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Accounting for Business Combinations and Related Topics

A Roadmap to Applying FASB Statements 141(R), 142, and 160

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Contents

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Executive Summary

Background

In December 2007, the FASB completed the second phase of its business combinations project. The first phase, completed in 2001, had resulted in the issuance of Statements 141[1] and 142 and included such changes as the elimination of the pooling-of-interest method of accounting and the amortization of goodwill. The second phase constituted a major overhaul of the accounting rules for business combinations and noncontrolling interests (formerly referred to as "minority interests") that were not reconsidered in the first phase (e.g., many aspects of the purchase method of accounting).

The FASB issued the following two standards at the end of the second phase:

- Statement No. 141(R), *Business Combinations*.
- Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements* — an amendment of ARB No. 51.

The new statements will generally require:

- Additional use of fair value measurements, both as of the acquisition date and in postcombination periods, which may result in increased use of third-party valuation specialists.
- Recognition of additional assets and liabilities, as of the acquisition date and in postcombination periods, in accounting for the business combination. These assets and liabilities include (1) preacquisition contingencies, (2) contingent consideration, (3) assets that an acquirer does not intend to use (e.g., defensive intangible assets), and (4) acquired assets associated with research and development activities (i.e., acquired in-process research and development (IPR&D)).
- The accounting for certain items, such as acquisition costs and restructuring charges related to the acquired business, outside of business combination accounting. This requirement may result in earnings volatility both before and after consummation of the business combination.
- Enhanced disclosures about completed business combinations.

Some of the recent changes to business combination accounting will affect not only U.S. companies but also companies reporting under IFRSs. In the second phase of the project, the FASB worked with the IASB to substantially converge the accounting for business combinations and noncontrolling interests under U.S. GAAP and IFRSs. This has been the most significant convergence project to date and has helped pave the way for future convergence projects in other areas. A few differences between U.S. GAAP and IFRSs in the accounting for business combinations still remain, including the delayed effective date for the IASB's standards IFRS 3(R) and IAS 27(R) (annual periods beginning on or after July 1, 2009) and the initial measurement of noncontrolling interests in business combinations.

In addition, note that Statements 141(R) and 160 affect areas other than business combinations, including (1) the accounting for existing noncontrolling interests, (2) goodwill impairment testing (regardless of when the goodwill was recognized), and (3) accounting for changes in the parent's ownership interest in a subsidiary (including deconsolidations). Significant changes from the previous accounting under U.S. GAAP are described in more detail below.

1 The titles of the standards and regulations referenced in this Roadmap are defined in **Appendix D**.

Effective Date and Transition

The statements' **accounting** provisions require prospective application to transactions consummated in fiscal years beginning on or after December 15, 2008, with one exception for certain income tax balances.[2] Early adoption is prohibited. Therefore, for calendar-year-end companies, the new statements only affect transactions closing on or after January 1, 2009. Statement 160 requires retrospective application of its **presentation and disclosure** provisions for all prior periods presented in the financial statements.

Overview of Significant Accounting Changes

Contingent Consideration — Many purchase agreements contain contingent consideration arrangements (commonly referred to as "earnouts"). These arrangements typically obligate the acquirer to transfer additional consideration to the former owners of the acquiree if a future event or condition is met (e.g., a contingency based on the postcombination performance of the acquired entity). Under Statement 141(R), the acquirer must (1) recognize the arrangement in the acquisition method accounting at fair value and (2) classify the amount as either a liability or equity in accordance with other existing U.S. GAAP. The acquirer recognizes subsequent changes in fair value of a liability in its postcombination earnings, but does not adjust amounts classified as equity. Under previous guidance, the acquirer typically adjusted its purchase accounting when the contingency was settled or paid, with no direct effect on postcombination earnings.

The determination of fair value in these arrangements and classification as a liability or equity is often difficult and may require the assistance of third-party valuation and financial instrument specialists. The structure of many contingent consideration arrangements will most likely result in liability classification under the new guidance, which may lead to postcombination earnings volatility. Therefore, under Statement 141(R), entities may change the structure, timing, and use of earnouts in future deals to avoid uncertainties in their postcombination earnings.

Measurement Date of the Acquirer's Equity Securities Issued — Statement 141(R) requires that equity securities issued as consideration in a business combination be recorded at fair value as of the acquisition date. Under previous guidance, the acquirer's equity securities were generally valued over a reasonable period before and after the terms of the business combination are agreed to and announced. Because the value of securities may change significantly between the announcement date and the acquisition date, under Statement 141(R), substantially different amounts might be recorded as consideration transferred and thus as goodwill.

Preacquisition Contingencies[3] — The accounting for an acquired contingency depends on whether it is contractual or noncontractual. Contractual contingencies are recognized at their acquisition-date fair value. Noncontractual contingencies are recognized at their acquisition-date fair value, but only if it is more likely than not (i.e., more than 50 percent likely) that the contingency meets the definition of an asset or a liability. In other words, for a noncontractual contingent liability, if it is more than 50 percent likely that an acquirer has assumed a present obligation, the recognition threshold is met. If not, no amount is recognized. Therefore, under Statement 141(R), more acquired contingencies will

2 Statement 141(R) requires that an entity record, as a component of income tax expense, adjustments after the measurement period (and adjustments during the measurement period that relate to facts and circumstances that did not exist as of the acquisition date) to (1) valuation allowances for acquired deferred tax assets and (2) uncertain tax positions of the acquired entity. Under the transition provisions of Statement 141(R), this requirement applies to all business combinations, regardless of the consummation date (i.e., it could affect prior deals).

3 Paragraph 1 of Statement 5 defines a contingency as "an existing condition, situation, or set of circumstances involving uncertainty as to possible gain . . . or loss . . . to an entity that will ultimately be resolved when one or more future events occur or fail to occur." The accounting for contingent consideration arrangements is discussed separately.

be measured at fair value as of the acquisition date. Under previous guidance, when accounting for acquired contingencies, entities often did not record any amount in the purchase accounting and generally followed the guidance in Statement 5.

In addition, unlike previous guidance, Statement 141(R) covers subsequent measurement of contingencies recorded at fair value as of the acquisition date. Under Statement 141(R), if new information becomes available after the acquisition date, a contingent liability recognized as of the acquisition date must be remeasured at the higher of its acquisition-date fair value or the amount that would be recognized under Statement 5. A contingent asset is remeasured at the lower of its acquisition-date fair value or the best estimate of its future settlement amount. In addition, an acquired contingency is derecognized only upon its resolution.

Editor's Note: On December 15, 2008, the FASB issued proposed FSP FAS 141(R)-a, which would amend Statement 141(R) to require that preacquisition contingencies generally be measured at fair value as of the acquisition date if such amounts can be reasonably determined. It is expected that the guidance in the proposed FSP would result in the recognition of more contingent assets and liabilities at fair value than the guidance in Statement 141, but fewer than the current Statement 141(R) guidance. This Roadmap will be updated for the final guidance once it is issued by the FASB.

Assets That the Acquirer Intends Not to Use or to Use in a Way Other Than Their Highest and Best Use (e.g., Defensive Value Intangible Assets) — An acquirer may decide not to use an acquired asset for competitive or other reasons (e.g., a trade name of an acquiree that competes with the acquirer's own trade name), but it would still defend the asset so that others cannot use it. Under Statement 141(R), an acquirer must recognize an acquired asset and measure it at fair value in accordance with Statement 157, even if it decides not to use that acquired asset. This valuation would need to reflect the asset's highest and best use from a market participant's point of view (i.e., someone else may be willing to pay for this asset). Under the previous guidance, the acquirer typically assigned little or no value to these acquired assets.

Partial Acquisitions — In certain business combinations, the acquirer obtains control, but does not acquire a 100 percent interest in the acquiree. Under Statement 141(R), once an acquirer obtains control, it will measure 100 percent of the acquired net assets at fair value (it must measure fair value in accordance with Statement 157) regardless of its ownership interest. Under previous guidance, only the portion of net assets purchased by the acquirer was measured at fair value; the remainder was measured at historical book value.

Under Statement 141(R), an acquisition of a controlling interest in another entity that is less than 100 percent owned may result in the recognition of higher (1) net asset balances, (2) depreciation and amortization expenses in postcombination periods, and (3) asset impairment charges, as compared with previous guidance.

Noncontrolling Interests — Statement 141(R) requires that the noncontrolling interest in a business combination, if any, be measured initially at fair value, including its share of goodwill. In addition, Statement 160 requires that the parent (acquirer) present the noncontrolling interest as a separate component of shareholders' equity.[4] Under previous guidance, the noncontrolling interest was recorded at historical book value, goodwill was only recorded for the acquirer's interest, and the noncontrolling interest was presented as either mezzanine (or temporary) equity or a liability.

Statement 141(R)'s "full goodwill" method (i.e., goodwill represents amounts attributable to both the parent and the noncontrolling interest) will result in higher initial amounts of goodwill than did the previous guidance. This may lead to larger goodwill impairment charges in postcombination earnings. Furthermore, the classification of the noncontrolling interest in permanent equity may affect some key financial statement ratios used by management or investors and included in debt covenants (e.g., debt-to-equity ratio).

Restructuring and Exit Costs — Restructuring and exit costs are costs that an acquirer expects to incur for exiting an activity, involuntarily terminating employees, or relocating employees of an acquiree. Under Statement 141(R), an acquirer will generally record these costs outside of acquisition method accounting through a charge to postcombination earnings. The previous guidance was less stringent and, as long as certain criteria were met, generally resulted in an acquirer's recording liabilities related to a future restructuring as part of its purchase accounting (i.e., generally as a component of goodwill).

Acquired IPR&D — Before a business combination, an acquiree may have incurred costs associated with research and development activities. These costs most likely would have been expensed, with no resulting asset recorded on the acquiree's books. In a business combination, the research and development activities most likely represent an asset to the acquirer. Statement 141(R), like previous guidance, requires that the fair value of such an asset be measured as of the acquisition date. However, Statement 141(R) differs from previous guidance regarding the accounting for the asset. Under the previous guidance, the acquirer immediately expensed the entire fair value of the IPR&D (assuming it had no alternative future use) in the postcombination income statement. Conversely, under Statement 141(R), the acquired IPR&D is capitalized as an indefinite-lived intangible asset and tested for impairment at least annually. Once the research and development activities are complete, the intangible asset is amortized into earnings over the related product's useful life. If the project is subsequently abandoned, the carrying amount would generally be expensed at that time. Therefore, under Statement 141(R), the timing of when the acquired IPR&D will affect postcombination earnings is less certain.

Adjustments to Certain Acquired Tax Balances — Statement 141(R) requires that an entity record, generally through income tax expense, adjustments made after the measurement period (and adjustments during the measurement period that relate to facts and circumstances that did not exist as of the acquisition date) to (1) valuation allowances for acquired deferred tax assets and (2) acquired tax uncertainties. Upon adopting Statement 141(R), an entity must also apply this new guidance to tax balances recorded before the Statement's effective date. Therefore, this new guidance may affect remaining valuation allowances for deferred tax assets and tax uncertainty balances from prior deals and, consequently, may affect future earnings. This new guidance differs from previous guidance in which adjustments to these tax balances were generally recorded as an adjustment to goodwill (i.e., earnings were generally not directly affected).

4 In determining the appropriate classification of a noncontrolling interest, an entity must look to other relevant GAAP to determine whether the financial instrument issued by a subsidiary can be classified as permanent equity (e.g., Statements 133 and 150, EITF Topic D-98, and SEC Accounting Series Release No. 268). More complex financial instruments (e.g., those with certain call or put features) may be outside the scope of Statement 160 and, therefore, classified in either mezzanine (or temporary) equity or as liabilities.

Acquisition-Related Costs — Statement 141(R) requires that the acquirer expense all acquisition-related costs as incurred, even those incurred by the acquiree on behalf of the acquirer. However, certain direct costs paid to register debt or equity securities as part of a business combination may still be recorded on the balance sheet in accordance with other applicable U.S. GAAP. Acquisition-related costs that will be expensed include fees paid to investment bankers, lawyers, accountants, valuation specialists, and other consultants. Under the previous guidance, incremental and direct costs of an acquisition were capitalized and generally recorded as part of goodwill.

Measurement-Period Adjustments — Like the previous guidance, the new guidance gives an acquirer up to one year (formerly referred to as the "allocation period") to finalize its business combination accounting, as long as any adjustments made to provisional amounts relate to facts and circumstances that existed as of the acquisition date (e.g., the acquirer may be waiting on a third-party valuation specialist's report that details the fair value of certain assets and liabilities). However, Statement 141(R) now requires that the acquirer revise comparative prior-period information for any adjustments made to provisional amounts during the measurement period (i.e., adjustments are made retrospectively as of the acquisition date). This represents a significant change from prevailing prior practice, in which adjustments to provisional amounts were generally accounted for prospectively as a change in accounting estimate.

The revised guidance will require that an entity apply additional effort in recording measurement-period adjustments. For example, an entity that subsequently adjusts a depreciable asset's provisional balance must also retrospectively adjust the asset's depreciation or amortization expense, accumulated depreciation or amortization, and retained earnings for all prior periods presented. Additional communication and disclosures to financial statement users may also be required. Public entities may need to update financial statements and information included in a registration statement if a measurement-period adjustment (1) is recorded after the issuance of those items and (2) would have a material effect on the amounts recorded in those filings.

Bargain Purchases — Bargain purchases occur when the fair value of the consideration transferred is less than the fair value of the net assets acquired from the acquiree (that difference is referred to as the "excess"). Statement 141(R) requires the acquirer to record the entire excess in earnings. Under the previous guidance, the acquirer would first reduce the value assigned to certain noncurrent assets acquired. The acquirer would then record any remaining excess, after reducing those noncurrent assets to zero, as an *extraordinary* gain. The revised guidance may result in the recognition of a larger gain by the acquirer. Note, however, that bargain purchases are not expected to be common.

Definition of a Business — Statement 141(R) significantly broadens the definition of a business (e.g., development-stage entities may qualify as a business under Statement 141(R), whereas they did not under the previous guidance). The expanded definition not only affects the determination of whether a transaction qualifies as a business combination or an asset acquisition, but may also have an effect on (1) the goodwill impairment analysis (see below), (2) the consolidation analysis under Interpretation 46(R), and (3) the allocation of goodwill when a portion of reporting unit is sold or otherwise disposed of.

Changes in the Parent's Ownership Interest — Under Statement 160, after a parent (acquirer) obtains control over a subsidiary, the parent must account for additional purchases and sales of a subsidiary's stock as equity transactions (as long as control is retained). Thus, the parent cannot recognize a gain or loss in earnings on dispositions, nor can it apply additional acquisition method accounting for incremental interests acquired. Under the previous guidance, sales of the subsidiary's stock to third parties may have resulted in gains or losses in earnings and a purchase of the subsidiary's shares by the parent may have required additional purchase accounting (which could have also resulted in additional goodwill).

Goodwill Impairment Testing — Statement 142 requires entities to test goodwill for impairment at least annually. Step 2 of the goodwill impairment test requires that the entity compute the current implied fair value of goodwill. The entity then compares that balance to the current carrying amount of the goodwill to determine whether an impairment is required. The implied fair value of goodwill is determined in the same manner as goodwill recognized in a business combination. In other words, before the adoption of Statement 141(R), an entity would refer to Statement 141 for this analysis. After the entity adopts Statements 141(R) and 160, it must perform step 2 of the goodwill impairment test in accordance with Statement 141(R). Therefore, Statement 141(R) will most likely affect the mechanics in which step 2 of the goodwill impairment analysis is performed.

In addition, goodwill impairment testing is performed at the reporting-unit level. A key factor in determining an entity's reporting-unit structure is to identify which components are businesses, as defined in the accounting literature. As previously noted, Statement 141(R) significantly broadens the definition of a business. Therefore, upon adoption of Statement 141(R), an entity should carefully review whether the new guidance will affect its reporting-unit structure and thus its goodwill impairment testing.

How This Roadmap Is Structured

This publication constitutes a single source for both the accounting requirements for, and the available interpretive guidance on, the following topics:

Initial Acquisition Accounting

- Business combinations.

Post-Acquisition Accounting

- Goodwill and other intangible assets.
- Push-down accounting.
- Noncontrolling interests.

Where appropriate, we have included our own views, which are based on our experience with and understanding of the underlying principles.

The Roadmap is structured as follows:

Accounting for Business Combinations	Section 1 — Scope of Statement 141(R)
	Section 2 — Identifying the Acquirer
	Section 3 — Recognizing and Measuring Assets Acquired and Liabilities Assumed — General
	Section 4 — Recognizing and Measuring Assets Acquired and Liabilities Assumed (Other Than Intangible Assets and Goodwill)
	Section 5 — Recognizing and Measuring Acquired Intangible Assets and Goodwill
	Section 6 — Recognizing and Measuring the Consideration Transferred in a Business Combination
Accounting for Noncontrolling Interests During and After a Business Combination	Section 7 — Noncontrolling Interests
Income Tax Considerations for Business Combinations	Section 8 — Income Tax Considerations
Accounting After a Business Combination	Section 9 — Push-Down Basis of Accounting
	Section 10 — Subsequent Accounting for Intangible Assets (Other Than Goodwill)
	Section 11 — Subsequent Accounting for Goodwill
Presentation and Disclosure Considerations	Section 12 — Financial Statement Presentation Requirements
	Section 13 — Financial Statement Disclosure Requirements
Transition Issues and Considerations	Section 14 — Transition Requirements and Other Adoption Considerations
Comparisons to IFRSs and Previous U.S. GAAP	Appendix A — Differences Between Statements 141 and 141(R)
	Appendix B — Differences Between Pre-Amended ARB 51 and Statement 160
	Appendix C — Differences Between U.S. GAAP and IFRSs
Index of Standards and Regulations Referenced Throughout the Roadmap	Appendix D — Glossary of Standards and Regulations

Section 1 — Scope of Statement 141(R)

Occurrence of a Business Combination

1.01 Paragraph 3(e) of Statement 141(R) defines a "business combination" as follows:

> A *business combination* is a transaction or other event in which an acquirer obtains **control** [see **1.02–1.07**] of one or more **businesses** [see **1.08–1.11**]. Transactions sometimes referred to as "true mergers" or "merger of equals" also are business combinations as that term is used in this Statement. [Emphasis added]

Obtaining Control

1.02 Paragraph A2 of Statement 141(R) provides the following examples of transactions or events that may result in an entity's obtaining control of another business:

- Transfers of cash, cash equivalents, or other assets (including net assets that constitute a business).
- Incurrence of liabilities.
- Issuance of equity interests.
- Issuance of more than one type of consideration.
- Other transactions or events that do not involve the transfer of consideration, including by contract alone (see **1.05–1.07**).

1.03 In specifying how entities determine whether they have obtained control of another business, Statement 141(R) refers to the description of "controlling financial interest" in paragraph 2 of ARB 51, as amended by Statement 160, which states:

> The usual condition for a **controlling financial interest** is ownership of a majority voting interest, and, therefore, as a general rule ownership by one company, directly or indirectly, of over fifty percent of the outstanding voting shares of another company is a condition pointing toward consolidation. [Emphasis added]

1.04 A control assessment is not necessarily based solely on a voting interest model such as that described in ARB 51. Entities must also determine whether they have a controlling financial interest in a variable interest entity (VIE) in accordance with Interpretation 46(R). Control under Interpretation 46(R) is assessed on the basis of economic risks and rewards to the investor and is not dependent on the voting interest. See **1.17–1.21** for a discussion of the interaction between VIEs and Statement 141(R).

1.05 An acquirer may obtain control of an acquiree without transferring consideration to the former owners. Paragraph 49 of Statement 141(R) lists certain circumstances in which this may occur:

> a. The acquiree repurchases a sufficient number of its own shares for an existing investor (the acquirer) to obtain control.
>
> b. Minority veto rights lapse that previously kept the acquirer from controlling an acquiree in which the acquirer held the majority voting interest.

> c. The acquirer and acquiree agree to combine their businesses by contract alone. The acquirer transfers no consideration in exchange for control of an acquiree and holds no equity interests in the acquiree, either on the acquisition date or previously. Examples of business combinations achieved by contract alone include bringing two businesses together in a stapling arrangement or forming a dual listed corporation. [See **1.06**.]

1.06 Stapling arrangements and the formation of dual-listed corporations do not occur frequently in practice and most often involve foreign entities. Characteristics of such arrangements are as follows:

- *Stapling arrangements* — These are generally contractual agreements between two parties in which the issued equity securities of one legal entity are combined with the issued securities of another legal entity. These securities, often referred to as "stapled," are then quoted at a single market price and cannot be separately traded or transferred.
- *Dual-listed corporation* — In such transactions, no consideration is exchanged by either entity, and contracts are executed between the parties that equalize the rights of the respective shareholders. Such rights often include voting, dividends, governance, and executive management decisions. Although separate legal entities are retained (i.e., the securities of each respective entity are usually separately quoted and traded in the capital markets), a dual-listed corporation is substantively similar to a business combination in that the shareholders of the respective entities both share in the risks and rewards of the two entities. Historically, the SEC has required such transactions to be accounted for as a business combination, and Statement 141(R) is not expected to significantly change this practice.

1.07 Business combinations achieved without the transfer of consideration are accounted for under the acquisition method of accounting. Paragraph 50 of Statement 141(R) states that for those achieved by contract alone, "the acquirer shall attribute to the equity holders of the acquiree the amount of the acquiree's net assets recognized." In other words, the noncontrolling interest should be recognized in the acquirer's postcombination financial statements even if the result is that it represents 100 percent of the acquiree's net assets.

Definition of a Business

1.08 An entity may obtain control of a business by acquiring its net assets or its equity interests. For a business combination to be within the scope of Statement 141(R), the entity over which control is obtained must be a **business**. Paragraph 3(d) of Statement 141(R) defines 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 a return in the form of dividends, lower costs, or other economic benefits directly to investors or other owners, members, or participants.

1.09 Statement 141(R) nullifies the definition of a business that was in Issue 98-3 and significantly broadens what is considered a business (see **A.05**).

1.10 Paragraphs A4–A9 of Statement 141(R) provide implementation guidance to help entities identify what constitutes a business:

> A4. This Statement defines a business as an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs, or other economic benefits directly to investors or other owners, members, or participants.

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, the 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, but 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 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 in the form of dividends, lower costs, or other economic benefits directly to investors or other owners, members, or participants.

A5. 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 market participants are capable of acquiring the business and continuing to produce outputs, for example, by integrating the business with their own inputs and processes. FASB Statement No. 157, *Fair Value Measurements*, describes *market participants* as:

> . . . buyers and sellers in the principal (or most advantageous) market for the asset or liability that are:
>
> a. Independent of the reporting entity; that is, they are not related parties
>
> b. Knowledgeable, having a reasonable understanding about the asset or liability and the transaction based on all available information, including information that might be obtained through due diligence efforts that are usual and customary
>
> c. Able to transact for the asset or liability
>
> d. Willing to transact for the asset or liability; that is, they are motivated but not forced or otherwise compelled to do so. [Paragraph 10; footnote reference omitted.]

A6. 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 different types 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 liabilities.

A7. An integrated set of activities and assets in the development stage might not have outputs. If not, the acquirer should consider other factors to determine whether the set is a business. Those factors include, but are not limited to, 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. Will be able to obtain access to customers that will purchase the outputs.

Not all of those factors need to be present for a particular integrated set of activities and assets in the development stage to qualify as a business.

> A8. Determining 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 market participant. 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.
>
> A9. In the absence of evidence to the contrary, a particular set of assets and activities in which goodwill is present shall be presumed to be a business. However, a business need not have goodwill.

1.11 While Statement 141(R) provides useful factors to consider, it does not prescribe a definitive checklist for entities to follow when assessing whether a group of assets constitutes a business. Therefore, professional judgment should be used.

Acquiring Net Assets or Equity Interests That Do Not Meet the Definition of a Business

1.12 The accounting requirements for an acquisition of net assets or equity interests that is not deemed to be a business combination (see **1.01**) will differ in certain respects from those used for business combinations. The following tables highlight such differences.

Cost of the Acquisition

Business Combination	Acquisition of an Asset Group Determined Not to Be a Business
Paragraph 39 of Statement 141(R) states: The consideration transferred in a business combination shall be measured at fair value, which shall be calculated as the sum of the acquisition-date fair values of the assets transferred by the acquirer, the liabilities incurred by the acquirer to former owners of the acquiree, and the equity interests issued by the acquirer. (However, any portion of the acquirer's share-based payment awards exchanged for awards held by the acquiree's employees that is included in consideration transferred in the business combination shall be measured in accordance with paragraph 32 rather than at fair value.) Examples of potential forms of consideration include cash, other assets, a business or a subsidiary of the acquirer, contingent consideration (paragraphs 41 and 42), common or preferred equity instruments, options, warrants, and member interests of mutual entities. The fair value of the consideration transferred **excludes the transaction costs** the acquirer incurs to effect a business combination (acquisition-related costs).	Paragraph D4 of Statement 141(R) states, in part: Assets are recognized based on their cost to the acquiring entity, which generally **includes the transaction costs of the asset acquisition,** and no gain or loss is recognized unless the fair value of noncash assets given as consideration differs from the assets' carrying amounts on the acquiring entity's books. [Emphasis added] The accounting for contingent consideration does not follow the guidance in paragraphs 41 and 42 of Statement 141(R). Contingent consideration is measured in accordance with other applicable GAAP, including Statement 5 and Statement 133, as appropriate.

Measuring the Assets Acquired and Liabilities Assumed

Business Combination	Acquisition of an Asset Group Determined Not to Be a Business
Paragraph 20 of Statement 141(R) provides that the "acquirer shall measure the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at their acquisition-date fair values." Paragraph 34 of Statement 141(R) indicates that goodwill should be recorded as the sum of the (1) consideration transferred, (2) fair value of any noncontrolling interest, and (3) fair value of the acquirer's previously held interest in the acquiree, if any, less the acquisition-date fair value of the net assets acquired. In accordance with Statement 141(R), contractual contingencies are recognized at fair value as of the acquisition date, whereas noncontractual contingencies are recognized at fair value only if, as of the acquisition date, it is more likely than not that the contingency meets the definition of an asset or liability in accordance with Concepts Statement 6.* * On December 15, 2008, the FASB issued proposed FSP FAS 141(R)-a, which would amend Statement 141(R) to require that preacquisition contingencies generally be measured at fair value as of the acquisition date if such amounts can be reasonably determined. It is expected that the guidance in the proposed FSP would result in the recognition of more contingent assets and liabilities at fair value than the guidance in Statement 141, but fewer than the current Statement 141(R) guidance. This Roadmap will be updated for the final guidance once it is issued by the FASB.	Paragraph D6 of Statement 141(R) states, in part: 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 D4 and D5. 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. Acquired contingent assets and assumed contingent liabilities are accounted for in accordance with Statement 5, generally resulting in (1) no recognition of acquired contingent assets and (2) recognition of a contingent liability only if it is probable that a liability has been incurred and the amount can be reasonably estimated.

1.13 When an entity allocates the cost of an asset group not determined to be a business, it cannot recognize the difference between the total cost and the amounts assigned to the assets (and liabilities) as goodwill. If, upon review of the initial measurements of the tangible and intangible assets acquired, the entity does not eliminate that difference, it must allocate it. If the difference is an excess of cost, the difference should be allocated pro rata on the basis of relative fair values to increase the assets acquired, except for financial assets (other than investments accounted for by the equity method) and assets subject to fair value impairment testing, such as inventories and indefinite-lived intangible assets, since increasing the value of such assets would most likely result in an impairment as of the next testing date.

Recognition of Intangible Assets

Business Combination	Acquisition of an Asset Group Determined Not to Be a Business
Paragraph A19 of Statement 141(R) states that the "acquirer shall recognize separately from goodwill the *identifiable* intangible assets acquired in a business combination. An intangible asset is identifiable if it meets either the separability criterion or the contractual-legal criterion described in paragraph 3(k)." (See **5.01**.) Under Statement 141(R), as explained in paragraph A25, an assembled workforce is not an intangible asset that can be recognized apart from goodwill. (See **5.07**.) Statement 141(R) requires assets acquired in a business combination that are used in research and development activities (i.e., IPR&D) to be initially recognized as an indefinite-lived intangible asset and be measured at fair value.	Footnote 7 of Statement 142 states that the recognition criteria in Statement 141(R) for intangible assets apart from goodwill "do not apply to intangible assets acquired in transactions other than business combinations." Paragraph B37 of Statement 142 states: The Board observed that intangible assets that are acquired individually or with a group of assets in a transaction other than a business combination also may meet the asset recognition criteria in Concepts Statement 5 even though they do not meet either the contractual-legal criterion or separability criterion (for example, specially-trained employees or a unique manufacturing process related to an acquired manufacturing plant). . . . Thus, those assets should be recognized as intangible assets. See **5.06–5.07** for discussion of intangible assets that are not recognized apart from goodwill in a business combination, but may exist and require recognition in an acquisition of an asset group determined not to be a business. In accordance with Statement 2, the cost of acquired intangible assets obtained from others to be used in research and development activities that do not have an alternative future use are charged to expense.

Example 1-1
Allocating the Cost of the Acquisition in a Transaction Other Than a Business Combination

Company A acquires assets from Company B for $120 that are determined collectively not to constitute a business. Company A identifies, among the acquired group of assets, an intangible asset related to the assembled workforce. The following table illustrates the allocation of the cost of the assets on the basis of relative fair values.

	Initial Fair Value Measurement	Allocation	Total
Assembled workforce	$ 10	$ 2	$ 12
Property, plant, and equipment	90	18	108
Total	$ 100	$ 20	$ 120

If the assets acquired were determined instead to constitute a business, the assembled workforce intangible asset would not be recognized apart from goodwill. Also, the $30 excess of the cost of the acquired assets ($120) over the amounts assigned to the identifiable assets ($90) would be recognized as goodwill.

Identifying a Business During the Assessment of Reporting Requirements Under SEC Regulation S-X

1.14 When an SEC registrant (acquirer) consummates or it is probable that it will consummate a significant business acquisition, the SEC may require the filing of certain financial statements for the acquired or to be acquired business (acquiree). For example, the filing in a Form 8-K of financial statements for the acquired business, if significant, may be required. Further, if the acquirer files a registration statement or a proxy statement in addition to the financial statements for the acquirer, separate financial statements for the acquiree may be required. Pro forma financial information may be required in addition to these financial statements.

1.15 Several factors govern whether financial statements for the acquiree are required, including whether the acquired or to be acquired assets and liabilities meet the SEC's definition of a business. SEC Regulation S-X, Rule 11-01(d), states:

> For purposes of this rule, the term business should be evaluated in light of the facts and circumstances involved and whether there is sufficient continuity of the acquired entity's operations prior to and after the transactions so that disclosure of prior financial information is material to an understanding of future operations. A presumption exists that a separate entity, a subsidiary, or a division is a business. However, a lesser component of an entity may also constitute a business. Among the facts and circumstances which should be considered in evaluating whether an acquisition of a lesser component of an entity constitutes a business are the following:
>
> (1) Whether the nature of the revenue-producing activity of the component will remain generally the same as before the transaction; or
>
> (2) Whether any of the following attributes remain with the component after the transaction:
>
> (i) Physical facilities,
>
> (ii) Employee base,
>
> (iii) Market distribution system,
>
> (iv) Sales force,
>
> (v) Customer base,
>
> (vi) Operating rights,
>
> (vii) Production techniques, or
>
> (viii) Trade names.

1.16 Because the definition of a business in SEC Regulation S-X, Rule 11-01(d), differs from that in Statement 141(R), SEC registrants must undertake a separate analysis under Rule 11-01(d) when evaluating the reporting requirements of SEC Regulation S-X. However, we believe that the changes to the definition of a business in Statement 141(R) more closely align the FASB's definition with the SEC's than did the previous guidance.

Variable Interest Entities

1.17 Statement 141(R) amends the initial consolidation guidance for VIEs that are accounted for under Interpretation 46(R). In addition, Statement 141(R) amends Interpretation 46(R) to make the definition of a business consistent with that in Statement 141(R) (see **1.08**).

1.18 The primary beneficiary is always the acquirer when the acquisition method of accounting is used (see **2.02**). Regarding determination of the VIE's primary beneficiary, paragraph 9 of Statement 141(R) states, in part:

> The determination of which party, if any, is the primary beneficiary of a variable interest entity shall be made in accordance with FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities*, as amended, not by applying either the guidance in ARB 51 or that in paragraphs A11–A15 [of Statement 141(R)].

1.19 If a VIE meets the definition of a business (see **1.08**), the primary beneficiary's initial consolidation of the VIE must be accounted for as a business combination under Statement 141(R).

1.20 If a VIE does not meet the definition of a business, the primary beneficiary's initial measurement of the VIE's assets (except goodwill) and liabilities would follow the measurement guidance of Statement 141(R). However, the primary beneficiary is prohibited from recognizing goodwill, and would instead recognize a loss. In addition, paragraphs 21(a) and 21(b) of Interpretation 46(R), as amended by Statement 141(R), state:

> a. The primary beneficiary initially shall measure and recognize the assets (except for goodwill) and liabilities of the variable interest entity in accordance with paragraphs 12–33 of Statement 141(R). However, the primary beneficiary shall initially measure assets and liabilities that it has transferred to that variable interest entity at, after, or shortly before the date that the entity became the primary beneficiary at the same amounts at which the assets and liabilities would have been measured if they had not been transferred. No gain or loss shall be recognized because of such transfers.
>
> b. The primary beneficiary shall recognize a gain or loss for the difference between (1) the fair value of any consideration paid, the fair value of any noncontrolling interests, and the reported amount of any previously held interests and (2) the net amount of the variable interest entity's identifiable assets and liabilities recognized and measured in accordance with Statement 141(R). No goodwill shall be recognized if the variable interest entity is not a business.

1.21 Paragraph B21 of Statement 141(R) explains the FASB's rationale for the amendments to Interpretation 46(R):

> The FASB concluded that variable interest entities that are businesses should be afforded the same exceptions to fair value measurement and recognition that are provided for assets and liabilities of acquired businesses. The FASB also decided that upon the initial consolidation of a variable interest entity that is not a business, the assets (other than goodwill), liabilities, and noncontrolling interests should be recognized and measured in accordance with the requirements of [Statement 141(R)], rather than at fair value as previously required by Interpretation 46(R). The FASB reached that decision for the same reasons described above, that is, if this Statement allows an exception to fair value measurement for a particular asset or liability, it would be inconsistent to require the same type of asset or liability to be measured at fair value. Except for that provision, the FASB did not reconsider the requirements in Interpretation 46(R) for the initial consolidation of a variable interest entity that is not a business.

Combinations Between Two or More Mutual Entities

1.22 Business combinations between two or more mutual entities are within the scope of Statement 141(R). Paragraph 3(m) of Statement 141(R) defines a "mutual entity" as follows:

> A *mutual entity* is an entity other than an investor-owned entity that provides dividends, lower costs, or other economic benefits directly to its owners, members, or participants. For example, a mutual insurance company, a credit union, and a cooperative entity are all mutual entities.

1.23 Since a combination of mutual entities involves an exchange, albeit typically of membership interests, Statement 141(R) makes no concession to its usual requirements regarding applying the acquisition method of accounting. Consequently, an acquirer must be identified in any combination of mutual entities using the Statement 141(R) criteria (see **Section 2**).

1.24 Mutual entities did not follow the guidance in Statement 141 because its effective date was deferred until interpretive guidance was issued for transactions involving such entities. See additional Statement 141(R) transition guidance for mutual entities in **14.39–14.45**.

Leveraged Buyout Transactions

1.25 Statement 141(R) nullifies Issue 88-16, which previously provided guidance to entities that participated in leverage buyout (LBO) transactions. Issue 88-16 described LBO transactions as follows:

> [T]he LBO should be effected in a single highly leveraged transaction or a series of related and anticipated highly leveraged transactions that result in the acquisition by NEWCO of all previously outstanding common stock of OLDCO; that is, there can be no remaining minority interest. [footnote 2 omitted] This Issue excludes LBO transactions in which existing majority stockholders utilize a holding company to acquire all of the shares of OLDCO not previously owned. Step acquisition accounting continues to be appropriate in such transactions.

Upon their adoption of Statement 141(R), entities must now consider the provisions of Statement 141(R) for transactions that would have been previously accounted for under Issue 88-16. Note that Statement 141(R) does not provide guidance or amend the accounting for recapitalization transactions, including leveraged recapitalizations (see **1.37**).

Additional Scope Considerations

1.26 Business combinations can be achieved in a variety of ways. It may not always be clear whether a specific transaction form is within the scope of Statement 141(R), is otherwise addressed in Statement 141(R), or is addressed in other authoritative literature. Transactions discussed elsewhere in this Roadmap are as follows:

- Control obtained but less than 100 percent of the business is acquired (see **1.27**).
- Business combinations achieved in stages (see **1.28–1.30**).
- Acquisition of a noncontrolling interest of a subsidiary (see **1.31**).
- Roll-up or put-together transactions (see **1.32–1.33**).
- Formation of a joint venture (see **1.34–1.36**).
- Recapitalizations (see **1.37**).
- Transactions between entities under common control (see **1.38–1.44**).
- Combinations between entities with common ownership (see **1.45–1.46**).
- Combinations involving not-for-profit organizations (see **1.47–1.49**).

Control Obtained but Less Than 100 Percent of the Business Is Acquired (i.e., Partial Acquisitions)

1.27 Statement 141(R) applies to transactions or events in which an entity obtains control of one or more businesses (see **1.01**). In a transaction or event involving equity interests, control is generally indicated by ownership by one entity, directly or indirectly, of over 50 percent of the outstanding voting shares of another entity (see **1.02–1.07**). Accordingly, a business combination may occur when an entity acquires enough, but less than 100 percent of, voting shares to obtain control. In such cases, the acquirer recognizes in its consolidated financial statements the assets acquired, liabilities assumed, and the noncontrolling interest at 100 percent of their acquisition-date fair values (with certain exceptions specified in Statement 141(R)), regardless of its level of controlling interest. The FASB has indicated that once an acquirer obtains control of an entity, it controls 100 percent of its assets, not just a portion of them.

Example 1-2
Control Obtained but Less Than 100 Percent of the Business Is Acquired

Company A, with no prior ownership interest in Company B, acquired 80 percent of the equity interest in Company B in a business combination for $1,600. The fair value of the noncontrolling interest is $400 (assuming no control premium). The fair value of all identifiable net assets of Company B as of the acquisition date was $1,500.

In its consolidated financial statements, Company A will reflect the acquisition of the equity interest in Company B as follows:

Identifiable net assets	$ 1,500	Full fair value of Company B's net assets
Goodwill	500	Calculated as ([$1,600 + $400] – $1,500)
Noncontrolling interest (a separate component of shareholders' equity)	(400)	Fair value
Company A's investment in B	$ 1,600	

Business Combinations Achieved in Stages

1.28 A business combination achieved in stages occurs when control of a business is obtained after the acquirer already owns a noncontrolling interest in the acquiree's equity. Such acquisitions are commonly called step acquisitions. Under Statement 141(R), the acquirer applies Statement 141(R)'s acquisition method accounting on the date control is obtained. In addition, the acquirer's preexisting interest in the acquiree is remeasured to its fair value, with a resulting gain or loss recorded in earnings upon consummation of the business combination. In prior periods, the previously held interest may have been remeasured to fair value with changes recognized in other comprehensive income (e.g., if it was classified as available for sale). In such cases, the amount of other comprehensive income related to the previously held interest should be reclassified and included in the gain or loss.

1.29 Paragraph B384 of Statement 141(R) explains the FASB's rationale for the accounting treatment:

> The Boards concluded that 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. Once it obtains control, the acquirer no longer is the owner of a noncontrolling investment asset in the acquiree. As in present practice, the acquirer ceases its accounting for an investment asset and begins reporting in its financial statements the underlying assets, liabilities, and results of operations of the acquiree. 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 its operations.

1.30 See **7.20–7.23** regarding additional acquisitions of noncontrolling interests in a subsidiary after control is obtained.

Example 1-3
Business Combination Achieved in Stages

AC purchases a 35 percent interest in Target Company (TC) for $2,000 on January 1, 20X8 (example ignores deferred tax accounting implications). AC uses the equity method to account for its 35 percent interest in TC. On December 31, 20X9:

- AC purchases an additional 40 percent of TC for $4,000.
- The fair value of TC's identifiable net assets is $8,000.
- The fair value of the 25 percent noncontrolling interest is $1,800.
- The fair value of AC's 35 percent of TC is $3,500. The book value of that interest is $2,500.
- TC constitutes a business.

The acquisition of the 40 percent interest results in AC's obtaining control of TC. Therefore, that transaction is accounted for as a business combination.

AC's existing 35 percent interest in TC is remeasured to $3,500, resulting in a gain of $1,000 ($3,500 less the $2,500 book value) in the income statement.

AC recognizes TC's identifiable net assets at the full amount of their fair values ($8,000). AC also recognizes goodwill of $1,300 ([$4,000 + $1,800 + $3,500] – $8,000) (see **5.38–5.41**).

If AC purchases (or disposes of) additional interests in TC in the future (provided that control is retained), those interests would be accounted for as equity transactions — no assets or liabilities would be remeasured at fair value, and no gains or losses would be recognized (see **7.20–7.23**).

Acquisition of a Noncontrolling Interest of a Subsidiary

1.31 Once an entity has control of a subsidiary, its acquisitions of some or all of the noncontrolling interests in that subsidiary are accounted for as equity transactions under Statement 160 (see **7.20–7.23**). Such transactions are not considered business combinations within the scope of Statement 141(R).

Roll-Up or Put-Together Transactions

1.32 In some transactions, more than two entities agree to combine their businesses but none of the owners of the combining entities individually or as a group retain or receive a majority of the voting rights of the combined entity. Such transactions, often referred to as "roll-up" or "put-together" transactions, are within the scope of Statement 141(R).

1.33 The FASB's view on roll-up or put-together transactions is discussed in paragraph B27 of Statement 141(R):

> The Boards concluded that most business combinations, both two-party transactions and those involving three or more entities (multiparty combinations) are acquisitions. The Boards acknowledged that some multiparty combinations (in particular, those that are commonly referred to as roll-up or put-together transactions) might not be acquisitions; however, they noted that the acquisition method has generally been used to account for them. The Boards decided not to change that practice at this time. Consequently, this Statement requires the acquisition method to be used to account for all business combinations, including those that some might not consider acquisitions.

Formation of a Joint Venture

1.34 Paragraph 2(a) of Statement 141(R) states that the formation of a joint venture is not within the Statement's scope.

1.35 Paragraph 3(d) of Opinion 18 defines "corporate joint venture," which is also considered to be applicable to other forms of joint ventures (e.g., partnerships), as follows:

> "Corporate joint venture" refers to a corporation owned and operated by a small group of businesses (the "joint venturers") as a separate and specific business or project for the mutual benefit of the members of the group. A government may also be a member of the group. The purpose of a corporate joint venture frequently is to share risks and rewards in developing a new market, product or technology; to combine complementary technological knowledge; or to pool resources in developing production or other facilities. A corporate joint venture also usually provides an arrangement under which each joint venturer may participate, directly or indirectly, in the overall management of the joint venture. Joint venturers thus have an interest or relationship other than as passive investors. An entity which is a subsidiary of one of the "joint venturers" is not a corporate joint venture. The ownership of a corporate joint venture seldom changes, and its stock is usually not traded publicly. A minority public ownership, however, does not preclude a corporation from being a corporate joint venture.

1.36 EITF Issue 98-4 states:

> The SEC Observer indicated that the SEC staff would object to a conclusion that did not result in the application of Opinion 16 [Statement 141(R)] to transactions in which businesses are contributed to a newly formed, jointly controlled entity if that entity is not a joint venture. The SEC staff also would object to a conclusion that joint control is the only defining characteristic of a joint venture.

Recapitalizations

1.37 In a recapitalization transaction, a series of steps is generally undertaken involving the equity of an entity, which may result in the establishment of a new controlling shareholder. In a leveraged recapitalization, new debt is issued with the proceeds used to redeem shares from existing shareholders as part of a series of steps that also may result in the establishment of a new controlling shareholder. Questions are often raised about whether, in recapitalization transactions that result in a new controlling shareholder of the recapitalized entity, the accounting basis of the net assets of the recapitalized entity should be adjusted. Statement 141(R) does not provide specific guidance in this area. Consultation with specialists is recommended when the potential accounting effects of recapitalization transactions are evaluated.

Transactions Between Entities Under Common Control

1.38 Paragraph 2(c) of Statement 141(R) states that a combination between entities or businesses under common control is not within its scope. Paragraph D8 of Statement 141(R) provides the following 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 transfers the net assets of a wholly owned subsidiary into the parent and liquidates the subsidiary. That transaction is a change in legal organization but no change in the reporting entity.
>
> c. A parent transfers its controlling interest in several partially owned subsidiaries to a new wholly owned subsidiary. That also is a change in legal organization but not to the reporting entity.
>
> d. A parent exchanges its ownership interests or the net assets of a wholly owned subsidiary for additional shares issued by the parent's less-than-wholly owned subsidiary, thereby increasing the parent's percentage of ownership in the less-than-wholly-owned subsidiary but leaving all of the existing noncontrolling interest outstanding. (FAS 141, ¶D11)

e. A parent's less-than-wholly-owned subsidiary issues its shares in exchange for shares of another subsidiary previously owned by the same parent, and the noncontrolling shareholders are not party to the exchange. That is not a business combination from the perspective of the parent. (FTB 85-5, ¶7)

f. A limited liability company is formed by combining entities under common control. (Practice Bulletin 14, ¶.05)

1.39 Statement 141(R), however, does not define "common control." In Issue 02-5, the Task Force discussed how to define common control, but did not reach a consensus. However, the SEC observer stated that common control exists between (or among) separate entities in the following situations:

a. An individual or enterprise holds more than 50 percent of the voting ownership interest of each entity.

b. Immediate family members hold more than 50 percent of the voting ownership interest of each entity (with no evidence that those family members will vote their shares in any way other than in concert).

    (1) Immediate family members include a married couple and their children, but not the married couple's grandchildren.

    (2) Entities might be owned in varying combinations among living siblings and their children. Those situations would require careful consideration regarding the substance of the ownership and voting relationships.

c. A group of shareholders holds more than 50 percent of the voting ownership interest of each entity, and contemporaneous written evidence of an agreement to vote a majority of the entities' shares in concert exists.

1.40 Because of a lack of guidance, the SEC's comments are widely applied by public and private companies. However, there may be other circumstances in which common control exists. Therefore, professional judgment should be used.

1.41 While not specifically within the scope of Statement 141(R), the measurement of assets and liabilities transferred in a combination between entities under common control is discussed in paragraph D9 of Statement 141(R):

> 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. (FAS 141, ¶D12) If the carrying amounts of the assets and liabilities transferred differ from the historical cost of the parent of the entities under common control, for example, because push-down accounting had not been applied, then the financial statements of the receiving entity should reflect the transferred assets and liabilities at the historical cost of the parent of the entities under common control. [Emphasis added]

1.42 See paragraphs D10–D14 of Statement 141(R) for additional procedural guidance on common control transactions.

1.43 Transactions between entities under common control are accounted for in a manner similar to the pooling-of-interest method. However, paragraph D13 of Statement 141(R) states that in the determination of the period for which combined financial information should be presented, "comparative information in prior years should only be adjusted for periods during which the entities were under common control."

1.44 Regarding preparation of the financial statements of the then-combined entities for periods before common control, we understand that the SEC staff further believes that the entity to be presented as the historical (predecessor) entity is generally the combining entity first owned by the controlling shareholder, regardless of the legal form of the common control combination. Presentation of the historical (predecessor) entity for periods before common control as other than the first entity owned by the controlling shareholder is expected to be infrequent, such as when the first entity owned by the controlling shareholder is a nonoperating shell corporation.

Example 1-4
Transaction Between Entities Under Common Control

Investor A owns 100 percent of Company B and Company C. Investor A acquired Company B on January 1, 20X9, and Company C on January 1, 20X4. Investor A applied push-down accounting to Company B and Company C at the time of their acquisition. On January 1, 20Y0, Investor A elects to combine Company B and Company C. This is accomplished by Company B issuing additional shares in exchange for the outstanding shares of Company C. Both Company B and Company C are operating businesses.

Company C is presented as the historical reporting entity up to the date of common control by Investor A (January 1, 20X9) when preparing the financial statements for the combined Company B/Company C entity. Despite the legal form of the combination, Company C is presented as the historical reporting entity because it was the first entity of the combining entities controlled by Investor A. After January 1, 20X9, combined financial information is presented.

Combinations Between Entities With Common Ownership

1.45 In some instances, a combination may occur between two or more entities with a high degree of common ownership, but the combining entities are not under common control. For a transaction between entities with a high degree of common ownership to be accounted for in a manner consistent with a common control transaction (see **1.41–1.44**), identical owners of the entities before the transaction with ownership in very similar percentages would most likely be required to demonstrate that the transaction lacks substance. Such fact patterns are expected to be rare.

1.46 The conclusion in **1.45** has historically been supported by the SEC's analogy to paragraph 6 of Technical Bulletin 85-5. While Technical Bulletin 85-5 was nullified by Statement 141(R), we believe that analogizing to this guidance remains appropriate. Paragraph 6 of Technical Bulletin 85-5 states, in part:

> [I]f the exchange lacks substance, it is not a purchase event and should be accounted for based on existing carrying amounts. That is, if the minority interest does not change and if in substance the only assets of the combined entity after the exchange are those of the partially owned subsidiary prior to the exchange, a change in ownership has not taken place, and the exchange should be accounted for based on the carrying amounts of the partially owned subsidiary's assets and liabilities.

Example 1-5
Transaction Between Two Entities With Common Ownership

Before being combined, Company B and Company C were owned as follows:

	Company B	**Company C**
Owner 1	80%	5%
Owner 2	10	10
Owner 3	5	20
Owner 4	5	65

Example 1-5 (continued)
Transaction Between Two Entities With Common Ownership

Company B is significantly larger than C such that after the combination, the ownership is as follows:

	Combined B/C
Owner 1	60%
Owner 2	10
Owner 3	10
Owner 4	20

Although B and C had identical owners before the combination, when the resulting change in relative ownership is taken into account, accounting for the combination in a manner consistent with a transaction between entities under common control is not appropriate.

Combinations Involving Not-for-Profit Organizations

1.47 Paragraph 2(d) of Statement 141(R) states that the following two transactions are not within its scope: (1) a combination between not-for-profit organizations and (2) an acquisition of a for-profit business by a not-for-profit organization. However, the acquisition of a not-for-profit organization by a for-profit business entity is within the scope of Statement 141(R).

1.48 Appendix D of Statement 116 defines a not-for-profit organization as follows:

> An entity that possesses the following characteristics that distinguish it from a business enterprise: (a) contributions of significant amounts of resources from resource providers who do not expect commensurate or proportionate pecuniary return, (b) operating purposes other than to provide goods or services at a profit, and (c) absence of ownership interests like those of business enterprises. Not-for-profit organizations have those characteristics in varying degrees (Concepts Statement 4, paragraph 6). Organizations that clearly fall outside this definition include all investor-owned enterprises and entities that provide dividends, lower costs, or other economic benefits directly and proportionately to their owners, members, or participants, such as mutual insurance companies, credit unions, farm and rural electric cooperatives, and employee benefit plans (Concepts Statement 4, paragraph 7).

1.49 The FASB has an ongoing project to address the accounting for mergers and acquisitions involving not-for-profit organizations, as well as the subsequent accounting for goodwill and other intangible assets for these entities. In October 2006, the FASB released the following two exposure drafts: *Not-for-Profit Organizations: Mergers and Acquisitions* and *Not-for-Profit Organizations: Goodwill and Other Intangible Assets Acquired in a Merger or Acquisition*. In May 2008, the FASB issued a request for additional comments regarding potential revisions to the prior exposure drafts. The comment period for the request for additional comments ended on July 8, 2008. The FASB expects to issue final standards in the first half of 2009.

Section 2 — Identifying the Acquirer

2.01 Paragraph 8 of Statement 141(R) states, "For each business combination, one of the combining entities shall be identified as the acquirer."

2.02 Paragraph 3(b) of Statement 141(R) defines the "acquirer" as follows:

> The *acquirer* is the entity that obtains control of the acquiree. However, in a business combination in which a variable interest entity is acquired, the primary beneficiary of that entity always is the acquirer.

2.03 ARB 51, as amended by Statement 160, indicates that one entity controls another if it holds a "controlling financial interest" and it prescribes criteria for determining which entity has obtained control. If, upon evaluating these criteria, the combining entities are unable to determine which entity has obtained control, they may consider the additional factors in paragraphs A11–A15 of Statement 141(R). Each of these factors is described in more detail below (see **2.06–2.22**).

2.04 In addition to evaluating the criteria in ARB 51, as amended by Statement 160, an acquirer must determine whether the acquiree is a variable interest entity (VIE) in accordance with Interpretation 46(R). Note that not all VIEs would meet Statement 141(R)'s definition of a business. Therefore, the initial consolidation of certain VIEs is outside the scope of Statement 141(R). (See **1.17–1.21** for additional scope considerations regarding VIEs.)

2.05 The acquirer is determined as of the acquisition date. An entity that made an initial assessment of the acquirer before the acquisition date must consider all pertinent facts and circumstances as of the acquisition date when making the final determination. Changes in facts and circumstances after the acquisition date do not affect the determination of the acquirer.

Business Combinations Effected Primarily by Transferring Cash or Other Assets or by Incurring Liabilities

2.06 Paragraph A11 of Statement 141(R) states, "In a business combination effected primarily by transferring cash or other assets or by incurring liabilities, the acquirer usually is the entity that transfers the cash or other assets or incurs the liabilities."

Business Combinations Effected Primarily by Exchanging Equity Interests

2.07 Paragraph A12 of Statement 141(R) states, in part:

> In a business combination effected primarily by exchanging equity interests, the acquirer usually is the entity that issues its equity interests. However, in some business combinations, commonly called *reverse acquisitions*, the issuing entity is the acquiree. [See **2.23**.]

2.08 Paragraph A12 of Statement 141(R) further indicates:

> Other pertinent facts and circumstances also shall be considered in identifying the acquirer in a business combination effected by exchanging equity interests, including:
>
> a. *The relative voting rights in the combined entity after the business combination* . . . . [See **2.10–2.11**.]

b. *The existence of a large minority voting interest in the combined entity if no other owner or organized group of owners has a significant voting interest . . . .* [See **2.12**.]

c. *The composition of the governing body of the combined entity . . . .* [See **2.13–2.15**.]

d. *The composition of the senior management of the combined entity . . . .* [See **2.16–2.17**.]

e. *The terms of the exchange of equity interests . . . .* [See **2.18**.]

2.09 Statement 141(R) provides no hierarchical guidance on determining the acquirer in a business combination effected through an exchange of equity interests. **All** pertinent facts and circumstances should be considered, particularly those in paragraphs A12(a)–A12(e). (See **2.10–2.18**.) Additional facts and circumstances that may be pertinent include which of the combining entities initiated the business combination as well as the relative size of the combining entities. (See **2.19**.)

Consideration of the Relative Voting Rights in the Combined Entity After the Business Combination

2.10 Paragraph A12(a) of Statement 141(R) states, in part:

> The acquirer usually is the combining entity whose owners as a group retain or receive the largest portion of the voting rights in the combined entity. In determining which group of owners retains or receives the largest portion of the voting rights, an entity shall consider the existence of any unusual or special voting arrangements and options, warrants, or convertible securities.

2.11 The relative voting rights in the combined entity should be considered as of the acquisition date on the basis of all securities with voting rights, not just voting common stock. Any unusual or special voting arrangements in place as of the acquisition date must also be considered, because such arrangements may serve to alter the outstanding voting rights of the holders of voting securities. In addition, while some options, warrants, or convertible securities of the legal acquiree may be exchanged for voting securities as of the acquisition date, other options, warrants, or convertible securities of the legal acquiree, as well as similar securities of the legal acquirer, may remain outstanding as of the acquisition date. To the extent that options, warrants, or convertible securities outstanding as of the acquisition date could result in the subsequent issuance of voting securities in the combined entity, the specific facts and circumstances associated with such options, warrants, or convertible securities must be considered.

Example 2-1
Relative Voting Rights of the Combined Entity

A nonvoting security that is held by a large minority owner, that is outstanding as of the acquisition date, and that can be immediately converted into a voting security may be determined to be a pertinent fact or circumstance. However, options with varying terms that are held by employees of both combining entities and that will remain outstanding in the combined entity may not be a pertinent fact or circumstance.

Consideration of the Existence of a Large Minority Voting Interest in the Combined Entity If No Other Owner or Organized Group of Owners Has a Significant Voting Interest

2.12 Paragraph A12(b) of Statement 141(R) states, in part:

> The acquirer usually is the combining entity whose single owner or organized group of owners holds the largest minority voting interest in the combined entity.

Consideration of the Composition of the Governing Body of the Combined Entity

2.13 Paragraph A12(c) of Statement 141(R) states, in part:

> The acquirer usually is the combining entity whose owners have the ability to elect or appoint or to remove a majority of the members of the governing body of the combined entity.

2.14 Consideration should be given to (1) the initial composition of the governing body of the combined entity and (2) the process in place as of the acquisition date governing how subsequent members of the governing body are to be elected or appointed and when the next election or appointment may occur. A plan, as of the acquisition date, to alter the initial composition of the governing body or a process in place as of the acquisition date that could result in an alteration of the governing body should be evaluated to determine whether such a plan or process is a pertinent fact or circumstance.

2.15 At the 2007 AICPA National Conference on Current SEC and PCAOB Developments, an SEC staff member (Eric C. West), in prepared remarks, addressed the staff's view on evaluating temporary control of the combined entity's governing body. Mr. West stated, in part:

> The goal is to determine whether control of the board by any shareholder group is temporary and, therefore, control may not be substantive. This is particularly important in situations where the board of directors of the combined entity is dominated by members that represent the minority shareholders' interests. In this situation many have asserted that the [SEC] staff employs a bright line. Some believe that we won't accept a conclusion that the minority shareholder controls the board if its members control for a period of less than two years, three years and sometimes even five years. I'd like to tell you we have no bright line and simply believe that control of the board should be substantive. I'd also like to emphasize that we understand that judgment may be required in applying paragraph 17c [superseded by paragraph A12(c) of Statement 141(R)].

