquisition date with any changes in fair value recognized in income of the period.

B206. Fair value is defined as the price at which an item could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation. In the

absence of observable market transactions or market-based measures, fair value must be estimated based on the "hypothetical" exchange price that would occur between "hypothetical" marketplace participants using an expected present value technique as discussed in FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*. In the case of nonfinancial contingent consideration liabilities and liabilities for contingencies, such measures of fair value are supposed to include the profit element that a hypothetical third party would demand to assume the reporting entity's obligation. Because such liabilities are not normally settled, nor often even capable of being settled by "lay-off" to a third party, accounting gains and losses automatically result as the reporting entity actually settles the liability through its own performance. Examples of such measures of fair value are contained in the Appendix C of Statement 143.

B207. The Board member questions both the relevance and the reliability of such fair value measures and of the accounting gains and losses that would result from their use. In his view, because such measures necessarily involve estimates that are not based on actual or potential exchange transactions or on market inputs, they would be difficult to verify and audit. Moreover, because they do not represent either what the reporting entity will do or even what it may be able to do, the Board member views such measures as artificial constructs that lack representational faithfulness with actual economic phenomena. As such, they would seem to be of questionable relevance to users of financial statements in assisting them in predicting the future cash flows of the reporting entity.

B208. He also observes that many of the eight entities that participated in the field visits (paragraphs B12 and B17) expressed significant concerns related to measuring and auditing the fair value of assets and liabilities for an acquiree's contingencies and an acquirer's contingent consideration arrangements. Additionally, the proposal that contingent consideration can be measured and remeasured with sufficient reliability seems to contradict the Board's decision in Statement 123(R) regarding the treatment of performance conditions in measuring the fair value of share-based payments. Further, he notes that the subject of the appropriate measurement attribute(s) in financial reporting will be an important area of focus in the Board's project to improve its conceptual framework, and the Board's proposals in this project seem to prejudge the outcome of those discussions. In that regard, the Board has yet to agree on the appropriate measurement of performance obligations relating to revenue transactions in its current project on revenue recognition, or in his view, to fully address the measurement of fair value of nonfinancial liabilities in its project on fair value measurement.

B209. Accordingly, the Board member believes that contingent consideration liabilities incurred in business combinations should continue to be recorded as they are under Statement 141 "at present values of amounts to the paid discounted at appropriate interest rates" and that the treatment of preacquisition contingencies (see paragraphs 40 and 41 of Statement 141) should be retained. However, he prefers a modification to the accounting for contingent consideration in cases in which a preparer concludes that it cannot determine the fair value with sufficient reliability. In those circumstances, the Board member would prefer a treatment under which any contingent consideration payable by the acquirer be charged as a postcombination expense as such amounts become

determinable over the current practice of recording such amounts as additional purchase consideration and goodwill. In this Board member's view, contingent consideration arrangements generally represent a postacquisition profit-sharing arrangement with the prior owners of the acquiree rather than conditional payments related to the value at the acquisition date of the acquiree.

Separate Display of Remeasurement Gains and Losses

B210. In addition to the remeasurement gains and losses noted above relating to an acquiree's contingencies and an acquirer's contingent consideration arrangements, this Statement also would result in a number of other potential remeasurement gains and losses that would be reported in net income. These include gains and losses on nonmonetary assets transferred by the acquirer as part of the consideration, gains and losses on remeasuring any existing noncontrolling equity investment of the acquirer in the acquiree, and in some cases, any "negative goodwill" measured in the business combination. Additionally, in accordance with the Board's tentative decisions for its proposed Statement on consolidated financial statements, gains and losses would arise from remeasuring at fair value any retained noncontrolling equity investment arising at the time of loss of control of a subsidiary. Thus, when compared with current practice, these proposed requirements would create various new types of gains and losses in the income statement relating to remeasurements at fair value, thereby potentially further adding to the challenges of effective communication in financial statements already posed by the mixed attribute model. While the Board's tentative decisions would require disclosure of these gains and losses, it would not require any specific display or highlighting of them on the face of the income statement.

B211. The Board member is concerned that the failure to require a separate display of such gains and losses on the face of the income statement may complicate and hinder, rather than help, financial analysis. In his view, professional users of financial statements have repeatedly informed the Board that they attempt to separate such items from other components of net income in performing their analyses and for valuation purposes. Furthermore, examining potential display alternatives along these lines is an important aspect of the Board's current project on reporting on financial performance. Accordingly, and in the meantime, in order to enhance the transparency and understandability of the income statement, the Board member believes that it is important that any new standard that introduces potentially significant new fair value measurements that affect net income also require separate display of the resulting gains and losses on the face of the income statement and not just in disclosures in the footnotes. This might be accomplished, for example, by requiring that the aggregate gain or loss for the period resulting from such remeasurements be displayed separately on the face of the income statement, with disclosure in the footnotes of the components of that aggregate gain or loss.

Use of the Acquisition Method for Particular Combinations Involving Mutual Entities

B212. The Board member has significant concerns over the use of the acquisition method for particular combinations involving mutual entities. In some of these transactions (including one included in the Board's field visits relating to this Statement), no

consideration is exchanged, the combining entities are of similar size, and the governing board and management of the combined entity are drawn equally from each of the combining entities. In such cases the Board member believes that properly identifying an acquirer is an essentially futile exercise that results in arbitrary revaluation of part of the combined entity and in an accounting treatment that is not representationally faithful of the underlying combination transaction. In his view, such combinations of mutual entities do not represent the acquisition of one entity by another, but rather the creation of a new entity. Accordingly, in such cases, the Board member believes that "fresh-start" accounting for the entire combined entity would be preferable to what he views as the essentially arbitrary, partial revaluation that would result from applying the provisions of this proposed Statement. This Board member therefore disagrees with the Board's decision not to reconsider the alternative of the fresh-start method and this Statement's tentative affirmation of the conclusion reached in Statement 141 that precludes the use of the fresh-start method in those circumstances (paragraphs B30 and B45–B47).

Appendix C

CONTINUING AUTHORITATIVE GUIDANCE

CONTENTS

Paragraphs

Introduction C1

Accounting for Asset Acquisitions—General Concepts C2–C8

Business Combinations Involving Only Mutual Entities That Were Accounted for by the Pooling-of-Interests Method C9–C12

Disposition of Assets after a Combination Accounted for Using the Pooling Method C11–C12

Transition Requirements for Mutual Entities That Previously Recognized Goodwill, Negative Goodwill, or Unidentified Intangible Assets C13–C24

Transition for Entities That Have Not Adopted Statement 141 .... C16

Transition for Entities That Have Not Adopted Statement 147 .... C17–C18

Reclassified Goodwill—Transitional Impairment Testing and Disclosure Requirements C19–C24

Transactions between Entities under Common Control C25–C31

Procedural Guidance C27–C31

Appendix C

CONTINUING AUTHORITATIVE GUIDANCE

Introduction

C1. This appendix provides continuing authoritative guidance for asset acquisitions, business combinations involving only mutual entities, and entities under common control. The guidance in this appendix has been quoted, paraphrased, or modified as necessary so that it can be understood in the context of this Statement. The original source of the guidance is noted parenthetically or otherwise. The Board may reconsider that guidance at a later date in another project.

Accounting for Asset Acquisitions—General Concepts

C2. As noted in paragraph 5 of this Statement, a transaction or event is accounted for as a business combination only if the assets acquired and liabilities assumed constitute a business (an acquiree). If the assets acquired and liabilities assumed do not constitute a business, the acquirer should account for the transaction as an asset acquisition, which is described in paragraphs C3–C8 or in accordance with other applicable generally accepted accounting principles.[26]

C3. (FAS 141, ¶4) *Initial recognition*. Assets are commonly acquired in exchange transactions that trigger the initial recognition of the assets acquired and any liabilities assumed. If the consideration given in exchange for the assets (or net assets) acquired is in the form of assets surrendered (such as cash), the assets surrendered are derecognized at the date of acquisition. If the consideration given is in the form of liabilities incurred or equity interests issued, the liabilities incurred and equity interests issued are initially recognized at the date of acquisition (Opinion 16, paragraph 67).