Consideration of the Composition of the Senior Management of the Combined Entity

2.16 Paragraph A12(d) of Statement 141(R) states, in part:

> The acquirer usually is the combining entity whose former management dominates the management of the combined entity.

2.17 Senior management would generally include, but not be limited to, the chief executive officer, the chief financial officer, and the chief operating officer. Consideration should be given to (1) the initial composition of the senior management of the combined entity and (2) any plan or intention as of the acquisition date to make subsequent changes in the initial composition of the senior management after the acquisition date. A plan or intention as of the acquisition date to alter the initial composition of senior management, such as a planned retirement with a determined successor, should be evaluated to determine whether such a plan or intention is a pertinent fact or circumstance. The pertinence of a planned or intended change to the initial composition of the senior management of the combined entity will most likely be influenced by both the specific senior management position(s) affected and the expected timing of the change(s).

Consideration of the Terms of the Exchange of Equity Securities

2.18 Paragraph A12(e) of Statement 141(R) states, in part:

> The acquirer usually is the combining entity that pays a premium over the precombination fair value of the equity interests of the other combining entity or entities.

Consideration of the Relative Size of the Combining Entities

2.19 Paragraph A13 of Statement 141(R) states, in part:

> The acquirer usually is the combining entity whose relative size (measured in, for example, assets, revenues, or earnings), is significantly larger than that of the other combining entity or entities.

Business Combinations Involving More Than Two Entities

2.20 Paragraph A14 of Statement 141(R) states, in part:

> 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, as well as the relative size of the combining entities (paragraph A13). [See **2.19**.]

Use of a New Entity to Effect a Business Combination

2.21 Paragraph A15 of Statement 141(R) states, in part:

> A new entity formed to effect a business combination is not necessarily the acquirer. 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 by applying the guidance in paragraphs A10–A14. [See **2.03–2.20**.] In contrast, a new entity that transfers cash or other assets or incurs liabilities as consideration may be the acquirer.

Example 2-2
NewCo Issues Equity Interests to Combining Entities

Company A and Company B agree to combine in a transaction to be accounted for as a business combination. To effect the transaction, a new entity ("NewCo") will be formed to issue equity interests to the shareholders of both A and B. In this transaction, either A or B will be determined to be the acquiring entity on the basis of the available evidence. The guidance in paragraphs A12–A15 of Statement 141(R) (see **2.07–2.20**) should be used in identifying the acquirer.

2.22 Paragraph 19 of Statement 141 prohibited a new entity (often referred to as a "NewCo") from being identified as an acquirer in a business combination. However, in certain situations, the SEC staff may have required a NewCo to be deemed the acquirer. In an August 16, 2001, correspondence to the FASB staff, then SEC Chief Accountant Lynn E. Turner discusses one such situation:

> The staff continues to believe however, that when a Newco has any precombination activities that are deemed to be significant, the Newco cannot be viewed as a new corporation solely formed to issue stock to effect a business combination and therefore could be deemed the accounting acquirer.

Under Statement 141(R), a NewCo can be considered the acquiring entity in certain situations.

Example 2-3
NewCo as the Acquirer

Company C, an investment company, and several unrelated investors form a new entity ("NewCo") by contributing cash in exchange for equity interests of NewCo. NewCo subsequently secures debt financing from a third-party bank. Using the cash contributions and debt financing, NewCo negotiates and acquires a controlling interest in an unrelated company, Company D. NewCo survives the acquisition and becomes the new parent to D. On the basis of the available evidence, the parties to the transaction might determine that NewCo is a substantive company rather than a new corporation formed solely to issue equity interests. If so, NewCo would be deemed the acquirer.

Reverse Acquisitions

2.23 Under Statement 141(R), a reverse acquisition is a business combination in which the entity that issues its stock or gives other consideration to effect the transaction is determined to be the accounting acquiree (also called the legal acquirer or legal parent), while the entity receiving the stock or other consideration is the accounting acquirer (also called the legal acquiree or legal subsidiary). Statement 141(R)'s guidance on reverse acquisitions applies only when the accounting acquiree meets the definition of a business. (See **1.08**.) Otherwise, the transaction is not considered a business combination and would be accounted for as either an asset acquisition or a capital transaction.

Example 2-4
Reverse Acquisition

Company A, a public entity with a December 31 year-end, has 1 million common shares outstanding as of June 30, 20X9. Company A has substantive operations and is not considered a nonoperating public shell corporation. (See **2.32**.) On July 1, 20X9, in a transaction accounted for as a business combination, A issues 4 million of its newly registered common shares to Company B, a private entity, in exchange for all of B's 2 million outstanding common shares (an exchange rate of 2:1). After the transaction, B controls the voting rights of A through its 80 percent ownership interest (4 million common shares held ÷ 5 million total common shares outstanding) as well as its ability to elect a majority of the board members of the combined entity. Although A issued common shares to effect the business combination, B would be considered the accounting acquirer (legal acquiree) under Statement 141(R), provided that there are no other existing pertinent facts and circumstances to the contrary after consideration of the factors in paragraphs A12–A14 of Statement 141(R). (See **2.07–2.20**.)

Calculating Consideration Transferred

2.24 In a reverse acquisition, the accounting acquirer (legal acquiree) usually issues no consideration for the acquiree. However, to apply acquisition method accounting, the accounting acquirer must still calculate a hypothetical amount of consideration it would have transferred to acquire the accounting acquiree (legal acquirer) to obtain the same percentage of ownership interest in the combined entity that results from the transaction. Paragraph A109 of Statement 141(R) states, in part:

> Accordingly, the acquisition-date fair value of the consideration transferred by the accounting acquirer for its interest in the accounting acquiree is based on the number of equity interests the legal subsidiary [legal acquiree] would have had to issue to give the owners of the legal parent [legal acquirer] the same percentage equity interest in the combined entity that results from the reverse acquisition . . . . The fair value of the number of equity interests calculated in that way can be used as the fair value of consideration transferred in exchange for the acquiree.

2.25 In some reverse acquisitions, the accounting acquiree may issue cash or other consideration, as well as stock, to acquire the shares of the accounting acquirer. The payment of cash to the shareholders of the accounting acquirer should be considered a distribution of capital and, accordingly, a reduction of shareholders' equity of the accounting acquirer.

Measuring Goodwill

2.26 Paragraph A121 of Statement 141(R) indicates that goodwill in a reverse acquisition is measured as the excess of the fair value of the consideration effectively transferred by the accounting acquirer over the fair value of the accounting acquiree's identifiable net assets.

Noncontrolling Interests

2.27 In some reverse acquisitions, certain shareholders of the accounting acquirer (legal acquiree) may not exchange their interests for interests in the accounting acquiree (legal acquirer), thereby creating noncontrolling interests in the combined entity. (For information about accounting for noncontrolling interests in a reverse acquisition, see **7.10**.)

Measurement Basis of the Combined Entity's Financial Statements

2.28 Paragraph A110 of Statement 141(R) states:

> Consolidated financial statements prepared following a reverse acquisition are issued under the name of the legal parent (accounting acquiree) but described in the notes as a continuation of the financial statements of the legal subsidiary (accounting acquirer), with one adjustment, which is to retroactively adjust the accounting acquirer's legal capital to reflect the legal capital of the accounting acquiree. That adjustment is required to reflect the capital of the legal parent (the accounting acquiree). Comparative information presented in those consolidated financial statements also is retroactively adjusted to reflect the legal capital of the legal parent (accounting acquiree).

2.29 The following table summarizes the measurement basis for the combined entity's financial statements after a reverse acquisition:

Statement of Financial Position Balance(s)	Measurement Basis
Assets and liabilities	Sum of (1) the accounting acquiree's assets and liabilities, measured by using the acquisition method under Statement 141(R), and (2) the accounting acquirer's assets and liabilities, measured by using the precombination carrying values.
Retained earnings and other equity balances	The accounting acquirer's precombination carrying amount, proportionately reduced for any noncontrolling interests.
Issued equity	Sum of (1) the accounting acquirer's issued equity immediately before the business combination, proportionately reduced for any noncontrolling interests, and (2) the fair value of the accounting acquiree (i.e., the hypothetical consideration transferred). The equity structure (i.e., the number and type of equity interests issued) reflects the equity structure of the accounting acquiree.
Noncontrolling interest	The noncontrolling interest's proportionate share of the accounting acquirer's precombination retained earnings, issued equity, and other equity balances. (See **7.10**.)

Earnings per Share

2.30 Paragraph A115 of Statement 141(R) states that the weighted-average number of common shares outstanding, used when calculating earnings per share during the period in which the reverse acquisition occurs, should be calculated as the sum of the following two items:

> a. The number of common shares outstanding from the beginning of that period to the acquisition date shall be computed on the basis of the weighted-average number of common shares of the legal acquiree (accounting acquirer) outstanding during the period multiplied by the exchange ratio established in the merger agreement.
>
> 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 acquirer (the accounting acquiree) outstanding during that period.

2.31 For prior periods, paragraph A116 of Statement 141(R) requires that comparative earnings-per-share amounts be calculated by dividing:

> a. The income of the legal acquiree attributable to common shareholders in each of those periods, by
>
> b. The legal acquiree's historical weighted average number of common shares outstanding multiplied by the exchange ratio established in the acquisition agreement.

Mergers of a Private Operating Company Into a Nonoperating Public Shell Corporation

2.32 In a reverse acquisition (see **2.23**), the legal acquirer generally continues in existence as the legal entity whose shares represent the outstanding common stock of the combined company. In some instances, the legal acquirer is a public company whose shares are listed on an exchange. By effecting a reverse acquisition, the accounting acquirer (if a private entity) can gain access to the public market without going through an initial public offering. The SEC's Division of Corporation Finance, Frequently Requested Accounting and Financial Reporting Interpretations and Guidance, dated March 31, 2001, states:

> The merger of a private operating company into a non-operating public shell corporation with nominal net assets typically results in the owners and management of the private company having actual or effective operating control of the combined company after the transaction, with shareholders of the former public shell continuing only as passive investors. These transactions are considered by the staff to be capital transactions in substance, rather than business combinations. That is, the transaction is equivalent to the issuance of stock by the private company for the net monetary assets of the shell corporation, accompanied by a recapitalization. The accounting is identical to that resulting from a reverse acquisition, except that no goodwill or other intangible should be recorded.

Section 3 — Recognizing and Measuring Assets Acquired and Liabilities Assumed — General

Date of Acquisition

3.01 Transfer of control is the concept used to determine the acquisition date. Control is generally obtained on the date on which an acquirer legally transfers consideration to a seller and acquires the assets and assumes the liabilities of the acquiree (i.e., the closing date). However, entities should consider all relevant details associated with a business combination to determine when control has been obtained. Such considerations may include the following:

- *Regulatory or shareholder approval* — Certain business combinations require regulatory or shareholder approval (shareholder approval may be sought by either the acquirer or the acquiree). It is generally presumed that effective control cannot pass to the acquirer until such required approval is obtained.
- *Acquisition date different from the closing date* — An acquirer may obtain control over an acquiree on a date that either precedes or follows the closing date. This may occur when control transfers via a written agreement that may not correspond to the closing date. Although such situations are expected to occur rarely, all relevant details about how the acquisition date was determined must be considered.

3.02 Determining the acquisition date is important, because on this date:

- All forms of consideration are measured, including contingent consideration and the acquirer's equity securities issued to the seller. (See **Section 6**.)
- The assets acquired, liabilities assumed, and any noncontrolling interests are measured.
- The acquirer begins consolidating the acquired entity.

3.03 Statement 141(R) eliminates the "convenience" exception in paragraph 48 of Statement 141. That exception allowed an acquirer, in certain circumstances, to designate an effective date that was other than the acquisition date of the business combination (e.g., the end of an accounting period between the dates a business combination is initiated and consummated).

Recognition and Measurement Principles

Recognition Principle

3.04 Paragraph 12 of Statement 141(R) specifies an overall recognition principle and states that "[a]s of the acquisition date, the acquirer shall recognize, separately from goodwill, the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree."

3.05 The guidance in Statement 141(R) emphasizes two fundamental principles about the recognition of assets acquired, liabilities assumed, and noncontrolling interests of the acquiree:

1. They must "meet the definition of an asset or a liability in FASB Concepts Statement No. 6" as of the acquisition date.

2. They must be "[p]art of the business combination [and not] the result of a separate transaction."

3.06 Paragraphs 25 and 35 of Concepts Statement 6, respectively, define assets and liabilities as follows:

> - **Assets** are probable [footnote 18] future economic benefits obtained or controlled by a particular entity as a result of past transactions or events. [Emphasis added]
> - **Liabilities** are probable [footnote 21] future sacrifices of economic benefits arising from present obligations [footnote omitted] of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events. [Emphasis added]

Footnotes 18 and 21 in Concepts Statement 6 both state:

> *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 . . .). 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).

3.07 Statement 141(R) may result in an acquirer recognizing some assets and liabilities that were not previously recognized in the acquiree's financial statements. For example, Statement 142 generally requires that costs associated with internally generated intangible assets be expensed as incurred. Therefore, an entity may have incurred a significant amount of costs in developing its trade name; however, it would generally have expensed such costs as incurred, rather than recognizing them as an asset. If, however, that entity was acquired in a business combination, under Statement 141(R) the acquirer would generally recognize the fair value of that trade name as an intangible asset apart from goodwill.

3.08 Transactions that are to be accounted for separately from a business combination are discussed in **3.28–3.39** and **6.37–6.38**.

3.09 There are limited exceptions to Statement 141(R)'s requirement that an acquirer recognize every identifiable asset and liability. For example, assets and liabilities arising from contingencies are not recognized unless they meet certain criteria. Exceptions to the general recognition and measurement principles are summarized in **3.15** and discussed further in **Sections 4** and **5**.

Classification or Designation on the Acquisition Date for Subsequent Accounting

3.10 After assets acquired or liabilities assumed are recognized, Statement 141(R) requires that the acquirer classify or designate them on the acquisition date. Specifically, paragraph 17 of Statement 141(R) states:

> At the acquisition date, the acquirer shall classify or designate the identifiable assets acquired and liabilities assumed as necessary to subsequently apply other GAAP. The acquirer shall make those classifications or designations on the basis of the contractual terms, economic conditions, its operating or accounting policies, and other pertinent conditions as they exist at the acquisition date.

3.11 Paragraph 18 of Statement 141(R) provides some examples of classifications or designations that the acquirer may be required to make on the acquisition date in accordance with the guidance in paragraph 17:

> a. Classification of particular investments in securities as trading, available for sale, or held to maturity in accordance with FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*
>
> b. Designation of a derivative instrument as a hedging instrument in accordance with FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*
>
> c. Assessment of whether an embedded derivative should be separated from the host contract in accordance with Statement 133 (which is a matter of *classification* as this Statement uses that term).

3.12 An acquirer is required to designate or classify assets or liabilities as of the acquisition date because the subsequent accounting can vary according to their classification. For example, an acquirer's subsequent accounting for a security differs depending on whether the acquirer classifies the security as trading, available for sale, or held to maturity. However, paragraph 19 of Statement 141(R) provides some exceptions to the classification or designation requirement:

> a. Classification of a lease contract as either an operating lease or a capital lease in accordance with FASB Statement No. 13, *Accounting for Leases,* as interpreted by FASB Interpretation No. 21, *Accounting for Leases in a Business Combination*
>
> b. Classification of a contract written by an entity that is in the scope of FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises*, as amended by this Statement, as an insurance or reinsurance contract or a deposit contract.
>
> The acquirer shall classify those contracts on the basis of the contractual terms and other factors at the inception of the contract (or, if the terms of the contract have been modified in a manner that would change its classification, at the date of that modification, which might be the acquisition date).

Exceptions to the general classification and designation principles are summarized in **3.15** and discussed further in **Sections 3** and **4**.

Measurement Principle

3.13 Paragraph 20 of Statement 141(R) provides an overall measurement principle and states that "[t]he acquirer shall measure the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at their **acquisition-date fair values**" (emphasis added). Refer to **3.40–3.58** for a discussion of general fair value concepts.

3.14 There are exceptions to Statement 141(R)'s requirement that every identifiable asset, liability, and equity instrument be measured at fair value. For example, an acquirer must measure an acquiree's deferred taxes, employee benefits, share-based payments, and assets held for sale in accordance with other applicable accounting literature. Exceptions to the general recognition and measurement principles are summarized in **3.15** and discussed further in **Sections 4** and **5**.

Summary of Exceptions to General Principles of Recognition and Measurement

3.15 An acquirer should apply the specified accounting guidance of each applicable U.S. GAAP standard, rather than the general principles discussed in Statement 141(R), to the exceptions noted below. Refer to the section number indicated after the individual exceptions for a more detailed discussion.

Exceptions to General Principles of Recognition and Measurement	
Recognition exceptions	• Contingencies (see **4.32–4.37**).
Measurement exceptions	• Share-based payment awards (see **4.49**). • Assets held for sale (see **4.50–4.51**). • Reacquired rights (see **5.31–5.34**).
Recognition and measurement exceptions	• Income taxes (see **4.38–4.40**). • Employee benefits (see **4.41–4.45**). • Indemnification assets (see **4.46–4.47**).
Classification or designation exceptions[1]	• Leases within the scope of Statement 13 (see **3.12** and **4.14–4.19**). • Contracts within the scope of Statement 60 (see **3.12**).

Measurement Period

3.16 The measurement period is the time after an acquisition during which the acquirer obtains the information needed to identify and measure the consideration transferred, the assets acquired, the liabilities assumed, and any noncontrolling interests.

3.17 The duration of the measurement period is not the same for every acquisition, or even for all items acquired in a specific acquisition. The measurement period for a particular asset, liability, or equity instrument ends once the acquirer determines that the available information has been obtained or that the information is not available. The measurement period for all items acquired in an acquisition, however, is limited to one year from the acquisition date.

3.18 The acquirer must determine whether, for each item to be measured, additional information is required or obtainable and must document and disclose, at each reporting period, the items requiring additional information. Refer to **13.24** for a discussion of the specific disclosure requirements for provisional measurements.

3.19 The acquirer must consider all pertinent factors in determining whether information obtained after the acquisition date should result in an adjustment to the provisional amounts recognized (see **3.20–3.23**) or whether that information results from events that occurred after the acquisition date. This determination requires judgment. In making that determination, the acquirer should consider whether it can identify the reason for the change and how long after the acquisition the new information was received. New information received soon after the acquisition is more likely to reflect facts and circumstances existing as of the acquisition date. Accordingly, the measurement period is not intended to allow for subsequent adjustments of the amounts recorded as a part of the business combination that result from the uncertainties and related risks assumed in the combination. Decisions made by the combined company, and economic events occurring after the acquisition, do not result in an adjustment to the provisional amounts. Rather, such adjustments are included in the determination of net income in the period in which the adjustment is made. For example, contingent consideration is subject to the same measurement-period requirements as all other assets acquired and liabilities assumed. After the acquisition date, changes in the fair value of contingent consideration due to the acquiree

1 Paragraph 19 of Statement 141(R) states, "The acquirer shall classify those contracts on the basis of the contractual terms and other factors at the inception of the contract (or, if the terms of the contract have been modified in a manner that would change its classification, at the date of that modification, which might be the acquisition date)."

meeting certain earnings targets or milestones are subsequent events and should not be recognized as measurement-period adjustments.

Provisional Measurement of Consideration Transferred, Assets Acquired, Liabilities Assumed, and Noncontrolling Interests

3.20 Because of the complexity of completing certain fair value measurements or because the acquisition may occur in close proximity to the acquirer's next reporting date, the assignment of amounts to the consideration transferred, the assets acquired, the liabilities assumed, and any noncontrolling interests may not be complete by the acquirer's next reporting date. Therefore, the acquirer must report provisional amounts on the basis of best estimates of information available as of the reporting date.

3.21 If a material adjustment to the provisional amounts is identified during the measurement period, the acquirer must recognize the adjustment as if the accounting for the business combination had been completed as of the acquisition date. Thus, the acquirer must revise comparative information for prior periods (i.e., via retrospective adjustment) as needed, including making any change in depreciation, amortization, or other income effects recognized in completing the initial accounting.

3.22 Because measurement-period adjustments are recognized retrospectively, entities may want to complete valuations as quickly as possible, to the extent practicable, to limit the number of times previously reported amounts will need to be adjusted.

3.23 Once the measurement period ends, any adjustments to the initial accounting for the business combination can only be recognized as the correction of an error in accordance with Statement 154.

Example 3-1

Accounting for Adjustments to Provisional Amounts Assigned to Identifiable Assets Acquired and Liabilities Assumed

The following example is extracted from paragraphs A74–A76 of Statement 141(R) and assumes that the business combination was accounted for under Statement 141(R). The example does not include any quarterly reporting requirements.

AC acquires TC on September 30, 20X7. AC seeks an independent appraisal for an item of property, plant, and equipment acquired in the combination, and the appraisal was not complete by the time AC issued its financial statements for the year ending December 31, 20X7. In its 20X7 annual financial statements, AC recognized a provisional fair value for the asset of $30,000. At the acquisition date, the item of property, plant, and equipment had a remaining useful life of five years. Five months after the acquisition date, AC received the independent appraisal, which estimated the asset's acquisition-date fair value as $40,000.

In its financial statements for the year ending December 31, 20X8, AC retrospectively adjusts the 20X7 prior-year information as follows:

a. The carrying amount of property, plant, and equipment as of December 31, 20X7, is increased by $9,500. That adjustment is measured as the fair value adjustment at the acquisition date of $10,000 less the additional depreciation that would have been recognized had the asset's fair value at the acquisition date been recognized from that date ($500 for 3 months' depreciation).

b. The carrying amount of goodwill as of December 31, 20X7, is decreased by $10,000.

c. Depreciation expense for 20X7 is increased by $500.

Example 3-1 (continued)

Accounting for Adjustments to Provisional Amounts Assigned to Identifiable Assets Acquired and Liabilities Assumed

In accordance with paragraph 72(a), AC discloses:

a. In its 20X7 financial statements, that the initial accounting for business combination has not been completed because the appraisal of property, plant, and equipment has not yet been received.

b. In its 20X8 financial statements, the amounts and explanations of the adjustments to the provisional values recognized during the current reporting period. Therefore, AC discloses that the 20X7 comparative information is retrospectively adjusted to increase the fair value of the item of property, plant, and equipment at the acquisition date by $9,500, offset by a decrease to goodwill of $10,000 and an increase in depreciation expense of $500.

Impact on SEC Registrants

3.24 SEC registrants are not required to file an amendment to retrospectively adjust previously filed Exchange Act periodic reports on Forms 10-Q/A and 10-K/A for material measurement-period adjustments because they did not contain errors when they were originally filed. Rather, comparative financial information is revised in subsequent filings to reflect the effect of the measurement-period adjustment. This requirement could affect SEC registrants that (1) plan to issue a new registration statement (see **3.25**) or (2) have existing effective registration statements (see **3.26**) (e.g., an existing Form S-3 that already is effective but upon which a registrant wishes to draw down or issue securities).

New Registration Statements

3.25 A new registration or proxy statement that is filed after the registrant determines that it must make a material retrospective adjustment to provisional amounts[2] must include (or incorporate by reference) financial statements that reflect the retrospective adjustments for all periods presented. In this context, materiality is a matter of judgment. The revised financial statements are filed on Form 8-K or included in the new registration statement. Other affected financial information (e.g., MD&A and selected financial data) that was reported in the registrant's reports on Forms 10-K and 10-Q also must be updated to reflect the retrospective adjustments. To be prepared for a potential registration statement, a registrant is **permitted** to file updated financial statements and other affected financial information that reflect the retrospective adjustment in a Form 8-K once it has determined that it has a material adjustment to provisional amounts. However, there is no **requirement** to do so until immediately before a registration statement is filed.

Effective Registration Statements

3.26 A registrant is under no specific obligation to update an existing, effective registration statement unless a fundamental change occurs as stipulated by Securities Act Rule 10(a)(3) regarding the age of information in the prospectus. The term "fundamental change" is not defined. Management, in consultation with legal counsel, should determine whether a retrospective adjustment constitutes a fundamental change. Generally, such a determination should be based on whether the additional information is necessary for an investor to make an informed investment decision (refer to SEC Regulation S-K, Item 512(a)). If the registrant and its legal counsel determine that the retrospective adjustment is a fundamental change, updated financial statements and other affected financial information, such as MD&A and selected financial data, should be filed on Form 8-K or included in the

2 This requirement applies when a registrant determines that it must make a material retrospective adjustment to provisional amounts. In contrast, for certain other retrospective changes, a registrant may file updated financial statements only after it has filed a 10-Q that first reports the new accounting treatment (e.g., segment changes under Statement 131 and discontinued operations under Statement 144 and the retrospective adoption of a new accounting pronouncement).

registration statement, as described above. All post-effective amendments that adjust the prospectus are considered "new filings" and would be treated pursuant to the guidance in **3.25**.

Form S-8

3.27 The Highlights of the July 8, 2008, SEC Regulations Committee Meeting indicate the following:

> The staff understands that there has been confusion regarding the need to provide restated financial statements in a Form S-8 for certain events occurring after the filing of a Form 10-K that result in differences between the financial presentation in the Form 10-K and subsequent Form 10-Qs that are incorporated by reference into the S-8. . . . It is the responsibility of the Company and their counsel to determine if there has been a material change that is required to be disclosed in a Form S-8. Likewise, it is the responsibility of the auditor to determine if they will issue a consent to the use of their report if there has been a change in the financial statements that is reflected in the 10-Q but the annual accounts have not been retroactively restated.

Example 3-2

SEC Registrant's Accounting for Adjustments to Provisional Amounts Assigned to Identifiable Assets Acquired and Liabilities Assumed

Assume the same facts as in Example 3-1 above except that AC is an SEC registrant that is a large accelerated filer. On February 15, 20X8, AC filed its Form 10-K for the year ended December 31, 20X7, and disclosed a provisional amount related to an item of property, plant, and equipment acquired through a business combination. On February 28, 20X8, AC received the independent appraisal and determined that it must make a material retrospective adjustment to the provisional amount related to the item of property, plant, and equipment. AC plans to issue a new registration statement on April 5, 20X8.

As a result of the new registration statement, AC must include in its new registration statement (or incorporate by reference on a Form 8-K) adjusted annual financial statements for the year ended December 31, 20X7, reflecting the retrospective adjustments for the revised amount of goodwill, property, plant, and equipment and related depreciation. The Form 8-K would also include revisions to the financial information outside of the financial statements such as the selected financial data section and MD&A to the extent applicable.

Determining What Is Part of the Business Combination Transaction

3.28 Sometimes an acquirer may settle a preexisting relationship or other arrangement simultaneously with the business combination. The acquirer must account for such arrangements as a transaction separate from the business combination. Paragraph 57 of Statement 141(R) provides the following guidance for the accounting for preexisting relationships or other arrangements between an acquirer and an acquiree that are present before the business combination:

> The acquirer and the acquiree may have a preexisting relationship or other arrangement before negotiations for the business combination began, or they may enter into an arrangement during the negotiations that is separate from the business combination. In either situation, the acquirer shall identify any amounts that are not part of what the acquirer and the acquiree (or its former owners) exchanged in the business combination, that is, amounts that are not part of the exchange for the acquiree. The acquirer shall recognize as part of applying the acquisition method only the consideration transferred for the acquiree. **Separate transactions shall be accounted for in accordance with the relevant GAAP.** [Emphasis added]

3.29 A strong indicator of a preexisting relationship that would qualify for accounting apart from the business combination is a transaction that is entered into by or on behalf of the acquirer or primarily for the benefit of the acquirer or the anticipated combined entity. Paragraph 58 of Statement 141(R) specifies examples of such transactions:

- "A transaction that in effect settles preexisting relationships between the acquirer and acquiree."
- "A transaction that compensates employees or former owners of the acquiree for future services" (i.e., compensation arrangements); see **6.39**.
- "A transaction that reimburses the acquiree or its former owners for paying the acquirer's acquisition-related costs;" see **3.36**.

3.30 Determining what is or is not part of a business combination requires judgment. Paragraph A77 of Statement 141(R) specifies three factors that "are neither mutually exclusive nor individually conclusive" that should be considered in making this determination:

> a. *The reasons for the transaction* — 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 is part of the consideration transferred and the assets acquired or liabilities assumed. For example, if a transaction is arranged primarily for the benefit of the acquirer or the combined entity rather than primarily for the benefit of the acquiree or its former owners before the combination, that portion of the transaction price paid (and any related assets or liabilities) is less likely to be part of the exchange for the acquiree. Accordingly, the acquirer would account for that portion separately from the business combination.
>
> b. *Who initiated the transaction* — Understanding who initiated the transaction may also provide insight into whether it is 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 before the combination. On the other hand, a transaction or arrangement initiated by the acquiree or its former owners is less likely to be for the benefit of the acquirer or the combined entity and more likely to be part of the business combination transaction.
>
> c. *The timing of the transaction* — The timing of the transaction may also provide insight into whether it is part of the exchange for the acquiree. For example, a transaction between the acquirer and the acquiree that takes place during the negotiations of the terms of a business combination may have been entered into in contemplation of the business combination to provide future economic benefits to the acquirer or the combined entity. If so, the acquiree or its former owners before the business combination are likely to receive little or no benefit from the transaction except for benefits they receive as part of the combined entity.

3.31 A contract in a preexisting relationship may represent a reacquired right of the acquirer, as discussed in **5.31–5.34**. If the contract contains favorable or unfavorable terms regarding pricing for current market transactions, then a settlement gain or loss would be recognized apart from the business combination and measured in accordance with **3.32**.

3.32 If a business combination effectively results in the settlement of a preexisting relationship between an acquirer and an acquiree, the acquirer would recognize a gain or loss. Paragraph A79 indicates how such gain or loss should be measured:

> a. For a preexisting noncontractual relationship (such as a lawsuit), fair value
>
> b. For a preexisting contractual relationship, the lesser of:
>
> (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. (An *unfavorable contract* is a contract that is unfavorable in terms of current market terms. It is not necessarily a loss contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.)
>
> (2) The amount of any stated settlement provisions in the contract available to the counterparty to whom the contract is unfavorable.
>
> If (2) is less than (1), the difference is included as part of the business combination accounting.

3.33 The acquirer's recognition of an asset or liability related to the preexisting relationship before the business combination will affect the calculation of the settlement (see Example 3-4 below).

Example 3-3
Effective Settlement of a Supply Contract as a Result of a Business Combination

The following example is extracted from paragraphs A82–A84 of Statement 141(R):

> 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 allows AC to terminate the contract before the end of the initial 5-year term only by paying a $6 million penalty. With 3 years remaining under the supply contract, AC pays $50 million to acquire TC, which is the fair value of TC based on what other market participants would be willing to pay.
>
> Included in the total fair value of TC is $8 million related to the fair value of the supply contract with AC. The $8 million represents a $3 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 $5 million component for pricing that is unfavorable to AC because it exceeds the price of current market transactions for similar items. 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.
>
> In this example, AC recognizes a loss of $5 million (the lesser of the $6 million stated settlement amount and the amount by which the contract is unfavorable to the acquirer) separately from the business combination. The $3 million at-market component of the contract is part of goodwill.

Example 3-4
Effective Settlement of a Contract Between the Acquirer and Acquiree in Which the Acquirer Had Recognized a Liability Before the Business Combination

Paragraph A85 of Statement 141(R) states:

> Whether AC had previously recognized an amount in its financial statements related to a preexisting relationship will affect the amount recognized as a gain or loss for the effective settlement of the relationship. In Example 4 [**Example 3-3**], GAAP might have required AC to recognize a $6 million liability for the supply contract before the business combination. In that situation, AC recognizes a $1 million settlement gain on the contract in earnings at the acquisition date (the $5 million measured loss on the contract less the $6 million loss previously recognized). In other words, AC has in effect settled a recognized liability of $6 million for $5 million, resulting in a gain of $1 million.

3.34 See **13.13** for discussion of disclosures required for business combinations between parties with a preexisting relationship.

Types of Transactions to Be Assessed

Employee Compensation Arrangements

3.35 Replacement awards or other compensation arrangements for past services or future services may be given to employees of the acquiree. The acquirer must determine what portion of the arrangement, if any, should be considered part of the business combination. Amounts not related to the business combination are accounted for under the applicable other standards (e.g., Statement 123(R)). See **6.05–6.19** for further discussion of compensation arrangements.

Reimbursement for Paying the Acquirer's Acquisition Costs

3.36 Acquisition costs cannot be part of the consideration transferred in a business combination. That is, if the acquirer and acquiree enter into an arrangement in which the acquiree pays the acquisition-related costs and the acquirer agrees to reimburse the acquiree, such costs must be accounted for separately from the business combination and not as part of the consideration transferred. Statement 141(R) generally requires such transaction costs to be expensed as incurred. See **6.31–6.36** for further discussion of the accounting treatment for acquisition costs.

Settlement of Disputes With the Former Owners of a Business Combination

3.37 After a business combination, disputes may occur between the acquirer and the former owners of the acquiree, sometimes resulting in amounts being transferred between the parties after the acquisition date. Questions may arise about whether, in accounting for such subsequent payments, the acquiring entity should reflect the amount paid or received as an adjustment to the consideration transferred (formerly referred to as "purchase price" under Statement 141) for the acquired entity or in the postacquisition income statement. At the 2003 AICPA National Conference on Current SEC Developments, SEC staff member Randolph P. Green indicated in prepared remarks that the SEC has "generally concluded that legal claims between an acquirer and the former owners of an acquired business should be reflected in the income statement when settled." This view is based on the general belief that such contingencies related to litigation about the business combination itself are not preacquisition contingencies. Mr. Green offered that treatment of such payments by the acquirer as an adjustment to the consideration transferred for the acquisition may be warranted when there is a "clear and direct link to the purchase price." Mr. Green gave the following example:

> [A]ssume a purchase agreement explicitly sets forth the understanding that each "acquired customer" is worth $1,000, that not less than one thousand customers will be transferred as of the consummation date, and subsequent litigation determines that the actual number of acquired customers was only nine hundred. The effects of the litigation should properly be reflected as part of the purchase price. In contrast, if the purchase agreement obligates the seller to affect its best efforts to retain customers through the consummation date and litigation subsequently determines that the seller failed to do so, the effects are not clearly and directly linked to the purchase price and, accordingly, should be reflected in the income statement.

Note: While not stated by Mr. Green, if the buyer had incurred legal costs to settle the dispute or if the settlement amount had included reimbursement to the sellers for legal costs or other damages, those amounts are not clearly and directly linked to the consideration transferred. Thus, they should be reflected in the income statement.

3.38 As an alternative to the example in **3.37**, Mr. Green also noted that "claims that assert one party misled the other or that a provision of the agreement is unclear are not unique to business combination agreements." Therefore, they would not generally establish a clear and direct link to the consideration transferred and should be reflected in the income statement.

Settlement Disputes With the Shareholders of the Acquiring Entity Over a Business Combination

3.39 In connection with a business combination, the acquiring entity's shareholders may bring a claim against the acquiring entity for various reasons, such as that the acquiring entity overpaid for the acquisition. The acquiring entity should recognize costs incurred for such disputes, including any settlement amount if paid, in the income statement and not as part of the consideration transferred for the acquired entity. This view is consistent with an additional statement by SEC staff member Randolph Green (see **3.37** and **3.38**). Referring to settlements of litigation over consideration transferred, Mr. Green stated that "the cost of litigation brought by the acquirer's shareholders should always be reflected in the income statement."

Fair Value Measurements in Business Combinations

3.40 Statement 141(R) requires most identifiable assets acquired, liabilities assumed or incurred, and noncontrolling interests to be measured at fair value. Statement 157 provides the guidance for measuring fair value. Paragraph 5 of Statement 157 defines fair value as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants [see **3.45**] at the measurement date."

3.41 The summary section of Statement 157 discusses the definition of fair value:

> The definition of fair value retains the exchange price notion in earlier definitions of fair value. This Statement clarifies that the exchange price is the price in an orderly transaction **between market participants to sell the asset or transfer the liability in the market in which the reporting entity would transact** for the asset or liability, that is, the principal or most advantageous market for the asset or liability. The transaction to sell the asset or transfer the liability is a hypothetical transaction at the measurement date, considered from the perspective of a market participant that holds the asset or owes the liability. Therefore, **the definition focuses on the price that would be received to sell the asset or paid to transfer the liability (an exit price), not the price that would be paid to acquire the asset or received to assume the liability (an entry price).** [Emphasis added]

3.42 There are conceptual differences between an "entry price" and an "exit price." Assets are typically not sold and liabilities are typically not settled for the same price paid to obtain them. However, paragraph 17 of Statement 157 acknowledges that upon initial recognition, the entry and exit price may be the same in the absence of certain factors (e.g., related party transactions, forced transactions, the unit of valuation, or differing markets).

3.43 Statement 157 further emphasizes that "fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability."

3.44 Paragraph A2 of Statement 157 states that because fair value is an exit price for assets and liabilities, the following need to be determined for an entity to calculate the fair value measurement:

> a. The particular asset or liability that is the subject of the measurement (consistent with its unit of account)
>
> b. For an asset, the valuation premise appropriate for the measurement (consistent with its highest and best use) [See **3.50–3.53**.]
>
> c. The principal (or most advantageous) market for the asset or liability (for an asset, consistent with its highest and best use) [See **3.54–3.55**.]

d. The valuation technique(s) appropriate for the measurement, considering the availability of data with which to develop inputs that represent the assumptions that market participants would use in pricing the asset or liability and the level in the fair value hierarchy within which the inputs fall. [See **3.56–3.58**.]

Market Participants

3.45 Paragraph 10 of Statement 157 defines a market participant as follows:

> Market participants are buyers and sellers in the principal (or most advantageous) market for the asset or liability that are:
>
> a. Independent of the reporting entity; that is, they are not related parties [footnote omitted]
>
> b. Knowledgeable, having a reasonable understanding about the asset or liability and the transaction based on all available information, including information that might be obtained through due diligence efforts that are usual and customary
>
> c. Able to transact for the asset or liability
>
> d. Willing to transact for the asset or liability; that is, they are motivated but not forced or otherwise compelled to do so.

3.46 Market participants generally fall into two categories — strategic buyers (e.g., an existing operating company) and financial buyers (e.g., private equity investors). Strategic buyers are those that are in the same or similar industry or have the same or similar operations as the acquirer. Strategic buyers typically would use acquired net assets the same way the acquiree would, whereas financial buyers are investors that may use the acquired net assets differently from the way the acquiree uses them.

3.47 Determining the market participants is an important component of measuring fair value, especially as it relates to the use of an asset. Assumptions about the value of an asset and its highest and best use may differ depending on whether the market participant is a strategic buyer or a financial buyer. However, strategic buyers and financial buyers are each considered market participants and must be taken into account in measuring fair value.

3.48 An entity is not required to identify specific market participants. Rather, according to paragraph 11 of Statement 157, an entity would "identify characteristics that distinguish market participants generally, considering factors specific to (a) the asset or liability, (b) the principal (or most advantageous) market for the asset or liability, and (c) market participants with whom the reporting entity would transact in that market." Example 3-5 below illustrates the concept of selecting market participant characteristics that maximize the value of an asset group.

3.49 Under a market-participant measurement approach, acquired intangible assets may have fair value under Statement 157 even if the acquiring entity does not intend to actively use the asset (e.g., an acquired trademark that the acquirer does not intend to use or support after the combination). (See **5.09–5.10**.)

Highest and Best Use

3.50 Statement 157 requires that a fair value measurement assume the highest and best use of an asset. Paragraph 12 of Statement 157 states:

> A fair value measurement assumes the highest and best use of the asset by market participants, considering the use of the asset that is physically possible, legally permissible, and financially feasible at the measurement date. In broad terms, highest and best use refers to the use of an asset by market

participants that would maximize the value of the asset or the group of assets within which the asset would be used. Highest and best use is determined based on the use of the asset by market participants, even if the intended use of the asset by the reporting entity is different.

3.51 The highest and best use of an asset establishes the valuation premise. The valuation premise is used to measure the fair value of an asset. Paragraph 13 of Statement 157 states that the valuation premise of an asset is either of the following:

a. *In-use*. The highest and best use of the asset is in-use if the asset would provide maximum value to market participants principally through its use in combination with other assets as a group (as installed or otherwise configured for use). For example, that might be the case for certain nonfinancial assets. If the highest and best use of the asset is in-use, the fair value of the asset shall be measured using an in-use valuation premise. When using an in-use valuation premise, the fair value of the asset is determined based on the price that would be received in a current transaction to sell the asset assuming that the asset would be used with other assets as a group and that those assets would be available to market participants. Generally, assumptions about the highest and best use of the asset should be consistent for all of the assets of the group within which it would be used.

b. *In-exchange*. The highest and best use of the asset is in-exchange if the asset would provide maximum value to market participants principally on a standalone basis. For example, that might be the case for a financial asset. If the highest and best use of the asset is in-exchange, the fair value of the asset shall be measured using an in-exchange valuation premise. When using an in-exchange valuation premise, the fair value of the asset is determined based on the price that would be received in a current transaction to sell the asset standalone.

3.52 Paragraph 14 of Statement 157 states that "[b]ecause the highest and best use of the asset is determined based on its use by market participants, the fair value measurement considers the assumptions that market participants would use in pricing the asset, whether using an in-use or an in-exchange valuation premise." Although the discussion in paragraphs 12–14 of Statement 157 appears under the heading "Application to Assets," the in-use (in combination) valuation premise may also be appropriate for liabilities (e.g., a portfolio of similar written life insurance policies) or for a combination of assets and liabilities (e.g., a portfolio of similar derivatives).

Example 3-5
Highest and Best Use of an Asset Group

The following example is extracted from paragraphs A7–A9 of Statement 157:

> The reporting entity, a strategic buyer, acquires a group of assets (Assets A, B, and C) in a business combination. Asset C is billing software developed by the acquired entity for its own use in conjunction with Assets A and B (related assets). The reporting entity measures the fair value of each of the assets individually, consistent with the specified unit of account for the assets. The reporting entity determines that each asset would provide maximum value to market participants principally through its use in combination with other assets as a group (highest and best use is in-use).
>
> In this instance, the market in which the reporting entity would sell the assets is the market in which it initially acquired the assets (that is, the "entry" and "exit" markets from the perspective of the reporting entity are the same). Market participant buyers with whom the reporting entity would transact in that market have characteristics that are generally representative of both financial buyers and strategic buyers and include those buyers that initially bid for the assets. [Footnote 13] As discussed below, differences between the indicated fair values of the individual assets relate principally to the use of the assets by those market participants within different asset groups:

Example 3-5 (continued)
Highest and Best Use of an Asset Group

a. *Strategic buyer asset group.* The reporting entity, a strategic buyer, determines that strategic buyers have related assets that would enhance the value of the group within which the assets would be used (market participant synergies). Those assets include a substitute asset for Asset C (the billing software), which would be used for only a limited transition period and could not be sold standalone at the end of that period. Because strategic buyers have substitute assets, Asset C would not be used for its full remaining economic life. The indicated fair values of Assets A, B, and C within the strategic buyer asset group (reflecting the synergies resulting from the use of the assets within that group) are $360, $260, and $30, respectively. The indicated fair value of the assets as a group within the strategic buyer asset group is $650.

b. *Financial buyer asset group.* The reporting entity determines that financial buyers do not have related or substitute assets that would enhance the value of the group within which the assets would be used. Because financial buyers do not have substitute assets, Asset C (the billing software) would be used for its full remaining economic life. The indicated fair values of Assets A, B, and C within the financial buyer asset group are $300, $200, and $100, respectively. The indicated fair value of the assets as a group within the financial buyer asset group is $600.

The fair values of Assets A, B, and C would be determined based on the use of the assets as a group within the strategic buyer group ($360, $260, and $30). Although the use of the assets within the strategic buyer group does not maximize the fair value of each of the assets individually, it maximizes the fair value of the assets as a group ($650).

Footnote 13 states, "While market participant buyers might be broadly classified as strategic and/or financial buyers, there often will be differences among the market participant buyers within each of those groups, reflecting, for example, different uses for an asset and different operating strategies."

3.53 Example 3-6 below illustrates the difference between an **in-use valuation premise** (i.e., maximum value to market participants is principally derived through the use of the asset in combination with other assets as a group) and an **in-exchange valuation premise** (i.e., the asset provides maximum value to market participants principally on a stand-alone basis). With an in-use valuation premise, assumptions made by the entity to determine the highest and best use of the asset should be consistent for all of the assets in the group in which the asset would be used. In contrast, with an in-exchange valuation premise, the fair value of the asset is based the assumption that the asset would be sold on a stand-alone basis. When entities measure the fair value of a group of assets, they should follow the same valuation premise for each asset in the group. For example, if the highest and best use of a manufacturing plant is assumed to be in use, the value assigned to the land should not be based on the assumption that high-rise condominiums would be built on the property ("in-exchange").

Example 3-6
Highest and Best Use of Land

The following example is extracted from paragraphs A10 and A11 of Statement 157:

The reporting entity acquires land in a business combination. The land is currently developed for industrial use as a site for a manufacturing facility. The current use of land often is presumed to be its highest and best use. However, nearby sites have recently been developed for residential use as sites for high-rise condominiums. Based on that development and recent zoning and other changes to facilitate that development, the reporting entity determines that the land currently used as a site for a manufacturing facility could be developed as a site for residential use (for high-rise condominiums).

Example 3-6 (continued)
Highest and Best Use of Land

> In this instance, the highest and best use of the land would be determined by comparing (a) the fair value of the manufacturing operation, which presumes that the land would continue to be used as currently developed for industrial use (in-use) and (b) the value of the land as a vacant site for residential use, considering the demolition and other costs necessary to convert the land to a vacant site (in-exchange). The highest and best use of the land would be determined based on the higher of those values. [Footnote 14]

Footnote 14 states, "In situations involving real estate appraisal, the determination of highest and best use in the manner described above also might consider other factors relating to the manufacturing operation, including its assets and liabilities."

Determining the Market

3.54 According to paragraph 8 of Statement 157, a "fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability." The determination of the principal (or most advantageous) market is from the perspective of the reporting entity. This allows for differences in fair value among reporting entities depending on the market or markets in which they transact.

3.55 The principal market is the market in which the reporting entity would sell the asset or transfer the liability with the greatest volume or level of activity. Often an entity's principal market will be its most advantageous market because most entities attempt to maximize profits. Therefore, it will transact in the most advantageous market with the greatest volume or level of activity. If an entity does not have a principal market, in accordance with the highest and best use concept, it should use the price in the market that maximizes the fair value of an asset or minimizes the fair value of a liability (i.e., the most advantageous market).

Example 3-7
Determination of the Market

Paragraph A23 of Statement 157 states the following:

> A financial asset is traded on two different exchanges with different prices. The reporting entity transacts in both markets and has the ability to access the price in those markets for the asset at the measurement date. In Market A, the price that would be received is $26, and transaction costs in that market are $3 (the net amount that would be received is $23). In Market B, the price that would be received is $25, and transaction costs in that market are $1 (the net amount that would be received in Market B is $24).
>
> a. If Market A is the principal market for the asset (the market in which the reporting entity would sell the asset with the greatest volume and level of activity for the asset), the fair value of the asset would be measured using the price that would be received in that market ($26).
>
> b. If neither market is the principal market for the asset, the fair value of the asset would be measured using the price in the most advantageous market. The most advantageous market is the market in which the reporting entity would sell the asset with the price that maximizes the amount that would be received for the asset, considering transaction costs in the respective markets (that is, the net amount that would be received in the respective markets). Because the price in Market B adjusted for transaction costs would maximize the net amount that would be received for the asset ($24), the fair value of the asset would be measured using the price in that market ($25). Although transaction costs are considered in determining the most advantageous market, the price in that market used to measure the fair value of the asset is not adjusted for those costs.

Valuation Techniques

3.56 Paragraph 18 of Statement 157 states that the market approach, income approach, and cost approach are valuation techniques used to measure fair value. Paragraph 18 of Statement 157 summarizes the key aspects of those approaches:

> a. *Market approach.* The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities (including a business). For example, valuation techniques consistent with the market approach often use market multiples derived from a set of comparables. Multiples might lie in ranges with a different multiple for each comparable. The selection of where within the range the appropriate multiple falls requires judgment, considering factors specific to the measurement (qualitative and quantitative). Valuation techniques consistent with the market approach include matrix pricing. Matrix pricing is a mathematical technique used principally to value debt securities without relying exclusively on quoted prices for the specific securities, but rather by relying on the securities' relationship to other benchmark quoted securities.
>
> b *Income approach.* The income approach uses valuation techniques to convert future amounts (for example, cash flows or earnings) to a single present amount (discounted). The measurement is based on the value indicated by current market expectations about those future amounts. Those valuation techniques include present value techniques; option-pricing models, such as the Black-Scholes-Merton formula (a closed-form model) and a binomial model (a lattice model), which incorporate present value techniques [footnote omitted]; and the multiperiod excess earnings method, which is used to measure the fair value of certain intangible assets. [Footnote omitted]
>
> c. *Cost approach.* The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (often referred to as current replacement cost). From the perspective of a market participant (seller), the price that would be received for the asset is determined based on the cost to a market participant (buyer) to acquire or construct a substitute asset of comparable utility, adjusted for obsolescence. Obsolescence encompasses physical deterioration, functional (technological) obsolescence, and economic (external) obsolescence and is broader than depreciation for financial reporting purposes (an allocation of historical cost) or tax purposes (based on specified service lives).

3.57 As discussed in paragraph 21 of Statement 157, valuation techniques should maximize the use of observable market data. Whenever appropriate, entities should consider using multiple valuation techniques. However, Statement 157 acknowledges that it is not possible to use multiple valuation techniques for some assets and liabilities. Therefore, entities should use the valuation techniques appropriate under the circumstances. In addition, paragraph 19 of Statement 157 states that if "multiple valuation techniques are used to measure fair value, the results (respective indications of fair value) shall be evaluated and weighted, as appropriate, considering the reasonableness of the range indicated by those results. A fair value measurement is the point within that range that is most representative of fair value in the circumstances." Valuation techniques should be consistently applied unless a change in technique would be at least as or more representative of fair value under the circumstances.

3.58 Reporting entities should evaluate each individual unit of valuation and use judgment to determine whether a valuation technique is appropriate. While the appropriateness of each valuation technique is assessed individually, an analysis may include a comparison of the technique with other valuation techniques (e.g., the income approach may be capable of being performed but not be considered appropriate in particular circumstances because the market approach provides superior market information). Some factors reporting entities should consider in evaluating the appropriateness of valuation techniques, including whether a single technique or multiple techniques should be employed, include the following (this list is not all-inclusive):

- *Availability and reliability of data* — If, for example, a reporting entity does not have sufficient reliable data to support an income and cost approach, but has sufficient reliable data to support a market approach, a single approach (market approach) might be appropriate.
- *Comparative level of the alternative approaches in the fair value hierarchy* — As discussed in paragraph 21 of Statement 157, valuation techniques should maximize the use of observable market data. Reporting entities should determine the level in the Statement 157 fair value hierarchy (paragraphs 22–31) at which an approach would be classified and compare that to the levels of the other approaches that may be deemed relevant and applicable. For example, if a reporting entity uses the market approach, which renders the fair value measurement a Level 2 in its entirety, and uses the income approach, which results in a Level 3 measurement, the reporting entity may conclude that a single approach (market approach) may be appropriate (assuming that the cost approach is not relevant). On the other hand, if both measurements are Level 3, the entity may conclude, after considering other factors, that both approaches should be used (even if one approach is only used to corroborate the results of the other).
- *Views of market participants on the relevance of valuation techniques* — Reporting entities may observe approaches used by market participants to gain an understanding of techniques that are used by market participants in determining the fair value at which they will transact. For example, the cost approach may not be appropriate in valuing equity investments because this approach is not considered relevant by market participants.

Fair Value Measurements — Tax Amortization Benefits

3.59 Paragraphs A127–A129 of Statement 109 state the following:

> A127. Values are assigned to identified assets and liabilities when a business combination is accounted for as a purchase. The assigned values frequently will be different from the tax bases of those assets and liabilities. The Board concluded that a liability or asset should be recognized for the deferred tax consequences of differences between the assigned values and the tax bases of the assets and liabilities (other than nondeductible goodwill and leveraged leases) recognized in a purchase business combination.
>
> A128. The Board considered and rejected the approach that assigns net-of-tax values to those assets and liabilities. That approach mixes the normal amounts of expenses and revenues with their tax effects and thereby confuses the relationship between various items on the statement of earnings in subsequent years. For example, the relationship between sales and cost of sales is affected if cost of sales includes amounts that reflect the net-of-tax values assigned to acquired inventory or depreciable assets. Likewise, the relationship between pretax income from continuing operations and income tax expense is affected to the extent that pretax income from continuing operations includes any net-of-tax amounts.
>
> A129. Paragraph 89 of Opinion 16 stated that ". . . the fair value of an asset to an acquirer is less than its market or appraisal value if all or a portion of the market or appraisal value is not deductible for income taxes." The Board believes that the net result is the same whether amounts assigned to the individual assets acquired and liabilities assumed are pretax or net-of-tax. For example, assume (a) that the pretax market or appraisal value of depreciable assets acquired in a purchase business combination is $1,000, (b) that the tax basis of those assets is zero, and (c) that the enacted tax rate is 40 percent for all years. If net-of-tax, the assigned value of those assets would be $600. If pretax, the assigned value of those assets would be $1,000, and there would be a $400 deferred tax

> liability. Under either approach, the net result of allocating the purchase price is the same. The Board concluded that the amounts assigned to assets and liabilities in a purchase business combination should not be net of any related deferred tax liability or asset.

3.60 The appropriate treatment of tax amortization benefits in the measurement of fair value of an asset was addressed at the 2006 AICPA National Conference on Current SEC and PCAOB Developments by SEC staff member Cheryl Tjon-Hing, whose prepared remarks stated:

> Tax amortization benefits (TAB) represents, as its name implies, the cash flow generated to an owner of an asset as a result of being able to write-off the full fair value of that asset for tax purposes — generally, this benefit may impact a fair value conclusion, derived using an income approach, by as much as 20% to 30%. Now, it seems logical that the fair value of an asset should not change just because of the way a transaction is structured. So TABs should be taken into account, in determining asset fair values, no matter what the tax attributes of a transaction are. But for those requiring more specific guidance, FAS 109, paragraph A129 [footnote omitted] implicitly states that TABs should be factored into an asset's fair value. To the extent that a portion of the step-up value is not deductible for tax purposes, that is what deferred tax liabilities are for. In fact, preparers of fair value measurements should be aware that if a TAB is not factored into the fair value of an asset, there may be a mismatch if any associated deferred tax liability is recorded, for accounting purposes, in an acquisition transaction. Now, despite the aforementioned accounting guidance, we often see that TABs are excluded from asset fair values measured for business combinations effected through a purchase of shares — usually, this is because preparers argue that any step-up in fair value over tax value is not deductible for tax purposes.

3.61 Sections 5.3.97–.108 of the AICPA Practice Aid, *Assets Acquired in a Business Combination to Be Used in Research and Development Activities: A Focus on Software, Electronic Devices, and Pharmaceutical Industries,* illustrate the requirements of paragraphs A127–A129 of Statement 109 (see **3.59**) in the context of applying the multiperiod excess earnings method in estimating the fair value of intangible assets acquired for use in research and development (R&D) activities, including specific in-process R&D projects, for business combinations.

Use of a Third-Party Specialist to Assist in the Measurement of Fair Value

3.62 Many entities engage third-party specialists to perform valuations. Whether a fair value measurement is prepared entirely by the entity or with the assistance of a third-party specialist, the level of evidence needed to support a measurement is expected to be similar. Further, the entity should document its analysis of the qualifications of the individuals performing the fair value measurements.

3.63 The SEC staff has often commented about registrants' use of valuation experts to assign values to assets and liabilities in business combinations. Specifically, the SEC staff has reminded registrants that their filings need not refer to a third-party valuation firm. However, if registrants do not refer to the valuation firm, they must provide disclosures that explain the method and assumptions they used in the valuation. If they refer to the valuation firm, registrants must disclose the firm's name and a consent from the valuation firm as required by Item 601(a)(23) of Regulation S-K. The SEC staff has also cautioned registrants that if they want to incorporate their financial statements into a registration statement, the financial statements must be amended to name the expert and to include a consent from them if the statements do not already do so.

On November 26, 2008, the SEC's Division of Corporation Finance issued revised Compliance and Disclosure Interpretations (C&DIs) of Securities Act sections related to the use of third-party specialists. Question 141.02 states:

> **Question:** A registrant has engaged a third party expert to assist in determining the fair values of certain assets or liabilities disclosed in the registrant's Securities Act registration statement. Must the registrant disclose in the registration statement that it used a third party expert for this purpose? In what circumstances must the registrant disclose the name of the third party expert in its registration statement and obtain the third party's consent to be named?
>
> **Answer:** The registrant has no requirement to make reference to a third party expert simply because the registrant used or relied on the third party expert's report or valuation or opinion in connection with the preparation of a Securities Act registration statement. The consent requirement in Securities Act Section 7(a) applies only when a report, valuation or opinion of an expert is included or summarized in the registration statement and attributed to the third party and thus becomes "expertised" disclosure for purposes of Securities Act Section 11(a), with resultant Section 11 liability for the expert and a reduction in the due diligence defense burden of proof for other Section 11 defendants with respect to such disclosure, as provided in Securities Act Section 11(b).
>
> If the registrant determines to make reference to a third party expert, the disclosure should make clear whether any related statement included or incorporated in a registration statement is a statement of the third party expert or a statement of the registrant. If the disclosure attributes a statement to a third party expert, the registrant must comply with the requirements of Securities Act Rule 436 with respect to such statement. For example, if a registrant discloses purchase price allocation figures in the notes to its financial statements and discloses that these figures were taken from or prepared based on the report of a third party expert, or provides similar disclosure that attributes the purchase price allocation figures to the third party expert and not the registrant, then the registrant should comply with Rule 436 with respect to the purchase price allocation figures. On the other hand, if the disclosure states that management or the board prepared the purchase price allocations and in doing so considered or relied in part upon a report of a third party expert, or provides similar disclosure that attributes the purchase price allocation figures to the registrant and not the third party expert, then there would be no requirement to comply with Rule 436 with respect to the purchase price allocation figures as the purchase price allocation figures are attributed to the registrant.
>
> Independent of Section 7(a) considerations, a registrant that uses or relies on a third party expert report, valuation or opinion should consider whether the inclusion or summary of that report, valuation or opinion is required in the registration statement to comply with specific disclosure requirements, such as Item 1015 of Regulation M-A, Item 601(b) of Regulation S-K or the general disclosure requirement of Securities Act Rule 408.