C4. (FAS 141, ¶5) *Initial measurement*. Like other exchange transactions, generally asset acquisitions are measured on the basis of the fair values exchanged. In exchange transactions, the fair values of the net assets acquired and the consideration paid are assumed to be equal, in the absence of evidence to the contrary. Thus, the *cost*[27] of an asset acquisition to the acquiring entity is equal to the fair values exchanged, and no gain or loss is recognized, except for the gain or loss that is recognized if the fair value of noncash assets given as consideration differs from the assets' carrying amounts on the acquiring entity's books. (Opinion 16, paragraph 67).

C5. (FAS 141, ¶6) Asset acquisitions in which the consideration given is cash are measured by the amount of cash paid, which generally includes the transaction costs of the

---

[26]Paragraph D29(b) of this Statement amends FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities,* to require that the primary beneficiary of a variable interest entity that does not constitute a business initially measure and recognize the assets (except goodwill) and liabilities of the variable interest entity in accordance with paragraphs 28–48 of this Statement.
[27]*Cost* is a term that is often used to refer to the amount at which an entity initially recognizes an asset at the date it is acquired, whatever the manner of acquisition.

asset acquisition. However, if the consideration given is not in the form of cash (that is, in the form of noncash assets, liabilities incurred, or equity interests issued), measurement is based on the fair value of the consideration given, which also generally includes the transaction costs of the asset acquisition, or the fair value of the assets (or net assets) acquired, whichever is more clearly evident and, thus, more reliably measurable (Opinion 16, paragraph 67).

C6. (FAS 141, ¶7, FAS 142, ¶9) *Allocating cost*. Acquiring assets in groups requires not only ascertaining the cost of the asset (or net asset) group but also allocating that cost to the individual assets (or individual assets and liabilities) that make up the group. The cost of such a group is determined using the concepts described in paragraphs C4 and C5. The cost of a group of assets acquired in an asset acquisition is allocated to the individual assets acquired or liabilities assumed based on their relative fair values and does not give rise to goodwill (Opinion 16, paragraph 68).

C7. Additionally, the accounting for an asset acquisition differs from the accounting for business combinations in the following respects:

a. Intangible assets acquired in an asset acquisition are recognized in accordance with FASB Statement No. 142, *Goodwill and Other Intangible Assets,* not in accordance with this Statement.
b. In-process research and development assets acquired in an asset acquisition are accounted for in accordance with FASB Statement No. 2, *Accounting for Research and Development Costs,* as amended by this Statement, not in accordance with Statement 142.
c. Contingent consideration related to an asset acquisition and contingencies acquired in an asset acquisition are accounted for in accordance with FASB Statement No. 5, *Accounting for Contingencies,* not in accordance with this Statement.

C8. (FAS 141, ¶8) *Accounting after acquisition*. The nature of an asset or liability and not the manner of its acquisition determines an acquirer's subsequent accounting for the asset or liability. The basis for measuring the asset acquired or liabilities assumed—whether the cost, the fair value of an asset received or given up, the fair value of a liability incurred, or the fair value of equity shares issued—has no effect on the subsequent accounting for the asset or liability (Opinion 16, paragraph 69).

Business Combinations Involving Only Mutual Entities That Were Accounted for by the Pooling-of-Interests Method

C9. FASB Statement No. 141, *Business Combinations,* prohibited the use of the *pooling-of-interests method* (pooling method) for business combinations initiated after the effective date of that Statement (June 30, 2001). Statement 141 superseded APB Opinion No. 16, *Business Combinations,* and the AICPA Accounting Interpretations of that Opinion that provided guidance on applying the pooling method. Statement 141 defined the pooling method as:

A method of accounting for business combinations that was required to be used in certain circumstances by APB Opinion No. 16, *Business Combinations*. Under the pooling-of-interests method, the carrying amount of assets and liabilities recognized in the statements of financial position of each combining entity are carried forward to the statement of financial position of the combined entity. No other assets or liabilities are recognized as a result of the combination, and thus the excess of the purchase price over the book value of the net assets acquired (the purchase premium) is not recognized. The income statement of the combined entity for the year of the combination is presented as if the entities had been combined for the full year; all comparative financial statements are presented as if the entities had previously been combined. [paragraph F1]

C10. The effective date of Statement 141 was delayed for combinations between mutual entities. However, this Statement removes that delayed effective date. Thus, combinations between mutual entities are prohibited from being accounted for by the pooling method. That prohibition is to be applied prospectively as of the beginning of the annual period in which this Statement is first applied but no later than annual periods beginning on or after December 15, 2006. The following paragraphs carry forward, without reconsideration, guidance in Statement 141 (some of which was carried forward from Opinion 16 and its interpretations) that may be helpful in accounting for subsequent asset dispositions for business combinations to which the pooling method was applied.

Disposition of Assets after a Combination Accounted for Using the Pooling Method

C11. (FAS 141, ¶D9) Following a business combination accounted for by the pooling method, the combined entity might dispose of assets of the previously separate entities. Unless those disposals are part of customary business activities of the combined entity, any gain or loss recognized resulting from that disposition might be required to be recognized as an extraordinary item. Recognition as an extraordinary item is warranted because the pooling method of accounting would have been inappropriate if the combined entity had made a commitment or had planned to dispose of a significant part of the assets of one of the combining entities.

C12. (FAS 141, ¶D10) The combined entity should recognize the gain or loss resulting from the disposal of a significant part of the assets or a separable segment of the previously separate entities, less applicable income tax effect, as an extraordinary item if (a) the gain or loss is material in relation to the net income of the combined entity and (b) the disposition is within two years after the combination is consummated (Opinion 16, paragraph 60).

Transition Requirements for Mutual Entities That Previously Recognized Goodwill, Negative Goodwill, or Unidentified Intangible Assets

C13. Paragraphs 61 and 62 of Statement 141 provided transition provisions for business combinations for which the acquisition date was before July 1, 2001, that were accounted for using the purchase method requirements of Opinion 16. If a mutual entity had a

business combination that was accounted for using the purchase method and did not adopt Statement 141 when it became effective, that entity is required to apply those transition provisions at the time this Statement is applied (for example, a business combination between mutual entities that was accounted for using the purchase method requirements of Opinion 16).

C14. FASB Statement No. 147, *Acquisitions of Certain Financial Institutions,* applied to the acquisition of all or part of a financial institution, except for transactions between two or more mutual entities. The term *financial institution,* as used in Statement 147 and this Statement, includes all or part of a commercial bank, a savings and loan association, a credit union, or other depository institution having assets and liabilities of the same types as those institutions. Paragraphs 8–14 of Statement 147 provided transition provisions for previously recognized *unidentifiable intangible assets* that arose from an acquisition of all or part of a financial institution. An *unidentifiable intangible asset* was described in FASB Statement No. 72, *Accounting for Certain Acquisitions of Banking or Thrift Institutions,* as the amount by which the fair value of the liabilities assumed exceeds the fair value of tangible and identified intangible assets acquired. If a financial institution acquired a financial institution that resulted in an unidentifiable intangible asset and did not adopt Statement 147 when it became effective, that entity is required to apply those transition provisions at the time this Statement is applied (such as a transaction between two or more mutual entities that resulted in an unidentifiable intangible asset).

C15. Paragraphs C16–C24 explains how the transition provisions of Statements 141 and 147 would be applied to mutual entities.