Election Date for the Fair Value Option

3.64 Statement 159 allows an entity to make an irrevocable election on specified dates to measure certain financial assets and liabilities at fair value, both initially and in subsequent periods (referred to as the "fair value option"). The scope of eligible financial assets and liabilities is described in paragraphs 7 and 8 of Statement 159. The following excerpts (emphasis added) from paragraphs 9 and 10 of Statement 159, as amended, describe the election dates applicable to business combinations:

> 9. An entity may decide whether to elect the fair value option for each eligible item on its election date. Alternatively, an entity may elect the fair value option according to a preexisting policy for specified types of eligible items. An entity may choose to elect the fair value option for an eligible item only on the date that one of the following occurs . . .
>
> > e. **An event that requires an eligible item to be measured at fair value at the time of the event** but does not require fair value measurement at each reporting date after that, excluding the recognition of impairment under lower-of-cost-or-market accounting or other-than-temporary impairment. (See paragraph 10.) [Emphasis added]

> 10. **Some of the events that require remeasurement of eligible items at fair value,** initial recognition of eligible items, or both, and thereby create an election date for the fair value option as discussed in paragraph 9(e) are:
>
> a. **Business combinations**, as defined in FASB Statement No. 141 (revised 2007), *Business Combinations* [Emphasis added]

3.65 Statement 159 states that the decision to elect the fair value option (FVO) should be made as of the election date for each eligible item. It also allows an entity to automatically elect the FVO in accordance with a preexisting policy for specified types of eligible items. For example, an entity may document in a written policy that it will elect the FVO for all eligible assets it acquires and liabilities it assumes through business combinations.

3.66 Unlike Statement 133, Statement 159 provides little guidance on the documentation required to support an entity's decision to elect the FVO. Paragraph A22 of Statement 159 notes that compliance with the documentation requirements of the Statement is a matter of internal control. Although Statement 159 leaves room for discretion about documentation, if an entity does not have a well-developed preexisting policy for election, it should document evidence of the election concurrently with the recognition or remeasurement of eligible items.

Use of the Residual Method to Value Acquired Intangible Assets Other Than Goodwill

3.67 Certain entities, particularly in the telecommunications, broadcasting, and cable industries, have historically adopted a "residual method" for assigning fair value to certain intangible assets that were believed could not be separately and directly valued. Therefore, the residual method was used to allocate fair value to an "indistinguishable" intangible asset with either zero goodwill or to recognize goodwill in a manner outside of the guidance in Statement 141(R). In response to this practice, the EITF issued Topic D-108, which states:

> The SEC staff is aware of instances in which registrants have asserted that certain intangible assets that arise from legal or contractual rights cannot be separately and directly valued (hereinafter referred to as a "direct value method") because the nature of the particular asset makes it fundamentally indistinguishable from goodwill in a business combination (for example, cellular/spectrum licenses, cable franchise agreements, and so forth).

3.68 Topic D-108 also indicates:

> The SEC staff notes that a fundamental distinction between other recognized intangible assets and goodwill is that goodwill is both defined and measured as an excess or residual asset, while other recognized intangible assets are required to be measured at fair value. The SEC staff does not believe that the application of the residual method to the valuation of intangible assets can be assumed to produce amounts representing the fair values of those assets. . . . Furthermore, the SEC staff notes that the same types of assets being valued using the residual method by some entities are being valued using a direct value method by other entities. Accordingly, the SEC staff believes the residual method should no longer be used to value intangible assets other than goodwill.

Section 4 — Recognizing and Measuring Assets Acquired and Liabilities Assumed (Other Than Intangible Assets and Goodwill)

4.01 The fundamental principles of recognition and measurement underlie Statement 141(R). They indicate that an acquiring entity should (1) recognize, separately from goodwill, all assets acquired, liabilities assumed, and any noncontrolling interests as of the acquisition date and (2) measure such items at fair value. Therefore, other than in certain situations discussed below (see summary in **3.15**), assets acquired and liabilities assumed are generally recognized and measured at fair value as of the acquisition date.

Specific Guidance for Recognizing and Measuring Assets and Liabilities at Fair Value

Tangible Assets That the Acquirer Intends Not to Use or to Use in a Way Other Than Their Highest and Best Use

4.02 If an entity acquires a tangible (or intangible) asset that it does not intend to use or will use in a manner other than it its highest and best use, it must still recognize the asset at its fair value in accordance with Statement 157. The fair value of such assets is based on their highest and best use to market participants and does not depend on how the acquiring entity will use them (see **3.50–3.53**).

Assets With Uncertain Cash Flows (Valuation Allowances)

4.03 Valuation allowances are not recognized as of the acquisition date for assets that are initially recognized at fair value. Uncertainty about collectibility and future cash flows are incorporated into the fair value measurement. For example, acquired loans and receivables are measured at fair value and no valuation allowance is recognized as of the acquisition date. (However, valuation allowances are permitted for assets not measured at fair value (see summary in **3.15**), such as valuation allowances on deferred tax assets.) Entities may need to track their estimates of acquired receivables and loans that are uncollectible separately from preexisting receivables and loans, to comply with disclosure (see **13.07**) or regulatory requirements.

4.04 Loans recognized at fair value should be accounted for subsequently in a manner similar to acquired loans that are in the scope of SOP 03-3. After the acquisition date, if the fair value option in Statement 159 is not elected (see **3.64**), the loans will be accreted as interest income to the amount of expected cash flows to be received over the acquiring entity's initial investment in the loan on a level-yield basis over the life of the loan. If the loan is not accounted for as a debt security, and it is subsequently probable that the acquiring entity will be unable to collect all cash flows expected at acquisition, the loan may be impaired under the measurement and other provisions of Statement 5 or, if applicable, Statement 114. Thus, an allowance for loan losses may be recognized after the acquisition date.

4.05 The guidance in SAB Topic 2.A.5 (SAB 61) for SEC registrants on recognizing valuation allowances for acquired loan losses in a business combination is inconsistent with the guidance in Statement 141(R), and the SEC staff is currently reconsidering SAB 61.

Inventory

4.06 Inventory acquired in a business combination must be measured at fair value as of the acquisition date. Neither Statement 141(R) nor Statement 157 provides detailed guidance for measuring inventory at fair value. Some have questioned whether, under Statement 157's exit price notion and highest-and-best-use concept, an acquiring entity is permitted to recognize any profit on finished goods inventory acquired in a business combination. When asked to discuss the issue, the FASB's Valuation Resource Group (VRG)[1] indicated that the fair value of inventory is probably close to its net realizable value, which allows an acquiring entity to realize a profit on the selling effort. The VRG indicated that this view is supported by paragraph A24(f) of Statement 157, which provides the following guidance on valuing finished goods inventory at a retail outlet:

> For finished goods inventory that is acquired in a business combination, a Level 2 input would include either a price to customers in a retail market or a wholesale price to retailers in a wholesale market, adjusted for differences between the condition and location of the inventory item and the comparable (similar) inventory items so that the fair value measurement reflects the price that would be received in a transaction to sell the inventory to another retailer that would complete the requisite selling efforts. Conceptually, the fair value measurement should be the same, whether adjustments are made to a retail price (downward) or to a wholesale price (upward). Generally, the price that requires the least amount of subjective adjustments should be used for the fair value measurement.

4.07 On the basis of the VRG's comments and the guidance in Statement 157, the measurement of finished goods inventory at fair value under Statement 141(R) is unlikely to differ significantly from that under Statement 141 (i.e., estimated selling price less the sum of (a) costs of disposal and (b) a reasonable profit allowance on the selling effort).

LIFO Inventory

4.08 Inventories should be measured at fair value as of the acquisition date even if the acquiree previously used the last-in, first-out (LIFO) method of accounting. The method of accounting that the acquiring entity will follow or that the acquiree was following is not relevant. Carryover of the book basis of the acquired entity's LIFO inventories is not permitted.

4.09 SAB Topic 5.L (SAB 58) states that registrants should refer to the AICPA Issue Paper, "Identification and Discussion of Certain Financial Accounting and Reporting Issues Concerning LIFO Inventories," for guidance on determining what constitutes acceptable LIFO accounting practice. The Issue Paper states that if acquired inventory is added to an existing LIFO pool, it should be considered part of current-year purchases. Paragraph 2-15 of the Issue Paper notes that the order-of-acquisition approach (first purchase price) to pricing current purchases is the most compatible with the LIFO objective; however, any of the three approaches noted in paragraph 2-10 may be used: "(a) the order of acquisition price (first purchase price), (b) the most recent acquisition price (latest purchase price), or (c) the average purchase price."

Property, Plant, and Equipment

4.10 Property, plant, and equipment acquired in a business combination that will be used by the acquiring entity should be measured at fair value. The estimated useful life of the property is based on the expected remaining useful life to the acquiring entity. Accordingly, neither the acquiree's accumulated depreciation nor the acquiree's estimated useful life for the property carry over to the acquiring entity.

1 The FASB established the VRG to provide the FASB staff with information on existing implementation issues about fair value measurements used for financial statement reporting and the alternative viewpoints associated with those implementation issues. The VRG's discussions are not authoritative.

4.11 Property, plant, and equipment acquired in a business combination that will be sold by the acquiring entity should be classified as held for sale and measured at fair value less costs to sell, in accordance with Statement 144. (See **4.50–4.51** for further guidance on assets held for sale acquired in a business combination.)

Mining Assets

4.12 Paragraph A50 of Statement 141(R) describes a mineral right as "the legal right to explore, extract, and retain at least a portion of the benefits from mineral deposits." Mining assets include mineral rights. Acquired mineral rights are considered tangible assets under Statement 141(R), however no guidance is provided on how such amounts should be classified in the financial statements. Issue 04-2, which was nullified by Statement 141(R), indicated that such amounts should be classified as a separate component of property, plant, and equipment either on the face of, or in the notes to, the financial statements. Although such guidance was not carried forward to Statement 141(R), it remains applicable.

4.13 Statement 141(R) requires that mining assets be recognized at fair value as of the acquisition date. In addition, Issue 04-3, which continues to apply, provides guidance for measuring the fair value of mining assets. In that Issue, the Task Force reached a consensus that in estimating the fair value of mineral assets, an acquiring entity should take into account both:

- The "value beyond proven and probable reserves" (VBPP) "to the extent that a market participant would include VBPP in determining the fair value of the asset."
- The "effects of anticipated fluctuations in the future market price of minerals . . . in a manner that is consistent with the expectations of marketplace participants."

Leases

Classification

4.14 An acquiree's classification of its leases is not reconsidered in a business combination unless the lease agreement is modified as part of the business combination. Therefore, the acquiree's classification of its lease agreements generally carries over to the acquiring entity. See **3.12** for further discussion.

4.15 If the terms of a lease agreement are modified as part of the business combination and the lease qualifies as a new lease in accordance with paragraph 9 of Statement 13, the lease is classified as of the acquisition date under the terms of the new lease agreement.

Lessee Accounting

Operating Leases

4.16 In accordance with the requirements in Statement 13, Statement 141(R) prohibits recognition of a separate asset for the right to use an asset and a separate liability for the operating lease obligation for an operating lease in which the acquiree is the lessee. However, an intangible asset or liability may be recognized in a business combination related to an operating lease whose terms are favorable or unfavorable relative to the market terms of similar leases. See **5.35** for further discussion. In addition, in accordance with paragraph A18 of Statement 141(R), an intangible asset may be associated with an operating lease that is at current market terms. (See **5.36**.)

Capital Leases

4.17 Assets subject to a capital lease and capital lease obligations must be separately recognized at fair value as of the acquisition date.

Lessor Accounting

Operating Leases

4.18 If an acquiree is a lessor in an operating lease, the assets subject to that lease are measured at fair value without consideration of the in-place leases. That is, the assets have the same fair value regardless of whether they are subject to an operating lease. An intangible asset or liability must be recognized if the lease terms are favorable or unfavorable relative to the market terms of similar leases. In addition, in some circumstances an intangible asset may be recognized as of the acquisition date for the value associated with in-place leases and for any customer relationship with the lessee. See **5.37** for further discussion.

Direct Finance or Sales Type Leases

4.19 If an acquiree is a lessor in a direct finance or sales type lease, the acquirer recognizes and measures at fair value the receivable that represents its remaining investment in the lease.

Guarantees

4.20 Liabilities for guarantees made by the acquiree that are assumed by the acquiring entity must be measured at fair value as of the acquisition date. Interpretation 45's transition was to be applied prospectively to guarantees issued or modified after December 31, 2002. Therefore, an acquiree may not have recognized a liability for a guarantee in its financial statements if it was issued or modified before December 31, 2002. Nevertheless, an acquiring entity must recognize all liabilities for guarantees, even if the acquiree had not previously recognized them. All assumed guarantee arrangements are considered new arrangements for the acquiring entity. Therefore, the exemption in Interpretation 45 does not apply to acquisitions occurring after December 31, 2002.

4.21 After initial recognition in a business combination, the accounting for assets and liabilities is generally provided by other GAAP. However, Interpretation 45 does not provide detailed guidance on how the guarantor's liability for its obligations under the guarantee would be measured after its initial recognition. The liability that an acquiring entity initially recognizes as of the acquisition date would typically be reduced (by a credit to earnings) as it is released from risk under the guarantee. In some instances, the release from the risk under the guarantee will not occur until expiration of settlement of the guarantee. FSP FIN 45-2 states:

> A guarantor should not use fair value in subsequently accounting for the liability for its obligations under a previously issued guarantee unless the use of that method can be justified under generally accepted accounting principles, as is the case, for example, for guarantees accounted for as derivatives under FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities.*

4.22 At the 2003 National AICPA Conference on Current SEC Developments, an SEC staff member stated the following:

> So what do we believe the appropriate "day two" accounting for the obligation to stand ready would be? . . . It would seem a systematic and rational amortization method would most likely be the appropriate accounting. . . . We understand that some believe that a fair value model for these guarantee liabilities and recourse obligations is the right accounting. However we find it difficult to support such an approach in the current literature.

4.23 Interpretation 45 does not apply to guarantees between parents and their subsidiaries. If an acquiring entity and an acquiree had previously entered into a guarantee arrangement, such guarantee would not be recognized as part of the business combination; however, the acquiring entity must determine whether the transaction represents the settlement of a preexisting relationship (see **3.32–3.33**). The acquiring entity would be subject to the disclosure requirements in Interpretation 45.

Loss Contracts and Unfavorable Contracts

4.24 Paragraph A79(b)(1) of Statement 141(R) defines a loss contract as a "contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it." This paragraph defines an unfavorable contract as "a contract that is unfavorable in terms of current market terms. It is not necessarily a loss contract." The acquiring entity must recognize a liability either for a loss contract or an unfavorable contract at fair value as of the acquisition date.

4.25 An acquiring entity must recognize an intangible asset for a favorable operating lease when the acquiree is the lessee. See **5.35** for further discussion.

Amounts Due to Employees of the Acquiree Upon a Change in Control

4.26 An acquiree may have preexisting arrangements with its employees that provide for payments to them upon a change in control. The arrangements may take many forms, including payments to some or all employees as of the acquisition date and payments to an employee after the acquisition date if that employee voluntarily leaves employment of the combined entity within a predetermined period. These are typically not recognized as liabilities on the books of the acquiree, since payments are contingent upon a change in control. Such arrangements may nevertheless represent an assumed liability to the acquiring entity that should be recognized as part of the business combination. The following example is adapted from paragraphs A88–A90 of Statement 141(R):

Example 4-1
Amounts Due to Employees of the Acquiree Upon a Change in Control

Target Company (TC) hired a candidate as its new CEO under a 10-year contract. The contract required TC to pay the candidate $5 million if TC is acquired before the contract expired. AC acquires TC eight years later. The CEO is still employed at the acquisition date and will receive the additional payment under the existing contract.

TC entered into the employment agreement before the negotiations of the combination began, and the purpose of the agreement was to obtain the services of the CEO. Thus, there is no evidence that the agreement was arranged primarily to provide benefits to AC or the combined entity. Therefore the liability to pay $5 million is included in the application of the acquisition method.

In other circumstances, TC might enter into a similar agreement with CEO at the suggestion of AC during the negotiations for the business combination. If so, the primary purpose of the agreement might be to provide severance pay to CEO, and the agreement may primarily benefit AC of the combined entity rather than TC or its former owners. In that situation, AC accounts for the liability to pay CEO in its postcombination financial statements separately from the application of the acquisition method.

4.27 Each arrangement must be evaluated to determine whether it (1) is compensation expense rather than a payment for past services and (2) meets the criteria for being part of the business combination transaction.

Liabilities for Exiting an Activity of an Acquired Entity, Involuntary Termination Benefits, and Relocation Costs

4.28 Costs that an acquiring entity expects to incur in the future related to its plans to exit an activity, involuntarily terminate employees, or relocate employees of an acquiree (commonly called restructuring costs) generally will not qualify as liabilities assumed in the business combination. To qualify as liabilities assumed, such restructuring costs need to meet the recognition criteria in Statement 146 as of the acquisition date. Paragraph 4 of Statement 146 states:

> A liability for a cost associated with an exit or disposal activity is incurred when the definition of a liability is met. Paragraph 35 of FASB Concepts Statement No. 6, *Elements of Financial Statements,* defines liabilities as follows:
>
>> Liabilities are probable [footnote omitted] future sacrifices of economic benefits arising from present obligations [footnote omitted] of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.
>
> 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.

4.29 Therefore, if an acquiring entity expects to restructure the acquiree's operations but it is not obligated to do so as of the acquisition date, a liability for the restructuring cannot be recognized as part of the business combination. The acquiring entity would account for the restructuring in its postcombination financial statements. It is unlikely that an acquiring entity will be able to meet the recognition criteria in Statement 146 as of the acquisition date unless the acquiree had previously recognized a restructuring liability in accordance with Statement 146 in its preacquisition financial statements and the acquirer assumes that obligation. An arrangement entered into by the acquiree, once negotiations for the business combination have started, should be carefully examined to determine whether it meets the criteria to be recognized as part of the business combination.

4.30 The accounting for restructuring costs under Statement 141(R) represents a significant change from previous U.S. GAAP. Previously, Issue 95-3 allowed an acquiring entity to recognize liabilities for restructuring costs based on certain criteria that were less restrictive than the Statement 146 criteria.

Recognition of Liabilities for Contractual Termination Benefits or Changing Benefit Plan Assumptions in Anticipation of a Business Combination

4.31 Issue 96-5 addresses the accounting for contractual termination benefits and curtailment losses in an acquiree's preacquisition financial statements. It states that "a liability for the contractual termination benefits and curtailment losses under employee benefit plans that will be triggered" by the business combination should be recognized when the business combination is consummated rather than when "it is probable that the business combination will be consummated." This Issue's guidance continues to be relevant under Statement 141(R).

Exceptions to the Recognition and Measurement Principles

Assets and Liabilities Arising From Contingencies

4.32 Assets and liabilities arising from contingencies (often referred to as "preacquisition contingencies") are an exception to the recognition principle. Paragraph 24 of Statement 141(R) provides the following guidance on accounting for assets and liabilities arising from contingencies:

> The guidance in Statement 5 **does not apply** in determining which assets or liabilities arising from contingencies to recognize as of the acquisition date. Instead:
>
> a. The acquirer shall recognize as of the acquisition date all of the assets acquired and liabilities assumed that arise from contingencies related to contracts (referred to as *contractual contingencies*), measured at their acquisition-date fair values.
>
> b. For all other contingencies (referred to as *noncontractual contingencies*), the acquirer shall assess whether it is **more likely than not** as of the acquisition date that the contingency gives rise to an asset or a liability as defined in Concepts Statement 6. If that criterion is met as of the acquisition date, the asset or liability arising from a noncontractual contingency shall be recognized at that date, measured at its acquisition-date fair value. If that criterion is not met as of the acquisition date, the acquirer shall not recognize an asset or a liability at that date. The acquirer shall instead account for a noncontractual contingency that does not meet the more-likely-than-not criterion as of the acquisition date in accordance with other GAAP, including Statement 5, as appropriate.

4.33 For noncontractual contingencies, the more-likely-than-not recognition threshold is generally understood to mean a likelihood of more than 50 percent. In addition, in the assessment of whether an arrangement is contractual or noncontractual, paragraph 25 of Statement 141(R) acknowledges that "[i]n some situations, determining whether a contingency is contractual or noncontractual may require the exercise of judgment based on the facts and circumstances of the specific situation." Generally, litigation at a target entity would be considered a noncontractual contingency.

Example 4-2
Assets and Liabilities Arising From Contingencies

Case A

On June 30, 20X9, Company A acquires Company B. Before the acquisition, B was served with a class action lawsuit regarding the safety of one of its products that sought damages of $5 billion. The fair value of the contingency is $2 billion. As of the acquisition date, Company A believes that there is only a 30 percent chance that it is liable. The lawsuit is a noncontractual contingency. However, because the more-likely-than-not recognition threshold is not met, A would not recognize the contingent liability as of the acquisition date. The entity would account for the contingent liability in accordance with Statement 5 in postcombination periods.

Case B

Assume the same facts as in Case A except that as of the acquisition date A believes that there is a 55 percent chance that it is liable. In this case, because the more-likely-than-not recognition threshold is met, A must record the fair value of the contingent liability ($2 billion) as of the acquisition date.

Subsequent Measurement of Acquired Contingencies

4.34 If new information is obtained about the possible outcome of a contingent liability recognized as of the acquisition date, it is subsequently measured (with any changes recorded in earnings) at the higher of either of the following:

- The acquisition-date fair value.
- The amount that would be recognized under Statement 5.

4.35 If new information is obtained about the possible outcome of a contingent asset recognized as of the acquisition date, it is subsequently measured (with any changes recorded in earnings) at the lower of either of the following:

- The acquisition date fair value.
- The best estimate of its future settlement amount.

4.36 A contingency measured at fair value is discounted, whereas a contingency measured in accordance with Statement 5 (i.e., best estimate of its future settlement amount) is generally not. That alone could lead to an acquiring entity recognizing a loss (or gain) after the acquisition, because the amount for a contingent liability recognized under Statement 5 would generally be higher than its fair value. To prevent immediate losses, or gains in the case of contingent assets, the FASB decided that a contingency should not be remeasured until new information is obtained about its possible outcome.

4.37 An acquiring entity does not derecognize the contingent asset or liability if it subsequently falls below the more-likely-than-not threshold. Rather, a contingent asset would be derecognized when it is collected or sold or when the rights are lost, whereas a contingent liability would be derecognized when it is settled or the obligation to settle is canceled or has expired.

Example 4-3
Assets and Liabilities Arising From Contingencies

Case C

Assume the same facts as in Case B of Example 4-2 except that one year has passed since the acquisition date. As a result of an unfavorable court ruling against one of its competitors, A now believes there is a 95 percent chance that it will be found liable. Its best estimate of the amount of exposure is $3 billion. In accordance with Statement 141(R), A must increase the contingent liability recorded by $1 billion, to $3 billion (since this represents A's best estimate of the payment), because the amount required to be recorded under Statement 5 exceeds the acquisition-date fair value of $2 billion.

Editor's Note: On December 15, 2008, the FASB issued proposed FSP FAS 141(R)-a, which would amend Statement 141(R) to require that preacquisition contingencies generally be measured at fair value as of the acquisition date if such amounts can be reasonably determined. It is expected that the guidance in the proposed FSP would result in the recognition of more contingent assets and liabilities at fair value than the guidance in Statement 141, but fewer than the current Statement 141(R) guidance. This Roadmap will be updated for the final guidance once it is issued by the FASB.

Income Taxes

4.38 The acquirer recognizes and measures the deferred tax assets, liabilities, and valuation allowances of an acquired entity in a business combination that relate to temporary differences, tax carryforwards, and uncertain tax positions in accordance with other applicable GAAP, such as Statement 109 and Interpretation 48.

4.39 Any adjustments to an **acquired entity's** deferred tax assets, liabilities, valuation allowances, or liabilities related to uncertain tax positions of the acquiree that occur outside of the measurement period (or within the measurement period if it relates to new information that did not exist as of the acquisition date) are generally recorded as a component of income tax expense. In addition, adjustments to an **acquirer's** deferred tax assets, liabilities, and valuation allowances that result directly from the business combination are generally recorded as a component of income tax expense and do not affect the business combination accounting.

4.40 See **Section 8** for further discussion regarding income taxes.

Employee Benefits

4.41 Paragraph 28 of Statement 141(R) requires the acquirer to "recognize and measure a liability (or asset, if any) related to the acquiree's employee benefit arrangements in accordance with other GAAP, as amended by [Statement 141(R)]." The paragraph also notes the following standards that provide recognition and measurement guidance on employee benefits:

a. APB Opinion No. 12, *Omnibus Opinion — 1967* (deferred compensation contracts)
b. FASB Statement No. 43, *Accounting for Compensated Absences*
c. FASB Statement No. 87, *Employers' Accounting for Pensions* [see **4.43–4.44**]
d. FASB Statement No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*
e. FASB Statement No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions* [see **4.43–4.44**]
f. FASB Statement No. 112, *Employers' Accounting for Postemployment Benefits* [see **4.45**]
g. FASB Statement No. 146, *Accounting for Costs Associated With Exit or Disposal Activities* (one-time termination benefits)
h. FASB Statement No. 158, *Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans.*

4.42 Statement 141(R) provides a broad exception to recognition and measurement for all employee benefit obligations. The FASB decided not to require recognition and fair value measurement for all employee benefits because that would require a comprehensive reconsideration of the requirements in these standards, which was outside the scope of the business combinations project.

Pensions and Other Postretirement Benefits

4.43 Statement 141(R) amends Statements 87 and 106 to exclude the effects of any planned, but not executed, amendments, terminations, or curtailments in measuring the funded status of pension and other postretirement plans. Planned or anticipated amendments, terminations, or curtailments are not part of the liability assumed as of the acquisition date. Such actions are recognized in the postcombination financial statements in accordance with Statement 88. However, when measuring the projected benefit obligation or accumulated postretirement benefit obligation of acquired pension or postretirement plans, the acquiring entity should base it assumptions on its assessment of relevant future events. See **4.31** regarding curtailments that are triggered as of the acquisition date.

Multiemployer Plans

4.44 Statement 141(R) amends Statements 87 and 106 to clarify that an acquiring entity recognizes a withdrawal liability as of the acquisition date in accordance with Statement 5 if it is probable that, as of that date, the acquiring entity will withdraw from a multiemployer plan. Therefore, the provisions for multiemployer plans and single employer plans are not the same. The FASB considered amending Statements 87 and 106 to require recognition of withdrawal liabilities in the period that the withdrawal from the multiemployer plan occurs. However, the FASB observed that even though the provisions for withdrawal of liabilities from multiemployer plans and single employer plans seem inconsistent, the results are actually somewhat comparable. That is because the liability that is recognized upon withdrawal from a multiemployer plan relates to the previously unrecognized portion of the accumulated benefit obligation, which is recognized in a single employer plan.

Postemployment Benefits

4.45 Statement 112 applies to all types of postemployment benefits other than pensions, postretirement benefits, deferred compensation arrangements, or termination benefits, which are addressed in other standards. It requires that a liability for postemployment benefits be accounted for in accordance with Statement 5. However, the Basis for Conclusions in Statement 112 also states that an entity may refer to the guidance in Statements 87 and 106 for measuring a liability for postemployment benefit obligations. Thus, the amendments to Statements 87 and 106 would apply to exclude the effects of any planned amendments, terminations, or curtailments in measuring the assumed obligation in a business combination.

Indemnification Assets

4.46 In a business combination, the former owners of an acquiree may contractually agree to indemnify the acquiring entity for uncertainties related to specific assets or liabilities. Common examples relate to lawsuits and uncertain tax positions. Such an indemnification represents an asset acquired in the business combination.

4.47 The recognition and measurement of the indemnification asset is based on whether the indemnified item is recognized and how it is measured. In certain situations, the indemnification asset may relate to an asset or liability that is an exception to the recognition or measurement principles (see summary in **3.15**). Paragraph 30 of Statement 141(R) requires that in such situations, the indemnification asset be recognized only if the related asset or liability subject to indemnification is recognized in the business combination. If recognized, the indemnification asset is measured on the same measurement basis as the indemnified item, subject to management's assessment of collectibility and any contractual limitations. Thus, indemnification assets may be an exception to either or both of the recognition and measurement principles of Statement 141(R).

Example 4-4
Indemnification Assets

On June 15, 20X9, Company A acquired 100 percent of Company B. Before the acquisition, B had a $100 liability related to B's uncertain tax position that was recognized in accordance with Interpretation 48. In applying the acquisition method of accounting, A must follow Interpretation 48 and, therefore, recognize a $100 liability related to B's uncertain tax position. (That is, A agreed with B's analysis of the uncertain tax position.) As part of the acquisition, the former owners of B agreed to indemnify A for any losses related to the tax position (including the $100 liability recognized by A). Statement 141(R) requires that A recognize an indemnification asset at the same amount as the liability, $100 (assuming that collectibility is not in doubt), even though this amount most likely does not represent its fair value (i.e., the measurement requirements of Interpretation 48 are not fair value).

Subsequent Accounting for Indemnification Assets

4.48 Paragraph 64 of Statement 141(R) requires that after the acquisition, an indemnification asset continues to be measured on the basis of the indemnified item, subject to management's assessment of collectibility and any contractual limitations. An acquiring entity only derecognizes the indemnification asset "when it collects the asset, sells it, or otherwise loses the right to it."

Share-Based Payment Awards

4.49 The fair value of all share-based payment awards in a business combination is calculated in accordance with Statement 123(R). The measurement guidance in Statement 123(R) is fair-value-based, not fair value. A fair-value-based measure excludes some assumptions (e.g., the grant-date estimated fair value does not take into account the effect on fair value of the vesting conditions and other restrictions that apply only during the requisite service period) that would be included in a fair value measurement. Thus, share-based payment awards are an exception to the fair value measurement principle. See **6.05–6.19** for more details about the replacement of an acquiree's share-based payments awards.

Assets Held for Sale

4.50 Paragraph 33 of Statement 141(R) requires that "an acquired long-lived asset (or disposal group) that is classified as held for sale at the acquisition date [be measured] at fair value less costs to sell." The long-lived asset or disposal group must meet the criteria in paragraph 30 of Statement 144 to be classified as held for sale, except for the "one-year" criterion in paragraph 30(d). For a newly acquired long-lived asset or disposal group, an acquiring entity is allowed "a short period following the acquisition (usually within three months)" to meet all of the criteria. If the long-lived asset or disposal group cannot be classified as held for sale, it would be measured in accordance with the requirements in Statement 141(R), which would generally be fair value.

4.51 The Basis for Conclusions in Statement 141(R) describes the exception for assets held for sale as a "temporary exception." The FASB had considered amending Statement 144 to require that assets held for sale be measured at fair value rather than at fair value less costs to sell. However, the FASB has since taken that project off its agenda.

Section 5 — Recognizing and Measuring Acquired Intangible Assets and Goodwill

Intangible Assets

5.01 Paragraph 3 of Statement 141(R) defines an intangible asset as an asset (other than a financial asset) that lacks physical substance (excluding goodwill). Such 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, identifiable asset, or liability, regardless of whether the entity intends to do so; or
>
> (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.

Examples of Intangible Assets That Are Identifiable

5.02 Because the acquiree generally expenses internally developed intangibles as incurred, not all identifiable intangible assets will be recorded in the acquiree's balance sheet. The following list (not all-inclusive) of examples of identifiable intangible assets recognized in a business combination is extracted from paragraphs A30, A31, A36, A44, A46, and A51 of Statement 141(R) (paragraph references are in brackets below). Note that the FASB has cautioned that some of these examples may have characteristics of assets other than intangible assets and that the acquirer should account for such assets on the basis of the asset's substance. See paragraphs A29–A56 of Statement 141(R) for additional discussion regarding these examples.

> 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, but separability is not a necessary condition for an asset to meet the contractual-legal criterion. [A30]
>
> *Marketing-Related Intangible Assets*
>
> a. Trademarks, trade names, service marks, collective marks, certification marks #
>
> b. Trade dress (unique color, shape, package design) #
>
> c. Newspaper mastheads #
>
> d. Internet domain names #
>
> e. Noncompetition agreements. # [A31]
>
> *Customer-Related Intangible Assets*
>
> a. Customer lists * [See **5.12–5.14**.]
>
> b. Order or production backlog # [See **5.15**]
>
> c. Customer contracts and related customer relationships # [See **5.16–5.18**.]
>
> d. Noncontractual customer relationships. * [A36; see **5.22–5.23.**]
>
> *Artistic-Related Intangible Assets*
>
> 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. # [A44]

Contract-Based Intangible Assets

a. Licensing, royalty, standstill agreements #

b. Advertising, construction, management, service or supply contracts #

c. Lease agreements (whether the acquiree is the lessee or the 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, timber cutting, and route authorities. # [A46]

Technology-Based Intangible Assets

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. # [A51]

5.03 In correspondence to the FASB staff dated August 16, 2001, then SEC Chief Accountant Lynn E. Turner noted the following:

> Appendix A of SFAS No. 141 indicates that the list of identifiable intangible assets is illustrative. The SEC staff believes there is a rebuttable presumption that any intangible asset identified in the listing will be valued in a purchase business combination. In its review of filings, the staff may look to such documentation as the sales agreement, memorandums, presentations by the target to the buyer, minutes of the Board of Directors Meetings, etc. for discussions and evidence of assets, including intangibles, being purchased.

While the SEC staff's comments referred to Statement 141, the list of intangible assets it describes was carried forward to Statement 141(R), and therefore the views expressed remain applicable.

5.04 In addition to the documentation listed above, consideration of the following should be included in a search for the presence of acquired intangible assets:

- Other acquisitions by the acquirer in the same line of business.
- Other acquisitions in the same industry.
- Historical financial statements and disclosures of the acquired entity for disclosure, discussion, or both, of any previously recognized or unrecognized intangibles.

5.05 Companies that have recorded significant amounts of goodwill in a business combination are frequently asked by the SEC staff why the goodwill was not attributed to particular intangible assets. During such inquiries the SEC staff often requests additional information from companies, including items such as (1) the merger agreement (including any disclosure statement), (2) memorandums prepared in connection with the merger, (3) marketing materials prepared by the target (including presentations), and (4) minutes of the board of directors of the buyer about the merger. These SEC inquiries often result in companies having to disclose additional factors that contributed to a large goodwill balance and, in some instances, the recognition of additional intangible assets.

Intangible Assets That Are Not Identifiable

5.06 Statement 141 contained examples (listed below) of intangible assets that do not meet the criteria for recognition apart from goodwill. While Statement 141(R) did not carry forward these examples, they are still considered relevant:

- Customer base — a group of customers that are not known or identifiable to the entity (e.g., customers of a fast-food franchise).
- Customer service capability.
- Presence in geographic markets or locations.
- Nonunion status or strong labor relations.
- Ongoing training or recruiting programs.
- Outstanding credit ratings and access to capital markets.
- Favorable government relations.
- Potential contracts currently being negotiated.
- Assembled workforce (see **5.07**).

Assembled Workforce

5.07 Paragraph A25 of Statement 141(R) describes an assembled workforce as "[a]n existing collection of employees that permits the acquirer to continue to operate an acquired business from the acquisition date." Paragraph B178 of Statement 141(R) explains why an assembled workforce is not an identifiable intangible asset to be recognized separately from goodwill in a business combination:

> Because an assembled workforce is a collection of employees rather than an individual employee, it does not arise from contractual or legal rights. Although individual employees might have employment contracts with the employer, the collection of employees, as a whole, does not have such a contract. In addition, an assembled workforce is not separable, either as individual employees or together with a related contract, identifiable asset, or liability. An assembled workforce cannot be sold, transferred, licensed, rented, or otherwise exchanged without causing disruption to the acquirer's business. In contrast, an entity could continue to operate after transferring an identifiable asset.

5.08 For acquisitions of net assets outside of the scope of Statement 141(R) (i.e., net assets that are determined not to be a business), it is necessary to assess whether an assembled workforce intangible asset is present; if present, such an asset would be recognized (see **1.13**).

Intangible Assets the Acquirer Intends Not to Use or to Use in a Way Other Than Their Highest and Best Use

5.09 In a business combination or an asset acquisition, an entity may acquire an intangible asset that it does not intend to put to its highest and best use. For example, an entity may acquire a competitor, including its trade name, in business combination. In such situations, the acquirer may decide not to use the acquired entity's trade name because it directly competes with its own trade name. If the acquirer intends to prevent others from using the acquired trade name, the asset has value because it enhances the value of the acquirer's own trade name (such assets are commonly referred to as "defensive value assets").

5.10 Paragraph A59 of Statement 141(R) requires the acquiring entity to recognize at fair value an intangible asset that it does not intend to put to its highest and best use. After the issuance of Statement 141(R), questions arose related to the initial and subsequent accounting for such assets. While not addressing measurement issues, the EITF provided clarifying guidance on certain aspects of the initial and subsequent accounting for defensive value assets in Issue 08-7. Specifically, the Task Force noted:

> A defensive intangible asset could include an asset that the acquirer will never actively use, as well as an asset that will be used by the acquirer during a transition period when the intention of the acquirer is to discontinue the use of that asset.
>
> The determination of whether an intangible asset is a defensive intangible asset is based on the intentions of the reporting entity and that determination may change as the reporting entity's intentions change (for example, an intangible asset that was accounted for as a defensive intangible asset on the date of acquisition will cease to be a defensive asset if an acquirer subsequently decides to actively use the asset). . . .
>
> A defensive intangible asset should be accounted for as a separate unit of accounting. It should not be included as part of the cost of the acquirer's existing intangible asset(s) because the defensive intangible asset is separately identifiable.

In addition, the Task Force provided the following examples (not all-inclusive) of defensive value assets that fall within the scope of Issue 08-7:

> **Example 1**
>
> Company A, a consumer products manufacturer, acquires an entity that sells a product that competes with one of Company A's existing products. Company A plans to discontinue the sale of the competing product within the next six months, but will maintain the rights to the trade name, at minimal expected cost, to prevent a competitor from using the trade name. As a result, Company A's existing product will experience an increase in market share. Company A does not have any current plans to reintroduce the acquired trade name in the future.
>
> *Analysis:* Because Company A does not intend to actively use the acquired trade name, but intends to hold the rights to the trade name to prevent its competitors from using it, the trade name meets the definition of a defensive intangible asset.
>
> **Example 2**
>
> Company A acquires a group of assets, one of which is billing software developed by the selling entity for its own use. After a six month transition period, Company A plans to discontinue use of the internally developed billing software. In valuing the billing software in connection with the acquisition, Company A determines that a market participant would use the billing software, along with other assets in the asset group, for its full remaining economic life (that is, Company A does not intend to use the asset in a way that is at its highest and best use). Due to the specialized nature of the software, Company A does not believe the software could be sold to a third party without the other assets acquired.
>
> *Analysis:* Although Company A does not intend to actively use the internally developed billing software after a six month transition period, Company A is not holding the internally developed software to prevent its competitors from using it. Therefore, the internally developed software asset does not meet the definition of a defensive intangible asset.
>
> **Example 3**
>
> Company A acquires a research and development intangible asset in a business combination. The reporting entity does not intend to complete the acquired research and development project because if the project was completed, the technology developed would compete with one of Company A's existing products. Instead, Company A intends to hold the project to prevent its competitors from

obtaining access to the technology. Company A believes that holding the project will delay the development of a competing product, allowing Company A to keep its current market share for a longer period than it would if the competing project was completed.

Analysis: Because Company A does not intend to actively use the research and development intangible asset, but intends to hold the rights to the asset to prevent its competitors from using it, the intangible research and development asset meets the definition of a defensive intangible asset.

Example 4

Company A acquires a research and development intangible asset in a business combination. The project under development is similar to an existing project of Company A and Company A does not intend to immediately pursue the acquired project. However, if Company A's existing project is not successful in the next six months, Company A intends to resume work on the acquired project. If Company A's existing project is successful, the acquired project will be abandoned and Company A would not be concerned if a third party gained access to that project.

Analysis: Company A is not holding the intangible research and development asset to prevent its competitors from using it. Instead, Company A is holding the asset as an alternative to its existing research and development project. Therefore, the research and development intangible asset does not meet the definition of a defensive intangible asset.

See **10.28–10.29** for subsequent accounting considerations regarding acquired intangible assets that are recognized as of the acquisition date and will not be put to their highest and best use.

Grouping Complementary Assets

5.11 Statement 141(R) offers the following three examples of acquired assets grouped for financial reporting:

- A brand or brand name consisting of a "trademark (or service mark) and its related trade name, formulas, recipes, and technological expertise." See paragraph A34 of Statement 141(R).
- A license to own and operate a nuclear power plant. See paragraph A20(b) of Statement 141(R).
- An artistic-related copyright "and any related assignments or license agreements." See paragraph A45 of Statement 141(R).

In each example, a factor cited in support of grouping the assets for financial reporting was that the individual assets have similar useful lives. In addition, whether the grouping of assets is appropriate depends on whether the assets have similar methods of amortization, since this would ensure a similar effect on financial reporting.

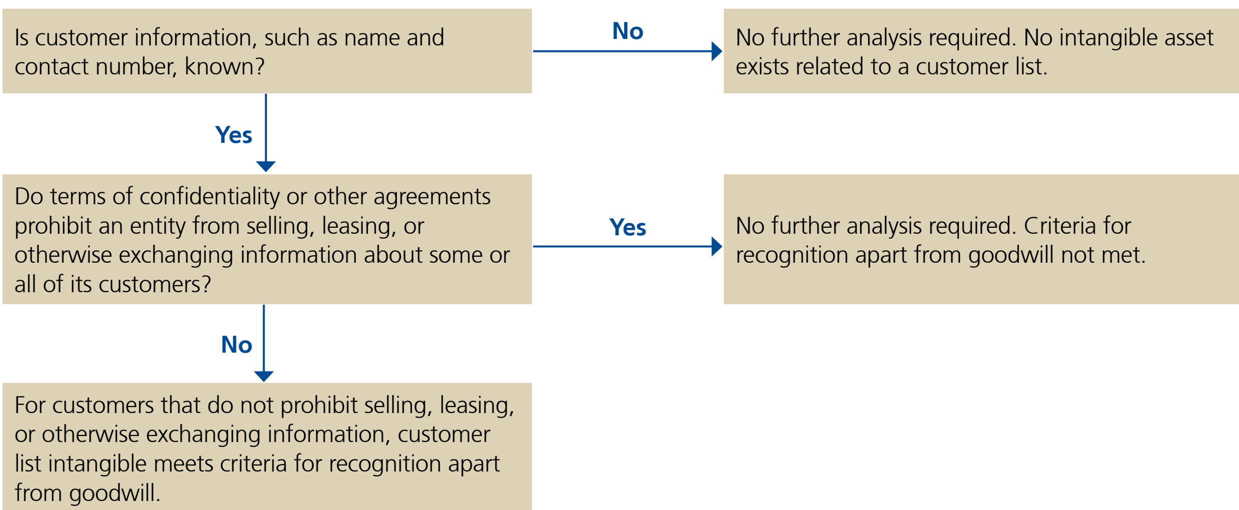
Customer Lists

5.12 Paragraph A37 of Statement 141(R) states:

> 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 generally does not 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.

5.13 While most entities possess some information about their customers, which would establish the existence of a customer-list intangible asset, the specific information possessed and the resulting value of this asset will vary. In addition, in some instances, restrictions on the sale or transfer of customer lists could prevent the separability criterion from being met altogether.

5.14 The following decision tree assists the acquiring entity in determining whether an intangible asset exists related to a customer list:



Order or Production Backlog

5.15 Typically, acquired entities possess order or production backlogs (e.g., purchase and sales orders). Paragraph A38 of Statement 141(R) provides that "[a]n order or production backlog acquired in a business combination meets the contractual-legal criterion even if the purchase or sales orders are cancelable." (See further discussion in **5.17**.)

Customer Contracts and Related Customer Relationships

5.16 Paragraph A39 of Statement 141(R) states:

> 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, even if confidentiality or other contractual terms prohibit the sale or transfer of a contract separately from the acquiree.

5.17 An entity is not required to have an existing contract with a customer as of the acquisition date for an intangible asset to be recognized. Rather, if the acquired entity routinely signs contracts with its customers (e.g., sales and purchase orders), the acquiring entity would recognize separate intangible assets for the following:

- Customer contracts existing as of the acquisition date.
- Customer relationships, regardless of whether a contract exists as of the acquisition date.

Although Statement 141(R) does not define the term "contractual," it states that both of the above items would satisfy the contractual-legal criterion. Therefore, the absence of enforceable rights by the parties to a particular agreement would not appear to preclude recognition. The SEC staff has historically agreed with this view.

5.18 Statement 141(R) nullified Issue 02-17 but carried forward the EITF's prior decisions about customer contracts and related customer relationships. Issue 02-17 offered the following illustration, which is still considered relevant under the guidance in Statement 141(R):

> Company X acquires Company Y in a business combination on December 31, 20X2. Company Y does business with its customers solely through purchase and sales orders. At December 31, 20X2, Company Y has a backlog of customer purchase orders in-house from 60 percent of its customers, all of whom are recurring customers. The other 40 percent of Company Y's customers are also recurring customers; however, as of December 31, 20X2, Company Y does not have any open purchase orders, or other contracts, with those customers.
>
> **Evaluation:** The purchase orders from 60 percent of Company Y's customers (whether cancelable or not) meet the contractual-legal criterion and, therefore, must be recorded at fair value apart from goodwill. Additionally, since Company Y has established its relationship with 60 percent of its customers through a contract, those customer relationships meet the contractual-legal criterion and must also be recorded at fair value apart from goodwill.
>
> Because Company Y has a practice of establishing contracts with the remaining 40 percent of its customers, those customer relationships also arise through contractual rights and, therefore, meet the contractual-legal criterion. Company X must record the customer relationship for the remaining 40 percent of Company Y's customers at fair value apart from goodwill, even though Company Y does not have contracts with those customers at December 31, 20X2.

Customer Loyalty Programs

5.19 Customer loyalty programs generally allow customers to earn current or future discounts, free products or services, or other benefits on the basis of cumulative purchases from the operator of the program. Many airlines, casinos, hotels, and retailers offer such programs. The program's enrollment process is often designed to be easy to complete, with the participant generally agreeing to the terms and conditions of the program at the time of enrollment. Participants in such programs generally have no obligation to complete future purchases of products or services, and operators of such programs generally reserve the right to modify or cancel the program at any time. Despite the absence of enforceable rights between the parties as to future purchases or fulfillment of accrued benefits, such arrangements are deemed "contractual" as that term is used in Statement 141(R), because the parties have agreed to certain terms and conditions, have had a previous contractual relationship (see **5.17–5.18**), or both. Any liability accruals, or revenue deferrals, by the operator are also evidence that the arrangement is "contractual" as that term is used in Statement 141(R).

5.20 Note that an acquiring entity, in addition to evaluating the recognition and measurement of an acquired customer-related intangible asset, must separately evaluate the recognition and measurement of assumed liabilities related to a customer loyalty program of the acquired entity as of the acquisition date.

Overlapping Customers

5.21 In a business combination, it is not uncommon that certain customers of the acquiring entity are also customers of the acquired entity ("overlapping customers"). This raises an issue regarding the recognition and measurement of an acquired customer contract and a related customer-relationship intangible asset. While an acquired entity's customer contracts would be instrumental to the acquiring entity, some have asserted that the related customer relationship is not instrumental to the acquiring entity and thus has no value to the acquiring entity. At the 2005 AICPA National Conference on Current SEC and PCAOB Developments, an SEC staff member (Pamela R. Schlosser), in prepared remarks, offered the following example that took exception to the view that no value to the acquiring entity was present upon acquisition in such a situation:

> Company A, which sells apparel products to retail customers, acquires Company B, which sells toy products to those same retail customers. The question is: at what amount the customer relationships of Company B should be recognized, considering the fact that Company A already had relationships with those very same customers, albeit for different product sales?
>
> Some have argued that in this situation, no value should be attributed to these intangible assets since Company A already sold its apparel products to Company B's customer base, and thus already had pre-established relationships with them. However, we have found this argument difficult to accept. Because of the acquisition, Company A now has the ability to sell new products (that is, toy products) to its retail customers that it was unable to sell prior to the acquisition of Company B. And even if the two companies sold competing products to the same retail customers, for instance both sold toy products, the fact that Company A has increased its "shelf space" at each of its customers' retail locations would be indicative of value to those relationships.

Noncontractual Customer Relationships

5.22 The acquired entity may not have contractual relationships with its customers (see **5.16**). Nevertheless, the acquiring entity may be required to recognize an intangible asset related to acquired customer relationships if the separability criterion is satisfied. Paragraph A41 of Statement 141(R) provides the following three criteria that can indicate a relationship between an entity and its customer:

- The acquired entity maintains current customer information.
- The acquired entity contacts its customers regularly.
- Customers can directly contact the acquired entity.

5.23 Paragraph A42 of Statement 141(R) states:

> A customer relationship acquired in a business combination that does not arise from a contract may nevertheless be identifiable because the relationship is separable. Exchange transactions for the same asset or a similar asset that indicate that other entities have sold or otherwise transferred a particular type of noncontractual customer relationship would provide evidence that the noncontractual customer relationship is separable. For example, relationships with depositors are frequently exchanged with the related deposits and therefore meet the criteria for recognition as an intangible asset separately from goodwill.

Considerations Regarding Valuation Techniques and Assumptions to Be Used in Measuring Fair Value of Customer-Relationship Intangible Assets

5.24 Paragraph 18 of Statement 157 provides that "[v]aluation techniques consistent with the market approach, income approach, and/or cost approach shall be used to measure fair value." (See **3.56–3.58**.) In the measurement of the fair value of a customer-relationship intangible asset, the use of a market approach is generally not possible because of the absence of market transactions involving identical or comparable assets. Regarding use of the cost approach when measuring customer-relationship intangible assets, the prepared remarks of an SEC staff member (Chad A. Kokenge) at the 2003 AICPA National Conference on Current SEC Developments indicated:

> [T]he [cost] approach only focuses on the entity's specific costs that are necessary to "establish" the relationship. Such an approach would not be sensitive to the volume of business that might be generated by the customer, other relationship aspects, such as referral capability, or other factors

> that may be important to how a marketplace participant might assess the asset. If these factors are significant, we believe the use of such an approach would generally be inconsistent with the Statement 142 definition of fair value [superseded by paragraph 5 of Statement 157].

5.25 At the 2006 AICPA National Conference on Current SEC and PCAOB Developments, the prepared remarks of an SEC staff member (Joseph B. Ucuzoglu) further addressed the topic of valuing customer-relationship intangible assets in a business combination:

> The fact that the acquired entity has a contractual relationship with the customer may also give rise to a valuable customer relationship which must be considered in the purchase price allocation pursuant to Statement 141 [superseded by Statement 141(R)]. [Footnote 2] This provides a nice segue into my next topic. The issue of valuing customer relationship intangible assets seems to have become an annual topic at the SEC conference.
>
> Some have suggested that the SEC staff always requires the use of an income approach to value customer relationship intangible assets. The staff has even heard some suggest that, as long as a registrant characterizes its valuation method as an income approach, the specific assumptions used or results obtained will not be challenged by the staff, because one has complied with a perceived bright line requirement to use an income approach. Let me assure you, these statements are simply false. While an income approach often provides the most appropriate valuation of acquired customer relationship intangible assets, circumstances may certainly indicate that a different method provides a better estimate of fair value. On the flipside, even when a registrant concludes that an income approach is the most appropriate valuation methodology, the staff may nevertheless question the result obtained when the underlying assumptions, such as contributory asset charges, do not appear reasonable in light of the circumstances.
>
> When determining the appropriate valuation of a customer relationship intangible asset, I believe that the first step in the process should be to obtain a thorough understanding of the value drivers in the acquired entity. That is, why is it that customers continually return to purchase products or services from the acquired entity? In some cases, the nature of the relationship may be such that customers are naturally "sticky," and tend to stay with the same vendor over time without frequently reconsidering their purchasing decisions. In that circumstance, it would appear that a significant portion of the ongoing cash flows that the acquired entity will generate can be attributed to the strength of its customer relationships.
>
> At the other end of the spectrum, relationships may be a less significant value driver in an environment where customers frequently reassess their purchasing decisions and can easily switch to another vendor with a lower price or a superior product. In that environment, if customers continually return to buy products from the acquired entity, perhaps they do so in large part due to factors other than the relationship, such as a well-know[n] tradename, strong brands, and proprietary technologies. As a result, the value of the customer relationship intangible asset may be less than would be the case in a circumstance where the relationship is stronger. However, the staff would generally expect that the amount attributed to other intangible assets would be commensurately higher, reflecting the increasingly important role of those assets in generating cash flows.

Footnote 2 refers to paragraph A14(b) of Statement 141, which was superseded by paragraph A36 of Statement 141(R).

In-Process Research and Development Assets

5.26 Prior to a business combination, an acquired entity may incur research and development (R&D) expenditures that could result in the development of certain intangible assets by the acquired entity that would be expensed as incurred in accordance with Statement 2 (unless they had an alternative future use). In other words, an acquired entity would probably not record any assets on its books before the consummation of a business combination related to R&D. To the extent that the acquired entity was using, or was planning to use, these unrecognized assets for R&D activities, the assets would represent acquired in-process research and development (IPR&D) to the acquirer.

5.27 Under Statement 141(R) and Statement 142 (as amended by Statement 141(R)), the acquiring entity recognizes IPR&D at fair value as of the acquisition date, and subsequently accounts for it as an indefinite-lived intangible asset until completion or abandonment of the associated R&D efforts. See **10.39–10.40** for additional guidance related to the subsequent accounting for IPR&D intangible assets.

5.28 If an entity acquires IPR&D in a business combination that it does not intend to use to its highest and best use (e.g., it has plans to discontinue the R&D project after the acquisition even though a marketplace participant would continue the R&D efforts), it would be required to recognize an intangible asset at fair value in its acquisition method accounting (see **5.09–5.10**).

5.29 Statement 141(R) does not affect the accounting for R&D expenditures incurred outside of a business combination. Therefore, the acquiring entity would generally expense research and development costs incurred after the acquisition date that relate to an acquired IPR&D project in accordance with Statement 2.

Example 5-1
Acquired IPR&D

On June 30, 20X9, Company A, a calendar year-end company, acquires Company B in a transaction accounted for as a business combination. Before the acquisition, Company B had incurred significant costs related to the R&D of a new line of products, all of which it expensed as incurred under Statement 2. Company A plans to continue these R&D efforts in hopes of releasing the new line of products into the market in the future.

As part of the acquisition method accounting, and in a manner consistent with the fair value measurement guidance in Statement 157, Company A calculates the fair value of the acquired IPR&D assets as $10 million. Therefore, as of the acquisition date, Company A would record an indefinite-lived intangible asset for $10 million.

Subsequent to the acquisition date, Company A would account for all additional costs it incurs related to this project under Statement 2 (i.e., such costs would generally be expensed as incurred).

5.30 Historically, the SEC has expressed concerns over the significance of acquired IPR&D. In 2001, the AICPA responded by publishing a Practice Aid, *Assets Acquired in a Business Combination to Be Used in Research and Development Activities: A Focus on Software, Electronic Devices, and Pharmaceutical Industries*. It states:

> This Practice Aid identifies what the task force members perceive as best practices related to defining and accounting for, disclosing, valuing, and auditing assets acquired to be used in R&D activities, including specific IPR&D projects.

Although the Practice Aid is a valuable resource for understanding and applying valuation techniques for intangible assets, entities should use caution when referring to it because it has not yet been updated to reflect certain changes in fair value guidance resulting from the issuance of Statement 157. The Practice Aid should only be used when it does not conflict with Statement 157 or other authoritative GAAP, as it has not been approved, disapproved, or otherwise acted upon by any senior technical committee of the AICPA or the FASB and thus has no official or authoritative status. The AICPA recently indicated that it intends to revisit the guidance in the Practice Aid soon.

Differences between Statement 157 and the Practice Aid include the following (not all-inclusive):

- Under Statement 157, an estimate of fair value would consider all potential market participants (i.e., strategic buyers and financial buyers). The Practice Aid indicates that only strategic buyers are relevant.

- Under Statement 157, an asset is valued using either the "in-use" or the "in-exchange" valuation premise. The Practice Aid indicates that these valuation premises should not be used in the determination of fair value in a business combination because they are not representative of fair value for financial reporting.
- Under Statement 157, an intangible asset may have a fair value, under a market participant approach, even if the acquiring entity intends to retire the intangible asset (e.g., a defensive value asset). In contrast, the Practice Aid indicates that a retired intangible asset would have no value since it does not provide the acquiring entity with a future economic benefit.

Reacquired Rights

5.31 In a business combination, the acquirer may reacquire a right that it previously granted to the acquiree (e.g., a license or franchise). Paragraph 31 of Statement 141(R) stipulates that reacquired rights are intangible assets that the acquirer must recognize apart from goodwill. The acquirer measures the value of the reacquired right in accordance with Statement 157, but with one exception: the value of the intangible asset is limited to its remaining contractual term (i.e., the contractual term that remains until the next renewal date), regardless of whether market participants would assume renewal or extension of the existing terms of the arrangement. Therefore, reacquired rights are **not** considered true "fair value" measurements in accordance with Statement 157.

5.32 In a manner consistent with their initial measurement of reacquired rights, entities must subsequently amortize intangible assets related to reacquired rights on the basis of their remaining contractual terms.

Example 5-2
Reacquired Rights

Case A

Company B sells products in Europe under a license agreement with Company A. Company A acquires Company B in a transaction accounted for as a business combination. As of the acquisition date, the license agreement has a remaining contractual term of three years, and can be renewed at the end of the current term and indefinitely every five years thereafter. The pricing of the license agreement is at-market, and the agreement does not have explicit settlement provisions. Company A has calculated the following values for the license agreement:

- $75 — value for the right to use the technology for the remaining three-year contractual term.
- $200 — fair value for the right to use the technology, calculated using the principles of Statement 157, which considers future renewals by market participants.

In this example, Company A would recognize an intangible asset for $75, and it would amortize this amount over the remaining three-year contractual term.

5.33 If the terms of the contract give rise to a reacquired right that is favorable or unfavorable relative to similar market transactions for similar rights, the acquirer recognizes a settlement gain or loss. Paragraph A79 of Statement 141(R) provides guidance for calculating the settlement gain or loss, stating that it should be recorded as the lesser of:

> (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 [, or]
>
> (2) The amount of any stated settlement provisions in the contract available to the counterparty to whom the contract is unfavorable.

Example 5-3
Reacquired Rights

Case B

Assume the same facts as in Example 5-2, except that under the terms of the license agreement, Company B pays a license fee that is below-market relative to that of its competitors with similar licensing agreements. In addition, Company A now measures the value of the license, for the remaining three-year contractual term, at $100. (Note that this amount is greater than the $75 value calculated in Example 5-2 for an at-market contract.)

Company A would record an intangible asset of $75 for the reacquired license (the at-market value for similar agreements) and recognize a settlement loss in the income statement for $25. In effect, the settlement loss represents additional consideration Company A would be required to give Company B to terminate the existing agreement, which was unfavorable to Company A. (See **3.28**.)

5.34 An acquirer may subsequently sell a reacquired right to a third party. The carrying amount of the recognized intangible asset (i.e., reacquired right) would thus be included in the gain or loss on sale.

Favorable or Unfavorable Operating Leases When the Acquiree Is the Lessee

5.35 The acquirer cannot recognize assets and liabilities related to an acquired operating lease in which the acquiree is the lessee except when (1) the lease is favorable or unfavorable relative to current market rates or (2) market participants would place value on an at-the-money contract.

Paragraph A17 of Statement 141(R) describes the first exception as follows:

> Regardless of whether the acquiree is the lessee or the lessor, the acquirer shall determine whether the terms of each of an acquiree's operating leases are favorable or unfavorable compared with the market terms of leases of the same or similar items at the acquisition date. The acquirer shall recognize an intangible asset if the terms of an operating lease are favorable relative to market terms and a liability if the terms are unfavorable relative to market terms.

For a discussion related to the second exception, see **5.36** below.

Valuing "At-the-Money" Contracts

5.36 Paragraph A18 of Statement 141(R) states, in part:

> An identifiable intangible asset may be associated with an operating lease, which may be evidenced by market participants' willingness to pay a price for the lease even if it is at market terms. For example, a lease of gates at an airport or of retail space in a prime shopping area might provide entry into a market or other future economic benefits that qualify as identifiable intangible assets, for example, as a customer relationship. In that situation, the acquirer shall recognize the associated identifiable intangible asset(s).

Although the above example refers to operating leases, by analogy an acquirer can apply this guidance to certain other types of contracts (e.g., at-market contracts with customers).

Intangible Assets Associated With Income-Producing Real Estate

5.37 Income-producing real estate, such as an office or apartment building that is occupied by tenants on the date of acquisition, represents to the acquirer a collection of tangible and intangible assets and, in certain instances, liabilities. When calculating the fair value of such income-producing real estate, it is necessary to separately identify and measure the tangible and intangible assets and liabilities present.

The following table identifies examples of tangible and intangible assets and liabilities that may be present in the acquisition of income-producing real estate, along with measurement considerations.

Measurement Considerations	
Land, Buildings, and Other Tangible Assets (e.g., Equipment)	Recognized at fair value under Statement 157. Acquiring entity must determine the highest and best use of the asset or group of assets (i.e., in-use or in-exchange) from the point of view of a market participant. Buildings are to be valued "as if vacant" to avoid including measurement value that may be attributable to other assets and liabilities discussed below.
Favorable or Unfavorable In-Place Leases	In-place leases may be favorable or unfavorable at the acquisition date relative to current market rates. Favorable leases from the perspective of the acquiring entity represent assets, while unfavorable leases from the perspective of the acquiring entity represent liabilities (or balance sheet credits). Separate classification of assets and liabilities (or balance sheet credits) is required.
In-Place Leases — Intangible Asset	In-place leases provide value to the acquiring entity in that cash outflows necessary to originate leases (such as marketing, sales commissions, legal costs, and lease incentives) are avoided. Also, in-place leases enable the acquiring entity to avoid lost cash flows during an otherwise required lease-up period. Measurement of in-place leases should therefore reflect both the benefits to the acquiring entity of avoided cash outflows otherwise necessary to originate such leases as well as cash inflows (net of service costs to tenants such as security and maintenance) resulting from not having to incur an otherwise required lease-up period.
Customer Contracts and Related Customer Relationships — Intangible Asset	Existing tenants may also provide value to the acquiring entity through renewals of existing leases or other benefits (such as purchases of additional services or rentals of additional space).

The list of examples is not all-inclusive. For example, other intangible assets may be present in a particular acquisition of income-producing real estate such as a customer list, management contract, or trade name.

Goodwill

Measurement of Goodwill

5.38 Goodwill is an unidentifiable asset (i.e., not contractual or separable) and, as such, can only be measured as a residual. Paragraph 34 of Statement 141(R) states:

> The acquirer shall recognize goodwill as of the acquisition date, measured as the excess of (a) over (b) below:
>
> a. The aggregate of:
>
> (1) The consideration transferred measured in accordance with this Statement, which generally requires acquisition-date fair value (paragraph 39) [see **Section 6**]
>
> (2) The fair value of any noncontrolling interest in the acquiree [see **7.07–7.09**]

(3) In a business combination achieved in stages, the acquisition-date fair value of the acquirer's previously held equity interest in the acquiree [see **5.41**]

b. The net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed measured in accordance with this Statement.

5.39 An underlying premise of Statement 141(R) is that an entity's acquisition of control of a business makes the acquiring entity accountable and responsible for all of the acquiree's assets and liabilities, regardless of its ownership percentage. Because goodwill is an asset, it is recognized like any other asset or liability. Therefore, the total amount of goodwill consists not only of the portion relating to the acquiring entity, but also the portion relating to any noncontrolling interest (referred to as the "full goodwill" approach). Even though goodwill relates to both the acquiring entity and any noncontrolling interest, goodwill is presented on the balance sheet as a single line-item.

Example 5-4
Calculation of Goodwill

On June 15, 20X9, Company X purchases an additional 55 percent of Company Y for $700 in cash (which includes a control premium). Immediately before the acquisition, X held a 25 percent interest in Y, which had carrying value of $200 and a fair value of $225. Company X agrees to pay the selling shareholders $80 if certain performance targets are met by December 31, 20Y0. The fair value of such arrangement as of the acquisition date is $50. The fair value of the 20 percent noncontrolling interest is $180. The fair value of 100 percent of Y's identifiable assets acquired, net of liabilities assumed, is $800.

The calculation of goodwill is as follows:

Cash transferred by X	$ 700
Fair value of contingent consideration arrangement	50
Total consideration transferred by X	750
Fair value of the noncontrolling interest	180*
Fair value of X's previously held interest in Y	225**
Subtotal	1,155
Fair value of the net assets acquired	(800)
Goodwill	$ 355

* The fair value of the 20 percent noncontrolling interest includes a minority discount for lack of control.

** Company X would recognize a $25 gain ($225 fair value – $200 carrying value) related to the remeasurement to fair value of its previously held interest in Company Y.

5.40 Generally, goodwill is measured on the basis of consideration transferred. However, in some acquisitions, either no consideration is transferred or the consideration transferred is less reliably measurable than a direct measurement of the business acquired (e.g., business combinations resulting from the exchange of equity interests). Paragraph 35 of Statement 141(R) states that when only equity interests are exchanged, goodwill should be calculated by using the fair value of the acquiree's equity interests if they are more reliably measurable than the fair value of the acquirer's equity interests. In acquisitions in which no consideration is transferred, the acquiring entity uses the fair value of the acquirer's interest in the acquiree, which is determined by using appropriate valuation techniques instead of the fair value of the consideration transferred.

5.41 For business combinations achieved in stages, paragraph 48 of Statement 141(R) states:

> In a business combination achieved in stages, the acquirer shall remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognize the resulting gain or loss, if any, in earnings. In prior reporting periods, the acquirer may have recognized changes in the value of its equity interest in the acquiree in other comprehensive income (for example, because the investment was classified as available for sale). If so, the amount that was recognized in other comprehensive income shall be reclassified and included in the calculation of gain or loss as of the acquisition date.

Note that after the acquirer obtains control of a business subsequent increases or decreases in its ownership interest, as long as control is retained, are accounted for as equity transactions (see **7.20–7.23**).

Bargain Purchases

5.42 Though uncommon, a bargain purchase could occur when the aggregate fair value of (1) the consideration transferred, (2) any noncontrolling interests in the acquiree, and (3) any previously held equity interest in the acquiree is less than the fair value of the net assets acquired.

5.43 Statement 141(R) requires the acquiring entity to double-check its calculations before concluding that a bargain purchase exists. If the same result is reached, any further excess is recognized as a gain in earnings as of the acquisition date. Paragraph 38 of Statement 141(R) states the following:

> Before recognizing a gain on a bargain purchase, the acquirer shall reassess whether it has correctly identified all of the assets acquired and all of the liabilities assumed and shall recognize any additional assets or liabilities that are identified in that review. The acquirer shall then review the procedures used to measure the amounts this Statement requires to be recognized at the acquisition date for all of the following:
>
> a. The identifiable assets acquired and liabilities assumed
>
> b. The noncontrolling interest in the acquiree, if any
>
> c. For a business combination achieved in stages, the acquirer's previously held equity interest in the acquiree
>
> d. The consideration transferred.
>
> The objective of the review is to ensure that the measurements appropriately reflect consideration of all available information as of the acquisition date.

5.44 Bargain purchases may occur because of underpayments for the business acquired (e.g., in a forced liquidation or distress sale). They may also occur because not all assets acquired or liabilities assumed are recognized or measured at fair value. For example, a contingent liability may not be recognized if it does not meet the recognition criteria in Statement 141(R) (see **4.32**). However, the risk related to that liability may be reflected in what the acquiring entity paid for the acquiree. That mismatch could lead to a bargain purchase.

Example 5-5
Accounting for a Bargain Purchase

Company A acquires 100 percent of Company B for $150 million in cash. Company A calculates the fair value of the net assets acquired as follows:

Investments	$ 90 million
Building	50 million
Trademark	50 million
Less: liabilities	(10 million)
Fair value of B's net assets	$ 180 million

After examining the $180 million fair value estimate again, A concludes that its measurements appropriately reflect consideration of all available information as of the acquisition date. Therefore, under Statement 141(R), A would record a $30 million gain ($180 million – $150 million) in earnings as of the acquisition date.

5.45 Statement 141(R) specifies that before an entity recognizes a gain related to a bargain purchase, the entity must reassess whether all of the assets acquired and liabilities assumed in the business combination have been appropriately recognized and measured. Statement 141(R) also requires retrospective application of any adjustments made during the measurement period to the provisional amounts recognized (see **3.16–3.23**). If a bargain purchase occurs, after reassessing the recognition and measurement of the assets acquired and liabilities assumed, an entity would recognize a gain as of the acquisition date. Subsequent measurement period adjustments would result in adjustment, or possibly reversal, of the gain. Appropriate disclosure must be provided indicating that the initial accounting is still provisional and therefore the gain recognized may be subject to future adjustments.

Section 6 — Recognizing and Measuring the Consideration Transferred in a Business Combination

6.01 Determining the amount of consideration transferred in a business combination is important because the amount directly affects the measurement of goodwill or, in more limited instances, the amount of the bargain purchase (see section **5.42–5.45**). The paragraphs below discuss how an entity makes this determination.

Consideration Transferred by the Acquiring Entity to the Former Owners of the Acquiree

6.02 The fair value measurement and recognition principles of Statement 141(R) require that, with the exception of share-based payment awards (see **6.05–6.19**), an acquirer measure and recognize the fair value of the consideration transferred in a business combination as of the acquisition date. Acquirers calculate share-based payment awards by using a fair value-based measure in accordance with Statement 123(R). Consideration transferred by the acquiring entity to the former owners can include assets, liabilities incurred by the acquiring entity to the former owners of the acquiree, and equity interests. Consideration can take many forms, including cash, other tangible or intangible assets, a business or subsidiary of the acquirer, contingent consideration, and equity instruments such as common or preferred shares, options, warrants, and share-based payment awards.

6.03 Sometimes the amount paid to the former owners includes amounts that are not in exchange for the business, such as payments to compensate for services, use of property, or profit sharing. Payments that do not represent consideration transferred for the acquired business should be accounted for separately from the business combination and expensed in the appropriate periods.

Equity Securities Issued as Consideration

6.04 If equity securities are issued as consideration in a business combination, the acquiring entity measures them at fair value *as of the acquisition date*. The accounting under Statement 141(R) is significantly different from the accounting under Statement 141 and Issue 99-12. Issue 99-12 required the acquiring entity to measure the fair value of its marketable equity securities on the basis of their quoted market price "over a reasonable period of time before and after the terms of the acquisition are agreed to and announced." A "reasonable period of time" was generally considered to be a few days. Statement 141(R) nullified Issue 99-12.

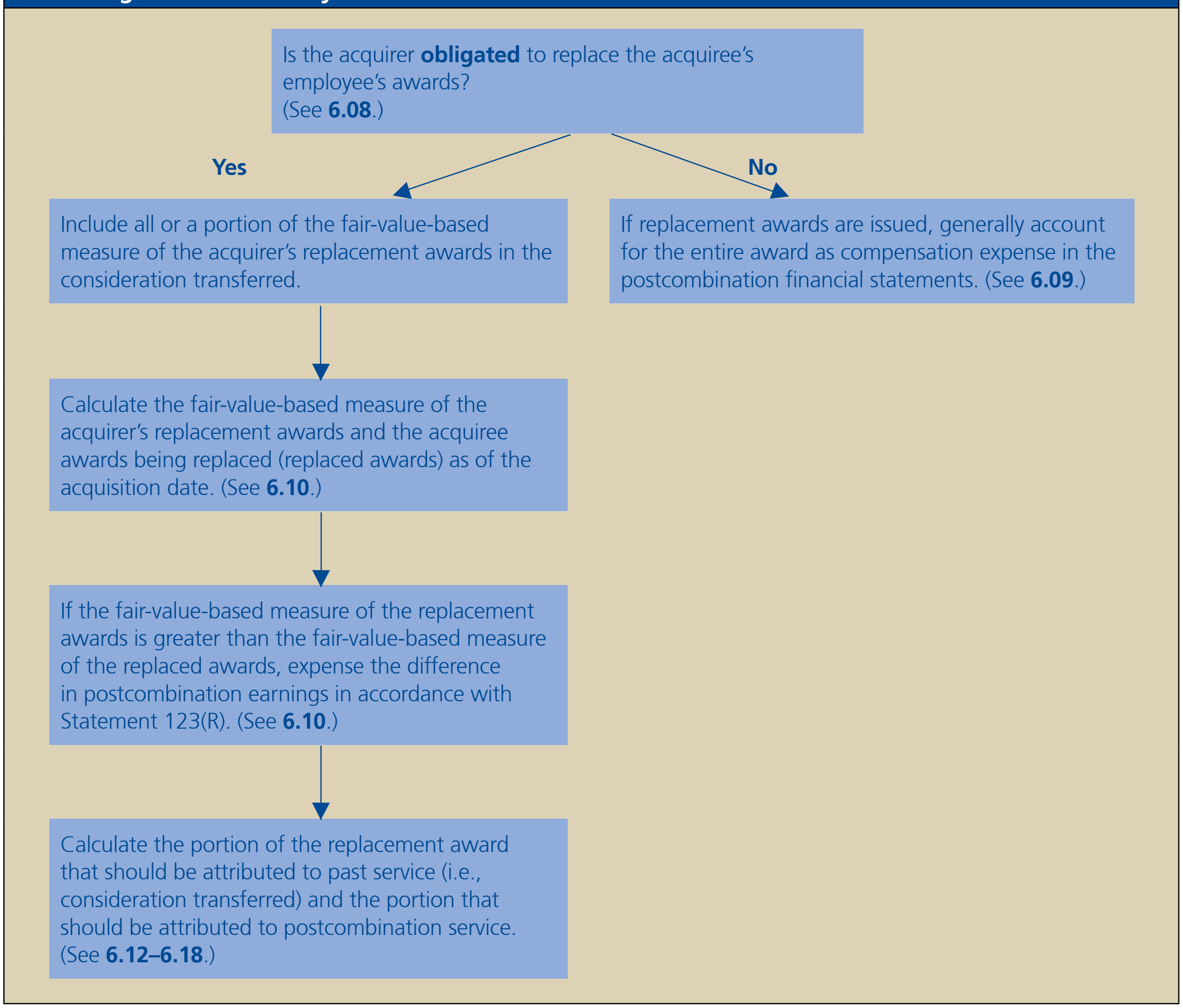
Share-Based Payment Awards

6.05 An acquiring entity may issue share-based payment awards (referred to as "replacement awards" in Statement 141(R)) to the employees of the acquiree to replace their existing share-based payment awards that are at least, in part, tied to the acquiree's common stock (e.g., stock options). Exchanges of share-based payment awards in a business combination are considered *modifications* in accordance with Statement 123(R).

6.06 Replacement awards are often issued by the acquirer to ensure that employees of the acquiree are in a similar economic position immediately before and after the consummation of the business combination. In contrast, an acquirer may issue replacement awards that also include an additional requirement for employees to remain with the company after the acquisition. Therefore, the issuance of share-based payment awards may represent consideration transferred in the business combination (i.e., the award relates to past services performed by the employee for the acquiree before the acquisition date), compensation for future services (i.e., postcombination) by an employee, or both.

6.07 The steps an entity should follow in determining the amount to recognize as consideration transferred in a business combination and as postcombination compensation expense are summarized in the chart below.

Allocating Share-Based Payments Between Past Service and Future Service



6.08 Statement 141(R) provides guidance for calculating the portion of a replacement award that is attributable to (1) past service and included in the consideration transferred and (2) future service and included in postcombination compensation expense. The entity must first analyze the arrangement to determine whether the acquirer is *obligated* to replace the acquiree's employees' awards. If the acquirer is *obligated* to replace the awards, then all or a portion of the fair-value-based measure of the acquirer's replacement awards is included in the measurement of the consideration transferred in the business combination. The acquirer is *obligated* to replace the acquiree awards if the acquiree or its employees have the ability to enforce replacement. Paragraph 43 of Statement 141(R) indicates that this obligation would be incurred if replacement is required by the terms of the acquisition agreement, the terms of the acquiree's awards, or by applicable laws or regulations.

An Acquirer Is Not Obligated to Replace the Awards

6.09 If an acquiree's share-based payment awards expire as a result of the business combination, and the acquirer issues replacement awards even though it is not obligated to do so, the entire amount of the awards is generally considered compensation expense in the postcombination period and is accounted for as a new award in accordance with Statement 123(R).

An Acquirer Is Obligated to Replace the Awards

6.10 If the acquirer is obligated to replace the acquiree's awards, it must determine what portion of a replacement award is part of the consideration transferred for the acquiree. The acquirer must first determine the fair-value-based measure of both the acquirer's replacement awards and the acquiree's replaced awards, as of the acquisition date, in accordance with the requirements of Statement 123(R). If the fair-value-based measure of the acquirer's replacement awards is greater than the fair-value-based measure of the replaced awards as of the acquisition date, the excess is recognized as an expense in postcombination earnings. Such expense would be recognized over the period from the acquisition date through the end of the requisite service period of the replacement awards.

6.11 The next step in accounting for the replacement award is determining what portion of the remaining fair value should be attributed to precombination service and what portion should be attributed to postcombination service. The portion attributable to precombination service (see **6.12**) is included in the consideration transferred for the acquired business, whereas the portion attributable to postcombination service (see **6.15**) is expensed in postcombination earnings. This applies regardless of whether the acquired entity's employees had performed all services required to earn the original awards.

6.12 The portion of the replacement award attributable to precombination service is calculated as follows:

	Acquisition date fair-value-based measure of the **replaced** awards
×	Ratio of the past service to the greater of (1) the total service period or (2) the original service period of the replaced award
=	Amount included in consideration transferred

The total service period is calculated as follows:

	Requisite service period for the replaced award completed before the acquisition date
+	Postcombination requisite service period, if any, for the replacement award
=	Total service period

6.13 Paragraph A93 of Statement 141(R) states, "The requisite service period includes explicit, implicit, and derived service periods during which employees are required to provide service in exchange for the award (consistent with the requirements of Statement 123(R))."

Determining the Postcombination Service Period for Replacement Awards With Equal or Greater Service Requirements

6.14 For acquiree awards that were fully vested before the acquisition date, and were replaced by new awards that require an additional future service period, the determination of the total service period would not include the period from the vesting date of the acquiree awards to the acquisition date.

Example 6-1
Determining the Total Service Period of the Replacement Award When the Replaced Award is Fully Vested

Assume Employee has 100 stock options of Company B's common stock that are fully vested on June 30, 20X8. These awards originally had a three-year service period associated with them, but have not been exercised yet. On January 1, 20X9, Company A acquires Company B in a transaction accounted for as a business combination and is obligated to replace Employee's awards. As part of the acquisition, A was obligated to replace B's fully vested awards with A's new awards that require an additional three years of service.

The total service period of A's new awards is six years, which is the sum of the service period for B's old awards plus the service period for A's new awards. In other words, the total service period does not include the period from the original vesting date (i.e., June 30, 20X8) to the acquisition date (i.e., January 1, 20X9).

Example 6-2
Determining the Total Service Period of the Replacement Award When the Service Period Is the Same as the Replaced Award

Company B grants 100 stock options to Employee on January 1, 20X7, that cliff-vest after four years (i.e., on January 1, 20Y1). On January 1, 20X9, Company A acquires B and was obligated to grant Employee 100 replacement options that have the same service terms as the original award (i.e., the replacement awards will vest at the end of two additional years).

The total service period of the replacement awards is four years, which is equal to the service period of the original awards. In the calculation of the portion attributable to precombination services, the precombination service period would equal two years (January 1, 20X7, to January 1, 20X9).

6.15 The portion of the replacement award attributable to future services is calculated as follows:

Acquisition date fair-value-based measure of the **acquirer replacement awards**
– Amount attributable to precombination service (see **6.12**)
= Postcombination compensation expense

Example 6-3
Allocation of Compensation Expense

Target Company (TC) issues 100 stock options to Employee on January 1, 20X8, that cliff-vest after three years (i.e., on January 1, 20Y1).

On January 1, 20X9, Parent Company (PC) acquires TC and replaces the 100 options on TC's stock with 100 options on its own stock (assume PC is obligated to replace Employee's awards). The fair-value-based measure of both the PC options and the TC options on January 1, 20X9, is $10 per option. The replacement options retain the original vesting conditions of TC options (i.e., they vest on January 1, 20Y1).

The total fair-value-based measure of the replacement options as of the acquisition date is $1,000, of which $333 (one of three years) is attributable to precombination services and $667 (two of three years) is attributable to future services. The $333 is included in the consideration transferred, and the $667 is recognized as compensation cost by PC as the services are performed by Employee (i.e., from January 1, 20X9, to January 1, 20Y1). Note that the grant-date fair value assigned to the options issued by TC is not relevant as of the acquisition date.

Determining the Postcombination Service Period for Replacement Awards With Reduced Service Requirements

6.16 An acquirer's decision to immediately vest or reduce the future service period of share-based payment awards held by employees of the acquiree affects the timing of when the postcombination compensation expense is recognized. However, if share-based payment awards of the acquiree become immediately vested on the date of the business combination because of a change-in-control provision, the original service period should be considered completed.

Example 6-4 **Allocation of Compensation Expense**
Assume the same facts as in Example 6-3 except that PC decides to immediately vest all outstanding TC options on the date of the business combination (January 1, 20X9). Instead of recognizing the $667 allocated to the future services over the period from January 1, 20X9, to January 1, 20Y1, PC would immediately expense this amount on the date of the business combination.

Replacement Awards With Graded Vesting

6.17 Paragraph A95 of Statement 141(R) states, "If the replacement award has a graded vesting schedule, the acquirer shall recognize the related compensation cost in accordance with its policy election for other awards with graded vesting in accordance with paragraph 42 of Statement 123(R)."

6.18 Paragraph 42 of Statement 123(R) states:

> An entity shall make a policy decision about whether to recognize compensation cost for an award with only service conditions that has a graded vesting schedule (a) on a straight-line basis over the requisite service period for each separately vesting portion of the award as if the award was, in-substance, multiple awards or (b) on a straight-line basis over the requisite service period for the entire award (that is, over the requisite service period of the last separately vesting portion of the award). However, the amount of compensation cost recognized at any date must at least equal the portion of the grant-date value of the award that is vested at that date.

Impact of Modifications, Changes in Forfeiture Estimates and Other Events Occurring After the Acquisition Date

6.19 Generally, any events that occur after the acquisition date that affect the estimates of forfeiture or cause modifications to the replacement awards would be accounted for in accordance with Statement 123(R). Therefore, such events would affect postcombination compensation expense and would not affect the amount of consideration transferred in the business combination. The only exception would be for adjustments that are made during the measurement period and pertain to details that existed as of the acquisition date. (See **3.16–3.19**.) Paragraph A95 of Statement 141(R) states:

> The portion of a nonvested replacement award attributable to precombination service, as well as the portion attributable to postcombination service, shall reflect the acquirer's estimate of the number of replacement awards for which the requisite service is expected to be rendered. For example, if the fair-value-based measure of the portion of a replacement award attributed to precombination service is $100 and the acquirer expects that the requisite service will be rendered for only 95 percent of the instruments awarded, the amount included in consideration transferred in the business combination is $95. Changes in the number of replacement awards for which the requisite service is expected to be rendered are reflected in compensation cost for the periods in which the changes or forfeitures occur—not as adjustments to the consideration transferred in the business combination. Similarly, the effects of other events, such as modifications or the ultimate outcome of awards with performance conditions, that occur after the acquisition date are accounted for in accordance with Statement 123(R) in determining compensation cost for the period in which an event occurs.

Gains or Losses on Assets Transferred as Consideration by the Acquiring Entity

6.20 An acquiring entity may transfer its tangible or intangible assets or liabilities as consideration whose carrying value differs from the fair value of the assets or liabilities as of the acquisition date. Examples include inventory, property, intangible assets, or a business or subsidiary. If an entity elects to make such a transfer, Statement 141(R) requires that the acquiring entity remeasure those assets or liabilities to their fair values as of the acquisition date and recognize the resulting gains or losses, if any, in earnings.

Example 6-5
Nonmonetary Asset Transferred as Consideration to the Former Owners of the Acquiree

Company B entered into an agreement with Company C to acquire Subsidiary S for consideration of $1 million cash and a building. The building's carrying value in B's financial statements is $100,000 and its fair value is $250,000.

The consideration transferred for S is $1,250,000, which includes the fair value of the building ($250,000). Company B recognizes a gain in earnings on the disposal of the building as of the acquisition date of S of $150,000 ($250,000 – $100,000).

6.21 Sometimes the consideration transferred includes assets or liabilities that the acquiring entity transfers to the acquiree rather than to its former owners. If the assets or liabilities stay in the combined entity, the acquiring entity does not lose control of them. Therefore, such assets are measured at their carrying amounts immediately before the acquisition date, and no gain or loss is recognized because the acquiring entity controls them both before and after the business combination. The same is true if the acquisition were for less than 100 percent of the equity interests in the acquiree.

Example 6-6
Nonmonetary Asset Transferred as Consideration Directly to the Acquiree

Company B entered into an agreement to acquire an 80 percent interest in Company C for consideration of $1 million cash and a building. The building will remain with the combined entity and will not be transferred to the former owners of C. The building's carrying value in B's financial statements is $100,000 and its fair value is $250,000. Therefore, the consideration transferred for the 80 percent interest in C is $1,100,000 ($1 million cash plus the $100,000 carrying value of the building).

As of the acquisition date, C has identifiable net assets with a fair value of $700,000. Also, the fair value of the 20 percent noncontrolling interest in C as of the acquisition date is $200,000.

On the acquisition date, the goodwill recognized as part of the acquisition is calculated as follows:

Cash	$ 1,000,000	
Building	100,000	B's carrying amount
Noncontrolling interest	200,000	Acquisition-date fair value
	1,300,000	
Less: assets acquired		
Building	100,000	
Other identifiable net assets	700,000	Acquisition-date fair value
	800,000	
Goodwill	$ 500,000	

Contingent Consideration

6.22 Contingent consideration is typically an obligation of the acquirer to transfer additional assets or equity instruments to the former owners of the acquiree if specified future events occur or conditions are met. In some instances, however, contingent consideration can also be an asset to the acquiring entity if the former owners of the acquiree are obligated to return part of the consideration if certain conditions are met.

Initial Recognition

6.23 Contingent consideration is part of the total consideration transferred for the acquiree and therefore must be measured and recognized at fair value as of the acquisition date. Typical contingent consideration arrangements are based on changes in security prices, meeting earnings targets, components of earnings, such as revenues or earnings before interest, taxes, depreciation, and amortization (EBITDA), and arrangements based on a future event, such as FDA approval of a pharmaceutical product. See **6.40** for additional considerations of whether an arrangement is contingent consideration or compensation expense related to the selling shareholders' continuing employment with the combined entity.

6.24 Once the contingent consideration is initially recognized, the acquiring entity must classify it as a liability, an equity instrument, or an asset. The initial classification will govern its subsequent accounting. It is usually clear if contingent consideration is an asset. However, determining whether contingent consideration is a liability or an equity instrument can be difficult. Statement 141(R) refers to existing accounting standards in the classification of contingent consideration. Such guidance includes Statement 133, Statement 150, Issue 00-19, and Issue 07-5. Most contingent consideration arrangements will most likely be classified as liabilities under this literature.

Example 6-7

Determining the Classification of Contingent Consideration as a Liability or Equity — Issuance of a Variable Number of Equity Securities

Company A acquires Company B for 1 million shares of A's common stock and an agreement to issue additional shares as consideration if the quoted market price of A's common stock is below $25 on the one-year anniversary of the acquisition date. The number of shares, if any, issued by A on the one-year anniversary date will be the amount necessary to guarantee the price of $25 per share.

On the one-year anniversary of the acquisition date, the quoted market price of A's common stock is $20. Accordingly, A issues an additional 250,000 shares to the seller.

On the basis of its analysis of existing accounting guidance, A concludes that this arrangement is a liability because the number of shares is variable.

Example 6-8

Determining the Classification of Contingent Consideration as a Liability or Equity — Payment of Additional Cash Consideration

Company A acquires Company B for 1 million shares of A's common stock and an agreement to pay cash consideration if the quoted market price of A's common stock is below $25 on the one-year anniversary of the acquisition date. The total cash, if any, paid by A on the one-year anniversary of the acquisition date will be the amount necessary to guarantee the $25 per share price.

On the one-year anniversary of the acquisition date, the quoted market price of A's common stock is $20. Accordingly, A pays additional cash consideration of $5 million to the former owners of B.

On the basis of its analysis of existing accounting guidance, A concludes that this arrangement is a liability because of the cash settlement feature.

Example 6-9
Determining the Classification of Contingent Consideration as a Liability or Equity — Issuance of a Fixed Number of Equity Securities

Company B acquires Company C for 1 million shares and an agreement to issue an additional 250,000 shares if the earnings of C equal or exceed a specified target for the 12-month period after the acquisition. If the earnings of C exceed the specified target, B will be required to issue the fixed amount of additional shares.

On the one-year anniversary of the acquisition date, it was determined that the earnings of C exceeded the specified target. Accordingly, B issued the additional 250,000 shares.

On the basis of its analysis of existing accounting guidance, A concludes that this arrangement may qualify as an equity instrument in part because the number of shares is fixed.

Subsequent Accounting

6.25 If the contingent consideration is classified as an asset or a liability, it is remeasured to fair value each reporting period. The acquiring entity recognizes changes in fair value in earnings each period unless the arrangement is a hedging instrument for which Statement 133 requires changes to be recognized in other comprehensive income.

6.26 If the contingent consideration is classified as an equity instrument, it is not remeasured. The initial amount recognized for contingent consideration classified as equity is not adjusted, even if the fair value of the arrangement on the date the contingency is resolved would be different.

6.27 Adjustments made during the measurement period that pertain to facts and circumstances that existed as of the acquisition date (see **3.16–3.19**) are recognized as adjustments to goodwill. However, most changes in fair value after the acquisition date will **not** likely be measurement period adjustments. For example, earnings targets that are met, changes in share prices, and FDA approvals are all changes that occur after the acquisition date. Changes in fair value resulting from these items are recognized in earnings and not as adjustments to goodwill.

Example 6-10
Subsequent Accounting for a Contingent Consideration Arrangement Classified as a Liability

On January 1, 20X9, Company A acquires Company B from Company X for $15 million. Company A agrees to pay an additional $6 million to X if the cumulative net income of B reaches $10 million within three years of the acquisition date. The fair value of the contingent consideration arrangement is classified as a liability and has an acquisition-date fair value of $4 million. At the end of each reporting period after the acquisition date, the contingent payment is remeasured to its fair value, with changes in fair value recorded in earnings. For example, if the likelihood of meeting the target increases, the fair value of the contingent consideration would likely increase. If the target is met and the $6 million contingent consideration is payable, $2 million will have been recorded cumulatively in the income statement (the difference between the $6 million payment and the $4 million originally recorded in the fair value allocation) by the time the $6 million is paid. Conversely, if the contingency is not met or its fair value declines, any accrued liability would be reversed into income.

6.28 When a contingency related to contingent consideration is not met (e.g., the earnings targets specified in the arrangement are not achieved), the acquirer should consider whether this factor represents an indicator that goodwill associated with the business combination should be tested for impairment (see **11.25–11.27**).

Consideration Held in Escrow Pending Resolution of Representation and Warranty Provisions

6.29 In some business combinations, the acquiring entity requests that a portion of the consideration be held in escrow pending resolution of representation and warranty provisions contained in the acquisition agreement. If the consideration held in an escrow account is shares or other securities, the arrangement typically provides that the risks and rewards of ownership are transferred to the sellers.

Voting rights and any dividends related to the shares or other securities held in escrow are also generally conveyed to the sellers during the escrow period. In such arrangements, the escrowed shares or other securities are a means for an acquiring entity to gain further assurance that the representations and warranties provided in the acquisition agreement are accurate. If they are not, it provides a ready means to obtain restitution. Representation and warranty provisions generally lapse within a short period after the acquisition date.

6.30 In the absence of evidence to the contrary, representation and warranties provided in the business combination agreement are assumed to be accurate, and release of the consideration from escrow is therefore determined to be beyond a reasonable doubt. Accordingly, inclusion of amounts in escrow in the total consideration transferred as of the acquisition date is generally considered appropriate. Each escrow arrangement must, however, be evaluated individually.

Acquisition-Related Costs of the Business Combination

6.31 Acquisition-related costs are costs that the acquirer incurs to effect a business combination. They include finders' fees; advisory, legal, accounting, valuation, and 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 acquiring entity should account for acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received. However, the costs to issue debt or equity securities as part of a business combination are recognized in accordance with other applicable GAAP. (See **6.34–6.36**.)

6.32 The FASB decided not to change current practice related to the costs to issue debt or equity securities and it is considering this issue as part of its current project on liabilities and equity. The accounting for costs to issue debt or equity securities may change pending the outcome of this project.

6.33 Refer also to the following additional guidance on acquisition-related costs:

- See **6.41** for guidance on reimbursements of the acquirer's acquisition-related costs paid to the former owners of the acquiree.
- See **13.13–13.14** for the disclosure requirements for acquisition costs incurred in a business combination.
- See **14.18–14.23** for guidance on acquisition costs incurred before the effective date of Statement 141(R).

Costs of Registering and Issuing Equity Securities

6.34 SAB Topic 5.A provides guidance on accounting for the costs of issuing equity securities. It states that "[s]pecific incremental costs directly attributable to a proposed or actual offering of securities may properly be deferred and charged against the gross proceeds of the offering." Therefore, the costs to issue equity securities are generally reflected as a reduction of the amount that would have otherwise been recorded in additional paid-in capital.

6.35 SAB Topic 5.A goes on to state that "management salaries or other general and administrative expenses may not be allocated as costs of the offering and deferred costs of an aborted offering may not be deferred and charged against proceeds of a subsequent offering. A short postponement (up to 90 days) does not represent an aborted offering."

Debt Issue Costs

6.36 SAB Topic 2.A.6 states that "[f]ees paid to an investment banker in connection with a business combination, when the investment banker is also providing interim financing or underwriting services, must be allocated between direct costs of the acquisition and debt issue costs." SAB Topic 2.A.6 further indicates that "debt issue costs are an element of the effective interest cost of the debt, and neither the source of the debt financing nor the use of the debt proceeds changes the nature of such costs. Accordingly, they should not be considered a direct cost of the acquisition." SAB Topic 2.A.6 also addresses the amortization of debt issue costs related to interim "bridge financing," stating that "[d]ebt issue costs should be amortized by the interest method over the life of the debt to which they relate. Debt issue costs related to the bridge financing should be recognized as interest cost during the estimated interim period preceding the placement of the permanent financing with any unamortized amounts charged to expense if the bridge loan is repaid prior to the expiration of the estimated period."

Separate Transactions Not Included in the Accounting for a Business Combination

6.37 Paragraph 58 of Statement 141(R) notes that some payments to the former owners of the acquiree are not part of the consideration transferred for the acquiree. They represent transactions to be accounted for separately from the business combination (see **3.28–3.39**).

6.38 For example, amounts paid or received to settle preexisting relationships between parties to the business combination are not part of the consideration transferred (see **3.28–3.34**). Such relationships may be either contractual (such as franchise or license agreements, supply agreements (whether fixed or executory)) or noncontractual (such as lawsuits or other disputes).

Compensation to Employees or Former Owners of the Acquiree for Future Products or Services

6.39 In some transactions, the acquiring entity may agree to provide products or services to the seller in the future. This may occur, for example, when the acquired entity is a subsidiary of the seller and that subsidiary provided products or services to its parent that the parent wishes to continue to receive after the sale. An agreement for future products or services to be exchanged between the acquiring entity and the seller must be evaluated to determine whether such an agreement represents consideration transferred. An analysis of such agreement would include a determination of (1) whether the arrangement is based on current market terms, (2) who initiated the arrangement, and (3) when the arrangement was entered into.

Example 6-11
Agreement to Provide Products or Services to a Seller After the Acquisition

Company B enters into an agreement with Company C to acquire Subsidiary S. Subsidiary S supplies a specific raw material to C that the company wants to continue to receive after the sale. Company B agrees to pay $3 million and provide a predetermined amount of raw materials to C for a fixed term at a fixed price ($10 per pound). An evaluation of the raw materials supply agreement indicates that the agreement is unfavorable to B by $750,000.

In determining the consideration transferred in the business combination, B should include the $750,000 related to the unfavorable raw materials supply agreement. That is, the total consideration transferred would be $3,750,000 ($3 million + $750,000).

Factors to Consider in Assessing Whether Contingent Payment Is Part of the Consideration Transferred

6.40 It is often difficult to determine whether an arrangement for payments to selling shareholders or employees represents contingent consideration or compensation expense. Contingent consideration is accounted for as part of the consideration transferred, whereas compensation arrangements are accounted for separately as expenses. Paragraph A87 provides the following factors to consider in making that determination:

a. *Continuing employment*—The terms of continuing employment by the selling shareholders who become key employees may be an indicator of the substance of a contingent consideration arrangement. The relevant terms of continuing employment may be included in an employment agreement, acquisition agreement, or some other document. A contingent consideration arrangement in which the payments are automatically forfeited if employment terminates is compensation for postcombination services. Arrangements in which the contingent payments are not affected by employment termination may indicate that the contingent payments are additional consideration rather than compensation.

b. *Duration of continuing employment*—If the period of required employment coincides with or is longer than the contingent payment period, that fact may indicate that the contingent payments are, in substance, compensation.

c. *Level of compensation*—Situations in which employee compensation other than the contingent payments is at a reasonable level in comparison to that of other key employees in the combined entity may indicate that the contingent payments are additional consideration rather than compensation.

d. *Incremental payments to employees*—If selling shareholders who do not become employees receive lower contingent payments on a per-share basis than the selling shareholders who become employees of the combined entity, that fact may indicate that the incremental amount of contingent payments to the selling shareholders who become employees is compensation.

e. *Number of shares owned*—The relative number of shares owned by the selling shareholders who remain as key employees may be an indicator of the substance of the contingent consideration arrangement. For example, if the selling shareholders who owned substantially all of the shares in the acquiree continue as key employees, that fact may indicate that the arrangement is, in substance, a profit-sharing arrangement intended to provide compensation for postcombination services. Alternatively, if selling shareholders who continue as key employees owned only a small number of shares of the acquiree and all selling shareholders receive the same amount of contingent consideration on a per-share basis, that fact may indicate that the contingent payments are additional consideration. The preacquisition ownership interests held by parties related to selling shareholders who continue as key employees, such as family members, also should be considered.

f. *Linkage to the valuation*—If the initial consideration transferred at the acquisition date is based on the low end of a range established in the valuation of the acquiree and the contingent formula relates to that valuation approach, that fact may suggest that the contingent payments are additional consideration. Alternatively, if the contingent payment formula is consistent with prior profit-sharing arrangements, that fact may suggest that the substance of the arrangement is to provide compensation.

g. *Formula for determining consideration*—The formula used to determine the contingent payment may be helpful in assessing the substance of the arrangement. For example, if a contingent payment is determined on the basis of a multiple of earnings, that might suggest that the obligation is contingent consideration in the business combination and that the formula is intended to establish or verify the fair value of the acquiree. In contrast, a contingent payment that is a specified percentage of earnings might suggest that the obligation to employees is a profit-sharing arrangement to compensate employees for services rendered.

h. *Other agreements and issues*—The terms of other arrangements with selling shareholders (such as noncompete agreements, executory contracts, consulting contracts, and property lease agreements) and the income tax treatment of contingent payments may indicate that contingent payments are attributable to something other than consideration for the acquiree. For example, in connection with the acquisition, the acquirer might enter into a property lease arrangement with a significant selling shareholder. If the lease payments specified in the lease contract are significantly below market, some or all of the contingent payments to the lessor (the selling shareholder) required by a separate arrangement for contingent payments might be, in substance, payments for the use of the leased property that the acquirer should recognize separately in its postcombination financial statements. In contrast, if the lease contract specifies lease payments that are consistent with market terms for the leased property, the arrangement for contingent payments to the selling shareholder may be contingent consideration in the business combination.

Reimbursement Made to the Acquiree for the Acquirer's Acquisition-Related Costs

6.41 Statement 141(R) generally requires acquisition-related costs to be expensed in the period they are incurred (see **6.31**). Payments to reimburse the acquiree for paying the acquirer's acquisition-related costs are not part of the consideration transferred and must be accounted for separately from the business combination (i.e., expensed when incurred).

Section 7 — Noncontrolling Interests

7.01 Paragraph 25 of ARB 51, as amended by Statement 160, states that a noncontrolling interest (formerly known as a minority interest) is "the portion of equity (net assets) in a subsidiary not attributable, directly or indirectly, to a parent." Typically, noncontrolling shareholders own less than 50 percent of an entity; however, a noncontrolling shareholder in a variable interest entity under Interpretation 46(R) might own more than 50 percent of the voting stock of the entity (even up to 100 percent) because the controlling entity exercises control by other means (see **7.36**).

7.02 While Statement 160 carries forward much of ARB 51's guidance on preparing consolidated financial statements, it significantly changes the accounting for (1) noncontrolling interests, (2) increases and decreases in parent ownership interests in subsidiaries, and (3) deconsolidations of subsidiaries (see **Appendix B**). Statement 160 applies to all entities except for not-for-profit organizations, which will continue to apply the pre-amended version of ARB 51.

Scope of Statement 160

7.03 Paragraph 27 of ARB 51, as amended by Statement 160, states, in part:

> Only a financial instrument issued by a subsidiary that is classified as **equity** in the subsidiary's financial statements can be a noncontrolling interest in the consolidated financial statements. A financial instrument issued by a subsidiary that is classified as a liability in the subsidiary's financial statements based on the guidance in other standards is not a noncontrolling interest because it is not an ownership interest.

7.04 While a noncontrolling interest may initially result from a business combination accounted for in accordance with Statement 141(R), it may also result from the dilution of a controlling shareholder's equity interest in a wholly owned subsidiary.

Example 7-1
Noncontrolling Interest Resulting From the Sale of Equity Interests

Company A has a wholly owned subsidiary that it acquired on June 30, 2007. On July 15, 2009, Company A sought to raise capital and issued shares of the subsidiary's common equity to an unrelated third party, which diluted its ownership interest from 100 percent to 90 percent. Upon the sale of equity to the third party, Company A would now be required to initially recognize the noncontrolling interest (i.e., the 10 percent of the subsidiary it no longer owns).

7.05 In determining the appropriate classification of a noncontrolling interest, an entity must look to other relevant GAAP to determine whether the financial instrument issued by a subsidiary can be classified as permanent equity. Such GAAP would include, but not be limited to:

- Statement 133.
- Statement 150.
- EITF Topic D-98.
- SEC Accounting Series Release No. 268.

7.06 More complex financial instruments (e.g., those with certain call, put, or redemption features) may be required to follow the presentation requirements in other GAAP and, therefore, could be classified in either mezzanine (or temporary) equity or as liabilities.

Recognizing and Measuring Noncontrolling Interests as of the Acquisition Date

7.07 Under Statement 141(R), noncontrolling interests are recognized and measured at fair value as of the acquisition date. In addition, as discussed in **12.11**, Statement 160 requires that the consolidated financial statements present the noncontrolling interest as a separate component of shareholders' equity. Net income and comprehensive income are attributed to the noncontrolling interest after the acquisition date (see **7.13**). The noncontrolling interest is not remeasured to fair value after the acquisition date.

7.08 Paragraph A60 of Statement 141(R) states, in part:

> An acquirer sometimes will be able to measure the acquisition-date fair value of a noncontrolling interest on the basis of active market prices for the equity shares not held by the acquirer. In other situations, however, an active market price for the equity shares will not be available. In those situations, the acquirer would measure the fair value of the noncontrolling interest using other valuation techniques.

7.09 In many business combinations, the acquiring entity pays a premium over market to obtain control of the acquired entity (commonly referred to as a control premium). Therefore, the per-share value of the acquiring entity's interest in the acquired entity may be greater than the noncontrolling shareholders' per-share value in that same entity.

Example 7-2
Impact of Control Premium on Fair Value of the Noncontrolling Interest

Company A acquires 60 percent (600,000 shares) of Company B for $6 million (or $10 per share). However, as of the acquisition date, the acquired entity's shares are trading at $7.50 per share. The acquirer acknowledges that a premium over market is paid because of synergies it believes it will be able to derive from the acquired business. Therefore, a conclusion that the fair value of the entire acquired entity is $10 million may not be reasonable. The fair value of the acquired entity might be $9 million, calculated as the $6 million paid plus $3 million for the noncontrolling shares (400,000 shares × $7.50 per share).

Example 7-3
Determining the Fair Value of the Noncontrolling Interest

Company C announces it will acquire 75 percent (750,000 shares) of Company D, a privately held entity, for $15 million in cash (or $20 per share). An independent third-party valuation firm calculates the fair value of the entire acquired business (i.e., 100 percent) as $19 million using valuation techniques consistent with the guidance in Statement 157. It may be appropriate for Company C to derive the fair value of the noncontrolling interest as $4 million (or $16 per share), calculated as the fair value of the entire business ($19 million) less the fair value of the consideration transferred by Company C ($15 million), which includes a control premium.

Measuring Noncontrolling Interests in Reverse Acquisitions

7.10 In some reverse acquisitions (see **2.23–2.31** for further discussion on reverse acquisitions), certain shareholders of the accounting acquirer (legal acquiree) may not exchange their interests for interests in the accounting acquiree (legal acquirer), which would create a noncontrolling interest in the combined entity. Paragraph A113 of Statement 141(R) describes the accounting for the noncontrolling interest in a reverse acquisition as follows:

> [I]n a reverse acquisition the noncontrolling interest reflects the noncontrolling shareholders' proportionate interest in the precombination carrying amounts of the legal acquiree's net assets even though the noncontrolling interests in other acquisitions are measured at their fair values at the acquisition date.

Example 7-4
Noncontrolling Interests in a Reverse Acquisition

Company A, a public entity, and Company B, a private entity, enter into a reverse acquisition within the scope of Statement 141(R). Company B is deemed to be the accounting acquirer (legal acquiree). Before the transaction, Company B has 5 million common shares outstanding, issued equity of $150 million, and retained earnings of $100 million. In addition, the fair value of Company A is $75 million (i.e., the hypothetical consideration transferred by Company B; see **2.24**).

As part of the transaction, Company A issues common shares in exchange for 4 million outstanding shares of Company B. Noncontrolling shareholders hold the remaining 1 million shares in Company B, or a 20 percent ownership interest. The combined entity would calculate its postcombination shareholders' equity as follows:.

Retained earnings	$ 80 million	$100 million × 80%
Issued equity	195 million	$75 million + ($150 million × 80%)
Noncontrolling interest	50 million	($100 million x 20%) + ($150 million × 20%)
Total shareholders' equity	$ 325 million	

Full Goodwill Approach

7.11 As discussed in **7.07**, the noncontrolling interest is recognized and measured at fair value as of the acquisition date. Therefore, in partial acquisitions, goodwill represents amounts attributable to both the acquiring entity (parent) and the noncontrolling interest. The FASB describes Statement 141(R)'s method for recognizing and measuring goodwill as the "full goodwill" approach.

7.12 Note that the parent's consolidated statement of financial position presents total goodwill on a single line item. See **11.58** for guidance related to allocating goodwill impairments between the parent and noncontrolling interest.

Attributing Net Income (Loss) and Comprehensive Income (Loss) to the Parent and Noncontrolling Interest

7.13 ARB 51, as amended by Statement 160, requires that entities attribute net income or loss and comprehensive income or loss to both the parent and noncontrolling interest. However, neither ARB 51 nor Statement 160 provides detailed guidance on making this attribution. In Statement 160's Basis for Conclusions, the FASB stated "that entities were making attributions before [Statement 160] was issued and that those attributions generally were reasonable and appropriate."

7.14 Entities generally allocate net income or loss and comprehensive income or loss to the parent and noncontrolling interest on the basis of relative ownership interests. However, this may not be appropriate in some situations, such as in certain contractual arrangements (see **7.15**) and partial acquisitions entered into before Statement 141(R) became effective (see **7.16**).

7.15 For example, a contractual agreement might specify investors' allocations of a subsidiary's profits and losses, certain costs and expenses, distributions from operations, or distributions upon liquidation that are different from relative ownership percentages. The entity should consider the substance of such agreements when determining how an increase or decrease in net assets of the subsidiary will affect cash payments to the parent and the noncontrolling interest over the life of the subsidiary and upon its liquidation.

7.16 In a business combination consummated before the effective date of Statement 141(R), and in which the acquirer obtained less than a 100 percent interest, the acquirer would measure the acquired entity's identifiable net assets at fair value only for the portion it acquired. For example, if an acquirer obtained a 75 percent interest, it would measure the acquired entity's identifiable net assets as 75 percent fair value and 25 percent carryover value. Because of the disproportionate interest in the identifiable net assets, allocation of the acquired entity's postcombination amortization expense, as well as its depreciation expense and impairment charges, to the parent and noncontrolling interest may not be based on their relative ownership interests. Paragraph B38 of Statement 160 provides the following example:

> [I]f an entity acquired 80 percent of the ownership interests in a subsidiary in a single transaction before Statement 141(R) was effective, it likely would have recorded the intangible assets recognized in the acquisition of that subsidiary at 80 percent of their fair value (80 percent fair value for the ownership interest acquired plus 20 percent carryover value for the interests not acquired in that transaction, which for unrecognized intangible assets would be $0). If the Board would have required net income to be attributed based on relative ownership interests in [Statement 160], the noncontrolling interest would have been attributed 20 percent of the amortization expense for those intangible assets even though no amount of the asset was recognized for the noncontrolling interest. Before [Statement 160] was issued, the parent generally would have been attributed all of the amortization expense of those intangible assets.

7.17 See **14.53–14.54** regarding the calculation of basic and diluted earnings per share when a noncontrolling interest is present.

Losses in Excess of the Carrying Amount of the Noncontrolling Interest

7.18 Paragraph 31 of ARB 51, as amended by Statement 160, states the following regarding losses incurred by the subsidiary:

> Losses attributable to the parent and the noncontrolling interest in a subsidiary may exceed their interests in the subsidiary's equity. The excess, and any further losses attributable to the parent and the noncontrolling interest, shall be attributed to those interests. That is, the noncontrolling interest shall continue to be attributed its share of losses even if that attribution results in a deficit noncontrolling interest balance.

7.19 Before the adoption of Statement 160, losses in excess of the carrying amount of the noncontrolling interest in the subsidiary were allocated to the controlling interest (parent), unless the noncontrolling shareholders had an obligation to make good on such losses. Since Statement 160's accounting guidance is entirely prospective, allocations of profits and losses before the effective date of

Statement 160 should not be revised. In addition, we believe that the controlling shareholders should not prospectively recover excess losses previously allocated to the controlling shareholders in periods before the adoption of Statement 160. (See **14.64**.)

Example 7-5
Allocating Excess Losses to the Noncontrolling Interest

On January 1, 20X9, Company A acquired 80 percent of Subsidiary B in a transaction accounted for as a business combination under Statement 141(R). As of the acquisition date, the equity attributable to Company A and the noncontrolling interest are $80 million and $20 million, respectively. Subsidiary B only has one class of common stock outstanding, and no shareholders (including the parent) have an explicit obligation to support the ongoing operations of Subsidiary B.

During 20X9, Subsidiary B incurred net losses of $150 million. If the allocation was 80/20, $120 million and $30 million of the loss would be allocated to Company A and the noncontrolling interest, respectively. As a result, the carrying amount of the noncontrolling interest will reflect a deficit balance of ($10 million) ($20 million beginning balance – $30 million current period losses).

Changes in the Parent's Ownership Interest in a Subsidiary When There Is No Change in Control

7.20 Paragraph 32 of ARB 51, as amended by Statement 160, provides the following four examples of transactions in which a parent changes its ownership interest in a subsidiary but retains control of that subsidiary:

1. A "parent purchases additional ownership interests in its subsidiary."
2. A "parent sells some of its ownership interests in its subsidiary."
3. A "subsidiary reacquires some of its ownership interests" held by a nonaffiliated entity.
4. A "subsidiary issues additional ownership interests" to a nonaffiliated entity.

7.21 Paragraph 33 of ARB 51, as amended by Statement 160, describes the accounting for such transactions:

> Changes in a parent's ownership interest while the parent retains its controlling financial interest in its subsidiary shall be accounted for as **equity transactions** (investments by owners and distributions to owners acting in their capacity as owners). Therefore, no gain or loss shall be recognized in consolidated net income or comprehensive income. The carrying amount of the noncontrolling interest shall be adjusted to reflect the change in its ownership interest in the subsidiary. Any difference between the fair value of the consideration received or paid and the amount by which the noncontrolling interest is adjusted shall be recognized in equity attributable to the parent. [Emphasis added]

7.22 The parent cannot recognize a gain or loss in consolidated net income or comprehensive income on such transactions, nor is the parent permitted to step up a portion of the subsidiary's net assets to fair value for any additional interests acquired (i.e., no additional acquisition-method accounting).

7.23 In its equity transaction accounting, the entity is also required to reallocate the subsidiary's accumulated other comprehensive income, if any, among the parent and the noncontrolling interest through an adjustment to the parent's equity.

Example 7-6
Acquisition of Noncontrolling Interests in a Subsidiary When There Is No Change in Control

Parent Company A owns 80 percent of its subsidiary, which has a net book value of $100 as of December 31, 20X9. The carrying amounts of the controlling and noncontrolling interests in the subsidiary are $80 and $20, respectively. Also, the noncontrolling interest's carrying amount includes $5 of accumulated other comprehensive income. On January 1, 20Y0, A purchases the remaining 20 percent of the subsidiary for $30.

When this transaction occurs, the noncontrolling interest's carrying amount (included as a separate component of consolidated equity) is reduced by $20 to zero. Company A's equity is reduced further by a net of $10 through a $15 charge to additional paid-in capital and a $5 credit to accumulated other comprehensive income. The only change to consolidated assets or liabilities is the recognition of $30 of cash paid for the additional interest.

Parent Company A's journal entry on January 1, 20Y0, is as follows:

	Debit	Credit
Noncontrolling interest in subsidiary (a separate component of consolidated equity)	$ 20*	
Additional paid-in capital (a component of A's equity)**	15	
Accumulated other comprehensive income (a component of A's equity)		$ 5
Cash		30

* Amount includes $5 of accumulated other comprehensive income previously attributable to the noncontrolling interest.

** If the parent subsequently loses control of and deconsolidates this subsidiary, Statement 160 does not permit the parent entity to reverse prior adjustments made to its additional paid-in capital account.

Example 7-7
Sale of an Ownership Interest in a Subsidiary When There Is No Change in Control

Parent Company A owns 80 percent of its subsidiary. The subsidiary has a net book value of $100 as of December 31, 20X9. The carrying amounts of the controlling interest (A) and noncontrolling interest (owned by Company B) in the subsidiary are $80 and $20, respectively. On January 1, 20Y0, the subsidiary issues stock to a nonaffiliated entity, Company C, for 6.25 percent interest and total proceeds of $20. As summarized in the table below, this transaction (1) brings the subsidiary's total book value to $120, (2) dilutes A's interest in the subsidiary to 75 percent but increases its carrying amount by $10 to $90, and (3) increases the total carrying amount of the noncontrolling interest (B and C) by $10 to $30.

Company	Original Carrying Amount	Original Ownership Interest	Carrying Amount 1/1/2010	Ownership Interest 1/1/2010
A	$ 80	80%	$ 90.00	75.00%
B	20	20	22.50	18.75
C	—	—	7.50	6.25
Total	$ 100	100%	$ 120.00	100.00%

Parent Company A's journal entry on January 1, 20Y0, is as follows:

	Debit	Credit
Cash held by the subsidiary	$ 20	
Noncontrolling interest in subsidiary (a separate component of consolidated equity)		$ 10
Additional paid-in capital (a component of A's equity)*		10

* If the parent subsequently loses control of and deconsolidates this subsidiary, Statement 160 does not permit the parent entity to reverse prior adjustments made to its additional paid-in capital account.