Transition for Entities That Have Not Adopted Statement 141

C16. The following transition provisions apply to business combinations involving only mutual entities that have not adopted Statement 141. For those business combinations that occurred prior to the adoption of this Statement and were accounted for using the purchase method:

a. (FAS 141, ¶61(a)) The carrying amount of acquired intangible assets that do not meet the criteria in paragraph 40 of this Statement for recognition apart from goodwill (and any related deferred tax liabilities if the intangible asset amortization is not deductible for tax purposes) should be reclassified as goodwill as of the date FASB Statement No. 142, *Goodwill and Other Intangible Assets,* is initially applied in its entirety. Paragraph D22(n) of this Statement amends Statement 142 to make it effective for business combinations between two or more mutual entities. For those business combinations, Statement 142 is effective in its entirety for annual periods beginning on or after December 15, 2006, with early application encouraged.
b. (FAS 141, ¶61(b)) The carrying amount of any intangible assets that meets the recognition criteria in paragraph 40 of this Statement that have been recognized and included in the amount reported as goodwill (or as goodwill and intangible assets) should be reclassified and accounted for as an asset apart from goodwill as of the date Statement 142 is initially applied in its entirety. For example, when a business combination was initially recorded, a portion of the cost of the acquiree was

assigned to intangible assets that meet the recognition criteria in paragraph 40 of this Statement. Those intangible assets have been included in the amount reported on the statement of financial position as goodwill (or as goodwill and other intangible assets). However, separate general ledger or other accounting records have been maintained for those assets.

c. As of the earlier of the first day of the annual period beginning on or after December 15, 2006, or the date Statement 142 is initially applied in its entirety, the amount of any unamortized deferred credit related to an excess over cost arising from (a) a business combination accounted for prior to the adoption of this Statement or (b) an investment accounted for by the equity method prior to the adoption of this Statement should be written off and recognized in net income as the effect of a change in accounting principle. The effect of the accounting change and related income tax effects should be presented in the income statement between the captions *extraordinary items* and *net income*.

Transition for Entities That Have Not Adopted Statement 147

C17. The following transition provisions apply to mutual entities excluded from the scope of Statement 147 that acquired all or part of a financial institution before the adoption of this Statement and recognized an unidentifiable intangible asset related to that acquisition in accordance with paragraph 5 of Statement 72:

a. (FAS 147, ¶9) If the transaction that gives rise to the unidentifiable intangible asset is a business combination, the carrying amount of that asset should be reclassified to goodwill[28] (reclassified goodwill) as of the later of the date of acquisition or the date Statement 142 is applied in its entirety (Statement 142 application date). The reclassified goodwill should be accounted for and reported prospectively as goodwill in accordance with Statement 142. In addition, the reclassified goodwill should be tested for impairment in accordance with paragraph C19.

b. (FAS 147, ¶9) The carrying amounts of any recognized intangible assets that meet the recognition criteria in paragraph 40 that are included in the amount reported as an unidentifiable intangible asset and for which separate accounting records are maintained (as discussed in paragraph C16(b)) should be reclassified and accounted for as assets apart from the unidentifiable intangible asset and should not be reclassified to goodwill.

c. (FAS 147, ¶8) If the transaction that gives rise to the unidentifiable intangible asset is *not* a business combination, the carrying amount of that asset should continue to be amortized as was previously set forth in paragraphs 5 and 6 of Statement 72, as amended by Statement 142. (As discussed in paragraph 9 of Statement 142, acquisitions of groups of assets that are not a business do not give rise to goodwill.) Paragraphs 5 and 6 of Statement 72, as amended, stated:

> That asset shall be amortized to expense over a period no greater than the estimated remaining life of the long-term interest-bearing assets

[28]If the amortization of the unidentifiable intangible asset is not deductible for tax purposes, any deferred tax liabilities related to that asset also should be reclassified to goodwill.