Former Parent Retains a Noncontrolling Interest of a Subsidiary After Control Is Lost

7.24 Statement 141(R) states that a significant economic event occurs when an acquiring entity obtains control of an acquiree that results in the (1) initial recognition and measurement of the assets acquired and liabilities assumed in that business combination at fair value and (2) remeasurement to fair value of any preexisting equity interests in the acquiree (e.g., a less-than-50 percent equity interest). Similarly, Statement 160 describes a parent's loss of control over a subsidiary as a significant economic event.

7.25 Paragraph 35 of ARB 51, as amended by Statement 160, provides the following four examples of events that would result in a loss of control and would require a parent company to deconsolidate its subsidiary:

1. The "parent sells all or part of its ownership interest in its subsidiary, and as a result, the parent no longer has a controlling financial interest in the subsidiary."
2. "The expiration of a contractual agreement that gave control of the subsidiary to the parent."
3. "The subsidiary issues shares, which reduces the parent's ownership interest in the subsidiary so that the parent no longer has a controlling financial interest in the subsidiary."
4. "The subsidiary becomes subject to the control of a government, court, administrator, or regulator."

The deconsolidation of a subsidiary through a nonreciprocal transfer to owners (e.g., a spinoff) is not within the scope of ARB 51, as amended (see **7.34**).

7.26 If the parent loses control of a subsidiary but retains a noncontrolling interest in that previously consolidated subsidiary, the retained noncontrolling interest in the former subsidiary is remeasured to fair value.

7.27 The parent's gain or loss on deconsolidation is calculated in accordance with paragraph 36 of ARB 51, as amended by Statement 160, as follows:

	Fair value of any consideration received
+	Fair value of any retained noncontrolling investment in the former subsidiary as of the date the subsidiary is deconsolidated
+	Carrying amount of any noncontrolling interest in the former subsidiary, including AOCI attributable to the noncontrolling interest, as of the date the subsidiary is deconsolidated
–	Carrying amount of the former subsidiary's assets and liabilities
=	Total gain or loss on deconsolidation

7.28 As discussed in **7.21**, the parent accounts for changes in its ownership interest of a subsidiary that do not result in a change of control as equity transactions, which often results in adjustments to the parent entity's additional paid-in capital account. If the parent subsequently loses control of and deconsolidates a subsidiary, Statement 160 does not permit the parent entity to reverse prior adjustments made to its additional paid-in capital account.

Example 7-8
Parent Retains an Investment in Its Former Subsidiary

Parent Company owns 80 percent of a subsidiary with a book value of $100 and (1) the carrying amounts of the controlling (Parent Company) and noncontrolling interests are $80 and $20, respectively; (2) Parent Company reduces its interest in the former subsidiary to 10 percent by selling stock for $105; and (3) the fair value of the 10 percent retained interest is $15.

The gain on the sale would be computed as follows:

Fair value of consideration received (cash proceeds)	$ 105
Fair value of retained noncontrolling interest in the subsidiary	15
Carrying value of noncontrolling interest	20
	140
Less: subsidiary's book value	100
Gain on sale	$ 40

The journal entry would be as follows:

	Debit	Credit
Cash	$ 105	
Investment in former subsidiary	15	
Noncontrolling interest in former subsidiary	20	
Net assets of former subsidiary		$ 100
Gain on sale		40

7.29 In the example above, the former parent is required to disclose the portion of the $40 gain that relates to the remeasurement of its retained 10 percent interest to fair value (see **13.40**).

7.30 If an entity's accounting for a subsidiary changes from consolidation to the equity method, the entity must apply the equity method of accounting prospectively from the date control over the subsidiary is relinquished. Application of the equity method of accounting as if the loss of control occurred at the beginning of the current fiscal period or year is prohibited. In addition, the entity should not revise its presentation of prior-year balances. Paragraph C2(b) of Statement 144 deleted paragraph 12 of ARB 51, eliminating the option to present the investment as if the loss of control occurred at the beginning of the year of the change (e.g., from consolidation to equity method). This guidance is further supported by Stephanie L. Hunsaker, an associate chief accountant in the SEC's Office of the Chief Accountant, in her speech at the 2007 AICPA National Conference on Current SEC and PCAOB Developments.

Multiple Arrangements Accounted for as a Single Disposal Transaction

7.31 Under Statement 160, the parent may be required to account for multiple arrangements as a single disposal transaction. Therefore, the parent should analyze the terms and conditions of multiple arrangements, including their combined economic effect. The presence of one or more of the following four indicators from paragraph 37 of ARB 51, as amended by Statement 160, may indicate that the parent should account for its multiple arrangements as a single transaction:

- The "arrangements are entered into at the same time or in contemplation of one another."
- The arrangements are designed to achieve an overall business plan.
- One of the arrangements depends on the success of one or more other arrangements.

- Any single arrangement is not economically justifiable; however, this particular arrangement is economically justifiable when all other arrangements are taken into account.

7.32 Statement 160 added the above guidance to prevent abuse by companies attempting to minimize earnings implications when disposing of a subsidiary.

Example 7-9
Multiple Arrangements Accounted for as a Single Disposal Transaction

Company A intends to sell its wholly owned subsidiary, Subsidiary B, for a loss. The current carrying value of Subsidiary B is $100. Company A structures the sale into two arrangements. In the first arrangement, A sells a 49 percent interest for $40 on July 1, 20X9. In the second arrangement, A sells the remaining 51 percent interest for $41 on September 1, 20X9.

The following illustrates the total loss that A would record in its consolidated statement of income if the multiple arrangements were accounted for (1) separately or (2) as a single transaction.

	Disposal arrangements are accounted for:	
	Separately	**As a single transaction**
Arrangement 1	$ 0*	$ 9
Arrangement 2	10	10
Total loss recognized by A	$ 10	$ 19**

Company A should evaluate all of the facts and circumstances, as well as the guidance and indicators in paragraph 37 of ARB 51, as amended by Statement 160, to determine whether the multiple arrangements should be accounted for as a single transaction.

* Because the first arrangement did not cause A to lose its control over B, A would account for it as an equity transaction with no gain or loss recorded in earnings (see **7.21**).

** Because both arrangements are accounted for as a single transaction, A would follow the deconsolidation guidance in paragraphs 35–37 of ARB 51, as amended by Statement 160, and record the entire loss in earnings (see **7.27**).

7.33 As noted in paragraph B57 of Statement 160, the FASB observed that the risk of concealing losses is further reduced by the impairment guidance in Statements 142 and 144. Under this guidance, a more-likely-than-not expectation to sell or dispose of a reporting unit, or a significant portion of a reporting unit, or a long-lived asset (asset group) would trigger a requirement to perform impairment testing for goodwill (under Statement 142) and intangible and long-lived tangible assets (under Statement 144).

Nonreciprocal Transfers to Owners

7.34 Nonreciprocal transfers to owners (e.g., spinoffs) are not within the scope of ARB 51, as amended by Statement 160. Paragraph 36 of ARB 51, as amended by Statement 160, states:

> If a parent deconsolidates a subsidiary through a nonreciprocal transfer to owners, such as a spinoff, the accounting guidance in APB Opinion No. 29, *Accounting for Nonmonetary Transactions*, applies.

7.35 Paragraph 23 of Opinion 29, which provides guidance for nonreciprocal transfers to owners, states the following:

> Accounting for the distribution of nonmonetary assets to owners of an enterprise in a spin-off or other form of reorganization or liquidation or in a plan that is in substance the rescission of a prior business combination should be based on the recorded amount (after reduction, if appropriate, for an indicated impairment of value) [footnote omitted] of the nonmonetary assets distributed. A prorata distribution to owners of an enterprise of shares of a subsidiary or other investee company that has

> been or is being consolidated or that has been or is being accounted for under the equity method is to be considered to be equivalent to a spin-off. Other nonreciprocal transfers of nonmonetary assets to owners should be accounted for at fair value if the fair value of the nonmonetary asset distributed is objectively measurable and would be clearly realizable to the distributing entity in an outright sale at or near the time of the distribution.

Example 7-10
Spin Off of a Business to the Parent Company

Company A manufactures computer-related communication applications. Company A acquired Company B in a business combination approximately two years ago. Company B was engaged in custom software development. After its acquisition by A, B developed an off-the-shelf software products business. Company A is preparing a filing for an initial public offering of B; however, B will distribute the custom software business to A before the offering.

The transfer of assets to A is a distribution to the owners in the form of a nonreciprocal transfer, as discussed in paragraph 23 of Opinion 29. As a result, the transaction is recorded at book value, with no gain or loss on the transaction.

Considerations for a Primary Beneficiary of a Variable Interest Entity

7.36 The definition of a "parent" in Appendix B of ARB 51, as amended by Statement 160, includes the primary beneficiary of a variable interest entity (VIE). Also, a VIE that is consolidated by a primary beneficiary is included in the definition of a "subsidiary" in ARB 51, as amended. Therefore, after its initial consolidation of the VIE, the primary beneficiary (parent) should prepare consolidated financial statements in accordance with ARB 51, as amended by Statement 160, with one exception related to fees or other sources of income and expense between a primary beneficiary and a VIE as described in paragraph 22 of Interpretation 46(R), as amended by Statement 160:

> The principles of consolidated financial statements in ARB 51 apply to primary beneficiaries' accounting for consolidated variable interest entities. After the initial measurement, the assets, liabilities, and noncontrolling interests of a consolidated variable interest entity shall be accounted for in consolidated financial statements as if the entity were consolidated based on voting interests. Any specialized accounting requirements applicable to the type of business in which the variable interest entity operates shall be applied as they would be applied to a consolidated subsidiary. The consolidated enterprise shall follow the requirements for elimination of intercompany balances and transactions and other matters described in paragraphs 6–39 of ARB 51 and existing practices for consolidated subsidiaries. Fees or other sources of income or expense between a primary beneficiary and a consolidated variable interest entity shall be eliminated against the related expense or income of the variable interest entity. The resulting effect of that elimination on the net income or expense of the variable interest entity shall be attributed to the primary beneficiary (and not to noncontrolling interests) in the consolidated financial statements.

Example 7-11
Primary Beneficiary's Accounting for a VIE

Company A has a 5 percent equity interest in Entity X (a VIE). Company A is the primary beneficiary of X and, therefore, consolidates X in accordance with Interpretation 46(R). The profits and losses of X are allocated between the parent (A) and the noncontrolling interest on the basis of the guidance in ARB 51, as amended by Statement 160, and paragraph 22 of Interpretation 46(R) (see **7.13** and **7.14**).

On July 1, 20Y1, A acquires an additional 10 percent equity interest in X. After this transaction, A remains the primary beneficiary of X. Because it retains control of X, A records this as an equity transaction in accordance with paragraphs 32–34 of ARB 51, as amended by Statement 160 (see **7.21**).

On September 1, 20Y2, after a required reconsideration assessment, A is no longer deemed to be the primary beneficiary of X. That is, A no longer controls X. Therefore, A deconsolidates X in accordance with paragraphs 35–37 of ARB 51, as amended by Statement 160, and recognizes a gain or loss on deconsolidation (see **7.27**).

Section 8 — Income Tax Considerations

Income Taxes — General

8.01 Paragraph 26 of Statement 141(R) highlights that the accounting for income taxes is an exception to the general recognition and measurement principles of that Statement. Paragraph 26 states, "The acquirer shall recognize and measure a deferred tax asset [DTA] or liability [DTL] arising from the assets acquired and liabilities assumed in a business combination in accordance with FASB Statement No. 109, *Accounting for Income Taxes*, as amended by this Statement."

8.02 Paragraph 30 of Statement 109, as amended by Statement 141(R), establishes the principles for tax accounting in a business combination. Paragraph 30 states:

> As of the acquisition date, a deferred tax liability or asset shall be recognized in accordance with the requirements of this Statement for an acquired entity's taxable or deductible temporary differences (except the portion of goodwill for which amortization is not deductible for tax purposes, leveraged leases, and acquired Opinion 23 differences [footnote omitted]) or operating loss or tax credit carryforwards. For example, taxable or deductible temporary differences arise from differences between the tax bases and the recognized values of assets acquired and liabilities assumed in a business combination. (Refer to paragraphs 259–272 for additional guidance). An acquirer shall assess the need for a valuation allowance as of the acquisition date for an acquired entity's deferred tax asset in accordance with this Statement.

Tax Treatment of Business Combinations

Tax Status of the Enterprise

8.03 Determining the tax status of an enterprise is an important initial step in the accounting for a business combination, since it affects the accounting for the temporary differences associated with the transaction. The enterprise can be taxable or nontaxable.

For *taxable* enterprises, deferred taxes must be provided on the taxable and deductible temporary differences that arise from a difference between the tax basis of an asset or a liability and its reported amount in the financial statements, unless a specific exception in Statement 109 exists for the temporary difference.

While the assets and liabilities of a partnership (i.e., a *nontaxable* enterprise) might give rise to taxable or deductible temporary differences, no deferred taxes are recorded in the partnership's financial statements because the tax consequences will be borne by its partners. If the partners are taxable enterprises, they must provide deferred taxes on any temporary difference associated with the partnership interest.

Taxable and Nontaxable Transactions

8.04 There are typically two types of business combinations — taxable and nontaxable.

In a *taxable* business combination, new tax bases for acquired assets and assumed liabilities are determined on the basis of the fair market value or another remeasurement technique required by the tax law. In other words, the acquirer "steps up" the acquiree's historical tax bases in the assets acquired and liabilities assumed to fair market value. Note that under the U.S. federal income tax law, certain stock purchases can be treated as taxable business combinations if an election to treat the stock purchase as a taxable asset purchase is filed. (See Section 338 of the Internal Revenue Code.)

In a *nontaxable* business combination, the acquirer assumes the historical tax basis of the acquired assets and assumed liabilities. In this case, the acquirer retains the "historic" or "carryover" tax bases in the acquiree's assets and liabilities. Generally, stock acquisitions are treated as nontaxable business combinations (unless a Section 338 election is made). Nontaxable business combinations generally result in significantly more temporary differences than do taxable business combinations because of the carryover of the tax bases of the assets acquired and liabilities assumed. To substantiate the relevant tax bases of the acquired assets and assumed liabilities (i.e., in accordance with Interpretation 48), the acquirer should review the acquired entity's tax filings and related books and records. This information should be evaluated within the acquisition's measurement period, as discussed in **3.16–3.19**.

The tax status of the enterprise does not affect whether a business combination is considered taxable or nontaxable; rather, these commonly used terms refer to whether the acquirer records the tax bases of assets and liabilities of the acquired entity on the basis of their historical tax basis or at fair market value or another remeasurement technique required by the tax law. As discussed in **Section 3**, most assets and liabilities are measured at fair value as of the acquisition date for financial reporting purposes.

8.05 Recognition of DTAs and DTLs for the tax consequences of temporary differences and carryforwards acquired in a business combination, as required by Statement 109, applies to both taxable and nontaxable business combinations. In both taxable and nontaxable business combinations, the amounts assigned to the individual assets acquired and liabilities assumed for financial reporting purposes are often different from the amounts assigned or carried forward for tax purposes.

The Basic Model — Tax Effects of Basis Differences

The Basic Model

8.06 The summary of Statement 109 states, in part, "The objectives of accounting for income taxes are to recognize (a) the amount of taxes payable or refundable for the current year and (b) deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an enterprise's financial statements or tax returns." Deferred taxes are provided on temporary differences.

8.07 Paragraph 289 of Statement 109 defines a temporary difference as:

> A difference between the tax basis of an asset or liability computed pursuant to FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, and its reported amount in the financial statements that will result in taxable or deductible amounts in future years when the reported amount of the asset or liability is recovered or settled, respectively.

8.08 Paragraph 27 of Statement 141(R) states:

> The acquirer shall account for the potential tax effects of temporary differences, carryforwards, and any income tax uncertainties of an acquiree that exist at the acquisition date or that arise as a result of the acquisition in accordance with Statement 109, as amended, and related interpretative guidance, including FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes.*

Impact of Tax Planning and Business Integration Steps

8.09 Deferred taxes recognized in a business combination should reflect the structure of the combined entity as it exists on the acquisition date. The tax effects of subsequent transaction steps that may be considered acquisition-related integration steps are accounted for separately and apart from the business combination (i.e., outside the business combination). Those transactions are accounted for under Statement 109 but are not included in the business combination accounting. Under paragraphs 57, 58, and A77 of Statement 141(R) (see **3.28–3.30**), when determining whether an individual transaction step is part of the acquisition, the acquirer should consider:

- The underlying rationale for the transaction and which party benefits from it (the acquirer and combined entity or the acquiree and its former owners).
- Whether the acquirer or acquiree (or its former owners) initiated the transaction.
- The timing of the transaction(s).

Push-Down of Acquisition Accounting

8.10 While Statement 141(R) and related interpretive guidance does not always require the acquirer to "push down" the acquisition accounting into each acquired entity (see **Section 9**), paragraph 17 of Statement 109 requires that "[d]eferred taxes shall be determined separately for each tax-paying component . . . in each tax jurisdiction." Therefore, to determine the temporary differences that arise as of the acquisition date and to apply Statement 109 accurately, an enterprise must push down (i.e., actual or notional push-down) the amounts assigned to the individual assets acquired and liabilities assumed for financial reporting purposes to each tax-paying component. The notion of push-down accounting for income taxes is different from the financial reporting requirements.

Process for Recording Deferred Taxes

8.11 The process for recording deferred taxes for the acquired entity's taxable and deductible temporary differences is essentially the same for taxable and nontaxable business combinations. Deferred taxes are recorded for temporary differences, unless an exception applies. A temporary difference exists when there is a taxable or deductible difference between (1) the carrying amount of an asset or liability for financial reporting purposes and (2) the tax basis of that asset or liability in accordance with Interpretation 48. The carrying amount for financial reporting purposes is the same, regardless of the form of the business combination. There is a difference in how the tax basis is determined depending on whether the business combination is taxable or nontaxable.

8.12 In nontaxable business combinations, at least two approaches are commonly used for recording deferred taxes: the "de novo" approach and the "layering-on" approach. The objective of the two approaches is the same: to account for all acquired temporary differences in accordance with Statement 109, as amended by Statement 141(R).

De Novo Approach

8.13 In the de novo approach, all existing deferred taxes are removed from the acquired entity's books and new temporary differences are calculated on the basis of the differences between book (i.e., fair value) and tax bases (which depends on the type of acquisition) in acquired assets and assumed liabilities. This is the preferred approach for recording deferred taxes on temporary differences arising in a business combination, because it is more precise and thus less likely to result in errors.

Layering-On Approach

8.14 In a nontaxable business combination, the acquirer sometimes abbreviates the de novo approach by limiting its examination to the change in book bases from historically reported amounts. This method is often described as the layering-on approach because the new book bases are recorded as an incremental adjustment to the historical book bases. The change from old to new book bases is added to (or subtracted from) the historical temporary differences.

8.15 The same amount of deferred taxes must be recorded under the layering-on approach as under the de novo approach. However, the layering-on approach can produce flawed results because of the following:

- The basic assumption that the historical deferred taxes are correct may not be appropriate and may inappropriately limit the due diligence used in evaluating historical information.
- It may be difficult to substantiate the historical deferred tax balances.
- All exceptions to deferred tax accounting must be reevaluated. For example, Statement 109 requires that the acquirer remove any (1) existing DTLs resulting from preexisting tax-deductible goodwill in accordance with paragraph 9(d) of Statement 109 and (2) any prepaid tax accounts or deferred credits recorded in accordance with paragraph 9(e) of Statement 109.
- A focus on the change in the temporary difference may limit the acquiring entity's process of assessing acquired DTAs for realizabililty (i.e., valuation allowance) because the historical deferred taxes are assumed to be correct.

Editor's Note: Deferred taxes on temporary differences resulting from a business combination are determined separately for each tax-paying component in each tax jurisdiction.

Example 8-1
Processes for Recording Deferred Taxes in a Business Combination

AC pays $1,000 to acquire Target Company (TC) stock in a **nontaxable** business combination. The fair value of the identifiable assets is $700 ($500 tangible, $200 intangible). TC has no liabilities except for its DTLs. TC had some historical goodwill from a prior taxable business combination. The historical book and tax bases of the acquired assets, along with the historical DTL, are presented in the table below. Assume a 40 percent tax rate.

	A Fair Value	B Historical Book Bases	C Historical Tax Bases	D Existing Deferred Tax Layer	E New Deferred Tax Layer (A–B) × 40%	F De Novo Calculation of Deferred Taxes (A–C) × 40%
Assets	$ 500	$ 300	$ 75	$ (90)	$ (80)	$ (170)
Identifiable intangibles	200	150	25	(50)	(20)	(70)
Goodwill		50		(20)	20*	0
DTL				(160)		
Total DTL recorded					(80)	(240)

Note: D + E (tax layer) = the layering-on approach

Example 8-1 (continued)
Processes for Recording Deferred Taxes in a Business Combination

Entry to record the business combination:

	Debit	Credit
Assets	$ 500	
Identifiable intangibles	200	
Goodwill	540**	
Cash		$ 1,000
DTL		240

* The historical DTL related to tax-deductible goodwill must be removed.

** Represents the $300 of goodwill ($1,000 purchase price less the $700 assigned to the fair value of tangible and intangible assets) plus the $240 of DTL. No DTL is recognized for the excess of financial reporting goodwill over tax-deductible goodwill because such recognition is precluded by Statement 109. (See **8.49**.)

Basis Differences

8.16 A basis difference arises when there is a difference between the financial reporting amount of an asset or liability and its tax basis, as determined by reference to the relevant tax laws in each tax jurisdiction. There are two categories of basis differences: inside basis differences and outside basis differences.

Inside Basis Differences

8.17 An inside basis difference is a temporary difference between the carrying amount for financial reporting purposes of individual assets and liabilities and their tax bases that will give rise to a tax deduction or taxable income when the related asset is recovered or liability is settled. Deferred taxes are always recorded on taxable and deductible temporary differences unless an exception applies. The determination of whether an exception applies is made as of the acquisition date and thereafter in accordance with Statement 109.

Example 8-2
Processes for Recording Deferred Taxes in a Business Combination

Assume the following:

- AC purchases Target Company's (TC's) stock for $1,000 in cash in a **nontaxable** business combination.
- TC has two subsidiaries (S1 and S2).
- All of the entities are domestic corporations with respect to AC.
- Assume a 40 percent tax rate.
- TC's only assets are its shares of S1 and S2, as illustrated in the following table:

Identifiable Assets	TC's Stock	S1	S2
Fair value	$ 1,000	$ 750	$ 250
TC's tax basis in its assets (i.e., the shares of S1 and S2 stock)	N/A	600	200
S1's and S2's tax bases in their underlying identifiable assets (assume no tax goodwill)	N/A	300	100

Example 8-2 (continued)
Processes for Recording Deferred Taxes in a Business Combination

Initial Acquisition Accounting Entries:

To record AC's investment in TC

AC	Debit	Credit
Investment in TC	$ 1,000	
Cash		$ 1,000

To record TC's investment in S1 and S2

TC	Debit	Credit
Investment S1	$ 750	
Investment S2	250	
Equity		$ 1,000

To record deferred taxes on the temporary differences inside S1 and S2

	S1		S2	
	Debit	**Credit**	**Debit**	**Credit**
Assets (buildings)	$ 750		$ 250	
Goodwill	180*		60*	
DTL		$ 180**		$ 60†
Equity		750		250

Note: Entries have been recorded (pushed down) to the subsidiaries' books because, in accordance with paragraph 17 of Statement 109, "deferred taxes [are] determined separately for each tax-paying component . . . in each tax jurisdiction."

* No DTL is recorded for the amount of goodwill for financial reporting ($180 or $60) in excess of the tax basis of goodwill ($0). (See **8.49**.)

** (750 – 300) × 0.40.

† (250 – 100) × 0.40.

Outside Basis Difference

8.18 The difference between a parent's tax basis in an investment in a subsidiary and its financial reporting basis results in an outside basis difference. Deferred taxes are always recorded on taxable and deductible temporary differences unless a specific exception applies. The exception that may apply under Statement 109 depends on whether the outside basis differences results in a DTL or a DTA. DTLs are recorded on all outside basis differences that are taxable temporary differences unless one of the exceptions in paragraph 31 or 33 of Statement 109 applies. The determination of whether one of these exceptions applies is made as of the acquisition date and thereafter in accordance with Statement 109. Under paragraph 34 of Statement 109, no DTAs should be recorded on outside basis differences that are deductible temporary differences unless it is apparent that the temporary difference will reverse in the foreseeable future (e.g., generally within the next 12 months).

8.19 Under paragraph 33 of Statement 109, outside basis differences in domestic entities (i.e., the holder of the investment is taxable in the same jurisdiction as the investee) would not be treated as taxable temporary differences if (1) the tax law provides a tax-free means to recover the reported amount of the investment **and** (2) the holder of the investment expects to recover the investment in that manner. The holder of the investment must meet both criteria to avoid recording the DTL. Outside basis differences in foreign entities (i.e., the holder of the investment is taxable in a jurisdiction different from the investee's) are taxable temporary differences. See **8.65** for a discussion of outside basis differences in foreign entities and the related exception for permanently reinvested earnings.

8.20 The acquiring entity should evaluate all outside basis differences in the acquired entity and its subsidiaries when determining whether deferred taxes should be recorded. The following example illustrates two possible conclusions about whether an outside basis difference is a temporary difference.

Example 8-3
Determining Whether an Outside Basis Difference Is a Temporary Difference

Assuming the same facts as in Example 8-2, AC must determine whether there is a basis difference in its investment in TC and subsidiaries and whether that difference (if any) is a taxable temporary difference.

The initial outside basis differences are as follows:

	TC Stock	S1 Stock	S2 Stock
Initial book basis	$ 1,000	$ 750	$ 250
Tax basis	1,000	600	200
Difference	0	150	50
DTL	0	60	20

As illustrated in the chart above, there is no difference between AC's book and tax basis in its investment in TC to assess as of the acquisition date. AC does, however, have differences to assess with respect to TC's investments in S1 and S2. The following are two potential conclusions the acquirer could reach in assessing the outside basis difference:

- AC could determine that it would liquidate both S1 and S2 into TC to eliminate the outside basis differences in a tax-free manner. Accordingly, in applying the provisions of paragraph 33 of Statement 109, AC could conclude that the outside basis differences in S1 and S2 stock are not temporary differences.
- AC could determine that to dispose of its S1 and S2 businesses, it would choose to have TC sell the stock of its subsidiaries rather than sell S1 and S2's assets to maximize after-tax proceeds. Accordingly, the outside basis differences in the S1 and S2 stock are both taxable temporary differences and the deferred tax liabilities should be recorded in the business combination accounting.

Temporary Differences and Carryforwards

8.21 Because the tax bases of assets and liabilities may differ from the amounts recorded for financial reporting purposes, entities must identify, on the basis of enacted tax laws and regulations as of the date of acquisition, the tax bases of identifiable assets acquired and liabilities assumed. They should then compare the fair values of the identifiable assets and liabilities assigned for book purposes with the tax bases to determine what temporary differences exist. DTAs and DTLs for the tax consequences of deductible and taxable temporary differences between the assigned values and the tax bases of identifiable assets and liabilities should be recorded. In addition, a DTA should be recorded for the tax benefits of operating loss and tax credit carryforwards acquired in the acquisition.

In-Process Research and Development

8.22 Paragraph 15 of Statement 141(R) requires that, for financial reporting purposes, the acquirer recognize all assets and liabilities, including acquired identifiable intangible assets that the acquiree may have developed internally and charged to expense before the acquisition. In accordance with Statement 141(R), an intangible asset for acquired in-process research and development (IPR&D) activities must be recognized separately and recorded at fair value (see **5.26–5.30**). Statement 141(R) also amends Statement 142 to provide specific guidance on the subsequent amortization method and impairment analysis to apply to those intangible assets (see **10.39–10.40**). As with all acquired assets and assumed liabilities, the amount recorded for an IPR&D intangible asset must be compared with its tax basis to determine whether a temporary difference exists. If the tax basis of the IPR&D intangible asset is zero, as it will be in typical nontaxable business combinations, a DTL will be recorded for that basis difference.

Contingent Environmental Liability — Taxable Business Combination

8.23 There are unique tax considerations for situations in which a buyer acquires the assets of an entity with contingent environmental liabilities. Presumably, the buyer has factored any known remediation requirements into the amount that it would pay for the property or for the property's impact on the fair value of the business in a business combination.

8.24 In taxable business combinations, assumed contingent liabilities (including costs to remediate an environmental liability) typically are not tax-deductible when paid. For financial reporting purposes, the asset requiring remediation is recorded at fair value, assuming full remediation, and a liability is recorded to recognize the costs of remediation. For tax purposes, the asset is recorded at its unremediated value. As a result, the acquirer will record a DTL. Treasury Regulation Section 1.338–5(b)(2)(iii) gives the following example illustrating when to adjust the tax basis for the contingent environmental liability:

> T, an accrual basis taxpayer, is a chemical manufacturer. In Year 1, T is obligated to remediate environmental contamination at the site of one of its plants. Assume that all the events have occurred that establish the fact of the liability and the amount of the liability can be determined with reasonable accuracy but economic performance has not occurred with respect to the liability within the meaning of section 461(h). P acquires all of the stock of T in Year 1 and makes a section 338 election for T. Assume that, if a corporation unrelated to T had actually purchased T's assets and assumed T's obligation to remediate the contamination, the corporation would not satisfy the economic performance requirements until Year 5. . . . The incurrence of the liability in Year 5 under the economic performance rules is an increase in the amount of liabilities properly taken into account in the basis and results in the redetermination of AGUB [adjusted grossed-up basis].

Therefore, a buyer that has assumed a contingent environmental liability records an increase in the goodwill tax basis and a corresponding DTA when the liability becomes fixed and determinable and economic performance with respect to the liability occurs.

Assets Held for Sale

8.25 As discussed in **4.50** and **4.51**, paragraphs 34 and 35 of Statement 144 require that long-lived assets that are classified as held for sale as of the acquisition date under that Statement be measured at fair value less costs to sell. Consequently, in a taxable business combination, the tax bases of assets held for sale (fair value) should exceed the book bases of those assets (fair value less costs to sell). A DTA should be established for this temporary difference as part of the business combination.

Preexisting Relationships Between Parties to a Business Combination and Reacquired Rights

Preexisting Relationships Between Parties to a Business Combination

8.26 As discussed in **3.31–3.33**, preexisting relationships may exist between parties to a business combination. The implementation guidance in paragraph A79 of Statement 141(R) states, "If the business combination in effect settles a preexisting relationship, the acquirer recognizes a gain or loss . . . ." The gain or loss recognized on the preexisting relationship under paragraph 58 of Statement 141(R) is considered a transaction that is separate and apart from the business combination (i.e., not to be included in business combination accounting). The following examples have been adapted from paragraphs A82–A85 of Statement 141(R) to illustrate the tax effects for a preexisting relationship between parties to a business combination.

Example 8-4
Effective Settlement of a Supply Contract as a Result of a Business Combination

AC acquires TC in a **taxable** business combination. The acquisition includes a supply contract under which AC purchases electronic components from TC at fixed rates over a five-year period. Currently, the fixed rates are higher than the rates at which AC could purchase similar electronic components from another supplier. The supply contract allows AC to terminate the contract before the end of the initial five-year term only by paying a $60 penalty. With three years remaining under the supply contract, AC pays $500 to acquire TC. This amount is the fair value of TC and is based on what other market participants would be willing to pay for the enterprise (inclusive of the above market contract).

The total fair value of TC includes $80 related to the fair value of the supply contract with AC. The $80 represents a $30 component that is "at-market" because the pricing is comparable to pricing for current market transactions for the same or similar items (e.g., selling effort, customer relationships) and a $50 component for pricing that is unfavorable to AC because it exceeds the price of current market transactions for similar items. TC has no other identifiable assets or liabilities that are related to the supply contract, and AC has not recognized any assets or liabilities related to the supply contract before the business combination. The remaining fair value of $420 relates to machine equipment. The tax rate is 40 percent. Assume a taxable transaction in a jurisdiction that allows for tax-deductible goodwill.

AC will record the following entries on the acquisition date:

	Debit	Credit
Machine equipment	$ 420	
Goodwill	30	
Loss on unfavorable supply contract	50	
Cash		$ 500

In applying paragraph A79(b) of Statement 141(R), A recognizes a loss of $50 (the lesser of the $60 stated settlement amount in the supply contract or the amount by which the contract is unfavorable to the acquirer) separately from the business combination. The $30 at-market component of the contract is part of goodwill.

	Debit	Credit
DTA	$ 20	
Income tax expense		$ 20

Typically, the supply contract will not be viewed as a separate transaction for tax purposes. The loss on the supply contract for accounting purposes will be a temporary difference because the amount expensed for financial reporting would be included in tax-deductible goodwill. The loss of $50 is tax-affected in the income statement, since Statement 141(R) clarifies that the settlement is considered a separate transaction for financial reporting purposes. The resulting DTA would be reversed when the goodwill is deducted on the tax return (as long as there are no realization concerns).

Note: If this transaction was structured as a **nontaxable** business combination (AC acquires the stock of TC), the basis difference that arises when the loss is expensed would generally be assessed by reference to the outside basis difference guidance. (See **8.18–8.20**.)

Example 8-5
Effective Settlement of a Supply Contract Between the Acquirer and Acquiree in Which the Acquirer Recognized a Liability Before the Business Combination

Assume the same facts as in Example 8-4 (e.g., a **taxable** business combination and tax-deductible goodwill), except that AC had recorded a $60 liability and a $24 DTA related to the supply contract with TC before the business combination.

AC will record the following entries on the acquisition date:

	Debit	Credit
Machine equipment	$ 420	
Goodwill	30	
Liability	60	
Cash		$ 500
Gain		10

AC recognizes a $10 settlement gain on the contract in earnings as of the acquisition date (reversal of the $60 liability offset by the actual $50 loss, which results in a net book gain of $10).

	Debit	Credit
Income tax expense	$ 24	
DTA		$ 24

Reversal of the $24 pre-acquisition DTA is related to the reversal of the $60 contract liability in the entry above.

	Debit	Credit
DTA	$ 20	
Income tax expense		$ 20

Typically, the supply contract will not be viewed as a separate transaction for tax purposes. The $50 loss on the supply contract for accounting purposes will be a temporary difference because the amount expensed for financial reporting would be included in tax-deductible goodwill. The loss of $50 is tax-affected in the income statement, since Statement 141(R) clarifies that the settlement is considered a separate transaction for financial reporting purposes. The resulting DTA would be reversed when the goodwill is deducted on the tax return (as long as there are no realization concerns).

Note: If this transaction was structured as a **nontaxable** business combination (AC acquires the stock of TC) the basis difference that arises when the $50 loss is expensed would generally be assessed by reference to the outside basis difference guidance. (See **8.18–8.20**.)

Reacquired Rights

8.27 As discussed in **5.31–5.34**, the acquirer may reacquire a right that it previously granted to the acquiree (e.g., a license or franchise). Paragraph 31 of Statement 141(R) stipulates that reacquired rights are intangible assets that the acquirer must recognize apart from goodwill. In addition, the intangible asset is measured (and subsequently amortized) on the basis of the remaining contractual term only, regardless of whether market participants would take into account renewals in the fair value determination. The initial measurement (acquisition-date measurement) of reacquired rights is one of the limited exceptions to the measurement principle in Statement 141(R). Because renewals are not taken into consideration in the determination of the fair value of reacquired rights, these intangible assets are not measured at fair value in accordance with Statement 157. Therefore, the reacquired right's tax basis and its financial reporting basis as of the acquisition date will generally differ and a DTA should be recognized for the differences between the assigned values (financial reporting amount vs. the tax basis). **Examples 5-2** and **5-3** have been adapted to illustrate the tax effects for a reacquired right between parties to a business combination.

Example 8-6
Reacquired Rights

Case A

Company B sells products in Europe under a licensing agreement with Company A. Company A acquires Company B for $1,000 in a **taxable** business combination. As of the acquisition date, the licensing agreement has a remaining contractual term of three years and can be renewed at the end of the current term and indefinitely every five years thereafter. Assume that the pricing of the license agreement is at-market and that the agreement does not have explicit settlement provisions. The tax rate is 40 percent. Company A has calculated the following values:

- $75 — Value of the license for the remaining three-year contractual term (financial reporting value in accordance with Statement 141(R)).
- $200 — Fair value of the license agreement.
- $600 — Other tangible assets.

The following illustrates the book and tax bases of the assets:

	Book Basis	New Tax Basis
Other tangible assets	$ 600	$ 600
License agreement	75	200
Goodwill	275	200

The following entries will be recorded by Company A on the acquisition date:

	Debit	Credit
Other tangible assets	$ 600	
License agreement	75	
Goodwill	325	
Cash		$ 1,000

Company A recognizes the license agreement at its remaining three-year contractual value of $75.

	Debit	Credit
DTA	$ 50	
Goodwill		$ 50

Company A recognizes a DTA related to the licensing agreement's tax-over-book basis of $50 [(200 – 75) × .40%]. In accordance with paragraph 9(d) of Statement 109, no DTL is recorded for the $75 book-over-tax-basis goodwill.

Case B

Assume the same facts as in Case A, except that under the licensing agreement, B pays a below-current-market license fee compared with those of its competitors with similar licensing agreements. In addition, A now calculates the value of the license fee to be $100 for the remaining three-year contractual term. Note that this amount is greater than the $75 value calculated in Case A for an at-market contract.

The following illustrates the book and tax bases of the assets:

	Book Basis	New Tax Basis
Other tangible assets	$ 600	$ 600
License agreement	75	200
Goodwill	260	200

Example 8-6 (continued)
Reacquired Rights

The following entries will be recorded by Company A on the acquisition date:

	Debit	Credit
Other tangible assets	$ 600	
License agreement	75	
Goodwill	300	
Loss on unfavorable licensing agreement	25	
Cash		$ 1,000

Company A would record an intangible asset of $75 for the reacquired license (the at-market value for the contractual term) and would recognize a $25 settlement loss in the income statement (paragraph A79(b) of Statement 141(R)). In effect, the settlement loss represents additional consideration that A would be required to provide to B to terminate the existing agreement, which was unfavorable to A.

	Debit	Credit
DTA	$ 50	
Goodwill		$ 40
Income tax expense		10

Company A recognizes a DTA related to the license agreement's tax-over-book basis of $50 [(200 – 75) ×.40%], of which $40 is a DTA recorded in acquisition accounting (as a reduction in goodwill). The remaining $10 of the DTA is associated with and follows the $25 financial reporting loss as a separate transaction (i.e., separate and apart from the acquisition accounting). In addition, paragraph 9(d) of Statement 109 prohibits the recognition of a DTL for the $60 book-over-tax-basis goodwill.

Tax Rates

8.28 Paragraph 17 of Statement 109 states, in part:

> Deferred taxes shall be determined separately for each tax-paying component (an individual entity or group of entities that is consolidated for tax purposes) in each tax jurisdiction.

8.29 In addition, paragraph 18 of Statement 109 states, in part:

> The objective is to measure a deferred tax liability or asset using the enacted tax rate(s) expected to apply to taxable income in the periods in which the deferred tax liability or asset is expected to be settled or realized.

Tax Holidays

8.30 Deferred taxes are not recognized for the expected taxable or deductible amounts of temporary differences that are recovered or settled during a tax holiday. Paragraph 183 of Statement 109 states:

> The Board considered whether a deferred tax asset ever should be recognized for the expected future reduction in taxes payable during a tax holiday. In most jurisdictions that have tax holidays, the tax holiday is "generally available" to any enterprise (within a class of enterprises) that chooses to avail itself of the holiday. The Board views that sort of exemption from taxation for a class of enterprises as creating a nontaxable status (somewhat analogous to S-corporation status under U.S. federal tax law) for which a deferred tax asset should not be recognized.

Therefore, deferred taxes are recognized for the expected taxable or deductible amounts of temporary differences that are recovered or settled outside of the tax holiday. In some situations, a temporary difference associated with a particular asset or liability may reverse during both the tax holiday and periods in which the entity is taxed at the enacted rates. Accordingly, it may be necessary to use scheduling to determine the appropriate deferred taxes to record in connection with the business combination.

State Tax Footprint

8.31 The acquirer's state tax footprint for an entity can change because of a business combination. For example, an acquirer that is operating in Nevada with no deferred state taxes but substantial temporary differences acquires a target company in California. As a result of this acquisition, the acquirer is now required to file a combined California tax return with the target company. Therefore, the acquirer must record deferred taxes for California state tax when no state taxes were previously recognized. When calculating the impact of this change on the state tax footprint, an entity must account for the income tax effects of its assets and liabilities before the combination separately from those that were acquired as part of the business combination.

Any change in the measurement of existing deferred tax items of the acquirer as a result of this acquisition are recorded "outside" of the business combination accounting as a component of income tax expense or another appropriate financial statement component. The initial recognition of deferred tax items of the target company by the acquirer is accounted for as part of the business combination.

Costs of the Business Combination

8.32 Costs of a business combination are expensed as incurred unless they are subject to other U.S. GAAP and relate to the issuance of equity securities or debt instruments in connection with the business combination. All other general and indirect costs related to a business combination are expensed as incurred.

Acquisition-Related Costs

8.33 As discussed in **6.31**, acquisition-related costs incurred as a result of a business combination (e.g., deal fees for attorneys, accountants, investment bankers, and valuation experts) must be expensed as incurred under paragraph 59 of Statement 141(R). This is unlike previous GAAP, in which these acquisition-related costs were included in the consideration paid for an acquired entity. For U.S. tax purposes, acquisition-related costs may or may not be deductible. A temporary difference exists if acquisition-related costs are deductible for tax purposes and if that deduction occurs in a period different from that in which they are expensed for financial reporting purposes. Because acquisition-related costs are not considered part of the acquisition and are expensed as incurred for financial reporting purposes, the related deferred taxes (if any) will be recorded as a component of income tax expense (i.e., outside the business combination).

Example 8-7
Taxable Business Combination Acquisition-Related Costs

AC acquires Target Company in a **taxable** business combination for $1,000 and incurs $200 of costs related to the acquisition. The identifiable assets have a fair value of $700. For financial reporting purposes, AC expenses the $200 acquisition-related costs. For tax purposes, AC adds the $200 acquisition-related costs to the total amount that is allocated to assets, resulting in tax-deductible goodwill of $500. Assume a 40 percent tax rate.

AC would record the following entries on the acquisition date:

	Debit	Credit
Assets	$ 700	
Goodwill	300	
Cash		$ 1,000
Acquisition expenses	$ 200	
Cash		$ 200
DTA	$ 80*	
Income tax expense		$ 80

Note: Because the tax-deductible goodwill in this example relates solely to the acquisition costs that are expensed for financial reporting purposes, the simultaneous equation discussed in paragraphs 262 and 263 of Statement 109, as amended by Statement 141(R), is not required because the tax impact of acquisition costs is reflected in the income statement.

* $200 (acquisition-related costs that are capitalized for tax purposes) × 40%.

Example 8-8
Nontaxable Business Combination Acquisition-Related Costs

AC acquires Target Company (TC) in a **nontaxable** business combination for $1,000 and incurs $200 of costs related to the acquisition. The identifiable assets have a fair value of $700 and a tax basis of $250. For financial reporting purposes, AC expenses the $200 acquisition-related costs. For tax purposes, AC adds the $200 acquisition-related costs to the basis of the TC stock. Assume a 40 percent tax rate.

AC would record the following entries on the acquisition date:

	Debit	Credit
Assets	$ 700	
Goodwill	480	
DTL		$ 180*
Cash		1,000
Acquisition expenses	$ 200	
Cash		$ 200

In contrast to Example 8-7, the acquisition expenses may not be tax-affected in a nontaxable business combination. The acquisition-related costs are included in the outside tax basis of AC's investment in TC. Therefore, the DTA would have to be assessed in accordance with paragraph 34 of Statement 109. Provided that the investment is essentially permanent in duration and it is not apparent that the temporary difference will reverse in the foreseeable future, no DTA is recorded.

* ($700 fair value – $250 tax basis) × 40%.

Acquisition-Related Costs Incurred in a Period Before the Business Combination

8.34 When acquisition costs are incurred in a period before the acquisition date of a business combination and those costs are not immediately deductible for tax purposes, the acquirer will need to assess whether that difference is a temporary difference that will result in the recognition of a DTA. To determine the expected tax consequences of the acquisition-related costs, the acquirer may use either of the following two approaches:

1. If the acquisition-related costs would result in a future tax deduction if the business combination did not occur, then it is a deductible temporary difference and a DTA should be recorded when the expense is recognized for financial reporting purposes. Upon consummation of the business combination, the acquirer will need to reassess the DTA to determine whether it continues to be appropriate (i.e., whether it is a taxable or nontaxable business combination). If no longer appropriate, the DTA should be reversed to the income statement.
2. The acquirer can record a DTA if, on the basis of the expected tax structure of the business combination, the acquisition-related expenses would result in the recording of the DTA. This approach is based on the tax structure of the business combination. **Examples 8-7** and **8-8** illustrate how this view would be applied. **Example 8-7** assumes a taxable business combination that would generally result in the recording of the DTA. **Example 8-8** assumes a nontaxable business combination that would not result in the recording of the DTA because of the exception in paragraph 34 of Statement 109. This approach requires the acquirer to make assumptions about how the transaction would be structured from a tax perspective and about the probability that the business combination will be consummated to determine whether to record all or a portion of DTA for the acquisition expenses. As a result of this approach, the entity would conform its financial reporting to its "expectation" as of each reporting date (i.e., the DTA may be recognized and subsequently derecognized if expectations change from one reporting period to the next).

As with all accounting policy elections, once selected the policy should be applied consistently.

Debt Issue Costs

8.35 As discussed in **6.36**, debt issuance costs should be excluded from business combination accounting. Generally, entities should capitalize and amortize debt issuance costs by using the effective interest method over the term of the related debt (unless Statement 159 applies). Deferred taxes should be recorded if there is a difference between the book and tax approaches to recognizing debt issue costs and the difference gives rise to a taxable or a deductible temporary difference.

Costs of Registering and Issuing Equity Securities

8.36 Like debt issuance costs, and as discussed in **6.34–6.35**, costs of registering and issuing equity securities are excluded from the consideration transferred in a business combination and are not part of business combination accounting. For example, when equity securities are issued to consummate a business combination, the related out-of-pocket registration and issuance costs are generally treated as a reduction in additional paid-in capital in accordance with SAB Topic 5.A. If the registration costs have not been paid by the acquisition date, the costs should be accrued as a liability, with a corresponding reduction in additional paid-in capital (APIC). For U.S. tax purposes, the costs of registering and issuing equity securities are generally neither deductible nor amortizable. Accordingly, no temporary differences should exist for the costs of registering and issuing equity securities. If any amount of the costs of registering and issuing equity securities is tax-deductible, the temporary difference should be recorded to equity in accordance with paragraph 36(c) of Statement 109.

Share-Based Payment Awards Exchanged for Awards Held by the Acquiree's Employees

8.37 As discussed in **Section 6**, in a business combination, the acquirer will often exchange its share-based payment awards ("replacement awards") for awards held by employees of the acquired entity ("replaced awards").

If the replacement awards are required by the terms of the acquisition agreement or for some other legal or contractual reason, the fair-value-based measure of the replacement awards (net of the benefit of a related DTA) associated with precombination services should be included in the total consideration transferred in the business combination. However, if the acquirer was not obligated to issue the replacement award (i.e., when the award expires by its terms as a consequence of the business combination), all of the fair-value-based measure should generally be recognized as compensation costs in the postcombination financial statements.

The precombination portion of the replacement award included in the calculation of the consideration transferred associated with the business combination is equal to the Statement 123(R) fair-value-based measure of the replaced award that is attributable to precombination services. The postcombination portion of the replacement award is equal to the Statement 123(R) fair-value-based measure of the replacement award less the amount attributable to the precombination portion of the replacement award (see **6.10–6.18**). The following examples from Appendix A of Statement 141(R) have been adapted to illustrate the tax effects for replacement awards with an assumed tax rate of 40 percent. Assume that all of the awards illustrated will result in a postcombination tax deduction.

Example 8-9

Acquirer Replacement Awards That Require No Postcombination Services Exchanged for Acquiree Awards for Which Employees Have Rendered the Required Services as of the Acquisition Date

AC issues replacement awards of $110 (fair-value-based measure) on the acquisition date in exchange for Target Company (TC) awards of $100 (fair-value-based measure) on the acquisition date. No postcombination services are required for the replacement awards, and TC's employees had rendered all of the required service for the acquiree awards as of the acquisition date.

The amount attributable to precombination service is the fair-value-based measure of TC's awards ($100) on the acquisition date; that amount is included in the consideration transferred in the business combination. The amount attributable to postcombination service is $10, which is the difference between the total value of the replacement awards ($110) and the portion attributable to precombination service ($100). Because no postcombination service is required for the replacement awards, AC immediately recognizes $10 as compensation cost in its postcombination financial statements. Assume a 40 percent tax rate.

Journal entries on the acquisition date are as follows:

	Debit	Credit
Goodwill	$ 100	
Compensation expense	10	
APIC		$ 110
DTA	$ 44	
Goodwill		$ 40
Income tax expense		4

Example 8-10

Acquirer Replacement Awards That Require Postcombination Services Exchanged for Acquiree Awards for Which Employees Have Rendered the Requisite Service as of the Acquisition Date

AC exchanges replacement awards that require one year of postcombination service for share-based payment awards of Target Company (TC) for which employees had completed the requisite service period before the business combination. The fair-value-based measure of both awards is $100 on the acquisition date. When originally granted, TC's awards had a requisite service period of four years. As of the acquisition date, TC's employees holding unexercised awards had rendered a total of seven years of service since the grant date. Even though TC's employees had already rendered all of the requisite service, AC attributes a portion of the replacement award to postcombination compensation cost in accordance with paragraph 46 of Statement 141(R) because the replacement awards require one year of postcombination service. The total service period is five years — the requisite service period for the original acquiree award completed before the acquisition date (four years) plus the requisite service period for the replacement award (one year).

The portion attributable to precombination services equals the fair-value-based measure of the acquiree award ($100) multiplied by the ratio of the precombination service period (four years) to the total service period (five years). Thus, $80 ($100 × 4 ÷ 5 years) is attributed to the precombination service period and therefore is included in the consideration transferred in the business combination. The remaining $20 is attributed to the postcombination service period and therefore is recognized as compensation cost in AC's postcombination financial statements in accordance with Statement 123(R). Assume a 40 percent tax rate.

Journal entries on the acquisition date are as follows:

	Debit	Credit
Goodwill	$ 80	
APIC		$ 80
DTA	$ 32	
Goodwill		$ 32

Journal entries in the year immediately following the acquisition date are:

	Debit	Credit
Compensation expense	$ 20	
APIC		$ 20
DTA	$ 8	
Income tax expense		$ 8

Example 8-11

Acquirer Replacement Awards That Require Postcombination Services Exchanged for Acquiree Awards for Which Employees Have Not Rendered All of the Requisite Service as of the Acquisition Date

AC exchanges replacement awards that require one year of postcombination service for share-based payment awards of Target Company (TC) for which employees had not yet rendered all of the required services as of the acquisition date. The fair-value-based measure of both awards is $100 on the acquisition date. When originally granted, TC's awards had a requisite service period of four years. As of the acquisition date, TC's employees had rendered two years of service, and they would have been required to render two additional years of service after the acquisition date for their awards to vest. Accordingly, only a portion of the TC awards is attributable to precombination service.

The replacement awards require only one year of postcombination service. Because employees have already rendered two years of service, the total requisite service period is three years. The portion attributable to precombination services equals the fair-value-based measure of the acquiree award ($100) multiplied by the ratio of the precombination service period (two years) to the greater of the total service period (three years) or the original service period of TC's award (four years). Thus, $50 ($100 × 2 ÷ 4 years) is attributable to precombination service and therefore is included in the consideration transferred for the acquiree. The remaining $50 is attributable to postcombination service and therefore is recognized as compensation cost in AC's postcombination financial statements. Assume a 40 percent tax rate.

Journal entries on the acquisition date are as follows:

	Debit	Credit
Goodwill	$ 50	
APIC		$ 50
DTA	$ 20	
Goodwill		$ 20

Journal entries in the year immediately following the acquisition date are:

	Debit	Credit
Compensation expense	$ 50	
APIC		$ 50
DTA	$ 20	
Income tax expense		$ 20

Example 8-12

Acquirer Replacement Awards for Which No Postcombination Services Are Required Exchanged for Acquiree Awards for Which Employees Have Not Rendered All of the Requisite Service as of the Acquisition Date

Assume the same facts as in Example 8-11 above, except that AC exchanges replacement awards that require no postcombination service for share-based payment awards of TC for which employees had not yet rendered all of the requisite service as of the acquisition date. The terms of the replaced TC awards did not eliminate any remaining requisite service period upon a change in control. (If the TC awards had included a provision that eliminated any remaining requisite service period upon a change in control, the guidance in Example 8-9 would apply.) The fair-value-based measure of both awards is $100. Because employees have already rendered two years of service and the replacement awards do not require any postcombination service, the total service period is two years.

The portion of the fair-value-based measure of the replacement awards attributable to precombination services equals the fair-value-based measure of the acquiree award ($100) multiplied by the ratio of the precombination service period (two years) to the greater of the total service period (two years) or the original service period of TC's award (four years). Thus, $50 ($100 × 2 ÷ 4 years) is attributable to precombination service and therefore is included in the consideration transferred for the acquiree. The remaining $50 is attributable to postcombination service. Because no postcombination service is required to vest in the replacement award, AC recognizes the entire $50 immediately as compensation cost in the postcombination financial statements.

Journal entries on the acquisition date are as follows:

	Debit	Credit
Goodwill	$ 50	
Compensation expense	50	
APIC		$ 100
DTA	$ 40	
Goodwill		$ 20
Income tax expense		20

Contingent Consideration

8.38 As discussed in **6.22–6.24**, for financial reporting purposes, the acquirer is required to recognize contingent consideration as part of the consideration transferred in a business combination. The obligation is recorded at its acquisition-date fair value and classified as a liability or as equity depending on the nature of the consideration.

- Contingent consideration classified as equity (e.g., contingent payment of a fixed number of shares) is not remeasured. All deferred tax consequences resulting from the resolution of the contingency are charged or credited directly to equity.
- Contingent consideration classified as a liability (e.g., fixed amount that is payable in a variable amount of shares or cash) is remeasured to fair value on each reporting date. All post-measurement-period adjustments are recorded through earnings.

Editor's Note: If the contingent consideration is considered a hedging instrument for which Statement 133 applies, then the changes in fair value are initially recognized in other comprehensive income (see paragraph 65(d) of Statement 141(R)).

For tax purposes, the acquirer is precluded from recognizing contingent consideration as part of the consideration until the contingency is settled or the amount has become fixed and determinable with reasonable accuracy.

Initial Measurement of Deferred Taxes as of the Acquisition Date

8.39 On the acquisition date, the acquirer should determine the expected tax consequences of settling the contingent consideration at its initial reported amount in the financial statements. The tax consequences will in part depend on how the business combination is structured for tax purposes (i.e., a taxable or nontaxable business combination). Deferred taxes should be recognized as part of the business combination, provided that the amount recognized for contingent consideration will be paid. The tax structure will determine the expected tax consequences.

- In a nontaxable business combination, the expected tax consequences are increased tax bases in the stock of the acquired company. On the acquisition date, there is generally no difference between the parent's investment in the outside basis of the acquired company's stock and its tax basis after the contingent consideration is taken into account.
- In a taxable business combination, the expected tax consequences are included in the tax bases in the acquired company's assets (e.g., goodwill) such that there will typically be no difference between the financial reporting and tax basis in goodwill after the contingent consideration is taken into account.

Accounting for Deferred Taxes After the Acquisition Date

8.40 Contingent consideration classified as a liability is remeasured on each subsequent reporting date, with the changes in fair value recognized in earnings (i.e., outside the business combination). The acquirer should determine the tax consequences expected to result from the change in fair value of the contingent consideration and, in accordance with financial reporting requirements, recognize the deferred tax consequences of such changes that are classified as a liability outside of the business combination (i.e., as a component of income tax expense).

- In a nontaxable business combination, an increase or a decrease in the contingent consideration liability would result in an adjustment of the expected tax basis of the acquired company's stock. In many cases, an exception to recording deferred taxes on outside basis differences will apply (e.g., see paragraphs 31(a) and 33 of Statement 109 for DTLs and paragraph 34 for DTAs).
- In a taxable business combination, an increase or a decrease in the contingent consideration liability would cause an adjustment to the tax bases of the acquired assets. A DTA or DTL would be recorded through the tax provision for the expected tax consequences. If the settlement amount exceeds the amount recorded as a liability on the books, a DTA will be recorded in connection with expected additional tax-deductible goodwill. For financial reporting purposes, this goodwill is treated as unrelated to the acquisition (attributed to expense); therefore, a DTA results in a provision benefit rather than a reduction in goodwill. If the contingency is settled for an amount less than the liability recorded on the books, there is a favorable adjustment to pretax book income. This pretax book income is eliminated from taxable income (e.g., by an M-1 adjustment for U.S. federal tax). This tax deduction is treated as a deduction to component 1 amortizable goodwill. In this case, a DTL is recognized and the related income tax expense is recorded. (See **Example 8-13** below.)

Example 8-13
Contingent Consideration

On June 1, 20X9, AC purchases the assets of Target Company (TC) for $450 and a contingent payment (classified as a liability) with a fair value of $50 in a **taxable** business combination. The identifiable assets have a fair value of $450 and an initial tax basis of $450. On September 30, 20X9, subsequent facts and circumstances indicate that the contingent consideration has a fair value of $30. On December 31, 20X9, AC settles the contingent consideration for $110 (fair value). Assume a 40 percent tax rate.

June 1, 20X9:

	Debit	Credit
AC:		
Investment in TC	$ 500	
Cash		$ 450
Contingent consideration liability		50
Target (assuming push-down accounting is applied):		
Identifiable assets	$ 450	
Goodwill	50	
Equity		$ 500

AC determines that the expected tax consequences of settling the $50 contingent consideration liability would be to increase the basis of its identifiable assets and goodwill to equal the book amounts. There are no differences between the book bases and the expected tax bases in the acquired assets, so no deferred taxes are recorded on the acquisition date.

September 30, 20X9:

	Debit	Credit
AC:		
Contingent consideration liability	$ 20	
Remeasurement income		$ 20
Income tax expense	$ 8	
DTL		$ 8

On September 30, 20X9, the fair value of the contingent consideration decreases to $30. The $20 decrease would reduce the expected tax-deductible component 1 goodwill (see **8.47**) by $20. Accordingly, an $8 DTL is recognized, with an offsetting entry to income tax expense.

December 31, 20X9, settlement — fair value of contingent consideration is $110:

	Debit	Credit
AC:		
Remeasurement expense	$ 80	
Contingent consideration liability	30	
Cash		$ 110
DTA	$ 32	
Income tax expense		$ 32

At settlement, the fair value of the contingent consideration increases to $110. The $80 increase gives rise to an equal amount of tax-deductible goodwill that corresponds to the $80 pretax book expense. Accordingly, a $32 DTA is

Acquirer's Valuation Allowance

Change in an Acquirer's Valuation Allowance as a Result of a Business Combination

8.41 Paragraph 266 of Statement 109 (before being amended by Statement 141(R)) on acquirers' valuation allowances (VAs) stated that in some circumstances, reversals of an **acquirer's** VA that resulted from the business combination would be included in the business combination accounting. Statement 141(R) amends paragraph 266 and clarifies that reversals of acquirers' VAs are not part of the business combination accounting. Accordingly, all adjustments to an acquirer's VA after the effective date of Statement 141(R) will be recorded to income tax expense and are not included in business combination accounting, regardless of when the business combination was consummated. Statement 141(R) amended paragraph 266 of Statement 109 to state:

> The tax law in some tax jurisdictions may permit the future use of either of the combining enterprises' deductible temporary differences or carryforwards to reduce taxable income or taxes payable attributable to the other enterprise subsequent to the business combination. If the combined enterprise expects to file a consolidated return, an acquirer may determine that as a result of the business combination its valuation for its deferred tax assets should be changed. For example, the acquirer may be able to utilize the benefit of its tax operating loss carryforwards against the future taxable profit of the acquiree. In such cases, the acquirer reduces its VA based on the weight of available evidence. However, that reduction does not enter into the accounting for the business combination but is recognized as an income tax benefit (or credited directly to contributed capital (refer to paragraph 26)).

Acquired Uncertain Tax Position Measurement and Recognition

8.42 Paragraph 27 of Statement 141(R) states:

> The acquirer shall account for the potential tax effects of temporary differences, carryforwards, and any income tax uncertainties of an acquiree that exist at the acquisition date or that arise as a result of the acquisition in accordance with Statement 109, as amended and related interpretative guidance, including FASB Interpretation No. 48, *Accounting for Uncertainties in Income Taxes*.

8.43 Uncertain tax positions are an exception to the recognition and measurement guidance in Statement 141(R). Therefore, income tax uncertainties of the acquired entity recognized by the acquirer as of the acquisition date should be based on **the measurement and recognition provisions of Interpretation 48, not on the acquisition-date fair value**. That is, as of the acquisition date, uncertain tax positions are recognized if they meet the more-likely-than-not recognition threshold and are measured at the largest amount of benefit that is greater than 50 percent likely to be realized upon settlement with a taxing authority that has full knowledge of all relevant information.

> **Editor's Note:** Income taxes are one exception to the prospective application of Statement 141(R)'s transition provisions. Upon an entity's adoption of Statement 141(R), any subsequent changes to the entity's acquired uncertain tax positions occurring after the measurement period will no longer be applied to goodwill, regardless of the acquisition date of the associated business combination. Rather, such changes will typically be recognized as an adjustment to income tax expense. For more discussion about Statement 141(R)'s income tax transition provisions, see **8.66–8.73**.

Uncertain Tax Positions — Seller Indemnification

8.44 The seller in a business combination may contractually indemnify the buyer against losses for certain income tax uncertainties. Paragraph 29 of Statement 141(R) requires an acquirer to record an indemnification asset when it recognizes the indemnified item, in this case the uncertain tax position (see **4.46**). The indemnification asset must be **measured on the same basis as the indemnified item**, subject to any contractual limitations or reserve required for amounts considered uncollectible. Since income tax uncertainties are recognized and measured in accordance with Interpretation 48, the indemnification asset is recognized and measured on the same basis as the uncertain tax position (the indemnified item), as stated in paragraph 30 of Statement 141(R):

> In some circumstances, the indemnification may relate to an asset or a liability that is an exception to the recognition or measurement principles. For example, an indemnification may relate to a noncontractual contingency that is not recognized at the acquisition date because it does not satisfy the more-likely-than-not criterion at that date. Alternatively, an indemnification may relate to an asset or liability, for example, one that relates from an uncertain tax position that is measured on a basis other than acquisition-date fair value (paragraphs 26 and 27). In those circumstances, the indemnification asset shall be recognized and measured using assumptions consistent with those used to measure the indemnified item, subject to management's assessment of the collectibility of the indemnification asset and any contractual limitations on the indemnified amount. Paragraph 64 provides guidance on the subsequent accounting for an indemnification asset.

Goodwill

Goodwill Components

8.45 Paragraph 3 of Statement 141(R) states, "Goodwill is an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized." For financial reporting purposes and in accordance with paragraph 28 of Statement 142, goodwill is not amortized but is tested for impairment at least annually, or earlier if certain events arise. Differences in tax laws and financial reporting rules usually result in different goodwill amounts being recorded for tax and book purposes.

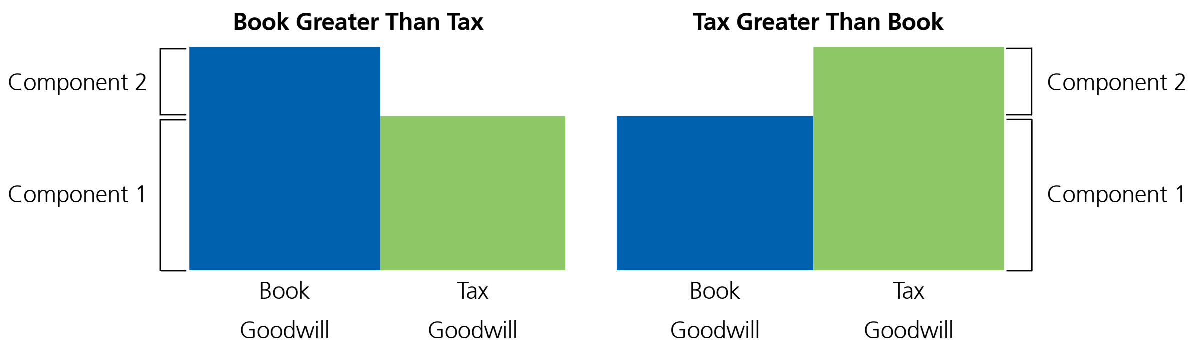
Editor's Note: Section 197 of the Internal Revenue Code identifies items that should be classified as intangibles for tax purposes in a taxable acquisition and assigns a 15-year amortization period to them. In certain cases, items considered to be separate intangibles for tax purposes, such as workforce in place, are included as part of goodwill for book purposes. To ensure that the goodwill components and deferred taxes are calculated appropriately, entities should review valuations to determine whether tax allocations between Section 197 intangibles and goodwill are appropriate.

8.46 In a taxable acquisition, goodwill is either tax-deductible or nondeductible. Paragraph 30 of Statement 109 notes that deferred taxes on differences between the book carrying amount and the tax basis of goodwill depend on whether the goodwill is deductible under the tax law. In tax jurisdictions in which amortization of goodwill is deductible, goodwill for financial reporting purposes and tax-deductible goodwill must be separated into two components as of the acquisition date, in accordance with paragraph 262 of Statement 109. This allocation is necessary to calculate the appropriate amount of deferred taxes.

8.47 The first component of goodwill (component 1 goodwill) equals the lesser of (1) goodwill for financial reporting purposes or (2) tax-deductible goodwill. The second component of goodwill (component 2 goodwill) equals (1) the greater of financial reporting goodwill or tax-deductible goodwill less (2) the amount calculated as component 1 goodwill.

Editor's Note: This calculation must be done by entity, by jurisdiction.

8.48 The following chart presents the concept of component 1 and component 2 goodwill:



In a nontaxable acquisition, the acquired entity might still have some tax basis in goodwill on account of having a taxable transaction in its history for which there is remaining unamortized tax-basis goodwill. In this case, the acquirer would include this historical tax basis in goodwill in its analysis, resulting in a reduction in component 2 goodwill and the recognition of component 1 goodwill.

Book Basis Exceeds Tax Basis

8.49 In some transactions, the value assigned to goodwill for financial reporting exceeds tax-deductible goodwill. For example, for book purposes the value associated with the in-place workforce is included as part of goodwill, which is not amortized. For tax purposes, in some jurisdictions, this asset is considered an intangible and is amortized over 15 years. When the amount assigned to goodwill for financial reporting purposes exceeds the tax basis, no deferred tax liability is recorded for this excess book basis. In theory, the difference between the book and the tax basis of goodwill is a temporary difference and deferred taxes should be recorded; however, Statement 109 prohibits the recognition of a deferred tax liability for such differences. Statement 109 contains different guidance on basis differences that result in a DTA (excess tax-deductible goodwill) or a DTL (excess book goodwill). In accordance with paragraph 9(d) of Statement 109, enterprises are prohibited from establishing a deferred tax liability when goodwill recorded for financial reporting is not tax-deductible or in excess of tax-deductible goodwill. Part of the rationale for this exception in Statement 109 is that the calculation would be iterative. Recording this deferred tax liability would increase the goodwill, which would then require another adjustment to the DTL, etc. Recording this iterative adjustment would result in a gross-up on the balance sheet. In paragraph 131 of Statement 109, the FASB concluded this would not be meaningful or relevant to readers of the financial statements.

Tax Basis Exceeds Book Basis

8.50 Recognition of deferred taxes on differences between the book and tax basis of goodwill depends on whether goodwill is deductible under the tax law (paragraph 30 of Statement 109).

Tax Basis Exceeds Book Basis — Nondeductible Goodwill

8.51 For financial reporting purposes, a DTA should not be recognized for basis differences associated with goodwill in tax jurisdictions in which goodwill is not amortizable. Tax basis in goodwill that does not amortize is akin to having no tax basis.

Tax Basis Exceeds Book Basis — Tax-Deductible Goodwill

8.52 Companies are required to recognize the tax benefit arising from the excess of tax-deductible goodwill over financial reporting goodwill as of the acquisition date as a DTA, as they would recognize other temporary differences (paragraph 9(d) of Statement 109 as amended by Statement 141(R)). The FASB has concluded that the excess of tax-deductible goodwill over financial reporting goodwill meets the definition of a temporary difference and that recognizing a temporary difference as of the acquisition date is appropriate and consistent with the principles of Statement 109.

8.53 Measurement of the DTA that must be recorded is an iterative calculation. Goodwill and the DTA are established in the same purchase price allocation process, in which the DTA is in part a function of the amount of goodwill recorded for financial reporting purposes.

8.54 Paragraph 263 of Statement 109, as amended by Statement 141(R), presents the following equation to facilitate quantifying the DTA that should be recorded:

DTA = (Tax rate ÷ (1 – tax rate)) × preliminary temporary difference

The preliminary temporary difference equals the excess of tax goodwill over book goodwill, before the tax benefit associated with the goodwill is taken into account.

Editor's Note: This equation uses one tax rate. On the basis of their tax jurisdictions, companies should assess whether temporary differences associated with the acquisition require different rates.

8.55 The DTA that is recorded reduces book goodwill. If the book goodwill is reduced to zero, the iterative calculation ends. No bargain purchase gain can result from the iterative calculation.

Example 8-14
Tax Basis Exceeds Book Basis — Tax-Deductible Goodwill

Assume the following facts:

- Acquisition date is January 1, 20X9.
- Financial reporting goodwill is $800, before initial tax adjustments.
- Tax goodwill is $1,000.
- Annual tax amortization is $500 per year.
- There are no other temporary differences.
- Tax rate is 40 percent.
- Income before taxes in year 1 is $10,000, in year 2 is $11,000, and in year 3 is $12,000.

Example 8-14 (continued)
Tax Basis Exceeds Book Basis — Tax-Deductible Goodwill

On Acquisition Date:

(1) Preliminary calculation of goodwill components:

	Book	Tax
Component 1 goodwill	$ 800	$ 800
Component 2 goodwill	—	200
Total goodwill	$ 800	$ 1,000

(2) Calculation of the DTA:

DTA = (0.40 ÷ (1 – 0.40)) × $200

DTA = $133

(3) Entry to record the DTA:

	Debit	Credit
Deferred tax assets	$ 133	
Goodwill		$ 133

(Note: "final" financial reporting goodwill is $667.)

Accounting in Years 1 through 3:

(1) Calculation of taxes payable:

	Year 1	Year 2	Year 3
Book income (pretax)	$ 10,000	$ 11,000	$ 12,000
Tax amortization	500	500	0
Taxable income	$ 9,500	$ 10,500	$ 12,000
Taxes payable (40%)	$ 3,800	$ 4,200	$ 4,800

(2) Calculation of deferred taxes:

Goodwill is not amortized for financial reporting purposes. Each year, a DTL must be calculated and recognized for the difference between the component 1 financial reporting goodwill and the component 1 tax goodwill. This DTL will reverse when the company impairs, sells, or disposes of the related assets.

	January 1, 20X9	End of Year 1	End of Year 2	End of Year 3
Financial reporting basis — goodwill	$ 667	$ 667	$ 667	$ 667
Tax basis — component 1 goodwill	667	334	0	0
Tax basis — component 2 goodwill	333	166	0	0
Total tax basis in goodwill	$ 1,000	$ 500	$ 0	$ 0
Temporary difference — component 1 goodwill	$ 0	$ 333	$ 667	$ 667
Temporary difference — component 2 goodwill	$ 333	$ 167	$ 0	$ 0
DTL — component 1 goodwill	$ 0	$ 133	$ 267	$ 267
DTA — component 2 goodwill	$ 133	$ 67	$ 0	$ 0
Deferred income tax expense		$ 200	$ 200	$ 0

Example 8-14 (continued)
Tax Basis Exceeds Book Basis — Tax-Deductible Goodwill

(3) Realization of the tax benefit:

A tax benefit will be realized for the tax deduction associated with goodwill.

Entries Years 1 and 2:

	Debit	Credit
Income tax expense	$ 200	
DTL		$ 133
DTA		67*

(4) Profit and loss snapshot:

	Year 1	Year 2	Year 3
Book income (pretax)	$ 10,000	$ 11,000	$ 12,000
Income tax expense:			
Current	3,800	4,200	4,800
Deferred	200	200	0
Total income tax expense	4,000	4,400	4,800
Net income	$ 6,000	$ 6,600	$ 7,200

* Represents deferred taxes associated with the component 2 goodwill temporary difference amortized over two years ([$333 ÷ 2] × 40%).

Bargain Purchases

8.56 As discussed in **5.42–5.45**, a bargain purchase occurs when the net of the fair value of the identifiable assets acquired and the liabilities assumed, including the deferred tax consequences arising in the business combination, exceeds the sum of:

1. The acquisition-date fair value of the consideration transferred, including the fair value of the acquirer's previously held interest (if any) in the acquiree (i.e., a business combination achieved in stages), and
2. The fair value of any noncontrolling interest in the acquiree.

8.57 The acquirer recognizes the excess (i.e., the bargain purchase element) as a gain on the acquisition date. The calculation of the gain on the bargain purchase is made after the "inside" deferred taxes are recorded on the acquired entity's assets and liabilities. This recognized gain increases the acquirer's investment in the acquired entity and causes a corresponding increase in the acquired entity's equity. If deferred taxes are recorded on the outside basis difference caused by the bargain purchase gain, the tax effects would be recorded outside the business combination as a component of income tax expense.

8.58 The following example illustrates the tax effects of a typical bargain purchase business combination:

Example 8-15
Taxable Business Combination — Bargain Purchase

AC pays $800 to acquire the assets of Target Company (TC) in a **taxable** business combination. The fair value of the identifiable assets is $1,000. AC recognizes $120 of gain as a result of the bargain purchase. Assume a 40 percent tax rate.

Inside basis difference: A DTL of $80 is recorded on the difference between the book basis ($1,000) and tax basis ($800) of the acquired assets.

Entries to record the acquisition, gain on bargain purchase, and resulting deferred taxes:

	Debit	Credit
TC's entry:		
Assets	$ 1,000	
Equity		$ 920*
DTL		80
AC's entry:		
Investment in TC	$ 920	
Cash		$ 800
Gain on bargain purchase		120

Outside basis difference: As a result of the recognition of $120 of gain, AC's investment in TC will increase by $120, with a corresponding increase in TC's equity.

AC's investment in TC:

	Book Basis	Tax Basis
TC stock	$ 800	$ 800
Gain on bargain purchase	120	0
Total	$ 920	$ 800

In accordance with paragraph 33 of Statement 109, AC could determine that the outside basis difference in TC stock is not a taxable temporary difference because the tax basis in the TC stock is equal to the net tax basis in TC's assets, as long as the tax law provides a means by which the reported amount of that investment can be recovered tax-free and the acquirer expects it will ultimately use that means.

* $800 consideration plus $120 gain.

8.59 The following example illustrates that no bargain purchase gain is recognized as a result of the recording of a DTL in the business combination:

Example 8-16
Nontaxable Business Combination — No Bargain Purchase Gain Recognized as a Result of the DTL

AC pays $800 to acquire the stock of Target Company (TC) in a nontaxable business combination. The fair value of the identifiable assets is $1,000. Assume that the tax bases of the identifiable assets are $400. Assume a 40 percent tax rate.

To record the acquisition and resulting deferred taxes:

	Debit	Credit
TC's entry:		
Assets	$ 1,000	
Goodwill	40	
Equity		$ 800
DTL		240
AC's entry:		
Investment in TC	$ 800	
Cash		$ 800

The calculation of gain on the bargain purchase is made after deferred taxes are recorded. AC recognizes no gain on the bargain purchase because the fair value of the identifiable assets acquired and liabilities assumed (net $760) does not exceed the consideration transferred. There is no bargain purchase after the DTL is recorded for the difference between the book basis of $1,000 and tax basis of $400 for the assets acquired.

Example 8-17
Nontaxable Business Combination — Bargain Purchase

Assume the same facts as in **Example 8-16**, except that the tax bases of the identifiable assets are $700 rather than $400.

A DTL of $120 is recorded on the difference between the book basis of $1,000 and tax basis of $700 for the assets acquired. Entries to record the acquisition gain on bargain purchase and resulting deferred taxes:

	Debit	Credit
TC's entry:		
Assets	$ 1,000	
Equity		$ 880
DTL		120
AC's entry:		
Investment in TC	$ 880	
Cash		$ 800
Gain on bargain purchase		80

AC recognizes $80 gain as a result of the bargain purchase.

As a result of the recognition of an $80 gain, AC's investment in TC will increase by $80, with a corresponding increase in TC's equity. This creates an outside basis difference between the book basis of $880 and tax basis of $800 for TC's stock. AC determines that the outside basis difference in TC's stock is a taxable temporary difference and records a DTL.

	Debit	Credit
AC's entry:		
Deferred tax expense	$ 32	
DTL		$ 32

The DTL represents an $80 basis difference at a tax rate of 40 percent. Goodwill is not affected because the outside basis difference is related to the gain recognized and therefore is unrelated to the business combination accounting.

Business Combinations Achieved in Stages

8.60 As discussed in **1.28–1.30**, a business combination achieved in stages occurs when an acquirer holds a noncontrolling investment in the acquired company (the "original investment") before obtaining control of the acquired company. When the acquirer obtains control of the acquired company, it remeasures the original investment at its acquisition-date fair value. The resulting gain or loss is reported in earnings. Any amounts recorded in other comprehensive income for the original investment are reclassified and included in the calculation of gain or loss.

8.61 The acquisition-date fair value of the original investment is added to the total amount of consideration transferred in the business combination (and the fair value of any noncontrolling interest) for purposes of determining the target's opening equity (which in turn drives the measurement of goodwill).

8.62 The remeasurement of the original investment is recorded outside of the business combination accounting as either a gain or loss in the income statement. Similarly, in accordance with paragraphs 31–34 of Statement 109, the deferred tax effects of the remeasurement are recorded outside of the business combination as a component of income tax expense, unless an exception applies.

Example 8-18
Business Combination Achieved in Stages

Case A

AC purchased 20 percent of Target Company (TC) in year 1. AC has a $200 book basis and $100 tax basis in its equity method investment and has recorded a DTL of $40 on the outside basis difference. Assume a 40 percent tax rate.

	Debit	Credit
AC's entries:		
Year 1		
Investment in TC	$ 100	
Cash		$ 100
Year 2		
Investment in TC	$ 100	
Equity earnings		$ 100
Deferred tax expense	$ 40	
DTL		$ 40

In a nontaxable business combination, AC purchases the remaining 80 percent of TC for $2,000. The fair value of all the identifiable assets is $2,000 and their tax basis is $500.

AC remeasures its 20 percent investment in TC to $500 and recognizes $300 of gain (ignoring any control premium).

Remeasurement entries — to record the remeasurement of the original investment:

	Debit	Credit
AC's entries:		
Investment in TC	$ 300	
Gain on remeasurement		$ 300
Deferred tax expense	$ 120	
DTL		$ 120

AC records a DTL on the remeasurement gain because it determines that the outside basis difference is a taxable temporary difference (i.e., no exceptions apply).

Example 8-18 (continued)
Business Combination Achieved in Stages

To record the acquisition and resulting deferred taxes:

	Debit	Credit
AC's entry:		
Investment in TC	$ 2,000	
Cash		$ 2,000
TC's entry:		
Assets	$ 2,000	
Goodwill	1,100	
DTL		$ 600
Equity		2,500

A DTL of $600 is recorded on the book-greater-than-tax basis ($2,000 – $500) in the identifiable assets. No DTL is recorded on the book-greater-than-tax basis ($1,100 – $0) in goodwill, in accordance with paragraph 9(d) of Statement 109.

Case B

Assume the same facts as in Case A, except that in applying paragraphs 31–33 of Statement 109, AC determines that its outside basis difference in the acquired entity is not a temporary difference, so no deferred taxes are recorded.

Remeasurement entries — to record the remeasurement of the original investment:

	Debit	Credit
AC's entries:		
Investment in TC	$ 300	
Gain on remeasurement		$ 300
DTL	$ 40	
Deferred tax benefit		$ 40

AC releases a DTL on the remeasurement gain because it determines that the outside basis difference is a not a temporary difference.

Editor's Note: For the acquisition of a foreign entity, paragraph 288(f) of Statement 109 requires the acquiring entity to continue to record the temporary difference for its share of the undistributed earnings of the acquiree before the date it became a subsidiary to the extent that dividends from the subsidiary do not exceed the acquirer's share of the subsidiary's earning after the date it became a subsidiary. If TC was a foreign subsidiary in this example, this guidance may be applicable.

To record the acquisition and resulting deferred taxes:

	Debit	Credit
AC's entry:		
Investment in TC	$ 2,000	
Cash		$ 2,000
TC's entry:		
Assets	$ 2,000	
Goodwill	1,100	
DTL		$ 600
Equity		2,500

International Tax Considerations

Inside Basis Differences in a Foreign Acquired Entity

8.63 Statement 141(R) does not explicitly require the acquirer to "push down" the acquisition accounting to each acquired entity. Paragraph 17 of Statement 109 makes it clear, however, that temporary differences have to be determined at the entity level. Paragraph 17 states, "Deferred taxes are determined separately for each tax-paying component in each tax jurisdiction." Therefore, the amounts assigned to the individual assets acquired and liabilities assumed for financial reporting purposes and the related valuations of assets must be "pushed down" (actual or notional push-down) to each tax-paying component in the relevant functional currency to correctly apply Statement 109.

8.64 Deferred taxes are provided for differences between (1) the amounts assigned to the individual assets acquired and liabilities assumed for financial reporting purposes (the "foreign currency financial reporting amount") and (2) the local tax basis (the "foreign currency tax basis"). The temporary difference is multiplied by the foreign tax rate and then translated into the reporting currency (e.g., U.S. dollars) at the spot rate on the acquisition date.

Outside Basis Differences in a Foreign Acquired Entity

8.65 Paragraph 31(a) of Statement 109 provides an exception to recording DTLs on investments in foreign subsidiaries. This exception must be evaluated for each foreign entity acquired in the business combination. If the permanent reinvestment assertion is not appropriate for a particular acquired foreign entity, DTLs should be recorded on that investment as part of the business combination.

Transition Provisions

8.66 Income taxes are an exception to the prospective application of Statement 141(R)'s transition provisions. Upon an entity's adoption of statement 141(R), any subsequent changes to the entity's acquired uncertain tax positions and VAs associated with acquired DTAs will no longer be applied to goodwill, regardless of the acquisition date of the associated business combination. Rather, such changes will typically be recognized as an adjustment to income tax expense.

8.67 Before Statement 141(R), any changes in an acquired entity's uncertain tax positions and reversals of VAs associated with acquired DTAs generally would be applied to goodwill, regardless of whether such changes occurred during the allocation period or after it. In contrast, Statement 141(R) requires any adjustments to an acquired entity's uncertain tax positions, or VAs associated with acquired DTAs that occur after the measurement period (and adjustments during the measurement period that relate to facts and circumstances that did not exist as of the acquisition date), to be recorded pursuant to Interpretation 48 and Statement 109. Accordingly, any changes after the measurement period will generally be reflected in income tax expense. The transition provisions of Statement 141(R) clarify that this new requirement applies to all tax uncertainties and VAs recognized as a result of a business combination, including those that arose in business combinations consummated before Statement 141(R)'s effective date. (See **A15–A16**.)

Acquired Uncertain Tax Positions

8.68 Historically, under Issue 93-7, any changes in an acquired entity's uncertain tax position balances were generally recognized as adjustments to goodwill. Statement 141(R) nullified Issue 93-7 and states that income tax uncertainties acquired in a business combination should be accounted for in accordance with Interpretation 48. Statement 141(R) also amended Interpretation 48 to add paragraph 12B, which states:

> The effect of a change to an acquired tax position, or those that arise as a result of the acquisition, shall be recognized as follows:
>
> a. Changes within the measurement period that result from new information about facts and circumstances that existed as of the acquisition date shall be recognized through a corresponding adjustment to goodwill. However, once goodwill is reduced to zero, the remaining portion of that adjustment shall be recognized as a gain on a bargain purchase in accordance with paragraphs 36–38 of Statement 141(R).
>
> b. All other changes in acquired income tax positions shall be accounted for in accordance with this Interpretation.

Therefore, if an acquired entity's unrecognized tax benefit for a tax position is adjusted during the measurement period because of new information about facts and circumstances that existed as of the acquisition date, goodwill should be adjusted. However, even during the measurement period, if the adjustment to the acquired entity's unrecognized tax benefit is the result of an identifiable event that occurred after the business combination's acquisition date, the adjustment is generally recorded to income tax expense. Note that Interpretation 48 states that judgments may be changed only after the evaluation of new information — not on the basis of a new evaluation or new interpretation of information that was available in previous financial reporting periods. After the measurement period, all changes in the acquired entity's unrecognized tax benefit will be recorded in accordance with Interpretation 48.

8.69 Paragraph 12B of Interpretation 48 is effective for all business combinations (regardless of when the business combination was consummated) on or after the effective date of Statement 141(R).

Example 8-19
Acquired Uncertain Tax Positions

Case A

On January 15, 2005, Company X acquired 100 percent of Company Y. As part of the purchase accounting, X recognized a liability associated with an unrecognized tax benefit. On December 31, 2006, X increased the liability as a result of new information to reflect a change in its best estimate of the ultimate settlement with the taxing authority. In accordance with Issue 93-7, X recorded this adjustment as an increase to goodwill. After it adopts Statement 141(R), X will be required to record any additional adjustments to the liability (related to new information) as a component of income tax expense.

Case B

Company X purchases 100 percent of Company Y on July 15, 2008, and the transaction is accounted for under Statement 141. Company X has recorded an unrecognized tax benefit of $100 related to Y's state tax nexus issues. Company X has a calendar year-end and will adopt Statement 141(R) on January 1, 2009. On March 15, 2009, X concludes, on the basis of new information related to the facts and circumstances after the acquisition date, that Y's $100 unrecognized tax benefit is no longer needed. Following the transitional provisions of Statement 141(R), X will reverse the liability for the unrecognized tax benefit and credit income tax expense.

Acquired Deferred Tax Asset Valuation Allowances

8.70 Under paragraph 30 of Statement 109, an acquired entity's DTAs, or operating loss carryforwards that were not initially realizable as of the acquisition date (partial or full VA against the acquired entity's DTAs) but that are considered realizable after the acquisition date, were generally applied to goodwill. Statement 141(R) amended Statement 109 to add paragraph 30A, which states:

> The effect of a change in a valuation allowance for an acquired entity's deferred tax asset shall be recognized as follows:
>
> a. Changes within the measurement period [footnote 8a] that result from new information about facts and circumstances that existed at the acquisition date shall be recognized through a corresponding adjustment to goodwill. However, once goodwill is reduced to zero, an acquirer shall recognize any additional decrease in the valuation allowance as a bargain purchase in accordance with paragraphs 36–38 of Statement 141(R).
>
> b. All other changes shall be reported as a reduction or increase to income tax expense (or a direct adjustment to contributed capital as required by paragraph 26).
>
> [Footnote 8a states that] the measurement period in the context of a business combination is described in paragraphs 51–56 of Statement 141(R).

Therefore, subsequent changes in an acquired entity's DTA VA that was established as of the business combination's acquisition date would generally be recorded to income tax expense unless such adjustments occurred in the measurement period and related to information about facts and circumstances that existed as of the acquisition date. If the adjustment occurred during the measurement period and relates to new information about facts and circumstances that existed as of the acquisition date, the adjustment would be recorded to goodwill.

When an entity adopts Statement 141(R), paragraph 30A is effective for **all** business combinations regardless of when they were consummated.

Example 8-20
Acquired Deferred Tax Asset Valuation Allowances

On July 15, 2006, Company X acquired 100 percent of Company Y. As part of the purchase accounting, X established a full valuation allowance on Y's DTA for net operating losses (NOLs) of $100. On September 30, 2007, X determined that $40 of Y's NOLs will be realizable and reversed its VA, with a corresponding entry to goodwill in accordance with paragraph 30 of Statement 109. Company X has a calendar year-end and will adopt Statement 141(R) on January 1, 2009. On June 15, 2009, X concludes that under Statement 109, Y's remaining $60 NOL DTA is realizable and the VA is no longer necessary. Following the transitional provisions of Statement 141(R), X will reverse its remaining $60 VA and record a corresponding credit to income tax expense.

Deferred Tax Asset for Deductible Tax Goodwill in Excess of Financial Reporting Goodwill

8.71 Statement 141(R) also amends Statement 109 concerning the recognition of a DTA for the excess of tax-deductible goodwill over goodwill for financial reporting. Under Statement 141(R), the recognition of a DTA for tax-deductible goodwill in excess of financial reporting goodwill is no longer prohibited. That is, all DTAs for tax-deductible goodwill from business combinations after the adoption of Statement 141(R) will be recorded as of the acquisition date. Paragraph 262 of Statement 109, as amended by Statement 141(R), states, in part:

> If that second component is an excess of tax-deductible goodwill over the reported amount of goodwill, the tax benefit for that excess is a temporary difference for which a [DTA] is recognized based on the requirements of this Statement (refer to paragraph 263).

See **Example 8-14** for an illustration of how the DTA for deductible tax goodwill in excess of financial reporting goodwill is calculated for all business combinations accounted for under Statement 141(R).

8.72 For excess tax-deductible goodwill from business combinations accounted for under Statement 141, paragraphs 262 and 263 of Statement 109 (before being amended by Statement 141(R)) still apply after the effective date of Statement 141(R). That is, for business combinations consummated before the effective date of Statement 141(R), goodwill will continue to be adjusted as the tax-deductible goodwill ("second component") is realized on the tax return.

8.73 The following example from paragraph 263 of Statement 109 (before being amended by Statement 141(R)) has been adapted to illustrate the accounting that still applies (even after the effective date of Statement 141(R)) for excess tax-deductible goodwill from business combinations consummated under Statement 141.

Example 8-21
Excess Tax-Deductible Goodwill Accounting for Business Combinations Consummated Under Statement 141

The assumptions are as follows:

- As of the acquisition date on January 1, 2008, the reported amount and tax basis of goodwill are $600 and $800, respectively.
- For tax purposes, amortization of goodwill will result in tax deductions of $400 in each of years 1 and 2. Those deductions result in current tax benefits in years 2008 and 2009.
- For simplicity, the consequences of other temporary differences are ignored for years 2008–2011.
- The entity has a calendar year-end and will adopt Statement 141(R) on January 1, 2009.
- Income before income taxes is $1,000 in each year from 2008–2011.
- The tax rate is 40 percent for all years.

Income taxes payable for years 2008–2011 are:

	2008	2009	2010	2011
Income before amortization of goodwill	$ 1,000	$ 1,000	$ 1,000	$ 1,000
Tax amortization of goodwill	400	400	0	0
Taxable income	$ 600	$ 600	$ 1,000	$ 1,000
Income tax payable	$ 240	$ 240	$ 400	$ 400

At the combination date, goodwill is separated into two components as follows:

	Reported Amount	Tax Basis
First component	$ 600	$ 600
Second component	—	200
Total goodwill	$ 600	$ 800

A DTL is recognized for the tax amortization of goodwill for years 2008 and 2009 for the excess of the financial reporting amount over the tax basis of the first component of goodwill. When the second component of goodwill is realized on the tax return for years 2008 and 2009, the tax benefit is allocated to reduce financial reporting goodwill.

Note: This example is only applicable for business combinations that were originally accounted for under Statement 141 and not those accounted for under Statement 141(R).

Example 8-21 (continued)
Excess Tax Deductible Goodwill Accounting for Business Combinations Consummated Under Statement 141

The second component of goodwill is deductible at $100 per year in years 2008 and 2009. Those tax deductions provide $40 ($100 at 40 percent) of tax benefits that are realized in years 2008 and 2009. The realized benefits reduce the first component of goodwill and produce a deferred tax benefit by reducing the taxable temporary difference related to that component of goodwill. Thus, the total tax benefit allocated to reduce the first component of goodwill in year 2008 and 2009 is the sum of (1) the $40 realized tax benefit allocated to reduce goodwill and (2) the deferred tax benefit from reducing the DTL related to goodwill. That total tax benefit (TTB) is determined as follows:

TTB = realized tax benefit plus (tax rate times TTB)

TTB = $40 + (0.40 × TTB)

TTB = $67

Goodwill for financial reporting for years 2008–2011 is:

	2008	2009	2010	2011
Balance at beginning of year	$ 600	$ 533	$ 466	$ 466
Total tax benefit allocated to reduce goodwill	67	67	0	0
Balance at end of year	$ 533	$ 466	$ 466	$ 466

The DTL for the first component of goodwill and the related amount of deferred tax expense (benefit) for years 2008–2011 are:

	2008	2009	2010	2011
Reported amount of goodwill at end of year	$ 533	$ 466	$ 466	$ 466
Tax basis of goodwill (first component)	300	0	0	0
Taxable temporary difference	$ 233	$ 466	$ 466	$ 466
Deferred tax liability:				
At end of year (40 percent)	$ 93	$ 186	$ 186	$ 186
At beginning of year	0	93	186	186
Deferred tax expense for the year	$ 93	$ 93	$ 0	$ 0

Income for financial reporting for years 2008–2011 is:

	2008	2009	2010	2011
Income before income tax	$ 1,000	$ 1,000	$ 1,000	$ 1,000
Income tax expense:				
Current	240	240	400	400
Deferred	93	93	0	0
Benefit applied to reduce goodwill	67	67	0	0
Income tax expense	400	400	400	400
Net income	$ 600	$ 600	$ 600	$ 600

Income Tax Disclosures for Business Combinations

8.74 Statement 141(R) amended some of the financial statement disclosures in Statement 109 and Interpretation 48. For example, paragraph 45 of Statement 109, as amended by Statement 141(R), states:

> The significant components of income tax expense attributable to continuing operations for year presented shall be disclosed in the financial statements or notes thereto. Those components would include, for example:
>
> a. Current tax expense or benefit
>
> b. Deferred tax expense of benefit (exclusive of the effects of other components listed below
>
> c. Investment tax credits
>
> d. Government grants (to the extent recognized as a reduction of income tax expense)
>
> e. The benefits of operating loss carryforwards
>
> f. Tax expense that results from allocating certain tax benefits ~~either~~ directly to contributed capital ~~or to reduce goodwill or other noncurrent intangible assets of an acquired entity~~
>
> g. Adjustments of a deferred tax liability or asset for enacted changes in tax laws or rates or a change in the tax status of the enterprise
>
> h. Adjustments of the beginning-of-the-year balance of a valuation allowance because of a change in circumstances that causes change in judgment about the realizability of the related deferred tax asset in future years. For example, any acquisition-date income tax benefits or expenses recognized from changes in the acquirer's valuation allowance for its previously existing deferred tax assets as a result of a business combination (paragraph 266).

8.75 Paragraph 48 of Statement 109, as amended by Statement 141(R), states:

> An enterprise shall disclose (a) the amounts and expiration dates of operating loss and tax credit carryforwards for tax purposes and (b) any portion of valuation allowance for deferred tax assets for which subsequently recognized tax benefits will be ~~allocated to reduce goodwill or other noncurrent intangible assets of an acquired entity or~~ credited directly to contributed capital (paragraph~~s 30 and~~ 36).

8.76 Subsequent business combination adjustments to income tax accounts could have an effect on Interpretation 48 disclosure requirements. Paragraph 21(a) of Interpretation 48 states:

> An enterprise shall disclose the following at the end of each annual reporting period presented:
>
> a. A tabular reconciliation of the total amounts of unrecognized tax benefits at the beginning and end of period, which shall include at a minimum:
>
> (1) The gross amounts of increases and decreases in unrecognized tax benefits as a result of tax positions taken during the period
>
> (2) The gross amount of increases and decreases in unrecognized tax benefits as a result of tax positions taken in the current year
>
> (3) The amounts of decreases in the unrecognized tax benefits relating to settlements with taxing authorities
>
> (4) Reductions to unrecognized tax benefits as a result of a lapse of applicable statute of limitations

Section 9 — Push-Down Basis of Accounting

9.01 For transactions within the scope of Statement 141(R), a new basis is established within the consolidated financial statements of the acquiring entity for the assets acquired and liabilities assumed, regardless of whether the acquired entity will remain as a separate corporate entity after the acquisition. Statement 141(R) does not address whether, if the acquired entity is to remain separate, the separate stand-alone financial statements of the acquired entity should reflect the new basis of accounting resulting from the acquisition through what is referred to as "push-down accounting." In the absence of guidance in Statement 141(R), the applicability of push-down accounting to a specific set of facts and circumstances should be based on:

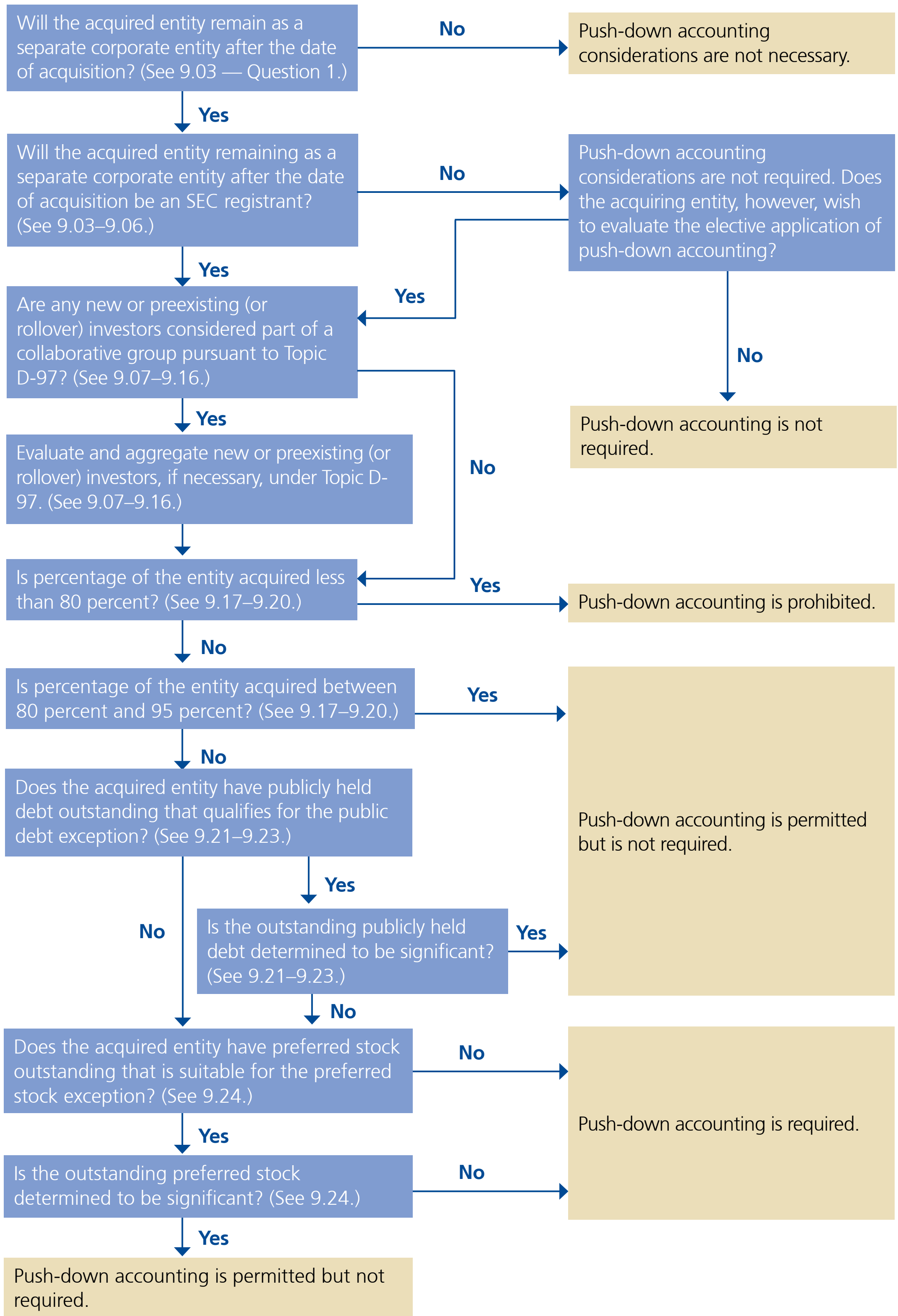
- SAB Topic 5.J.[1]
- EITF Topic D-97.[2]
- Selected speeches and informal comments on the topic by the SEC staff.

Evaluating the Applicability of Push-Down Accounting

9.02 The following flowchart can be used to evaluate the applicability of push-down accounting to specific situations.

1 See **14.37** regarding possible future updates to SEC guidance as a result of Statement 141(R). This publication will be updated after any new or amended guidance is issued by the SEC.

2 See footnote 1.


Will the acquired entity remain as a separate corporate entity after the date of acquisition? (See 9.03 — Question 1.)
No
Push-down accounting considerations are not necessary.
Yes
Will the acquired entity remaining as a separate corporate entity after the date of acquisition be an SEC registrant? (See 9.03–9.06.)
No
Push-down accounting considerations are not required. Does the acquiring entity, however, wish to evaluate the elective application of push-down accounting?
Yes
Yes
No
Are any new or preexisting (or rollover) investors considered part of a collaborative group pursuant to Topic D-97? (See 9.07–9.16.)
Push-down accounting is not required.
Yes
Evaluate and aggregate new or preexisting (or rollover) investors, if necessary, under Topic D-97. (See 9.07–9.16.)
No
Is percentage of the entity acquired less than 80 percent? (See 9.17–9.20.)
Yes
Push-down accounting is prohibited.
No
Is percentage of the entity acquired between 80 percent and 95 percent? (See 9.17–9.20.)
Yes
No
Does the acquired entity have publicly held debt outstanding that qualifies for the public debt exception? (See 9.21–9.23.)
Push-down accounting is permitted but is not required.
Yes
No
Is the outstanding publicly held debt determined to be significant? (See 9.21–9.23.)
Yes
No
Does the acquired entity have preferred stock outstanding that is suitable for the preferred stock exception? (See 9.24.)
No
Push-down accounting is required.
Yes
Is the outstanding preferred stock determined to be significant? (See 9.24.)
No
Yes
Push-down accounting is permitted but not required.

SEC Staff Accounting Bulletin Topic 5.J — Push-Down Basis of Accounting Required in Certain Limited Circumstances

9.03 SAB Topic 5.J provides the following series of facts, questions, and interpretive responses:

> ***Facts:*** Company A (or Company A and related persons) acquired substantially all of the common stock of Company B in one or a series of purchase transactions.
>
> ***Question 1:*** Must Company B's financial statements presented in either its own or Company A's subsequent filings with the Commission reflect the new basis of accounting arising from Company A's acquisition of Company B when Company B's separate corporate entity is retained?
>
> ***Interpretive Response:*** Yes. The staff believes that purchase transactions that result in an entity becoming substantially wholly owned (as defined in Rule 1-02(aa) of Regulation S-X) establish a new basis of accounting for the purchased assets and liabilities.
>
> When the form of ownership is within the control of the parent the basis of accounting for purchased assets and liabilities should be the same regardless of whether the entity continues to exist or is merged into the parent's operations. Therefore, Company A's cost of acquiring Company B should be "pushed down," i.e., used to establish a new accounting basis in Company B's separate financial statements. [Footnote 5]
>
> ***Question 2:*** What is the staff's position if Company A acquired less than substantially all of the common stock of Company B or Company B had publicly held debt or preferred stock at the time Company B became wholly owned?
>
> ***Interpretative Response:*** The staff recognizes that the existence of outstanding public debt, preferred stock or a significant minority interest in a subsidiary might impact the parent's ability to control the form of ownership. Although encouraging its use, the staff generally does not insist on the application of push down accounting in these circumstances.
>
> ***Question 3:*** Company A borrows funds to acquire substantially all of the common stock of Company B. Company B subsequently files a registration statement in connection with a public offering of its stock or debt. [Footnote 6] Should Company B's new basis ("push down") financial statements include Company A's debt related to its purchase of Company B?
>
> ***Interpretive Response:*** The staff believes that Company A's debt, [footnote 7] related interest expense, and allocable debt issue costs should be reflected in Company B's financial statements included in the public offering (or an initial registration under the Exchange Act) if: (1) Company B is to assume the debt of Company A, either presently or in a planned transaction in the future; (2) the proceeds of a debt or equity offering of Company B will be used to retire all or a part of Company A's debt; or (3) Company B guarantees or pledges its assets as collateral for Company A's debt.
>
> Other relationships may exist between Company A and Company B, such as the pledge of Company B's stock as collateral for Company A's debt. [Footnote 8] While in this latter situation, it may be clear that Company B's cash flows will service all or part of Company A's debt, the staff does not insist that the debt be reflected in Company B's financial statements providing there is full and prominent disclosure of the relationship between Companies A and B and the actual or potential cash flow commitment. In this regard, the staff believes that Statements 5 and 57 as well as Interpretation 45 require sufficient disclosure to allow users of Company B's financial statements to fully understand the impact of the relationship on Company B's present and future cash flows. Rule 4-08(e) of Regulation S-X also requires disclosure of restrictions which limit the payment of dividends. Therefore, the staff believes that the equity section of Company B's balance sheet and any pro forma financial information and capitalization tables should clearly disclose that this arrangement exists. [Footnote 9]
>
> Regardless of whether the debt is reflected in Company B's financial statements, the notes to Company B's financial statements should generally disclose, at a minimum: (1) the relationship between Company A and Company B; (2) a description of any arrangements that result in Company B's guarantee, pledge of assets [footnote 10] or stock, etc. that provides security for Company A's debt; (3) the extent (in the aggregate and for each of the five years subsequent to the date of the

> latest balance sheet presented) to which Company A is dependent on Company B's cash flows to service its debt and the method by which this will occur; and (4) the impact of such cash flows on Company B's ability to pay dividends or other amounts to holders of its securities.
>
> Additionally, the staff believes Company B's Management's Discussion and Analysis of Financial Condition and Results of Operations should discuss any material impact of its servicing of Company A's debt on its own liquidity pursuant to Item 303(a)(1) of Regulation S-K.

Footnote 5 states, "The Task Force on Consolidation Problems, Accounting Standards Division of the American Institute of Certified Public Accountants issued a paper entitled 'Push Down' Accounting, October 30, 1979. This paper addresses the issues relating to 'push down' accounting, cites authoritative literature and indicates that a substantial change in ownership justifies a new basis of accounting."

Footnote 6 states, "The guidance in this SAB should also be considered for Company B's separate financial statements included in its public offering following Company B's spin-off or carve-out from Company A."

Footnote 7 states, "The guidance in this SAB should also be considered where Company A has financed the acquisition of Company B through the issuance of mandatory redeemable preferred stock."

Footnote 8 states, "The staff does not believe Company B's financial statements must reflect the debt in this situation because in the event of default on the debt by Company A, the debt holder(s) would only be entitled to B's stock held by Company A. Other equity or debt holders of Company B would retain their priority with respect to the net assets of Company B."

Footnote 9 states, "For example, the staff has noted that certain registrants have indicated on the face of such financial statements (as part of the stockholder's equity section) the actual or potential financing arrangement and the registrant's intent to pay dividends to satisfy its parent's debt service requirements. The staff believes such disclosures are useful to highlight the existence of arrangements that could result in the use of Company B's cash to service Company A's debt."

Footnote 10 states, in part, "A material asset pledge should be clearly indicated on the face of the balance sheet. For example, if all or substantially all of the assets are pledged, the 'assets' and 'total assets' captions should include parenthetically: 'pledged for parent company debt — See Note X.'"

Additional SEC Staff Views — Applicability of EITF Topic D-97 to Certain Transactions

9.04 At the 2005 AICPA National Conference on Current SEC and PCAOB Developments, Professional Accounting Fellow Pamela Schlosser presented her views on determining the appropriate accounting model for certain "new basis" questions. In her prepared remarks, Ms. Schlosser referred to a situation encountered by the SEC staff and offered insight on the approach the staff may apply when analyzing push-down accounting questions:

> In Ms. Schlosser's example, Company A (OLDCO) was acquired for cash by Company B (NEWCO), a new entity that was formed to effectuate the transaction. She stated that "NEWCO was considered [to be] the accounting acquirer since it was deemed substantive; it acquired a single operating company for cash; and the entire ownership of [OLDCO] had changed." The transaction resulted in 100% step-up of OLDCO's basis.

Ms. Schlosser clarified that in situations such as the one described above, the requirement to apply push-down accounting must be assessed at the OLDCO level. Since the entire ownership of OLDCO had changed as part of the transaction, push-down accounting would be required. Therefore, assessing whether the new investors of NEWCO represent a collaborative group in accordance with Topic D-97 (see **9.07–9.16**) is not relevant in determining whether push-down accounting should be applied at OLDCO.

Applicability of Push-Down Accounting to Companies That Are Not SEC Registrants

9.05 In Issue 86-9, the EITF reached a consensus that "push-down accounting is not required for companies that are not SEC registrants." Push-down accounting for companies that are not SEC registrants is not addressed in Issue 86-9, but is acceptable under current practice when the same acquisition thresholds are used as those applied by the SEC staff. (See **9.17–9.20** for discussion of the thresholds to use when determining whether a company has become substantially wholly owned.)

9.06 For companies that become SEC registrants, the SEC staff requires push-down accounting to be applied retrospectively to the extent that it would have been required under Topic D-97 and SAB Topic 5.J.

Collaborative Groups — Topic D-97

9.07 Topic D-97 states the following regarding a collaborative group:

> In applying SAB 54 [Topic 5.J] to specific facts and circumstances, a registrant must distinguish between transactions resulting in only a significant change in (recapitalization of) a company's ownership (for example, as the result of an initial public offering for which push-down accounting is not required) and purchase transactions in which the company becomes substantially wholly owned and for which push-down accounting is required.
>
> For purposes of determining whether a company has become "substantially wholly owned" as the result of a single transaction or a series of related and anticipated transactions in which investors acquire ownership interests, the SEC staff believes that it is appropriate to aggregate the holdings of those investors who *both* "mutually promote" the acquisition and "collaborate" on the subsequent control of the investee company (the collaborative group). [Footnote 1] That is, the SEC staff believes that push-down accounting is required if a company becomes substantially wholly owned by a group of investors who act together as effectively one investor and are able to control the form of ownership of the investee.
>
> The SEC staff believes that under a "mutual promotion and subsequent collaboration" model, a member of a collaborative group would be any investor [footnote 2] that helps to consummate the acquisition and works or cooperates with the subsequent control of the acquired company. For purposes of assessing whether an investor is part of a collaborative group, the SEC staff believes that a rebuttable presumption exists that any investor investing at the same time as or in reasonable proximity to the time others invest in the investee is part of the collaborative group with the other investor(s). Determination of whether such a presumption is rebutted necessarily will involve the consideration of all pertinent facts and circumstances. Among the factors considered by the SEC staff [footnote 3] that would be indicative of an investor *not* being part of a collaborative group include:
>
> **I. Independence**
>
> - The investor is substantive. For example, the investor is an entity with substantial capital (that is, comparable to that expected for a substantive business with similar risks and rewards) and other operations. In contrast, an investor that is a special purpose entity whose only substantive assets or operations are its investment in the investee generally would not be considered substantive.

- The investor is independent of and unaffiliated with all other investors.
- The investor's investment in the investee is not contingent upon any other investor making investments in the investee.
- The investor does not have other relationships with any other investor that are material to either investor.

II. Risk of Ownership

- The investor is investing at fair value.
- The investor invests funds from its own resources.
- The investor fully shares with all other investors in the risks and rewards of ownership in the investee in proportion to its class and amount of investment. That is, the investor's downside risk or upside reward are not limited, and the investor does not receive any other direct or indirect benefits from any other investor as a result of investing in the investee. [Footnote 4]
- The funds invested by the investor are not directly or indirectly provided or guaranteed by any other investor.
- The investor is at risk only for its own investment in the investee and not another's investment in the investee. That is, the investor is not providing or guaranteeing any part of another investor's investment in the investee. [Refer to footnote 4.]

III. Promotion

- The investor did not solicit other parties to invest in the investee.

IV. Subsequent Collaboration

- The investor is free to exercise its voting rights in any and all shareholder votes.
- The investor does not have disproportionate or special rights that other investors do not have, such as a guaranteed seat(s) on the investee's board, required supermajority voting rights for major or significant corporate decisions, guaranteed consent rights over corporate actions, guaranteed or specified returns, and so forth.
- The investor's ability to sell its investee shares is not restricted, except as provided by the securities laws or by what is reasonable and customary in individually negotiated investment transactions for closely held companies (for example, a right of first refusal held by the investee on the investor's shares in the event of a bona fide offer from a third party).

The SEC staff has considered the applicability of push-down accounting in transactions in which financial investors, acting together effectively as one investor (that is, as a collaborative group), acquire ownership interests in a company. The investee company experiences a significant change in ownership, but no single financial investor obtains substantially all of the ownership interest in the company. Consider the following example:

> Investor C formulates a plan to acquire and consolidate companies in a highly fragmented industry in order to achieve economies of scale. Investor C approaches Investors A and B with the plan, and they agree to invest with Investor C in the acquisition and consolidation plan. Investors A, B, and C (the Investors) are each substantive entities, with no overlap of employees but with a number of prior joint investments and other business relationships that are individually material to the Investors. Furthermore, upon completion of the current plan, the resulting entity is expected to be material to each individual investor.
>
> Shortly thereafter, Company D is identified as an acquisition candidate in the industry. The Investors negotiate a legally binding agreement with Company D to acquire 100 percent of the outstanding common stock of Company D (to be held 40 percent, 40 percent, and 20 percent by Investors A, B, and C, respectively) for cash. In connection with the change in ownership, Company D's bylaws are amended to provide that the Investors each have the right to elect an equal number of members of Company D's board of directors. Company D's board of directors also is to include Company D's chief executive officer and two independent directors. In addition, the bylaws are amended to provide that no action requiring board of

> directors' approval may be approved without consent of a majority of the board as well as a majority of the Investor A directors, the Investor B directors, and the Investor C directors, each voting as a separate class. Effectively, any significant corporate action by Company D would require the approval of each investor.
>
> Stock held by the Investors is to be restricted as to transfer for five years, after which each of the Investors has a right of first refusal and tag-along rights if some part of the group of Investors decides to sell its interests.
>
> The funds invested by each investor come from the respective investor's resources; however, Investors A and B provide Investor C certain limited first-loss guarantees of its investment.

In the context of this example, the SEC staff concluded that Investors A, B, and C did not overcome the presumption that they were members of a collaborative group of investors. Furthermore, since the collaborative group of Investors acquired 100 percent of the outstanding common stock of Company D, the SEC staff concluded that push-down accounting was required to be applied in Company D's financial statements. The factors the SEC staff considered in reaching its conclusion that the presumption was not rebutted included, among others, the following:

- Investors A, B, and C acted in concert to negotiate their concurrent investments in Company D, which were made pursuant to the same contract.
- The investments by Investors A, B, and C were being made in connection with a broader strategic initiative the three investors were pursuing together.
- There were a number of prior business relationships between the Investors that were material to the Investors.
- Investor C does not share fully in the risks and rewards of ownership due to the limited first-loss guarantees provided by Investors A and B.
- No single Investor controlled the board of directors, and due to the amendments to the bylaws regarding board representation and voting, any of the three Investors could unilaterally block any board action. In other words, Investors A, B, and C were compelled to collaborate on the subsequent control of Company D.
- There are restrictions on each Investor's ability to transfer its shares.

Footnote 1 states, "A collaborative group is not necessarily the same as a control group as defined in Issue No. 88-16, 'Basis in Leveraged Buyout Transactions.'"

Footnote 2 states, "Preexisting, or rollover, investors should be evaluated for inclusion in the collaborative group on the same basis as new investors."

Footnote 3 states, "In an assessment of whether the presumption is overcome, any single factor should not be considered in isolation."