> acquired. Amortization shall be at a constant rate when applied to the carrying amount of those interest-bearing assets that, based on their terms, are expected to be outstanding at the beginning of each subsequent period. The prepayment assumptions, if any, used to determine the fair value of the long-term interest-bearing assets acquired also shall be used in determining the amount of those assets expected to be outstanding. However, if the assets acquired in such a combination do not include a significant amount of long-term interest-bearing assets, the unidentifiable intangible asset shall be amortized over a period not exceeding the estimated average remaining life of the existing customer (deposit) base acquired. The periodic amounts of amortization shall be determined as of the acquisition date and shall not be subsequently adjusted except as provided by paragraph 6 of this Statement. Notwithstanding the other provisions of this paragraph, the period of amortization shall not exceed 40 years. [Footnote references omitted.]
>
> Paragraph 14 of Statement 142 specifies that an entity should evaluate the remaining useful life of an intangible asset that is being amortized each reporting period to determine whether events and circumstances warrant a revision to the remaining period of amortization. In no event, however, shall the useful life of the unidentifiable intangible asset described in paragraph 5 of this Statement be revised upward. [Footnote references omitted.]

C18. Other than as set forth in paragraphs C16 and C17, the amount of the purchase price assigned to the assets acquired and liabilities assumed in a business combination for which the acquisition date was before this Statement is applied should not be changed.[29]

Reclassified Goodwill—Transitional Impairment Testing and Disclosure Requirements

C19. The following transitional impairment testing provisions apply to reclassified goodwill that is recognized in accordance with paragraph C17(a). As described in paragraphs C20–C22, reclassified goodwill should be tested for impairment as of the date Statement 142 is adopted in its entirety.

C20. (FAS 147, ¶12) If an entity has no goodwill other than reclassified goodwill, the transitional impairment testing provisions in paragraphs 54–58 of Statement 142 should be completed for the reclassified goodwill by the end of the annual period in which the transition provisions of this Statement are applied.

C21. (FAS 147, ¶13) If an entity has other goodwill in addition to reclassified goodwill, and it has not completed the transitional impairment testing provisions in paragraphs 54–58 of Statement 142 as of the first day of the annual period beginning on or after

---

[29]This transition provision does not, however, affect the requirement to change the amounts assigned to the assets acquired in a business combination for which the acquisition date was before this Statement is applied due to (a) the resolution of a consideration contingency based on earnings (paragraph 28 of Statement 141) or (b) changes to the purchase price allocation prior to the end of the allocation period (paragraph 40 of Statement 141).

December 15, 2006, the reclassified goodwill should be combined with other goodwill in applying those transition provisions.

C22. (FAS 147, ¶14) If an entity has other goodwill in addition to reclassified goodwill, and it has completed the transitional impairment testing provisions in paragraphs 54–58 of Statement 142 as of the first day of the annual period beginning on or after December 15, 2006, the following transition provisions should be applied for each reporting unit that includes reclassified goodwill:

a. If the fair value of the reporting unit exceeds its carrying amount (including the unidentifiable intangible asset) at the Statement 142 application date (that is, the first step of the transitional goodwill impairment test indicated no impairment), additional impairment testing related to the reclassified goodwill is not required.
b. If the first step of the transitional goodwill impairment test indicates a potential impairment of goodwill at the Statement 142 application date, the amount of the goodwill impairment loss (if any) should be remeasured based on the revised carrying amount of goodwill. The fair value of the reporting unit and related assets and liabilities used in calculating the implied fair value of goodwill should not be remeasured for purposes of applying this transition provision. The revised carrying amount of goodwill used in remeasuring the loss equals the amount of previously recognized goodwill and the amount of any unidentifiable intangible asset reclassified as goodwill in accordance with the transition provisions of this Statement. Any adjustment to the impairment loss should be recognized as the effect of a change in accounting principle in accordance with paragraph 56 of Statement 142.

C23. (FAS 147, ¶16) In the period that the transition provisions are first applied, an entity should disclose the following in the notes to the financial statements:

a. The carrying amount of previously recognized unidentifiable intangible assets reclassified as goodwill
b. The amount of any adjustment to the previously recognized goodwill impairment loss recognized pursuant to paragraph C22(b).