Footnote 4 states, "Put options, call options, tag-along rights, and drag-along rights should be carefully evaluated. They may act to limit an investor's risk and rewards of ownership, effective voting rights, or ability to sell its investee shares. A tag-along right grants a shareholder the option to participate in a sale of shares by the controlling shareholder or collaborative group, generally under the same terms and in the same proportion. A drag-along right grants the controlling shareholder or collaborative group the option to compel shareholders subject to the drag-along provision to sell their shares in a transaction in which the controlling shareholder or collaborative group transfers control of the company, generally under the same terms and in the same proportion."

Additional Considerations in Determining the Presence of a Collaborative Group Under Topic D-97

9.08 Topic D-97 refers to the SEC staff's position that "a rebuttable presumption exists that any investor investing at the same time as or in reasonable proximity to the time others invest in an investee is part of the collaborative group with the other investor(s)." In attempting to overcome this presumption, an investor should consider the factors cited by the SEC staff in Topic D-97 as well as all relevant facts and circumstances.

9.09 In her speech at the 2005 AICPA National Conference on SEC and PCAOB Developments, Professional Accounting Fellow Pamela Schlosser addressed factors the SEC staff considers in addition to those in Topic D-97 when determining whether a collaborative group exists. Ms. Schlosser stated:

> The staff has no golden rules in applying Topic D-97. Rather, the totality of all of the factors should be evaluated in concluding whether the investors represent a collaborative group. However, the following are some of the questions that the staff may ask in gaining a better understanding of the relationship among the investors, and thus whether a collaborative group exists:
>
> - How did the various investors come together to make this investment?
> - Hypothetically, if one of the investors would have backed out of the deal, would the deal still have been done?
> - How are board seats determined and can the number of seats change over time?
> - What is the nature of decisions that require unanimous or majority approval of the investors?
> - [W]hat evidence supports that sale restrictions are considered reasonable and customary?

9.10 The SEC staff has indicated, both formally and informally, that entities should consider the additional items below when applying Topic D-97.

Risk of Ownership — Tag-Along Rights, Drag-Along Rights, or Both

9.11 SEC staff comments have suggested that tag-along or drag-along rights in any form not only raise risk-of-ownership issues, but may also indicate subsequent collaboration. Footnote 4 of Topic D-97 addresses the factors in the Risk of Ownership section of Topic D-97 and indicates that drag-along rights and tag-along rights should be carefully evaluated. In addition, the following information should be considered:

- Drag-Along Rights — A drag-along right grants a shareholder or group of shareholders the option to compel other shareholders subject to the drag-along provision to sell their shares in a transaction in which the holder of the right sells its shares, generally under the same terms and in the same proportion. For example, Investor A and B are investing in Entity X. Investor A can require Investor B to sell its interest in Entity X if Investor A were to sell its interest on a future date. That is, Investor A can drag Investor B into the sale transaction. SEC staff members have indicated that the presence of drag-along rights among investors represents subsequent collaboration and will likely cause those investors to be considered part of the collaborative group.
- Tag-Along Rights — A tag-along right grants a shareholder the option to participate in a sale of shares by the controlling shareholder or collaborative group, generally under the same terms and in the same proportion. For example, Investor C and D are investing in Entity Y. Investor C can participate in any transaction with Investor D if Investor D decides to sell its interest in Entity Y on a future date. That is, Investor C can tag along with Investor D in the sale transaction.

SEC staff members have indicated that the presence of tag-along rights among investors may represent subsequent collaboration and may cause those investors to be considered part of the collaborative group.

Subsequent Collaboration — Disproportionate or Special Rights

9.12 SEC staff comments have suggested that any right, including one considered a protective right under Issue 96-16, may represent a special right indicating subsequent collaboration. SEC staff comments have also indicated that contractual terms that provide new or preexisting investors with guaranteed board seats, even when the seats are proportionate to the equity held, may be deemed a special right indicating subsequent collaboration.

Subsequent Collaboration — Transferability Restrictions

9.13 SEC staff comments have suggested that any transfer restrictions, other than those provided by securities law, may indicate subsequent collaboration.

Advisory or Management Committees

9.14 The SEC staff has questioned whether advisory groups or management committees established to advise entities, or to otherwise be involved with them after a purchase transaction that resulted in a Topic D-97 analysis, indicated subsequent collaboration by the investors.

Other Considerations

9.15 While the following items were not discussed with members of the SEC staff, they should also be considered when determining which investors to analyze under Topic D-97:

- Stub Investors — Footnote 2 of Topic D-97 states, "Preexisting, or rollover, investors should be evaluated for inclusion in the collaborative group on the same basis as new investors." In some transactions, certain parties (e.g., management of the investee) hold shares in the entity before the transaction and continue to hold shares in the entity after the transaction. These parties are sometimes referred to as "stub" investors. Certain stub investors may be viewed as mutually promoting the transaction. For example, stub investors that hold management positions in the entity both before and after the transaction could be perceived as having promoted the transaction because they may have been terminated if they had not acted together with the new investors to promote the transaction.
- Legal Agreement and Contracts — Investors must carefully analyze the legal agreements and contracts that define the terms of transactions that fall within the scope of Topic D-97. For example, investors must thoroughly review shareholder agreements to accurately determine whether a collaborative group is present. Contracts that should also be analyzed include merger or purchase and sales agreements, monitoring or management agreements, registration rights agreements, proxy or tender offer statements, LLC agreements, employment agreements, and others relevant to the analysis. If a transaction involving a Topic D-97 analysis is reviewed by the SEC staff, the staff may request and review all contracts associated with the transaction.

9.16 Note that the SEC staff may also request a timeline indicating when and how each investor became involved in a transaction, as well as when other events that are related to the transaction occurred (e.g., when financing was obtained and other agreements were signed).

Determining Whether a Company Has Become Substantially Wholly Owned

9.17 Topic D-97 states that "[i]n determining whether a company has become substantially wholly owned, the SEC staff has stated that push-down accounting would be required if 95 percent or more of the company has been acquired (unless the company has outstanding public debt or preferred stock that may impact the acquirer's ability to control the form of ownership of the company), permitted if 80 percent to 95 percent has been acquired, and prohibited if less than 80 percent of the company is acquired."

9.18 SEC Regulation S-X, Rule 1-02(aa), states that "[t]he term 'wholly owned subsidiary' means a subsidiary substantially all of whose outstanding voting shares are owned by its parents and/or the parent's other wholly owned subsidiaries." Although the term "substantially wholly owned" is defined in SEC regulations in the context of outstanding voting securities, the SEC staff may require a parent's investment in a subsidiary other than through outstanding voting securities (e.g., through nonvoting securities or instruments that are convertible into voting securities) to be analyzed in the determination of whether push-down accounting should be applied on an if-converted basis.

9.19 Because the SEC staff's views on this subject are uncertain, consultation with professionals who frequently analyze business combination transactions is encouraged for a parent that holds other outstanding equity or debt securities or when rights to equity or debt securities and the consideration of such instruments may lead to a different conclusion about the application of push-down accounting on the basis of the thresholds noted in **9.02**. A pre-filing consultation with the SEC staff may also be advisable.

9.20 If registrants engage in a planned acquisition of voting shares of a company over a period of time, an analysis should be performed after each acquisition of voting shares to determine whether the company has become substantially wholly owned.

Example 9-1
Determining When a Company Becomes Wholly Owned

Registrant M has an option with Company W (also an SEC registrant) to acquire a 20 percent interest in Company W each year for the next five years. Upon acquisition of the initial 20 percent interest, Registrant M will account for its interest in Company W as an equity method investment. Upon acquisition of the second 20 percent interest, Registrant M will continue to account for the investment as an equity method investment (cumulative interest of 40 percent). Upon acquisition of the third 20 percent interest (i.e., the change in control), Registrant M will account for the transaction as a business combination in accordance with Statement 141(R) and will begin to consolidate Company W (cumulative interest of 60 percent). In accordance with Statement 160, there will be no incremental step-up to fair value of the net assets upon the acquisition of the fourth 20 percent interest. Further, M has not yet elected to apply push-down accounting. Upon consummation of the remaining 20 percent, Registrant M will be required to apply push-down accounting in the separate financial statements of Company W since it is now substantially wholly owned (i.e., cumulative interest is equal to or greater than 95 percent).

Evaluating the Availability of the Public Debt Exception

9.21 The following general guidelines should be considered in the evaluation of whether outstanding public debt of the acquired entity qualifies for consideration under the exception discussed in Question 2 of SAB Topic 5.J.

- To qualify, the public debt must be issued by the acquired entity before the date of acquisition and must remain outstanding after the date of acquisition. Public debt issued in contemplation of the acquisition, even if it replaces other public debt then outstanding, is not likely to qualify for the exception.
- If the public debt qualifying for the exception is subsequently redeemed and no other condition preventing the application of push-down accounting is then present, push-down accounting must be reflected retrospectively.

9.22 When referring to the existence of outstanding public debt, SAB Topic 5.J does not use the term "significant." At the 1999 AICPA National Conference on Current SEC Developments, an SEC staff member (Eric W. Casey) addressed the application of push-down accounting when public debt is outstanding. In prepared remarks, Mr. Casey indicated that "while SAB 54 [SAB Topic 5.J] does not explicitly refer to significance of public debt, the staff believes that it is reasonable and consistent with the general principles of SAB 54 [SAB Topic 5.J] to consider the significance of public debt in assessing the applicability of push down accounting." Mr. Casey further noted that "[i]n evaluating the significance of public debt, the staff believes that it is reasonable to consider both the quantitative and qualitative significance of the public debt." Mr. Casey offered the following illustration of a quantitative and qualitative analysis of publicly held debt, concluding that the debt was neither quantitatively nor qualitatively significant and thus did not constitute a reason, in itself, not to apply push-down accounting as otherwise required:

> Quantitatively, the debt amounted to approximately 5 percent of the subsidiary's net book value and less than 1 percent of the subsidiary's fair value. The debt holders, in the aggregate, would hold an approximately 1 percent interest in the subsidiary on an as-if-converted basis. Qualitatively, the debt holders had virtually no ability to control or influence the form of the parent's ownership of its subsidiary, nor did the debt holders have consent rights regarding the buying out of the existing minority interests, issuing subsidiary equity, or the subsidiary paying dividends.

9.23 As indicated above, qualitative factors the SEC staff has historically considered include the percentage of (1) public debt in relation to the subsidiary's net book value, (2) public debt in relation to the subsidiary's fair value, and (3) common ownership that convertible public debt or preferred stock would equate to on an "if converted" basis.

Evaluating the Availability of the Preferred Stock Exception

9.24 The same general guidelines in **9.21** should be followed when evaluating whether outstanding preferred stock qualifies for consideration under the exception discussed in Question 2 of SAB Topic 5.J. As with outstanding public debt, references to the existence of preferred stock in SAB Topic 5.J do not include the term "significant." By analogy to the SEC staff's remarks on outstanding public debt (see **9.22**), for outstanding preferred stock to qualify for the exception, the preferred stock must be deemed significant. The SEC staff does not appear to have commented on whether the determination of significance should be based solely on a quantitative analysis or on both a quantitative and a qualitative analysis.

Subsequent Application of Push-Down Accounting

9.25 At the April 2005 AICPA SEC Regulations Committee Joint Meeting With the SEC Staff, the SEC staff noted a change in its position regarding whether a registrant could apply push-down accounting after an initial election not to apply it. If an entity subsequently elects to apply push-down accounting, the SEC staff stated that a preferability letter would be required and that the election of such "change in entity" accounting would require retroactive application. This position was reiterated by Associate Chief Accountant Leslie Overton of the SEC's Division of Corporation Finance at the 2006 AICPA National Conference on Current SEC and PCAOB Developments.

9.26 The SEC staff further stated that if a registrant were to apply push-down accounting in an interim period after the issuance of annual financial statements, then in future 1933 Act filings, the registrant would be required to restate those annual financial statements included or incorporated by reference in such a registration statement or a proxy statement.

Push-Down of Goodwill to a Subsidiary of an Acquired Company

9.27 If an acquirer chooses to apply push-down accounting to the assets and liabilities of a subsidiary of a company (parent) it purchases, then it should also push down the goodwill that resulted from the purchase to the parent's subsidiary. It is inappropriate to record the assets acquired and liabilities assumed at fair value without recording the goodwill that resulted from the transaction. While all of the goodwill from such an acquisition would have to be pushed down to the subsidiary, it may be assigned to different reporting units.

Example 9-2
Push Down of Goodwill to a Subsidiary of an Acquired Company

On July 1, 20X7, Company A, an SEC registrant, acquired 100 percent of Company D for $5 million. Company D has two wholly owned operating subsidiaries, Subsidiary X and Subsidiary Y. Company D is a holding company with no substantive operations.

As part of the business combination accounting for the acquisition of D (and establishment of a new basis of accounting), A recorded $1.5 million of goodwill. When preparing D's separate financial statements, A pushed down its cost of acquiring D to the acquired assets and assumed liabilities of D in accordance with SAB Topic 5.J. This cost was further pushed down to X and Y in the preparation of their separate financial statements. In addition, the goodwill was recognized in the separate GAAP financial statements of X and Y because A believes the goodwill was generated at the X and Y levels.

Section 10 — Subsequent Accounting for Intangible Assets (Other Than Goodwill)

Finite Useful Life Versus Indefinite Useful Life

10.01 In Appendix F of Statement 142, "intangible assets" are defined as "[a]ssets (not including financial assets) that lack physical substance." Among intangible assets recognized apart from goodwill in a business combination or acquired individually or with a group of other assets, intangible assets that are subject to amortization (finite-lived) are distinguished under Statement 142 from those that are not subject to amortization (indefinite-lived) on the basis of the intangible asset's expected useful life to the reporting entity. The term "intangible assets" refers to intangible assets other than goodwill.

10.02 The following table highlights some differences between finite-lived and indefinite-lived intangible assets.

	Finite-Lived Intangible Assets	Indefinite-Lived Intangible Assets
Characteristics	Expected useful life to the reporting entity is limited.	No legal, regulatory, contractual, competitive, economic, or other factors limit the useful life to the reporting entity.
Amortization period	Over the expected useful life to the reporting entity.	Not applicable.
Amortization method	On the basis of the pattern in which the economic benefits are consumed or otherwise used up. If that pattern cannot be reliably determined, a straight-line amortization method should be used.	Not applicable.
Impairment testing	Tested for impairment in accordance with Statement 144. Testing required whenever events or circumstances indicate that the carrying amount of a long-lived asset (asset group) may not be recoverable. Impairment loss is recognized if the carrying amount of the asset or asset group tested is not recoverable and its carrying amount exceeds its fair value (two-step test).	Tested for impairment in accordance with Statement 142. Testing required annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. Impairment loss is recognized if the carrying amount of the asset exceeds its fair value (one-step test). Issue 02-7 provides guidance on the unit of accounting to apply (see **10.45–10.50**).

Internally Developed Intangible Assets

10.03 Generally, research and development costs are expensed as incurred for internally developed intangibles. Paragraph 10 of Statement 142 states that "[c]osts of internally developing, maintaining, or restoring intangible assets (including goodwill) that are not specifically identifiable, that have indeterminate lives, or that are inherent in a continuing business and related to an entity as a whole, shall be recognized as an expense when incurred." See discussion in **5.26** on guidance related to the accounting for in-process research and development intangible assets acquired in a business combination.

Determining the Useful Life of an Intangible Asset

10.04 Paragraph 11 of Statement 142, as amended by FSP FAS 142-3, states, in part:

> The accounting for a recognized intangible asset is based on its **useful life** to the reporting entity. An intangible asset with a finite useful life is amortized; an intangible asset with an indefinite useful life is not amortized. The useful life of an intangible asset to an entity is the period over which the asset is expected to contribute directly or indirectly to the future cash flows of that entity. [Footnote omitted] The estimate of the useful life of an intangible asset to an entity shall be based on an analysis of all pertinent factors, in particular the following factors with no one factor being more presumptive than the other:
>
> a. The expected use of the asset by the entity [see **10.07–10.08**]
>
> b. The expected useful life of another asset or a group of assets to which the useful life of the intangible asset may relate [see **10.09**]
>
> c. Any legal, regulatory, or contractual provisions that may limit the useful life [see **10.10–10.11**]
>
> d. The entity's own historical experience in renewing or extending similar arrangements (consistent with the intended use of the asset by the entity), regardless of whether those arrangements have explicit renewal or extension provisions. In the absence of that experience, the entity shall consider the assumptions that market participants would use about renewal or extension (consistent with the highest and best use of asset by market participants), adjusted for entity specific factors in this paragraph. [see **10.12–10.16**]
>
> e. The effects of obsolescence, demand, competition, and other economic factors (such as the stability of the industry, known technological advances, legislative action that results in an uncertain or changing regulatory environment, and expected changes in distribution channels) [see **10.17–10.18**]
>
> f. The level of maintenance expenditures required to obtain the expected future cash flows from the asset (for example, a material level of required maintenance in relation to the carrying amount of the asset may suggest a very limited useful life). [Footnote omitted] [see **10.19–10.20**]

10.05 Entities commonly use an income approach to measure the fair value of an intangible asset. This valuation technique incorporates assumptions about the asset's expected cash flows, which the entity should consider when determining the useful life of an intangible asset, adjusted as appropriate for the entity-specific factors in paragraphs 11(a)–(f) noted above. Depending on the intangible asset's legal, regulatory, and contractual provisions, the analysis may benefit from the assistance of specialists.

10.06 The following factors are not, in themselves, sufficient to support a useful-life determination:

- *Examples in Statement 142* — The implementation guidance on intangible assets in Appendix A of Statement 142 includes examples that describe "an acquired intangible asset and the facts and circumstances surrounding the determination of its useful life and the subsequent accounting based on that determination." In these examples, an indefinite useful life is determined for an acquired broadcast license, an acquired airline route authority, and an acquired trademark. However, paragraph A1 of Appendix A states that "[t]he facts and circumstances unique to each acquired intangible asset need to be considered in making similar determinations." Therefore, the examples do not necessarily apply to other situations.
- *Reliance on Industry or Other Practices* — Intangible asset types may be common to entities in general (e.g., a trade name) or to entities in a specific industry (e.g., newspaper mastheads, operating and broadcasting rights). Since paragraph 11 of Statement 142 states that "[t]he useful life of an intangible asset to an entity is the period over which the asset is expected to

contribute directly or indirectly to the future cash flows of that entity," useful-life assessments made by one entity would not necessarily apply to another.

- *Useful-Life Determination Based on Another Intangible Asset Within the Same Intangible Asset Class* — Appendix F of Statement 142 defines "intangible asset class" as "[a] group of intangible assets that are similar, either by their nature or by their use in the operations of an entity." Intangible asset classes could be, for a specific entity, trade names, newspaper mastheads, operating rights, or broadcast rights. Since pertinent factors may vary, the useful-life determination for an intangible asset in a specific intangible asset class is not determinative for any other intangible asset within that class.

Analyzing the Expected Use of the Asset

10.07 According to paragraph 11(a) of Statement 142, in determining the useful life of an intangible asset, an entity must analyze the "expected use of the asset."

10.08 Example 9 in paragraph A1 of Statement 142 illustrates the impact of a change in the expected use of an asset on the determination of useful life by an entity holding that asset:

> ***A trademark for a line of automobiles that was acquired several years ago in an acquisition of an automobile company.*** The line of automobiles had been produced by the acquired entity for 35 years with numerous new models developed under the trademark. At the acquisition date, the acquiring entity expected to continue to produce that line of automobiles, and an analysis of various economic factors indicated there was no limit to the period of time the trademark would contribute to cash flows. Because cash flows were expected to continue indefinitely, the trademark was not amortized. Management recently decided to phase out production of that automobile line over the next four years.
>
> *Because the useful life of that acquired trademark is no longer deemed to be indefinite, the trademark would be tested for impairment in accordance with paragraph 17 of this Statement. The carrying amount of the trademark after adjustment, if any, would then be amortized over its remaining four-year useful life following the pattern in which the expected benefits will be consumed or otherwise used up. Because the trademark will be subject to amortization, in the future it would be reviewed for impairment under Statement 144.*

Analyzing the Relationship of the Intangible Asset to Other Assets

10.09 According to paragraph 11(b) of Statement 142, determining the useful life of an intangible asset requires analysis of the "expected useful life of another asset or a group of assets to which the useful life of the intangible asset may relate." The relationship of an intangible asset to another asset or group of assets with a shorter useful life may limit the useful life of that intangible asset.

Example 10-1
Analyzing the Relationship of an Intangible Asset to Other Assets

Case A

In recording an acquisition, Company A identified a nontransferable right held by the acquired entity to manufacture a specific product in a given geographic area. The remaining term is 10 years, and A intends to use the right for its full remaining term. However, manufacturing the product, whose sales have steadily declined in recent years, requires significant investment in specialized equipment. The acquired entity is using specialized equipment with an estimated remaining useful life of eight years. Because of the product's declining sales and the investment necessary for replacement equipment, A does not intend to replace the specialized equipment at the end of its estimated useful life. Although the manufacturing right has a remaining contractual term of 10 years, the 8-year term of the specialized equipment, along with management's intention regarding replacement equipment, would effectively limit the useful life of the right to a period shorter than its remaining contractual term.

Example 10-1 (continued)
Analyzing the Relationship of an Intangible Asset to Other Assets

Case B

In recording an acquisition, Company B identified a perpetual right held by the acquired entity to produce electric power in a given geographic area. Pursuant to this right, B will continue to produce electric power at an existing plant after the acquisition. Company B intends to replace this plant at the end of its remaining useful life, which is 30 years. Evidence also indicates that B will be able to construct a replacement plant when needed. Therefore, although the estimated useful life of the existing plant is shorter than the period granted by the right to produce electric power, the estimated useful life of the right to produce electric power would not be shortened, because management has the intention and ability to construct a replacement plant.

Analyzing Legal, Regulatory, or Contractual Provisions That May Limit Useful Life

10.10 According to paragraph 11(c) of Statement 142, determining the useful life of an intangible asset requires analysis of "[a]ny legal, regulatory, or contractual provisions that may limit the useful life."

10.11 Examples 4 and 5 in paragraph A1 of Statement 142 illustrate the analysis of this pertinent factor:

> ***An acquired broadcast license that expires in five years.*** The broadcast license is renewable every 10 years if the company provides at least an average level of service to its customers and complies with the applicable Federal Communications Commission (FCC) rules and policies and the FCC Communications Act of 1934. The license may be renewed indefinitely at little cost and was renewed twice prior to its recent acquisition. The acquiring entity intends to renew the license indefinitely, and evidence supports its ability to do so. Historically, there has been no compelling challenge to the license renewal. The technology used in broadcasting is not expected to be replaced by another technology any time in the foreseeable future. Therefore, the cash flows from that license are expected to continue indefinitely.
>
> *The broadcast license would be deemed to have an indefinite useful life because cash flows are expected to continue indefinitely. Therefore, the license would not be amortized until its useful life is deemed to be no longer indefinite. The license would be tested for impairment in accordance with paragraph 17 of this Statement.*
>
> The FCC subsequently decides that it will no longer renew broadcast licenses, but rather will auction those licenses. At the time the FCC decision is made, the broadcast license has three years until it expires. The cash flows from that license are expected to continue until the license expires.
>
> *Because the broadcast license can no longer be renewed, its useful life is no longer indefinite. Thus, the acquired license would be tested for impairment in accordance with paragraph 17 of this Statement. The license would then be amortized over its remaining three-year useful life following the pattern in which the expected benefits will be consumed or otherwise used up. Because the license will be subject to amortization, in the future it would be reviewed for impairment under Statement 144.*

Analyzing the Entity's Own Historical Experience With Renewing or Extending Similar Arrangements

10.12 According to paragraph 11(d) of Statement 142, as amended by FSP FAS 142-3, determining the useful life of an intangible asset requires analysis of:

> The entity's own historical experience in renewing or extending similar arrangements (consistent with the intended use of the asset by the entity), regardless of whether those arrangements have explicit renewal or extension provisions. In the absence of that experience, the entity shall consider the assumptions that market participants would use about the renewal or extension (consistent with the highest and best use of the asset by market participants), adjusted for entity specific factors in this paragraph [see **10.04**].

10.13 If renewal is not prohibited, entities customarily evaluate the likelihood of renewal or extension to determine the useful life of an intangible asset. An entity should consider its own historical experience in renewing or extending similar arrangements and should not be precluded from considering its own assumptions about renewal or extension. In addition, paragraph 10 of FSP FAS 142-3 states:

> It is common for an income approach to be used to measure the fair value of a recognized intangible asset. In determining the useful life of the asset for amortization purposes, an entity shall consider the period of expected cash flows used to measure the fair value of the recognized intangible asset, adjusted for the entity-specific factors in paragraph 11 of Statement 142. Those entity-specific factors include but are not limited to, the entity's expected use of the asset and the entity's historical experience in renewing or extending similar arrangements.

10.14 Therefore, an entity should look to its valuation model, adjusted for the entity-specific factors in paragraphs 11(a)–(f) of Statement 142 (see **10.04**), for further evidence of the useful life of the intangible asset. The useful life of the intangible asset in the valuation technique is often consistent with its useful life for financial reporting.

10.15 When there is a history of renewal or extension, assets may be renewed perfunctorily. Other situations may require judgment, including those in which the asset has not yet been subject to renewal or extension or in which historical patterns are less uniform. In these instances, the "entity shall consider the assumptions that market participants would use about renewal or extension (consistent with the highest and best use of the asset by market participants)" to determine the useful life of the asset.

10.16 FSP FAS 142-3 provides the following examples for determining the useful life when an entity lacks historical experience:

> **Example 1**
>
> An exclusive, annually renewable technology license with a third party is acquired by an entity that has made significant progress in developing next-generation technology for digital video products. The acquiring entity believes that in two years, after it has completed developing its next-generation products, the acquired technology license will be obsolete because customers will convert to the acquiring entity's products. Market participants, however, are not as advanced in their development efforts and are not aware of the acquiring entity's proprietary development efforts. Thus, those market participants would expect the technology license to be obsolete in three years. The acquiring entity determines that the fair value of the technology license utilizing 3 years of cash flows is $10 million, consistent with the highest and best use of the asset by market participants.
>
> To determine the useful life, the acquiring entity would consider its own historical experience in renewing or extending similar arrangements. In this case, the acquiring entity lacks historical experience in renewing or extending similar arrangements. Therefore, it would consider the assumptions that a market participant would use consistent with the highest and best use of the technology license. However, because the acquiring entity expects to use the technology license until it becomes obsolete in two years, it must adjust the market participants' assumptions for the entity-specific factors in paragraph 11 of Statement 142, specifically paragraph 11(a), which requires consideration of the entity's expected use of the asset. As a result, the technology license would be amortized over a two-year period.
>
> **Example 2**
>
> An insurance company acquired 50 customer relationships associated with contracts that are renewable annually. The acquiring entity determines that the fair value of the customer relationship asset is $10 million considering assumptions (including turnover rate) that a market participant would make consistent with the highest and best use of the asset by market participants. An income approach was used to determine the fair value of the acquired customer relationship asset.

In determining the useful life, the acquiring entity would consider its own historical experience in renewing or extending similar customer relationships. In this case, the acquiring entity concludes that its customer relationships are dissimilar to the acquired customer relationships and, therefore, the acquiring entity lacks historical experience in renewing or extending similar arrangements. Accordingly, the acquiring entity considers turnover assumptions that market participants would make about the renewal or extension of the acquired customer relationships or similar arrangements.

Analyzing the Effects of Obsolescence, Demand, Competition, and Other Economic Factors

10.17 According to paragraph 11(e) of Statement 142, an entity estimates the useful life of an intangible asset by analyzing "[t]he effects of obsolescence, demand, competition, and other economic factors (such as the stability of the industry, known technological advances, legislative action that results in an uncertain or changing regulatory environment, and expected changes in distribution channels)."

10.18 Example 3 in paragraph A1 of Statement 142 illustrates the analysis of this pertinent factor:

> ***An acquired copyright that has a remaining legal life of 50 years.*** An analysis of consumer habits and market trends provides evidence that the copyrighted material will generate cash flows for approximately 30 more years.
>
> *The copyright would be amortized over its 30-year estimated useful life following the pattern in which the expected benefits will be consumed or otherwise used up and reviewed for impairment under Statement 144.*

Analyzing the Level of Maintenance Expenditures

10.19 According to paragraph 11(f) of Statement 142, an entity estimates the useful life of an intangible asset by analyzing "[t]he level of maintenance expenditures required to obtain the expected future cash flows from the asset (for example, a material level of required maintenance in relation to the carrying amount of the asset may suggest a very limited useful life). [Footnote 10]"

10.20 Footnote 10 states, "As in determining the useful life of depreciable tangible assets, regular maintenance may be assumed but enhancements may not."

Determining Whether an Intangible Asset Has an Indefinite Useful Life

10.21 Paragraph 11 of Statement 142 states that "[i]f no legal, regulatory, contractual, competitive, economic, or other factors limit the useful life of an intangible asset to the reporting entity, the useful life of the asset shall be considered to be indefinite. The term *indefinite* does not mean infinite."

10.22 In certain cases the terms of the entity's use of the asset (e.g., trademark) may be indefinite, but the continued ability of the asset to generate cash flows may not be indefinite because of the effects of pertinent factors noted in paragraph 11(a)–(f) of Statement 142 (see **10.04**), such as obsolescence, demand, competition, and other factors. For an intangible asset to be considered to have an indefinite useful life, there can be no foreseeable limit on the period over which the asset is expected to contribute to the cash flows of the reporting entity.

Intangible Assets Subject to Amortization

10.23 Paragraph 12 of Statement 142 states:

> A recognized intangible asset shall be amortized over its useful life to the reporting entity unless that life is determined to be indefinite. If an intangible asset has a finite useful life, but the precise length of that life is not known, that intangible asset shall be amortized over the best estimate of its useful life. The method of amortization shall reflect the pattern in which the economic benefits of the intangible asset are consumed or otherwise used up. If that pattern cannot be reliably determined, a straight-line amortization method shall be used. An intangible asset shall not be written down or off in the period of acquisition unless it becomes impaired during that period. [Footnote 11]

Footnote 11 provides that "both Statement 2 and Interpretation 4 require amounts assigned to acquired intangible assets that are to be used in a particular research and development project and that have no alternative future use to be charged to expense at the acquisition date."

10.24 Paragraph 13 of Statement 142 states:

> The amount of an intangible asset to be amortized shall be the amount initially assigned to that asset less any **residual value**. The residual value of an intangible asset shall be assumed to be zero unless at the end of its useful life to the entity the asset is expected to continue to have a useful life to another entity and (a) the reporting entity has a commitment from a third party to purchase the asset at the end of its useful life or (b) the residual value can be determined by reference to an exchange transaction in an existing market for that asset and that market is expected to exist at the end of the asset's useful life.

10.25 Appendix F of Statement 142 defines "residual value" as "[t]he estimated fair value of an intangible asset at the end of its useful life to an entity, less any disposal costs."

Determining the Useful Life of an Intangible Asset Subject to Amortization Each Reporting Period

10.26 Paragraph 14 of Statement 142 states that "[a]n entity shall 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." Accordingly, after the initial determination of useful life, an entity must identify and evaluate events or circumstances that, if occurring after or changed from the previous determination, may affect the remaining useful life. Some events or circumstances will represent discrete and easily identifiable events to which the entity should readily respond (e.g., a change in regulation). Other events or circumstances may develop more gradually but must be monitored by the entity (e.g., obsolescence, competition, demand).

Accounting for a Change in Remaining Useful Life of an Intangible Asset Subject to Amortization

10.27 Paragraph 14 of Statement 142 states:

> If the estimate of an intangible asset's remaining useful life is changed, the remaining carrying amount of the intangible asset shall be amortized prospectively over that revised remaining useful life. If an intangible asset that is being amortized is subsequently determined to have an indefinite useful life, the asset shall be tested for impairment in accordance with paragraph 17. [For the requirements for testing of intangible assets not subject to amortization, see 10.41.] That intangible asset shall no longer be amortized and shall be accounted for in the same manner as other intangible assets that are not subject to amortization.

Intangible Assets the Acquirer Intends Not to Use or to Use in a Way Other Than Their Highest and Best Use

10.28 As noted in **5.09**, in a business combination or an asset acquisition, an entity may acquire an intangible asset that it does not intend to use to its highest and best use. Paragraph A59 of Statement 141(R) requires the acquiring entity in a business combination to recognize such assets at fair value. For example, an entity may acquire a competitor, including its trade name, in a business combination. In such situations, the acquirer may decide not to use the acquired entity's trade name because it directly competes with its own trade name. If the acquirer would prevent others from using the acquired trade name, then this asset has defensive value because it enhances the value of the acquirer's own trade name (such assets are commonly referred to as defensive value assets).

10.29 Issue 08-7 provides guidance on the subsequent accounting for defensive value assets, and it requires that such assets be assigned a useful life in accordance with paragraph 11 of Statement 142. We believe that entities should account for the useful lives for acquired assets that they do not intend to put to their highest and best use, but will not actively defend, in a similar manner. The Task Force provided the following guidance to assist in the useful life determination:

> A defensive intangible asset shall be assigned a useful life which reflects the entity's consumption of the expected benefits related to that asset. The benefit a reporting entity receives from holding a defensive intangible asset is the [direct and] indirect cash flows resulting from the entity preventing others from realizing any value from the intangible asset (defensively or otherwise). An entity shall determine a defensive intangible asset's useful life, that is, the period over which an entity consumes the expected benefits of the asset, by estimating the period over which the defensive intangible asset will diminish in fair value. The period over which a defensive intangible asset diminishes in fair value is a proxy for the period over which the reporting entity expects a defensive intangible asset to contribute [directly or] indirectly to the future cash flows of the entity.

It would be rare for a defensive intangible asset to have an indefinite life because the fair value of the defensive intangible asset will generally diminish over time as a result of a lack of market exposure or as a result of competitive or other factors. In addition, if an acquired intangible asset meets the definition of a defensive intangible asset, it cannot be considered immediately abandoned.

Recognition and Measurement of an Impairment Loss for Intangible Assets Subject to Amortization

10.30 Paragraph 15 of Statement 142 states:

> An intangible asset that is subject to amortization shall be reviewed for impairment in accordance with FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, by applying the recognition and measurement provisions in paragraphs 7–24 of that Statement. In accordance with Statement 144, an impairment loss shall be recognized if the carrying amount of an intangible asset is not recoverable and its carrying amount exceeds its fair value. After an impairment loss is recognized, the adjusted carrying amount of the intangible asset shall be its new accounting basis. Subsequent reversal of a previously recognized impairment loss is prohibited.

10.31 Under Statement 144, long-lived assets (including finite-lived intangible assets) are tested for recoverability at the asset group level whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. Paragraph 8 of Statement 144 includes a list of factors that may indicate such a change in facts and circumstances (see **10.42**). A two-step test is used to assess long-lived assets for impairment. In step 1, recoverability of the asset group is determined by comparing its carrying value with the sum of its undiscounted cash flows expected to result from the use and eventual disposition of the asset group. If the sum of the undiscounted cash flows exceeds the carrying value of the asset group, the asset group is not deemed impaired. If it does not exceed the carrying value of the asset group, then step 2 must be performed by comparing the fair value of the asset group to its carrying amount. The excess of the carrying value of the asset group over its fair value, if any, would be recognized as an impairment loss.

10.32 See **13.31** for disclosure requirements for intangible asset impairments.

Method of Amortization

10.33 Paragraph 12 of Statement 142 requires that for intangible assets subject to amortization, "[t]he method of amortization shall reflect the pattern in which the economic benefits of the intangible asset are consumed or otherwise used up. If that pattern cannot be reliably determined, a straight-line amortization method shall be used."

10.34 Paragraph B54 of Statement 142 states:

> In considering the methods of amortization, the Board noted that Opinion 17 required that a straight-line method be used to amortize intangible assets unless another method was demonstrated to be more appropriate. However, the Board also noted that circumstances may exist in which another method may be more appropriate, such as in the case of a license that entitles the holder to produce a finite quantity of product. The Board therefore concluded that the amortization method adopted should reflect the pattern in which the asset is consumed if that pattern can be reliably determined, with the straight-line method being used as a default.

10.35 While the example in paragraph B54 of Statement 142 of a license that permits production of a finite quantity of product may provide a reliably determinable pattern of benefits, other situations may not be as clear. For example, if the license instead allowed for unlimited production over a finite period, it is not clear whether the asset should be viewed as consumed on the basis of the estimate of production or on the basis of a lapse in time (since the holder of the right has unlimited access throughout the license period).

10.36 When a method of amortization is based on cash flow estimates, a separate question arises about whether the ratio of period cash flows to total cash should be based on undiscounted or discounted cash flows. Paragraph B12 of proposed FSP FAS 142-d stated:

> The provisions of this FSP require that upon acquisition of a renewable intangible asset the fair value of the asset be attributed to the initial contractual period of use and all future renewal periods based on the relative value of the discounted cash flows each period compared with the total discounted cash flows. The Board discussed whether this attribution should be based on discounted or undiscounted cash flows. The Board noted that in Issue 03-9 the Task Force discussed an amortization methodology that would have been based on undiscounted cash flows. The Task Force decided on the use of undiscounted cash flows to avoid a downward sloping amortization curve for assets with ratable cash flows due solely to the time value of money. The Board observed, however, that the asset's fair value determination by an income approach uses discounted cash flows and, therefore, consistent with paragraph 12 of Statement 142, using discounted cash flows for the attribution of amortization expense better represents the pattern of consumption of the economic benefits of the asset.

10.37 While the FASB voted to remove proposed FSP FAS 142-d from its agenda in May 2006, the issue was subsequently added back to the Board's agenda, which ultimately resulted in the issuance of FSP FAS 142-3. The final FSP, however, did not include any guidance on the method of amortization for intangible assets. In the absence of such guidance, the use of discounted versus undiscounted cash flows will most likely be an accounting policy election that should be consistently applied to all intangible assets subject to amortization.

Intangible Assets Not Subject to Amortization

Determining the Useful Life of an Intangible Asset Not Subject to Amortization Each Reporting Period

10.38 Paragraph 16 of Statement 142 states in part:

> If an intangible asset is determined to have an indefinite useful life, it shall not be amortized until its useful life is determined to be no longer indefinite. An entity shall evaluate the remaining useful life of an intangible asset that is not being amortized each reporting period to determine whether events and circumstances continue to support an indefinite useful life. If an intangible asset that is not being amortized is subsequently determined to have a finite useful life, the asset shall be tested for impairment in accordance with paragraph 17 [see **10.41**]. That intangible asset shall then be amortized prospectively over its estimated remaining useful life and accounted for in the same manner as other intangible assets that are subject to amortization.

In-Process Research and Development Intangible Assets Acquired in a Business Combination

10.39 Paragraph 16 of Statement 142 further states in part:

> Intangible assets acquired in a business combination that are used in research and development activities (regardless of whether they have an alternative future use) shall be considered *indefinite lived* until completion or abandonment of the associated research and development efforts. During the period those assets are considered indefinite lived they shall not be amortized but shall be tested for impairment in accordance with paragraph 17 [see **10.41**]. Once the research and development efforts are completed or abandoned, the entity shall determine the useful life of the assets based on the guidance in this Statement. Consistent with the guidance in paragraph 28 of Statement 144, intangible assets acquired in a business combination that have been temporarily idled shall not be accounted for as if abandoned.

10.40 While acquired assets related to in-process research and development (IPR&D) activities of an acquiree in a business combination may be recognized as intangible assets, Statements 141(R) and 142 do not change the accounting for research and development (R&D) expenditures incurred outside of a business combination. Therefore, subsequent R&D expenditures related to the acquired IPR&D intangible assets should generally be expensed as incurred. See **5.26–5.30** for additional guidance on the initial accounting for acquired IPR&D intangible assets in a business combination.

Example 10-2
In-Process Research and Development Intangible Assets Acquired in a Business Combination

Case A

On June 30, 20X9, Company A acquires Company B in a transaction accounted for as a business combination. Before the acquisition, B had incurred significant costs related to the R&D of a new product, all of which it expensed as incurred in accordance with Statement 2. Company A plans to continue these R&D efforts in hopes of commercializing the product in the future.

Using the acquisition method of accounting, and in a manner consistent with the fair value measurement guidance in Statement 157, A calculates the fair value of the acquired IPR&D assets as $10 million. Therefore, as of the acquisition date, A would record an indefinite-lived intangible asset for $10 million.

On July 1, 20Y2, A concludes that development of the new product is no longer feasible and decides to abandon its project because there is no alternative future use for the acquired IPR&D.

From June 30, 20X9, to June 30, 20Y2, A appropriately tested the acquired IPR&D asset ($10 million) for impairment in accordance with paragraph 17 of Statement 142 and did not record any impairment losses.

Because of its plans to now abandon the project, and the fact that the IPR&D assets have no alternative future use, A would expense the entire IPR&D asset balance of $10 million on July 1, 20Y2 (the date of abandonment), in the income statement.

Case B

Assume the same facts as in Case A but with the following exception: on July 1, 20Y2, Company A successfully completes its IPR&D project and has developed a commercially viable product that it intends to sell in the marketplace.

Per the example above, from June 30, 20X9, to July 1, 20Y2, A appropriately tested the acquired IPR&D asset ($10 million) for impairment in accordance with paragraph 17 of Statement 142 and did not record any impairment losses.

Now A is required to assess the useful life of the acquired IPR&D asset as of July 1, 20Y2 (the date the IPR&D project is successfully completed), and amortize the asset over the related products' useful lives. In other words, the acquired IPR&D asset's useful life is now finite rather than indefinite. In addition, the reclassification to a finite useful life triggers a required impairment test in accordance with paragraph 16 of Statement 142 (see **10.38**) as of July 1, 20Y2.

Recognition and Measurement of an Impairment Loss for Intangible Assets Not Subject to Amortization

10.41 Paragraph 17 of Statement 142 states that:

> An intangible asset that is not subject to amortization shall be tested for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired. (Paragraph 8 of Statement 144 includes examples of impairment indicators.) The impairment test shall consist of a comparison of the fair value of an intangible asset with its carrying amount. If the carrying amount of an intangible asset exceeds its fair value, an impairment loss shall be recognized in an amount equal to that excess. After an impairment loss is recognized, the adjusted carrying amount of the intangible asset shall be its new accounting basis. Subsequent reversal of a previously recognized impairment loss is prohibited.

10.42 Paragraph 8 of Statement 144 lists the following events or circumstances that can indicate that an asset's carrying amount may not be recoverable:

> a. A significant decrease in the market price of a long-lived asset (asset group)
>
> b. A significant adverse change in the extent or manner in which a long-lived asset (asset group) is being used or in its physical condition
>
> c. A significant adverse change in legal factors or in the business climate that could affect the value of a long-lived asset (asset group), including an adverse action or assessment by a regulator
>
> d. An accumulation of costs significantly in excess of the amount originally expected for the acquisition or construction of a long-lived asset (asset group)

> e. A current-period operating or cash flow loss combined with a history of operating or cash flow losses or a projection or forecast that demonstrates continuing losses associated with the use of a long-lived asset (asset group)
>
> f. A current expectation that, *more likely than not*, a long-lived asset (asset group) will be sold or otherwise disposed of significantly before the end of its previously estimated useful life. [Footnote omitted]

10.43 See **13.31** for disclosure requirements for intangible asset impairments.

Timing of the Annual Impairment Test

10.44 Although paragraph 17 of Statement 142 does not explicitly require it, entities with intangible assets not subject to amortization are expected to select a recurring date for testing each indefinite-lived intangible asset or unit of accounting as determined under Issue 02-7. Because of the lack of a specific requirement, however, if an entity changes this recurring date, it does not have to evaluate the change as an accounting change as required by paragraph 26 of Statement 142 when the annual testing date for goodwill is changed (see **11.29**).

Unit of Accounting for Impairment Testing of Indefinite-Lived Intangible Assets

10.45 Paragraph 2 of Issue 02-7 states:

> Questions have arisen on what the appropriate unit of accounting is when testing indefinite-lived intangible assets for impairment. Some entities acquire intangible assets in separate transactions; however, those individual assets are collectively used in a manner that suggests they represent one asset. For example, an entity might acquire, in separate transactions, contiguous easements to support development of a single gas pipeline. In fact patterns such as those, the question is whether the collection of legal rights should be deemed a single unit of accounting for impairment testing purposes (an easement supporting a pipeline) or whether each individually acquired legal right should be separately tested for impairment. Questions also have been raised as to when, if ever, different indefinite-lived intangible assets should be combined into a single "unit of accounting" for impairment testing purposes. An example is whether it is ever appropriate to combine (a) different trade names, (b) a trade name and a different type of indefinite-lived intangible asset such as an easement, or (c) all indefinite-lived intangible assets and test the combined asset for impairment.

10.46 Paragraph 3 of Issue 02-7 states that "[t]he issue is what the unit of accounting should be for purposes of testing indefinite-lived intangible assets for impairment pursuant to paragraph 17 of Statement 142."

10.47 Paragraph 4 of Issue 02-7 states:

> The Task Force reached a consensus that separately recorded indefinite-lived intangible assets, whether acquired or internally developed, should be combined into a single unit of accounting for purposes of testing impairment if they are operated as a single asset and, as such, are essentially inseparable from one another. The Task Force agreed that determining whether several indefinite-lived intangible assets are essentially inseparable is a matter of judgment that depends on the relevant facts and circumstances and that the indicators set forth below should be considered in making that determination. The Task Force agreed that none of the indicators should be considered presumptive or determinative.

Indicators that two or more indefinite-lived intangible assets should be combined as a single unit of accounting for impairment testing purposes:

- The intangible assets were purchased in order to construct or enhance a single asset (that is, they will be used together).
- Had the intangible assets been acquired in the same acquisition they would have been recorded as one asset.
- The intangible assets as a group represent the highest and best use of the assets (for example, they yield the highest price if sold as a group). This may be indicated if (a) it is unlikely that a substantial portion of the assets would be sold separately or (b) the sale of a substantial portion of the intangible assets individually would result in a significant reduction in the fair value of the remaining assets as a group.
- The marketing or branding strategy provides evidence that the intangible assets are complementary, as that term is used in paragraph A16 of Statement 141.

Indicators that two or more indefinite-lived intangible assets should not be combined as a single unit of accounting for impairment testing purposes:

- Each intangible asset generates cash flows independent of any other intangible asset (as would be the case for an intangible asset licensed to another entity for its exclusive use).
- If sold, each intangible asset would likely be sold separately. A past practice of selling similar assets separately is evidence indicating that combining assets as a single unit of accounting may not be appropriate.
- The entity has adopted or is considering a plan to dispose of one or more intangible assets separately.
- The intangible assets are used exclusively by different Statement 144 asset groups.
- The economic or other factors that might limit the useful economic life of one of the intangible assets would not similarly limit the useful economic lives of other intangible assets combined in the unit of accounting.

10.48 Paragraph 5 of Issue 02-7 states:

The Task Force made the following observations about the unit of accounting used to test indefinite-lived intangible assets for impairment.

a. The unit of accounting should include only indefinite-lived intangible assets — those assets cannot be tested in combination with goodwill or with a finite-lived asset.

b. The unit of accounting cannot represent a group of indefinite-lived intangible assets that collectively constitute a business.

c. A unit of accounting may include indefinite-lived intangible assets recorded in the separate financial statements of consolidated subsidiaries. As a result, an impairment loss recognized in the consolidated financial statements may differ from the sum of the impairment losses (if any) recognized in the separate financial statements of those subsidiaries.

d. If the unit of accounting used to test impairment of indefinite-lived intangible assets is contained in a single reporting unit, the same unit of accounting and associated fair value should be used for purposes of measuring a goodwill impairment loss in accordance with paragraph 20 of Statement 142.

10.49 Furthermore, paragraph 5 of Issue 02-7 states:

The Task Force reached a consensus that if, based on a change in the way in which intangible assets are used, a company combines as a unit of accounting for impairment testing purposes indefinite-lived intangible assets that were previously tested for impairment separately, those intangible assets should be separately tested for impairment in accordance with paragraph 17 of Statement 142 prior to being combined as a unit of accounting.

10.50 Exhibit 02-7A of Issue 02-7 provides the following illustrations:

> **Example 1 — Easements**
>
> Company X is a distributor of natural gas. Company X has two self-constructed pipelines, the Northern pipeline and the Southern pipeline. Each pipeline was constructed on land for which Company X owns perpetual easements. The Northern pipeline was constructed on 50 easements acquired in 50 separate transactions. The Southern pipeline was constructed on 100 separate easements that were acquired in a business combination and were recorded as 1 asset. Although each pipeline functions independently of the other, they are contained in the same reporting unit. Operation of each pipeline is directed by a different manager. There are discrete, identifiable cash flows for each pipeline; thus, each pipeline and its related easements represent a separate Statement 144 asset group. While Company X has no current plans to sell or otherwise dispose of any of its easements, Company X believes that if either pipeline was sold, it would most likely convey all rights under the easements with the related pipeline.
>
> **Evaluation:** Company X would have two units of accounting for purposes of testing the easements for impairment — the collection of easements supporting the Northern pipeline and the collection of easements supporting the Southern pipeline. The 50 easements supporting the Northern pipeline represent a single unit of accounting as evidenced by the fact that (a) they are collectively used together in a single Statement 144 asset group, (b) if acquired in a single transaction, they would have been recorded as one asset, and (c) if sold, they would likely be sold as a group with the related pipeline. For the same reasons, the easements supporting the Southern pipeline would represent a single unit of accounting. Because the collective land easements underlying the Northern and Southern pipelines generate cash flows independent of one another and are used exclusively by separate Statement 144 asset groups, they should not be combined into a single unit of accounting.
>
> **Example 2 — Trade Name**
>
> Company Y purchases an international vacuum cleaner manufacturer, Company A, which sells vacuums under a well-known trade name. The operations of Company A are conducted through separate legal entities in three countries and each of those legal entities owns the registered trade name used in that country. When the business combination was recorded, Company Y recorded three separate intangible trade name assets because separate financial statements are required to be prepared for each separate legal entity. There are separate identifiable cash flows for each country, and each country represents a Statement 144 asset group. A single brand manager is responsible for the Company A trade name, the value of which is expected to be recovered from the worldwide sales of Company A's products.
>
> **Evaluation:** The three separately recorded trade name assets should be combined into a single unit of accounting for purposes of testing the acquired trade name for impairment. The three registered trade names were acquired in the same business combination and, absent the requirement to prepare separate financial statements for subsidiaries, would have been recorded as a single asset. The trade name is managed by a single brand manager. If sold, Company X would most likely sell all three legally registered trade names as a single asset.
>
> **Example 3 — Brands**
>
> Company Z manufactures and distributes cereals under two different brands, Brand A and Brand B. Both brands were acquired in the same business combination. Company Z recorded two separate intangible assets representing Brand A and Brand B. Each brand represents a group of complementary indefinite-lived intangible assets including the trademark, the trade dress, and a recipe. Brand A has two underlying trade names for its Honey and Cinnamon cereals. The trade name and recipe of Cinnamon were internally generated subsequent to the acquisition of Brand A. Sales of Honey have decreased while sales of Cinnamon have increased over the past several years. Despite the decline in sales of Honey, the combined sales of Honey and Cinnamon have increased at the levels expected by management. Sales of Brand B also have increased at expected levels. There are discrete cash flows for Honey, Cinnamon, and Brand B, and each represents a separate Statement 144 asset group. Both Honey and Cinnamon are managed by one brand manager. A separate brand manager is responsible

for Brand B; however, there are some shared resources used by these groups, such as procurement. While Company Z has no current plans to sell its brands or exit the cereal business, it believes if it ever did, it would exit the cereal business in its entirety.

Evaluation: Company Z would have two units of accounting for purposes of testing the acquired brands for impairment. Brand A's purchased Honey and internally generated Cinnamon trademarks should be combined as a single unit of accounting for purposes of impairment testing. The intangible asset associated with the Cinnamon trademark is simply a variation of the previously acquired Brand A Honey trademark. Although they are associated with different Statement 144 asset groups, they are managed by a single brand manager. Company Z would consider Brand B to be a separate unit of accounting for purposes of testing impairment because that brand is managed separately from Brand A and is used exclusively by a separate Statement 144 asset group.

Determining the Carrying Amount of an Indefinite-Lived Intangible Asset When Removing That Asset From a Unit of Accounting

10.51 Paragraph 4 of Issue 02-7 states:

> The Task Force reached a consensus that separately recorded indefinite-lived intangible assets, whether acquired or internally developed, should be combined into a single unit of accounting for purposes of testing impairment if they are operated as a single asset and, as such, are essentially inseparable from one another.

10.52 An indefinite-lived intangible asset may need to be removed from a single unit of accounting if that intangible asset is sold separately from the unit of accounting, the unit of accounting is reconsidered (such as in connection with a larger reorganization of the entity), or the entity concludes that the indefinite-lived intangible asset is now finite-lived. The September 29–30, 2004, EITF Agenda Committee Report states that "[q]uestions have arisen about how to determine the carrying amount of an intangible asset that previously was combined with other indefinite-lived intangible assets for impairment testing purposes." It also states that "[t]he Agenda Committee decided not to add this issue to the EITF's agenda."

10.53 In the absence of specific guidance, an entity should determine the carrying amount of an intangible asset that was removed from a unit of accounting under Issue 02-7 on the basis of that intangible asset's historical carrying amount when placed into the unit of accounting less the intangible asset's allocation of any impairments subsequently recognized. Combining indefinite-lived assets into a unit of accounting is done solely for impairment testing; each individually recorded intangible asset does not cease to exist as a separately recorded asset as a result of the combination. Subsequent impairments should be allocated to the intangible assets within the unit of accounting on a pro rata basis by using the relative historical carrying amounts of the individual intangible assets. This approach is consistent with paragraph 14 of Statement 144 regarding the allocation of impairment losses within an asset group. The following examples illustrate these general principles.

Example 10-3
Readily Available Historical Carrying Amount

Company A holds three perpetual easements grouped into a unit of accounting for impairment testing. Easements 1 and 2 were acquired as part of a single transaction for consideration of $100 (no separate assignment of carrying amount to each easement was made at the time of the acquisition). Easement 3 was acquired separately for consideration of $150. No impairment in the carrying amount of the unit of accounting has been recognized subsequently.

Easement 3 was disposed of in connection with the sale of the underlying property to which the easement relates. The carrying amount of the easement disposed of (Easement 3) would be determined on the basis of the readily available historical carrying amount of that easement ($150).

Note: Issue 02-7 states that a "past practice of selling similar assets separately is evidence indicating that combining assets as a single unit of accounting may not be appropriate." While a past practice is only one of the indicators listed in Issue 02-7, entities that dispose of an asset or assets within a unit of accounting must be able to support their unit of accounting conclusions both historically and prospectively in accordance with the other indicators in Issue 02-7.

Example 10-4
Historical Carrying Amount That Is Not Readily Available

Company A holds three perpetual easements grouped into a unit of accounting for impairment testing. Easements 1 and 2 were acquired as part of a single transaction for consideration of $100 (no separate assignment of a carrying amount to each easement was made at the time of the acquisition). Easement 3 was acquired separately for consideration of $150. No impairment in the carrying amount of the unit of accounting has been recognized subsequently.

Easement 1 was disposed of in connection with the sale of the underlying property to which the easement relates. The historical carrying amount of the easement disposed of (Easement 1) is not readily available since no separate assignment of a carrying amount to each easement was made at the time of the acquisition. In the absence of a readily available historical carrying amount, A should develop a reasonable and supportable method to determine the historical carrying amount on the basis of the best evidence of the facts and circumstances existing at the time of the easement's acquisition.

See Note in **Example 10-3**.

Example 10-5
The Impact of a Subsequent Impairment of the Unit of Accounting

Company A holds three perpetual easements grouped into a unit of accounting for impairment testing. Easements 1 and 2 were acquired as part of a single transaction for consideration of $100 (no separate assignment of a carrying amount to each easement was made at the time of the acquisition). Easement 3 was acquired separately for consideration of $150. After the acquisition of the three easements, an impairment of $50 was measured for the unit of accounting.

Easement 3 was disposed of in connection with the sale of the underlying property to which the easement relates. The carrying amount of the easement disposed of (Easement 3) would be determined on the basis of the readily available historical carrying amount of that easement ($150) net of the effect of the subsequent impairment of the unit of accounting. The impairment loss should be allocated to the intangible assets of the unit of accounting on a pro rata basis by using the relative historical carrying amount of those assets, which is consistent with paragraph 14 of Statement 144. The impairment loss allocable to Easement 3 would equal 60 percent ($150 divided by $250) of the total impairment loss of $50, or $30, resulting in a historical carrying amount of Easement 3 equal to $120 ($150 less $30).

See Note in **Example 10-3**.

Carrying Forward the Fair Value Measurements of Indefinite-Lived Intangible Assets From One Year to the Next

10.54 Paragraph 27 of Statement 142 provides guidance on carrying forward fair value measurements of reporting units from one year to the next. Although Statement 142 does not contain guidance on carrying forward fair value measurements of identifiable intangible assets not subject to amortization, such an analogy is reasonable. Accordingly, an entity wishing to carry forward from the previous year the fair value measurement of an intangible asset with an indefinite useful life must carefully analyze the specific facts and circumstances to determine whether the following criteria, adapted from paragraph 27 of Statement 142 (see **11.48**), are met:

- The composition of the unit of accounting as determined under Issue 02-7 "has not changed significantly since the most recent fair value determination."
- The amount of the most recent fair value determination exceeded the carrying amount by a significant margin.
- "Based on an analysis of events that have occurred and circumstances that have changed since the most recent fair value determination, [it is unlikely] that a current fair value determination would be less than the current carrying amount."

10.55 See **14.31** for transitional considerations upon an entity's initial adoption of Statements 141(R) and 157.

Section 11 — Subsequent Accounting for Goodwill

11.01 Appendix F of Statement 142 defines goodwill as "[a]n asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized." Paragraph 18 of Statement 142 notes that "[g]oodwill shall not be amortized. Goodwill shall be tested for impairment at a level of reporting referred to as a reporting unit." Statement 142 requires that an entity with recognized goodwill do the following as of the acquisition date for purposes of subsequent testing of goodwill for impairment:

- Identify reporting units (see **11.05–11.10**).
- Assign assets and liabilities to reporting units (see **11.11–11.19** and **11.24**).
- Assign goodwill to reporting units (see **11.20–11.24**).