C24. (FAS 147, ¶17) For each period presented that precedes the Statement 142 application date, the amount of amortization expense related to reclassified goodwill should be disclosed, either separately or as part of the transitional disclosure requirements of Statement 142 (paragraph 61).

Transactions between Entities under Common Control

C25. (FAS 141, ¶D11) Consistent with the provisions of Statement 141 and Opinion 16, paragraph 2(b) states that this Statement does not apply to combinations involving only entities or businesses under common control. The following are examples of those types of transactions:

a. An entity charters a newly formed entity and then transfers some or all of its net assets to that newly chartered entity.

b. A parent company transfers the net assets of a wholly owned subsidiary into the parent company and liquidates the subsidiary. That transaction is a change in legal organization but not a change in the reporting entity.
c. A parent company transfers its interest in several partially owned subsidiaries to a new wholly owned subsidiary. That also is a change in legal organization but not in the reporting entity.
d. A parent company exchanges its ownership interests 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.

C26. (FAS 141, ¶D12) When accounting for a transfer of assets or exchange of shares between entities under common control, the entity that receives the net assets or the equity interests should initially recognize the assets and liabilities transferred at their carrying amounts in the accounts of the transferring entity at the date of transfer.

Procedural Guidance

C27. (FAS 141, ¶D14) Some transfers of net assets or exchanges of shares between entities under common control result in a change in the reporting entity. In practice, the method that many entities have used to account for those transactions is similar to the pooling method. Certain provisions in Opinion 16 relating to application of the pooling method provided a source of continuing guidance on the accounting for transactions between entities under common control. Paragraphs C28–C31 provide procedural guidance that should be considered when preparing financial statements and related disclosures for the entity that receives the net assets.

C28. (FAS 141, ¶D15) In some instances, the entity that receives the net assets or equity interests (the receiving entity) and the entity that transferred the net assets or equity interests (the transferring entity) may account for similar assets and liabilities using different accounting methods. In such circumstances, the carrying values of the assets and liabilities transferred may be adjusted to the basis of accounting used by the receiving entity if the change would be preferable. Any such change in accounting method should be applied retrospectively, and financial statements presented for prior periods should be adjusted, unless it is impracticable to do so. FASB Statement No. 154, *Accounting Changes and Error Corrections,* provides guidance if retrospective application is impracticable (Opinion 16, paragraph 52).

C29. (FAS 141, ¶D16) The financial statements of the receiving entity should report results of operations for the period in which the transfer occurs as though the transfer of net assets or exchange of equity interests had occurred at the beginning of the period. Results of operations for that period will thus comprise those of the previously separate entities combined from the beginning of the period to the date the transfer is completed and those of the combined operations from that date to the end of the period. By eliminating the effects of intercompany transactions in determining the results of operations for the period before the combination, those results will be on substantially the same basis as the results of operations for the period after the date of combination. The

effects of intercompany transactions on current assets, current liabilities, revenue, and cost of sales for periods presented and on retained earnings at the beginning of the periods presented should be eliminated to the extent possible. The nature of and effects on earnings per share of nonrecurring intercompany transactions involving long-term assets and liabilities need not be eliminated but should be disclosed (Opinion 16, paragraph 56).

C30. (FAS 141, ¶D17) Similarly, the receiving entity should present the statement of financial position and other financial information as of the beginning of the period as though the assets and liabilities had been transferred at that date. Financial statements and financial information presented for prior years also should be restated to furnish comparative information. All restated financial statements and financial summaries should indicate clearly that financial data of previously separate entities are combined (Opinion 16, paragraph 57).

C31. (FAS 141, ¶D18) Notes to financial statements of the receiving entity should disclose the following for the period in which the transfer of assets and liabilities or exchange of equity interests occurred:

a. The name and brief description of the entity included in the reporting entity as a result of the net asset transfer or exchange of equity interests
b. The method of accounting for the transfer of net assets or exchange of equity interests.

The receiving entity also should consider whether additional disclosures are required in accordance with FASB Statement No. 57, *Related Party Disclosures*.