11.02 Paragraph 26 of Statement 142 states:

> Goodwill of a reporting unit shall be tested for impairment on an annual basis and between annual tests in certain circumstances (refer to paragraph 28). The annual goodwill impairment test may be performed any time during the fiscal year provided the test is performed at the same time every year. Different reporting units may be tested for impairment at different times. [See **11.25–11.31**.]

11.03 The goodwill impairment test should be performed on the full amount of recorded goodwill (i.e., it should not exclude goodwill attributed to noncontrolling interests). See **7.11**.

11.04 Paragraphs 19–22 of Statement 142 indicate that the two-step impairment test under paragraph 18 "shall be used to identify potential goodwill impairment and measure the amount of a goodwill impairment loss to be recognized (if any)." See **11.32–11.35**.

Identification of Reporting Units

11.05 Paragraph 18 of Statement 142 states that "[g]oodwill shall be tested for impairment at a level of reporting referred to as a reporting unit." Paragraphs 30–31 of Statement 142 describe the identification of reporting units:

> A reporting unit is an operating segment or one level below an operating segment (referred to as a component). [Footnote 17] A component of an operating segment is a reporting unit if the component constitutes a business [footnote 18] for which discrete financial information is available and segment management [footnote 19] regularly reviews the operating results of that component. However, two or more components of an operating segment shall be aggregated and deemed a single reporting unit if the components have similar economic characteristics. [Footnote 20] An operating segment shall be deemed to be a reporting unit if all of its components are similar, if none of its components is a reporting unit, or if it comprises only a single component. The relevant provisions of Statement 131 and related interpretive literature shall be used to determine the reporting units of an entity.
>
> An entity that is not required to report segment information in accordance with Statement 131 is nonetheless required to test goodwill for impairment at the reporting unit level. That entity shall use the guidance in paragraphs 10–15 of Statement 131 to determine its operating segments for purposes of determining its reporting units.

Footnote 17 provides that "[f]or purposes of determining reporting units, an operating segment is as defined in paragraph 10 of FASB Statement No. 131, *Disclosures About Segments of an Enterprise and Related Information*."

Footnote 18 states that "Statement 141(R) includes guidance on determining whether an asset group constitutes a business."(See **1.08**.)

Footnote 19 provides that "[s]egment management consists of one or more segment managers, as that term is defined in paragraph 14 of Statement 131."

Footnote 20 states that "[p]aragraph 17 of Statement 131 shall be considered in determining if the components of an operating segment have similar economic characteristics."

11.06 Paragraph 30 of Statement 142 describes how to identify reporting units (see **11.05**). Guidance on applying paragraph 30 is specified in Topic D-101, which "summarizes the FASB staff's understanding of the Board's intent with respect to the determination of whether a component of an operating segment is a reporting unit."

The steps entities should take in identifying reporting units are as follows:

- **Step 1 — Identify operating segments in accordance with Statement 131.**

  Paragraph 10 of Statement 131 states, in part:

  > An *operating segment* is a component of an enterprise:
  >
  > a. That engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same enterprise),
  >
  > b. Whose operating results are regularly reviewed by the enterprise's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance, and
  >
  > c. For which discrete financial information is available.

- **Step 2 — Identify the components of each operating segment (paragraph 30 of Statement 142 defines a "component" as "one level below an operating segment"). Determine whether each component meets the definition of a reporting unit in steps 2(a)–(c).**

- **Step 2(a) — Determine whether the component constitutes a business.**

  Topic D-101 states:

  > The determination of whether a component constitutes a business requires judgment based on specific facts and circumstances. The guidance in FASB Statement No. 141 (revised 2007), *Business Combinations*, should be considered in determining whether a group of assets constitutes a business [see **1.08**].

- **Step 2(b) — Determine whether "discrete financial information" is available for the component.**

  Topic D-101 states:

  > The term *discrete financial information* should be applied in the same manner that it is applied in determining operating segments in accordance with paragraph 10 of Statement 131. The Statement 131 implementation guidance indicates that it is not necessary that assets be

> allocated for a component to be considered an operating segment (that is, no balance sheet is required). Thus, discrete financial information can constitute as little as operating information. Therefore, in order to test goodwill for impairment in accordance with Statement 142, an entity may be required to assign assets and liabilities to reporting units (consistent with the guidance in paragraphs 32 and 33 of Statement 142).

- **Step 2(c) — Determine whether segment management regularly reviews the operating results of the component.**

  Topic D-101 further notes:

  > Segment management, as defined in paragraph 14 of Statement 131, is either a level below or the same level as the chief operating decision maker. According to Statement 131, a segment manager is "directly accountable to and maintains regular contact with the chief operating decision maker to discuss operating activities, financial results, forecasts, or plans for the segment." The approach used in Statement 142 to determine reporting units is similar to the one used to determine operating segments in Statement 131; however, Statement 142 focuses on how operating segments are managed rather than how the entity as a whole is managed. The approach in Statement 142 is consistent with the Board's intent that reporting units should reflect the way an entity manages its operations.

- **Step 3 — Aggregate components that have similar economic characteristics.**

  Components of an operating segment, which steps 2(a)–(c) established as a business for which discrete financial information is available and segment management regularly reviews the operating results of that component, are aggregated and deemed a single reporting unit if the components have similar economic characteristics.

  Topic D-101 indicates:

  > Evaluating whether two components have similar economic characteristics is a matter of judgment that depends on specific facts and circumstances. That assessment should be more qualitative than quantitative.
  >
  > In determining whether the components of an operating segment have similar economic characteristics, footnote 20 to paragraph 30 of Statement 142 states that the guidance in paragraph 17 of Statement 131 should be considered. The Board intended that all of the factors in paragraph 17 of Statement 131 be considered in making that determination. However, the Board did not intend that every factor must be met in order for two components to be considered economically similar. In addition, the Board did not intend that the determination of whether two components are economically similar be limited to consideration of the factors described in paragraph 17 of Statement 131. In determining whether components should be combined into one reporting unit based on their economic similarities, factors that should be considered in addition to those in paragraph 17 include but are not limited to:
  >
  > - The manner in which an entity operates its business and the nature of those operations
  > - Whether goodwill is recoverable from the separate operations of each component business or from two or more component businesses working in concert (which might be the case if the components are economically interdependent)
  > - The extent to which the component businesses share assets and other resources, as might be evidenced by extensive transfer pricing mechanisms
  > - Whether the components support and benefit from common research and development projects.
  >
  > The fact that a component extensively shares assets and other resources with other components of the operating segment may be an indication that the component either is not a business or may be economically similar to those other components.

Components that share similar economic characteristics but relate to different operating segments may not be combined into a single reporting unit. For example, an entity might have organized its operating segments on a geographic basis. If its three operating segments (Americas, Europe, and Asia) each have two components (A and B) that are dissimilar to each other but similar to the corresponding components in the other operating segments, the entity would *not* be permitted to combine component A from each of the operating segments to make reporting unit A.

Equity Method Investments as Reporting Units

11.07 Question 2 of FASB Staff Implementation Guide (Statement 131) states that equity method investments may be considered operating segments if they qualify under the definition in paragraph 10 of Statement 131. That definition does not require an operating segment to be a business. Therefore, if an equity method investment is an operating segment, it qualifies as a reporting unit in which goodwill could be tested for impairment. However, if an equity method investment is only determined to be a component of an operating segment, it cannot qualify as a separate reporting unit because it will not meet the definition of a business (see **1.08**).

Disclosure Considerations Regarding Reporting Unit Determinations

11.08 See **13.33** for an SEC staff discussion of disclosure considerations related to the identification of reporting units.

Identification of Reporting Units — Examples

11.09 The following examples illustrate the reporting unit structure when the process for identifying reporting units is applied to a hypothetical and limited set of facts. Reporting unit structures will vary among entities depending on their unique facts and circumstances.

Example 11-1
Identification of Reporting Units

Case A

Assume that a parent company has three operating segments and two reportable segments determined in accordance with the provisions of Statement 131.

Step 1 — Identify the operating segments in accordance with Statement 131.

In this case, Operating Segments 1, 2, and 3 are identified.

Step 2 — Identify the components of each operating segment (paragraph 30 of Statement 142 defines a "component" as "one level below an operating segment"). Determine whether each component meets the definition of a reporting unit in steps 2(a)–2(c).

Step 2(a) — Determine whether the component constitutes a business.

Step 2(b) — Determine whether "discrete financial information" is available for the component.

Step 2(c) — Determine whether segment management regularly reviews the operating results of the component.

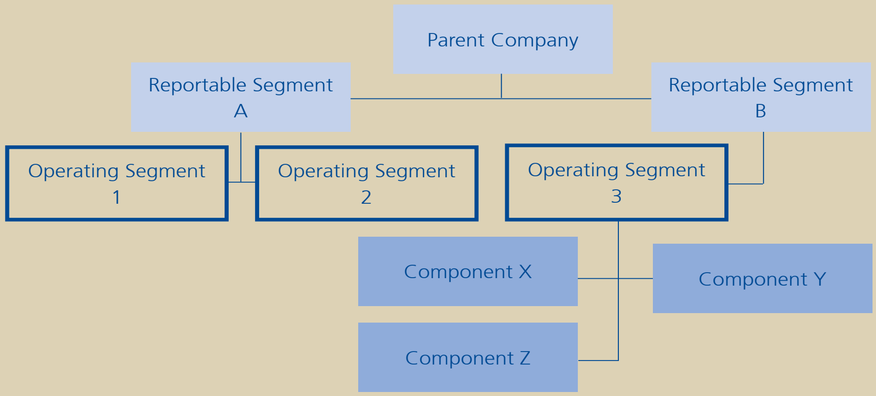
Assume that Operating Segments 1 and 2 are determined to have no components that meet the conditions in steps 2(a)–2(c), while Operating Segment 3 is determined to have three components (X, Y, and Z) that meet the conditions in steps 2(a)–2(c).

Example 11-1 (continued)
Identification of Reporting Units

Step 3 — Aggregate components that have similar economic characteristics.

Assume that Components X, Y, and Z have been determined to have similar economic characteristics.

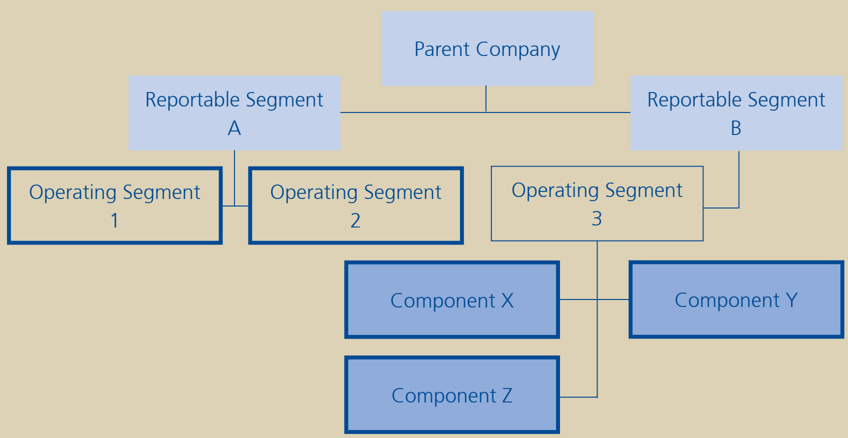
Conclusion — Operating Segments 1, 2, and 3 are reporting units.



Case B

Assume the same facts as Case A except that Components X, Y, and Z have been determined not to possess similar economic characteristics.

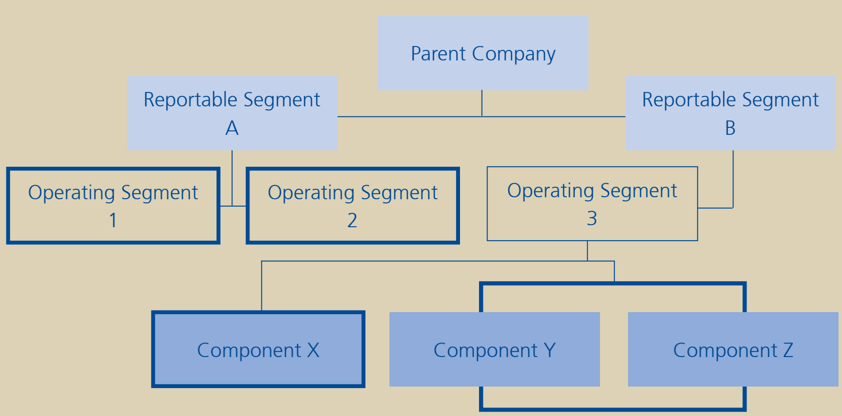
Conclusion — Operating Segment 1, Operating Segment 2, Component X, Component Y, and Component Z are reporting units.



Case C

Assume the same facts as Case A, except that the economic characteristics of Component Y and Component Z are determined to be similar to each other but not to those of Component X.

Conclusion — Operating Segment 1, Operating Segment 2, Component X, and the combination of Component Y and Component Z are reporting units.



Example 11-1 (continued)
Identification of Reporting Units

Case D

Assume that a parent company has three operating segments and two reportable segments determined in accordance with the provisions of Statement 131.

Step 1 — Identify the operating segments in accordance with Statement 131.

In this case, Operating Segments 1, 2, and 3 are identified.

Step 2 — Identify the components of the operating segment (paragraph 30 of Statement 142 defines "component" as "one level below an operating segment"). Determine whether each component meets the definition of a reporting unit in steps 2(a)–2(c).

Step 2(a) — Determine whether the component constitutes a business.

Step 2(b) — Determine whether "discrete financial information" is available for the component.

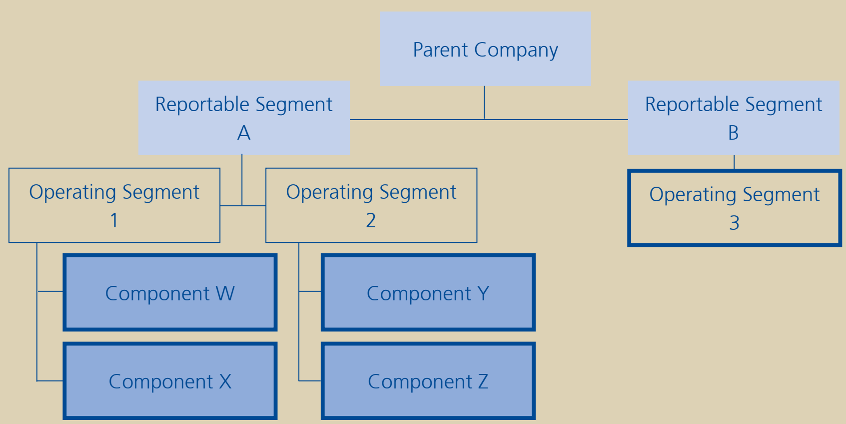
Step 2(c) — Determine whether segment management regularly reviews the operating results of the component.

Assume Operating Segment 1 has two components (Component W and Component X) that meet the conditions in steps 2(a)–2(c); Operating Segment 2 has two components (Component Y and Component Z) that meet the conditions in steps 2(a)–2(c); and Operating Segment 3 has no components that meet the conditions in steps 2(a)–2(c).

Step 3 — Aggregate components that have similar economic characteristics.

Assume that the economic characteristics of Component W of Operating Segment 1 are similar to those of Component Y of Operating Segment 2, but not to those of Component X of Operating Segment 1. Further assume that the economic characteristics of Component Z of Operating Segment 2 are similar to those of Component X of Operating Segment 1 but not to those of Component Y of Operating Segment 2. Because the components with similar economic characteristics (i.e., W/Y and X/Z) are not in the same operating segment, the components are not aggregated or deemed to represent a single reporting unit.

Conclusion — Because the economic characteristics of the components within each operating segment are not similar, Component W, Component X, Component Y, Component Z, and Operating Segment 3 are reporting units.



Comparison of Conclusions Reached Under Statements 131 and 142 in Identifying Operating Segments and Reporting Units, Respectively

11.10 Topic D-101 notes the following regarding the comparison of conclusions reached under Statement 131 and Statement 142 in identifying operating segments and reporting units, respectively:

> Some constituents have noted that two operating segments may have been aggregated into a reportable segment by applying the aggregation criteria in paragraph 17 of Statement 131, and have inquired about whether one or more of the components of those operating segments can be reporting units under Statement 142. The FASB staff believes it would be possible for one or more of those components to be economically dissimilar from the other components and thus be a reporting unit for purposes of testing goodwill for impairment. In particular, the FASB staff believes that the

situation might occur when an entity's operating segments are based on geographic areas. The following points need to be considered in addressing this question:

- The determination of reporting units under Statement 142 begins with the definition of an operating segment in paragraph 10 of Statement 131 and considers *disaggregating* that operating segment into economically dissimilar components for the purpose of testing goodwill for impairment. The determination of reportable segments under Statement 131 also begins with a paragraph 10 operating segment, but considers whether certain economically similar operating segments should be *aggregated* into a single operating segment or into a reportable segment.
- The level at which operating performance is reviewed differs between the two Statements — it is the chief operating decision maker who reviews operating segments and the segment manager who reviews reporting units (components of operating segments). Therefore, a component of an operating segment would not be considered an operating segment for Statement 131 purposes unless the chief operating decision maker regularly reviews its operating performance; however, that same component might be a reporting unit under Statement 142 if a segment manager regularly reviews its operating performance (and if other reporting unit criteria are met).

Assigning Assets and Liabilities to Reporting Units

11.11 Paragraph 32 of Statement 142 states, in part:

> For the purpose of testing goodwill for impairment, acquired assets and assumed liabilities shall be assigned to a reporting unit as of the acquisition date if both of the following criteria are met:
>
> a. The asset will be employed in or the liability relates to the operations of a reporting unit.
>
> b. The asset or liability will be considered in determining the fair value of the reporting unit.

11.12 Paragraph 32 of Statement 142 further states:

> Assets or liabilities that an entity considers part of its corporate assets or liabilities shall also be assigned to a reporting unit if both of the above criteria are met. Examples of corporate items that may meet those criteria and therefore would be assigned to a reporting unit are environmental liabilities that relate to an existing operating facility of the reporting unit and a pension obligation that would be included in the determination of the fair value of the reporting unit. This provision applies to assets acquired and liabilities assumed in a business combination and to those acquired or assumed individually or with a group of other assets.

11.13 Paragraph 33 of Statement 142 states:

> Some assets or liabilities may be employed in or relate to the operations of multiple reporting units. The methodology used to determine the amount of those assets or liabilities to assign to a reporting unit shall be reasonable and supportable and shall be applied in a consistent manner. For example, assets and liabilities not directly related to a specific reporting unit, but from which the reporting unit benefits, could be assigned according to the benefit received by the different reporting units (or based on the relative fair values of the different reporting units). In the case of pension items, for example, a pro rata assignment based on payroll expense might be used. For use in making those assignments, the basis for and method of determining the fair value of the acquiree and other related factors (such as the underlying reasons for the acquisition and managements expectation related to dilution, synergies, and other financial measurements) shall be documented at the acquisition date.

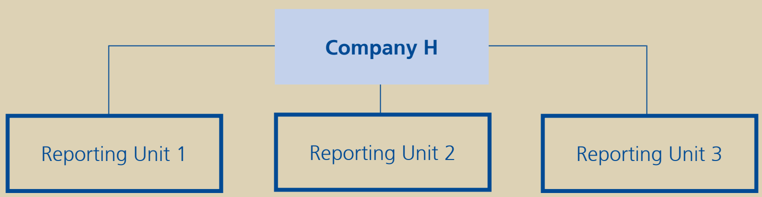
11.14 Paragraph B116 of Statement 142 states, in part:

> The Board concluded that the objective of the assignment process should be to ensure that the assets and liabilities that are assigned to a reporting unit are the same net assets that are considered in determining the fair value of that unit — an "apples-to-apples" comparison. Therefore, to the extent corporate items are reflected in the value of a reporting unit, they should be assigned to the reporting unit.

Example 11-2
Assigning Corporate-Level Assets and Liabilities to Reporting Units

This example illustrates the assignment of assets and liabilities held at the corporate level to reporting units in accordance with the guidance in Statement 142 (see **11.11–11.14**) on the basis of a hypothetical and limited set of facts and circumstances. Because facts and circumstances vary by entity, conclusions also will vary.

Company H Reporting Unit Structure
Company H has identified the following three reporting units:



Company H maintains a corporate function that holds the following assets and liabilities:

Assets		
Building — Net	(a)	$ 5,000,000
Trademark — Net	(b)	40,000,000
Receivable From Reporting Unit 3	(c)	10,000,000
Liabilities		
Accounts Payable	(c)	$ 10,000,000
Environmental Liability	(d)	7,000,000
Pension Obligation	(e)	6,500,000

Assignment of Corporate-Level Assets and Liabilities to Reporting Units

(a) Building — Net

Company H owns a 100,000-square-foot building that serves as the manufacturing facility for Reporting Unit 1. If H were to sell Reporting Unit 1, the building would most likely be included in the overall sales agreement. In accordance with the criteria of paragraph 32 of Statement 142 (see **11.11**), the building will be assigned to Reporting Unit 1 because it (a) is employed in the operations of Reporting Unit 1 and (b) would be considered in the determination of the fair value of Reporting Unit 1.

(b) Trademark — Net

In 1995, Company H acquired a trademark that Reporting Unit 2 continues to use. In accordance with the criteria of paragraph 32 of Statement 142 (see **11.11**), the trademark will be assigned to Reporting Unit 2 because it (a) is employed in the operations of Reporting Unit 2 and (b) would be considered in the determination of the fair value of Reporting Unit 2.

(c) Receivable From Reporting Unit 3 and Related Accounts Payable

Company H recently acquired a large amount of inventory for Reporting Unit 3 to use in producing finished goods. The inventory purchase resulted in $10 million of accounts payable. When Reporting Unit 3 received the inventory, Company H recorded the account payable and a corresponding receivable from Reporting Unit 3. Reporting Unit 3 recorded the inventory and a corresponding payable to Company H. Since the receivable from Reporting Unit 3 and the related accounts payable relate to the same reporting unit and net to zero, no amounts require assignment. In other words, if the accounts payable were assigned to Reporting Unit 3, the receivable from Reporting Unit 3 would be eliminated along with the corresponding payable by Reporting Unit 3 to Company H. Thus, the assignment would have no net effect on Reporting Unit 3.

Example 11-2 (continued)
Assigning Corporate-Level Assets and Liabilities to Reporting Units

(d) Environmental Liability

In May 2003, Company H closed a large manufacturing facility in connection with discontinuing a product line. At the time of the closure, the facility was under inspection by the Environmental Protection Agency. The inspection revealed land contamination requiring remedial action that is not yet complete. The estimated cost of completing the remedial action is recorded by Company H.

In accordance with the criteria of paragraph 32 of Statement 142 (see **11.11**), since the environmental liability will not be employed in or related to the operations of Company H's current reporting units and will not be considered in determining the fair value of any of the current reporting units, the $7 million liability will not be assigned to a specific reporting unit.

(e) Pension Obligation

Company H has established several defined benefit pension plans that cover all employees. The benefits are based on years of service and average compensation. The liability for the pension obligation is maintained only at the corporate level but applies to all employees. Paragraph 32 of Statement 142 indicates that a pension obligation is an example of a corporate item that (a) may relate to the operations (the workforce) of all reporting units, and (b) may also be included in the determination of the fair value of the reporting units. In this example, assume Company H has determined that the criteria for allocating the pension obligation are met.

Paragraph 33 of Statement 142 (see **11.13**) provides that "[s]ome assets or liabilities may be employed in or relate to the operations of multiple reporting units. The methodology used to determine the amount of those assets or liabilities to assign to a reporting unit shall be reasonable and supportable and shall be applied in a consistent manner." Because the pension benefits are based on years of service and average compensation, payroll expense would appear to be a reasonable and supportable method of calculating a pro rata allocation of the liability to each of the three reporting units.

Note that although not present in this example, when assigning pension or other employee benefit liabilities, an entity should consider whether any pension or employee benefit trust assets should be assigned to the reporting unit.

11.15 As a general rule, if an asset or liability would not be included if the reporting unit were to be sold, then no assignment should be made, and that fact should be considered when determining the fair value of the reporting unit.

Assigning Assets and Liabilities When an Entity Has Only One Reporting Unit

11.16 In its November 21, 2002, report, the EITF Agenda Committee noted that it considered the following issues regarding the application of step 1 of the goodwill impairment test:

1. If an entity has only one reporting unit, whether all the entity's assets and liabilities must be assigned to the reporting unit.
2. If the entity has only one reporting unit, when, if ever, it is appropriate to exclude an asset or liability from that reporting unit.

The committee recommended that these two issues not be added to the EITF agenda. Its report stated, however, that "[o]n Issues 1 and 2 above, the Agenda Committee indicated that, in its view, if an entity has only one reporting unit, all of the entity's assets and liabilities should be included in that reporting unit."

Assigning Accumulated Foreign Currency Translation Adjustments to a Reporting Unit

11.17 Paragraph 1 of Issue 01-5 states, in part, "[a]ccumulated foreign currency translation adjustments (CTA) are reclassified to net income only when realized upon sale or upon complete or substantially complete liquidation of the investment in the foreign entity." Paragraph 3 further states, "Statement 52, as interpreted by Interpretation 37, is clear that no basis exists to include the CTA in an impairment assessment if that assessment does not contemplate a planned sale or liquidation that will cause reclassification of some amount of the CTA."

11.18 Questions have arisen in practice about whether the carrying value of a reporting unit that has a CTA balance should be calculated as (1) assets net of liabilities translated at appropriate exchange rates or (2) the equity of the reporting unit less the effect of the CTA.

11.19 Paragraph 3 of Issue 01-5 does not specifically address goodwill impairments. However, when a reporting unit includes or is entirely a foreign entity, analogizing to this guidance results in the inclusion of any related CTA balance in the carrying amount of that reporting unit in the testing of goodwill for impairment only when there is a plan to sell or liquidate the investment in the foreign entity. The existence of such a plan would result in reclassification of some or all of the CTA to net income in accordance with Statement 52 and Interpretation 37. When no such sale or liquidation of the investment in the foreign entity is planned, the carrying value of the reporting unit would comprise its assets net of liabilities translated at appropriate exchange rates as of the date of the test.

Example 11-3
Assigning Accumulated Foreign Currency Translation Adjustments to a Reporting Unit

Company A has Reporting Unit 1, which consists entirely of a business whose operations are based in a foreign country. There is currently no planned sale of Reporting Unit 1. The balance sheet of Reporting Unit 1, translated into U.S. dollars in accordance with Statement 52, is as follows:

Cash	$ 300
PP&E	1,500
Goodwill	200
Total assets	$ 2,000
Liabilities	$ 200
Additional paid-in capital and retained earnings	1,900
Cumulative translation adjustment	(100)
Total liabilities and equity	$ 2,000

Because there is no planned sale of Reporting Unit 1, its carrying value would be $1,800, which is calculated as $2,000 of total assets less $200 of liabilities, both at their appropriately translated amounts as of the reporting date. In addition, the carrying value of Reporting Unit 1's goodwill is $200, which is also its appropriately translated amount as of the reporting date.

Assigning Goodwill to Reporting Units

11.20 Paragraph 34 of Statement 142 states:

> For the purpose of testing goodwill for impairment, all goodwill acquired in a business combination shall be assigned to one or more reporting units as of the acquisition date. Goodwill shall be assigned to reporting units of the acquiring entity that are expected to benefit from the synergies of the combination even though other assets or liabilities of the acquired entity may not be assigned to that reporting unit. The total amount of acquired goodwill may be divided among a number of reporting units. The methodology used to determine the amount of goodwill to assign to a reporting unit shall be reasonable and supportable and shall be applied in a consistent manner. In addition, that methodology shall be consistent with the objectives of the process of assigning goodwill to reporting units described in paragraph 35.

11.21 Paragraph 35 of Statement 142 states:

> In concept, the amount of goodwill assigned to a reporting unit would be determined in a manner similar to how the amount of goodwill recognized in a business combination is determined. An entity would determine the fair value of the acquired business (or portion thereof) to be included in a reporting unit — the fair value of the individual assets acquired and liabilities assumed that are assigned to the reporting unit [footnote omitted]. Any excess of the fair value of the acquired business (or portion thereof) over the fair value of the individual assets acquired and liabilities assumed that are assigned to the reporting unit is the amount of goodwill assigned to that reporting unit. However, if goodwill is to be assigned to a reporting unit that has not been assigned any of the assets acquired or liabilities assumed in that acquisition, the amount of goodwill to be assigned to that unit might be determined by applying a "with and without" computation. That is, the difference between the fair value of that reporting unit before the acquisition and its fair value after the acquisition represents the amount of goodwill to be assigned to that reporting unit.

Example 11-4
Assigning Goodwill to Reporting Units

Case A

Company A acquires Company B for $100. Identifiable net assets of Company B total $80. Company A has two reporting units (RU1 and RU2). Identifiable net assets of Company B totaling $50 will be assigned to RU1, and identifiable net assets totaling $30 will be assigned to RU2. The fair value measurement of the business (or portion thereof) assigned to RU1 is $60, while the fair value measurement of the business (or portion thereof) assigned to RU2 is $40.

Goodwill is assigned to reporting units on the basis of the difference between the fair value of the business (or portion thereof) assigned and the fair value of the identifiable net assets assigned. Under this approach, goodwill is assigned as follows:

	RU1	RU2	Total
Fair value of business (or portion thereof) assigned	$ 60	$ 40	$ 100
Fair value of identifiable net assets assigned	50	30	80
Goodwill assigned	$ 10	$ 10	$ 20

Case B

Company A acquires Company B for $200. Identifiable net assets of Company B total $160. Company A has three reporting units (RU1, RU2, and RU3). Identifiable net assets of Company B totaling $100 will be assigned to RU1, and identifiable net assets totaling $60 will be assigned to RU2. No identifiable net assets will be assigned to RU3; however, RU3 is expected to benefit from the synergies of the combination. The fair value measurement of the business (or portion thereof) assigned to RU1 is $115, and the fair value measurement of the business (or portion thereof) assigned to RU2 is $75. The fair value of RU3 before the acquisition is $200; after the acquisition, it is $210.

Goodwill is assigned to RU1 and RU2 on the basis of the difference between the fair value of the business (or portion thereof) assigned and the fair value of the identifiable net assets assigned. For RU3, goodwill is assigned on the basis of a "with and without" computation. Under this approach, goodwill is assigned as follows:

	RU1	RU2	RU3	Total
Fair value of business (or portion thereof) assigned	$ 115	$ 75	$ 10	$ 200
Fair value of identifiable net assets assigned	100	60	—	160
Goodwill assigned	$ 15	$ 15	$ 10	$ 40

Allocation of Goodwill to Reporting Units for a Mining Enterprise

11.22 Issue 04-4 addresses "whether an entity in the mining industry should assign goodwill to a reporting unit that consists of an individual operating mine." It states:

> Some argue that assigning goodwill to an operating mine results in a day-two impairment of the goodwill. That is, the fair value of the reporting unit only consists of the fair value of the operating mine (primarily mineral deposits) and, accordingly, there is no additional fair value in the reporting unit to support the recognition of goodwill. Others acknowledge that any goodwill assigned to an operating mine ultimately will be impaired because an operating mine is a wasting asset. Some argue that goodwill represents the premium for the exploration and development activities and relates to the enterprise's overall ability to sustain and replicate itself as a going concern entity and, therefore, goodwill should not be assigned to individual operating mines.

11.23 Issue 04-4 further notes:

> The Task Force discussed this Issue and observed that the guidance in Statement 142 is clear — goodwill should be allocated to reporting units and an individual operating mine may constitute a reporting unit. Further, the Task Force acknowledged that the allocation of goodwill to an individual operating mine likely will result in an eventual goodwill impairment due to the wasting nature of the primary asset of the reporting unit and could result in a day-two goodwill impairment. However, the Task Force agreed that because the guidance in Statements 131 and 142 is clear, the Task Force cannot resolve this Issue. Accordingly, the Task Force agreed to discontinue discussion of this Issue and to remove it from the Task Force's agenda.

Reorganization of Reporting Structure — Reassigning Assets, Liabilities, and Goodwill

11.24 Paragraph 36 of Statement 142 states:

> When an entity reorganizes its reporting structure in a manner that changes the composition of one or more of its reporting units, the guidance in paragraphs 32 and 33 shall be used to reassign assets and liabilities to reporting units affected [see **11.11–11.13**]. However, goodwill shall be reassigned to the reporting units affected using a relative fair value allocation approach similar to that used when a portion of a reporting unit is to be disposed of (refer to paragraph 39) [see **11.55**]. For example, if existing reporting unit A is to be integrated with reporting units B, C, and D, goodwill in reporting unit A would be assigned to units B, C, and D based on the relative fair values of the three portions of reporting unit A prior to those portions being integrated with reporting units B, C, and D.

When to Test Goodwill for Impairment

11.25 Paragraph 26 of Statement 142 states:

> Goodwill of a reporting unit shall be tested for impairment on an annual basis and between annual tests in certain circumstances (refer to paragraph 28). [See **11.26**.] The annual goodwill impairment test may be performed any time during the fiscal year provided the test is performed at the same time every year. Different reporting units may be tested for impairment at different times.

11.26 Paragraph 28 of Statement 142 states:

> Goodwill of a reporting unit shall be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. Examples of such events or circumstances include:
>
> a. A significant adverse change in legal factors or in the business climate
>
> b. An adverse action or assessment by a regulator

c. Unanticipated competition

d. A loss of key personnel

e. A more-likely-than-not expectation that a reporting unit or a significant portion of a reporting unit will be sold or otherwise disposed of

f. The testing for recoverability under Statement 144 of a significant asset group within a reporting unit

g. Recognition of a goodwill impairment loss in the financial statements of a subsidiary that is a component of a reporting unit.

11.27 An example of an event that might cause a company to perform a goodwill impairment test between annual dates is a decline in the quoted market price of its equity securities and, thus, its market capitalization. If the underlying cause of the decline in quoted market price is determined to represent an event or change in circumstance that would more likely than not reduce the fair value of the reporting unit below its carrying amount, an interim test of impairment should be performed. Management should seek to identify the underlying cause of the decline to determine whether such an event or change in circumstance has occurred. In addition, when an entity's own securities have not declined significantly in value, management should consider whether a broad market decline or slowing economy indicates a significant adverse change in legal factors or business climate. If so, the entity may need to immediately test goodwill for impairment.

11.28 In addition, goodwill must be tested for impairment after a portion of it has been allocated to a business to be disposed of. (See **11.55**.)

Change in Date of the Annual Goodwill Impairment Test — Preferability Letter Requirements

11.29 Section II.G.2 of the SEC's Current Accounting and Disclosure Issues in the Division of Corporation Finance (as updated November 30, 2006) states the following about a registrant's ability to change the date of annual goodwill impairment testing:

> SFAS 142 requires that goodwill be tested, at the reporting unit level, for impairment on an annual basis. An impairment test also could be triggered between annual tests if an event occurs or circumstances change. A reporting unit is required to perform the annual impairment test at the same time every year, however, nothing precludes a registrant from changing the date of the annual impairment test. If a registrant chooses to change the date of the annual impairment test, it should ensure that no more than 12 months elapse between the tests. The change in testing dates should not be made with the intent of accelerating or delaying an impairment charge. The staff will likely raise concerns if a registrant is found to have changed the date of its annual goodwill impairment test frequently.
>
> Any change to the date of the annual goodwill impairment test would constitute a change in the method of applying an accounting principle, as discussed in paragraph 4 of SFAS 154, and therefore would require justification of the change on the basis of preferability. The registrant is required by Rule 10-01(b)(6) of Regulation S-X to disclose the date of and reason for the change. The registrant is also required by Item 601 of Regulation S-K to file, as an exhibit to the first Form 10-Q or 10-QSB after the date of the change, a letter from the registrant's independent registered public accounting firm indicating whether or not the change is to an alternative principle which in his judgment is preferable under the circumstances. See Staff Accounting Bulletin Topic 6.G.2.b. for additional guidance.

11.30 Paragraph 7 of Statement 154 states:

> An entity shall report a change in accounting principle through retrospective application of the new accounting principle to all prior periods, unless it is impracticable to do so. Retrospective application requires the following:
>
> a. The cumulative effect of the change to the new accounting principle on periods prior to those presented shall be reflected in the carrying amounts of assets and liabilities as of the beginning of the first period presented.
>
> b. An offsetting adjustment, if any, shall be made to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) for that period.
>
> c. Financial statements for each individual prior period presented shall be adjusted to reflect the period-specific effects of applying the new accounting principle.

11.31 Entities should not assume that that a change in their goodwill impairment testing date, when applied to prior periods, will not yield a different financial statement result. For an entity to comply with the requirements of Statement 154, it must demonstrate that such retrospective application of the new goodwill impairment testing date would not yield a different financial statement result or must otherwise show that, pursuant to paragraph 11 of Statement 154, such a determination is impracticable.

Performing the Two-Step Goodwill Impairment Test

11.32 Paragraphs 19–21 of Statement 142 describe the following two-step goodwill impairment test based the fair value determined for each reporting unit (see **11.37–11.49**).

Step 1

Determine whether the fair value of the reporting unit is less than its carrying amount, including goodwill.

If the fair value of the reporting unit is less, proceed to step 2.

If the fair value of the reporting unit is not less, further testing of goodwill for impairment is not performed.

Step 2

Determine the implied fair value of goodwill of the reporting unit by assigning the fair value of the reporting unit used in step 1 to all the assets and liabilities of that reporting unit (including any recognized and unrecognized intangible assets) as if the reporting unit had been acquired in a business combination.

Compare the implied fair value of goodwill to the carrying amount of goodwill to determine whether goodwill is impaired.

Note: Paragraph 21 of Statement 142 provides that the assignment process in **step 2** "shall be performed only for purposes of testing goodwill for impairment; an entity shall not write up or write down a recognized asset or liability, nor should it recognize a previously unrecognized intangible asset as a result of that allocation process."

Example 11-5
Illustration of a Goodwill Impairment Test When the Fair Value of a Reporting Unit Exceeds the Carrying Amount (Step 2 Not Required)

Step 1		**Step 2**
Reporting Unit		**Not Required**
Cash	$ 100	
PP&E	800	
Goodwill	400	
Subtotal	1,300	
Liabilities	(200)	
Carrying amount	1,100	
Fair value of reporting unit	1,200	
Result: Pass step 1*	$ 100	

*Because the fair value of the reporting unit exceeds the carrying amount, no further testing of goodwill for impairment is necessary.

Example 11-6
Illustration of a Goodwill Impairment Test When Step 2 Is Required and Goodwill Impairment Results

Step 1		**Step 2**	
Reporting Unit		**Reporting Unit**	
Cash	$ 100	Cash	$ 100
PP&E	1,100	PP&E	1,200
Goodwill	400	Trademark*	50
Subtotal	1,600	Subtotal	1,350
Liabilities	(200)	Liabilities	(200)
Carrying amount	1,400	Net assets	1,150
Fair value of reporting unit	1,200	Fair value of reporting unit	1,200
Result: Fail step 1*	$ (200)	Implied fair value of goodwill	$ 50
		Carrying amount of goodwill	$ 400
		Impairment amount	$ 350

*Trademark represents a previously unrecognized intangible asset.

Example 11-7

Illustration of a Goodwill Impairment Test When Step 2 Is Required but No Goodwill Impairment Results

Step 1			Step 2		
Reporting Unit			**Reporting Unit**		
Cash	$	100	Cash	$	100
PP&E		1,100	PP&E*		950
Goodwill		400			
Subtotal		1,600	Subtotal		1,050
Liabilities		(200)	Liabilities		(200)
Carrying amount		1,400	Net assets		850
Fair value of reporting unit		1,300	Fair value of reporting unit		1,300
Result: Fail step 1*	$	(100)	Implied fair value of goodwill	$	450
			Carrying amount of goodwill	$	400
			Impairment amount	$	0

*Even though Reporting Unit 1 failed step 1, no goodwill impairment is recognized because the implied fair value of goodwill is $450. The decline in fair value of the reporting unit is due to the decline in fair value of PP&E. Before step 1 of the goodwill impairment test, the PP&E was not considered impaired. See **11.33–11.35** regarding the order of testing long-lived assets and goodwill for impairment.

Interaction of the Goodwill Impairment Test and the Long-Lived Asset Impairment Test

11.33 Calculating the fair value of assets and liabilities under step 2 may reveal that an asset's carrying value is greater than its fair value and that therefore the asset or group of assets should be tested for impairment under Statement 144. If the asset or asset group is impaired, the impairment loss would be recognized before goodwill is tested for impairment. Consequently, step 1 of the goodwill impairment test would need to be performed again.

11.34 Paragraph 29 of Statement 142 states:

> If goodwill and another asset (or asset group) of a reporting unit are tested for impairment at the same time, the other asset (or asset group) shall be tested for impairment before goodwill. For example, if a significant asset group is to be tested for impairment under Statement 144 (thus potentially requiring a goodwill impairment test), the impairment test for the significant asset group would be performed before the goodwill impairment test. If the asset group was impaired, the impairment loss would be recognized prior to goodwill being tested for impairment.

11.35 Because the impairment test for long-lived assets is performed before the impairment test for goodwill, goodwill is less likely to be impaired because writing down long-lived assets will cause the carrying value of the reporting unit to be reduced.

Example 11-8
Interaction Between the Goodwill Impairment Test and the Long-Lived Asset Impairment Test

Step 1		**Step 2**	
Initial Reporting Unit Test		**Reporting Unit**	
Cash	$ 100	Cash	$ 100
PP&E	1,100	PP&E	800
Goodwill	400	Subtotal	900
Subtotal	1,600	Liabilities	(200)
Liabilities	(200)	Net assets	700
Carrying amount	1,400	Fair value of reporting unit	1,200
Fair value of reporting unit	1,200	Implied fair value of goodwill	$ 500
Result: Fail step 1	**$ (200)**	Carrying amount of goodwill	$ 400
		Impairment amount	$ 0

Step 2 of the goodwill impairment test reveals that the fair value of the company's PP&E ($800) is actually less than the carrying value ($1,100). Management believes that because the PP&E is its own asset group, it must be tested for impairment in accordance with Statement 144. As a result of the impairment test, the company records an impairment charge for the PP&E of $300 (assume that step 1 of the impairment test required by Statement 144 was also failed) and performs step 1 of the goodwill impairment test again as shown below.

Step 1		
Subsequent Reporting Unit Test		
Cash	$ 100	
PP&E	800	($1,100 – $300 impairment)
Goodwill	400	
Subtotal	1,300	
Liabilities	(200)	
Carrying amount	1,100	
Fair value of reporting unit	1,200	
Result: Pass step 1	**$ 100**	

Because the fair value of the reporting unit is now greater than the adjusted carrying amount of the reporting unit, the company would not record any impairment charges related to its goodwill. The excess of the reporting unit's carrying amount over its fair value in the initial step 1 test ($200) was created as a result of the impaired PP&E.

Consideration of Assembled Workforce in the Performance of Step 2 of the Goodwill Impairment Test

11.36 As noted in **5.07**, Statement 141(R) does not allow an entity to recognize an intangible asset for an assembled workforce acquired in a business combination. However, an entity may have recognized an intangible asset for an assembled workforce if it acquired the workforce with a group of assets that did not meet the definition of a business. The assembled workforce intangible asset may be part of a reporting unit that is subjected to step 2 of the goodwill impairment test. In performing step 2, an entity would assign no value to the assembled workforce intangible asset because such asset is not recognizable under Statement 141(R).

Fair Value Measurements

11.37 Paragraph 23 of Statement 142 (as amended by paragraph E22 of Statement 157) states:

> The fair value of a reporting unit refers to the price that would be received to sell the unit as a whole in an orderly transaction between market participants at the measurement date. Quoted market prices in active markets are the best evidence of fair value and shall be used as the basis for the measurement, if available. However, the market price of an individual equity security (and thus the market capitalization of a reporting unit with publicly traded equity securities) may not be representative of the fair value of the reporting unit as a whole. Substantial value may arise from the ability to take advantage of synergies and other benefits that flow from control over another entity. Consequently, measuring the fair value of a collection of assets and liabilities that operate together in a controlled entity is different from measuring the fair value of that entity's individual equity securities. An acquiring entity often is willing to pay more for equity securities that give it a controlling interest than an investor would pay for a number of equity securities representing less than a controlling interest. That control premium may cause the fair value of a reporting unit to exceed its market capitalization. The quoted market price of an individual equity security, therefore, need not be the sole measurement basis of the fair value of a reporting unit.

11.38 Paragraph 25 of Statement 142 states:

> In estimating the fair value of a reporting unit, a valuation technique based on multiples of earnings or revenue or a similar performance measure may be used if that technique is consistent with the objective of measuring fair value. Use of multiples of earnings or revenue in determining the fair value of a reporting unit may be appropriate, for example, when the fair value of an entity that has comparable operations and economic characteristics is observable and the relevant multiples of the comparable entity are known. Conversely, use of multiples would not be appropriate in situations in which the operations or activities of an entity for which the multiples are known are not of a comparable nature, scope, or size as the reporting unit for which fair value is being estimated.

11.39 Any valuation technique should incorporate the principles of Statement 157. One of the Statement's overall principles is that the fair value of assets and liabilities should be determined on the basis of assumptions that market participants would use in pricing assets and liabilities.

11.40 Paragraph 23 of Statement 142 (see **11.37**) indicates that measuring the fair value of a reporting unit by referring to the quoted market price of the individual equity securities of that reporting unit (price times quantity) may require adjustment for a control premium. Statement 157 does not amend the guidance in paragraph 23 of Statement 142 regarding a control premium. Accordingly, when the fair value of a reporting unit is measured by reference to quoted market prices of individual equity securities of that reporting unit, the presence of a control premium must be evaluated and, if deemed appropriate, included.

11.41 If individual reporting units do not have separately traded equity securities, it would be inappropriate to allocate the per share market value of the consolidated entity's equity to the individual reporting units.

11.42 Statement 142 does not require a comparison of an entity's market capitalization with the aggregate sum of the fair value of its reporting units as part of an overall assessment of the appropriateness of the fair value measurements of individual reporting units. However, entities often perform such a comparison because it can sometimes yield useful information about the reasonableness of the fair value measurements. The exercise of judgment will be required when the comparison is reviewed for factors that may indicate appropriate differences (e.g., a control premium). Additional estimates or assumptions are required when portions of an entity's business do not have goodwill assigned and thus do not have a requirement for the periodic measurement of fair value. In prepared remarks at the 2008 AICPA National Conference on Current SEC and PCAOB Developments, an SEC staff member (Robert G. Fox III) addressed the staff's view on determining the reasonableness of control premiums:

> … the amount of a control premium in excess of a registrant's market capitalization can require a great deal of judgment. Contrary to some rumors I have heard, the staff does not have "bright line" tests that we use in determining the reasonableness of a control premium. Instead, we believe that a registrant needs to carefully analyze the facts and circumstances of their particular situation when determining an appropriate control premium and that there is normally a range of reasonable judgments a registrant might reach. While it would be prudent to reconcile the combined fair value of your reporting units to your market capitalization, I believe that this should not be viewed as the only factor to consider in assessing goodwill for impairment.

11.43 The SEC staff frequently refers to market capitalization of an entity when commenting about an entity's impairment testing of goodwill. When an enterprise's book value is greater than its market capitalization, questions may be raised about whether such status indicates that goodwill should be tested for impairment or, if goodwill was tested, whether goodwill at one or more reporting units is impaired. Entities should be able to explain how such status affected their judgments in these areas.

11.44 See **3.62–3.63** for discussion about the use of a third-party specialist to assist in the measurement of fair value.

Determining Fair Value When an Entity Has Only One Reporting Unit

11.45 While paragraph 23 of Statement 142 states that "[q]uoted market prices in active markets are the best evidence of fair value," it notes that these market prices may not be representative of fair value as a whole. Therefore, in certain instances when an entity only has one reporting unit, the use of the current quoted market price of its publicly traded securities may not represent the fair value of the entity. For example, a market participant may be willing to pay a premium over current market price to obtain the synergies and other benefits that control would provide (i.e., a control premium).

Changing the Method of Determining the Fair Value of a Reporting Unit

11.46 Although Statement 142 provides guidance on determining the fair value of a reporting unit, it does not indicate whether a consistent method must be used each time the goodwill impairment test is performed. While entities should generally use a consistent method to calculate the fair value of a reporting unit when performing the impairment test, there may be instances when a different method would yield more reliable results. For example, a reporting unit that completes a public offering of its common stock may wish to use the quoted market price of the common stock instead of a present value technique. Under no circumstances should entities change their methods to avoid recognizing a goodwill impairment charge. Similarly, entities should not change methods to accelerate the recording of an impairment charge.

Carrying Forward the Fair Value of a Reporting Unit From One Annual Testing Date to the Next

11.47 An entity does not necessarily have to recalculate the fair value of a reporting unit determined in step 1 of the goodwill impairment test each year. Integral to the FASB's decision that goodwill should be tested for impairment annually was its view that an annual requirement should not call for a "fresh start" effort with every fair value determination. That is, the Board noted that many entities should be able to conclude that the fair value of a reporting unit is greater than its carrying amount without recalculating the fair value of the reporting unit each annual period.

11.48 Paragraph 27 of Statement 142 states:

> A detailed determination of the fair value of a reporting unit may be carried forward from one year to the next if all of the following criteria have been met:
>
> a. The assets and liabilities that make up the reporting unit have not changed significantly since the most recent fair value determination. (A recent significant acquisition or a reorganization of an entity's segment reporting structure is an example of an event that might significantly change the composition of a reporting unit.)
>
> b. The most recent fair value determination resulted in an amount that exceeded the carrying amount of the reporting unit by a substantial margin.
>
> c. Based on an analysis of events that have occurred and circumstances that have changed since the most recent fair value determination, the likelihood that a current fair value determination would be less than the current carrying amount of the reporting unit is remote.

11.49 An entity wishing to carry forward the fair value measurement of a reporting unit from the previous year must carefully analyze the entity's specific situation to determine if the above criteria are met. See **14.31** for additional transitional considerations upon an entity's initial adoption of Statements 141(R) and 157.

Applying the Goodwill Impairment Test to a Reporting Unit With a Negative Carrying Value

11.50 In its November 21, 2002, report, the EITF Agenda Committee noted that it considered the following issue regarding the application of step 1 of the goodwill impairment test:

> If a reporting unit has a negative carrying value, that is, the liabilities of the reporting unit exceed its assets, whether the reporting unit passes Step 1 of the goodwill impairment test solely based on its negative carrying value, assuming its fair value is zero or greater.

Although the report stated that the committee recommended that this issue not be added to the EITF's agenda, it noted:

> [T]he Agenda Committee agreed that paragraph 19 of Statement 142 requires that 'If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired, thus the second step of the impairment test is unnecessary.' While the Agenda Committee members agreed that [the issue] (involving negative carrying value) warranted further consideration, they indicated that resolution of that Issue would require Board involvement and perhaps an amendment to Statement 142.

To date, the FASB has provided no further guidance on this issue.

Deferred Income Tax Considerations in Applying the Goodwill Impairment Test

11.51 Issue 02-13 states:

> In the context of recognizing and measuring impairment of goodwill, questions have arisen regarding how an entity should account for differences between the book and tax bases of assets and liabilities (that is, deferred tax balances) in determining (a) a reporting unit's fair value, (b) a reporting unit's carrying amount, and (c) the implied fair value of goodwill.

The Task Force considered the following issues in Issue 02-13:

> Issue 1 — Whether the fair value of a reporting unit should be estimated by assuming that the unit would be bought or sold in a nontaxable transaction versus a taxable transaction.
>
> Issue 2 — Whether deferred income taxes should be included in the carrying amount of a reporting unit for purposes of Step 1 of the Statement 142 goodwill impairment test.
>
> Issue 3 — For purposes of determining the implied fair value of a reporting unit's goodwill in Step 2 of the Statement 142 goodwill impairment test, what income tax bases an entity should use for a reporting unit's assets and liabilities in order to measure deferred tax assets and liabilities. That is, should an entity use the existing income tax bases or assume new income tax bases for the unit's assets and liabilities.

Paragraphs 4 and 5 of Issue 02-13 state:

> 4. The Task Force reached a consensus on Issue 1 that the determination of whether to estimate the fair value of a reporting unit by assuming that the unit could be bought or sold in a nontaxable transaction versus a taxable transaction is a matter of judgment that depends on the relevant facts and circumstances and must be evaluated carefully on a case-by-case basis. In making that determination, an entity should consider (a) whether the assumption is consistent with those that marketplace participants would incorporate into their estimates of fair value, (b) the feasibility of the assumed structure, and (c) whether the assumed structure results in the highest economic value to the seller for the reporting unit, including consideration of related tax implications.
> 5. The Task Force observed that in determining the feasibility of a nontaxable transaction, an entity should consider, among other factors, (a) whether the reporting unit could be sold in a nontaxable transaction and (b) whether there are any income tax laws and regulations or other corporate governance requirements that could limit an entity's ability to treat a sale of the unit as a nontaxable transaction.

Paragraph 6 of Issue 02-13 provides that "[t]he Task Force reached a consensus on Issue 2 that deferred income taxes should be included in the carrying value of the reporting unit, regardless of whether the fair value of the reporting unit will be determined assuming it would be bought or sold in a taxable or nontaxable transaction."

Paragraphs 7 and 8 of Issue 02-13 state:

> 7. The Task Force reached a consensus on Issue 3 that an entity should use the income tax bases of a reporting unit's assets and liabilities implicit in the tax structure assumed in its estimation of fair value of the reporting unit in Step 1. That is, an entity should use its existing income tax bases if the assumed structure used to estimate the fair value of the reporting unit was a nontaxable transaction, and it should use new income tax bases if the assumed structure was a taxable transaction.

> 8. The Task Force observed that in performing Step 2 of the goodwill impairment test, the implied fair value of a reporting unit's goodwill is determined in the same manner that the amount of goodwill recognized in a business combination accounted for in accordance with Statement 141 is determined. Paragraph 38 of Statement 141 indicates that a deferred tax liability or asset shall be recognized for differences between the assigned values and the income tax bases of the recognized assets acquired and liabilities assumed in a business combination in accordance with paragraph 30 of Statement 109. To the extent present, tax attributes that will be transferred in the assumed tax structure, such as operating loss or tax credit carryforwards, should be valued consistent with the guidance contained in paragraph 135 of Statement 109.

11.52 Examples demonstrating the consensuses reached in Issue 02-13 are given in paragraph 9, which notes that "these examples may not necessarily be indicative of actual income tax liabilities that would arise in the sale of a reporting unit or the relationship of those liabilities in a taxable versus nontaxable structure."

Reporting Requirements When Step 2 of the Goodwill Impairment Test Is Not Complete

11.53 Paragraph 22 of Statement 142 states:

> If the second step of the goodwill impairment test is not complete before the financial statements are issued and a goodwill impairment loss is probable and can be reasonably estimated, the best estimate of that loss shall be recognized in those financial statements. [Footnote omitted] Paragraph 47(c) requires disclosure of the fact that the measurement of the impairment loss is an estimate [see **13.32**]. Any adjustment to that estimated loss based on the completion of the measurement of the impairment loss shall be recognized in the subsequent reporting period.

Goodwill Impairment Testing by a Subsidiary

11.54 Paragraph 37 of Statement 142 states:

> All goodwill recognized by a public or nonpublic subsidiary (subsidiary goodwill) in its separate financial statements that are prepared in accordance with generally accepted accounting principles shall be accounted for in accordance with this Statement. Subsidiary goodwill shall be tested for impairment at the subsidiary level using the subsidiary's reporting units. If a goodwill impairment loss is recognized at the subsidiary level, goodwill of the reporting unit or units (at the higher consolidated level) in which the subsidiary's reporting unit with impaired goodwill resides must be tested for impairment if the event that gave rise to the loss at the subsidiary level would more likely than not reduce the fair value of the reporting unit (at the higher consolidated level) below its carrying amount (refer to paragraph 28(g)). Only if goodwill of that higher-level reporting unit is impaired would a goodwill impairment loss be recognized at the consolidated level.

Example 11-9

Goodwill Impairment Testing by a Subsidiary When the Subsidiary Is Public and Has Goodwill Recorded

Assume Company P (Parent) acquired 100 percent of Company B, electing to retain Company B as a separate corporate entity (Subsidiary B). Subsidiary B, an SEC registrant through the issuance of public debt, has goodwill recorded on its books entirely as a result of the application of push-down accounting by Company P (see **Section 9** for discussion of push-down accounting). In accordance with paragraph 37 of Statement 142, goodwill recognized in the separate financial statements of Subsidiary B must be tested for impairment using the reporting unit structure identified for Subsidiary B. Also, in accordance with paragraph 37 of Statement 142, if a goodwill impairment loss is recognized by Subsidiary B, goodwill of the reporting unit or units at Company P in which Subsidiary B resides must be tested for impairment if the event that gave rise to the loss at Subsidiary B would more likely than not reduce the fair value of the reporting unit at Company P below its carrying amount. Only if goodwill of that higher-level reporting unit is impaired would an impairment of goodwill be recognized at the consolidated level of Company P.

Example 11-10

Goodwill Impairment Testing by a Subsidiary When the Subsidiary Is Nonpublic and Has Goodwill Assigned Under Statement 142

Assume Company P (Parent) acquired 100 percent of Company B, electing to retain Company B as a separate corporate entity (Subsidiary B). Subsidiary B is not an SEC registrant and has no preexisting goodwill recognized. Subsidiary B has been identified as a reporting unit of Company P, which has elected not to apply push-down accounting (see **Section 9** for discussion of push-down accounting). Although Subsidiary B has no goodwill recognized in its separate financial statements, as a reporting unit of Company P, Company P has determined an assignment of goodwill to the reporting unit is necessary. Further assume that separate financial statements for Subsidiary B are prepared in accordance with GAAP for statutory reporting purposes. Although Subsidiary B has separate financial statements prepared in accordance with GAAP, goodwill testing at the separate subsidiary level is not required, since goodwill is not recognized in the separate financial statements of Subsidiary B but is only assigned to Subsidiary B as a reporting unit of Company P.

Disposal of All or a Portion of a Reporting Unit

11.55 Paragraph 39 of Statement 142 states that "[w]hen a reporting unit is to be disposed of in its entirety, goodwill of that reporting unit shall be included in the carrying amount of the reporting unit in determining the gain or loss on disposal."

11.56 Paragraph 39 of Statement 142 further states:

> When a portion of a reporting unit that constitutes a business [footnote omitted] [see **1.08**] is to be disposed of, goodwill associated with that business shall be included in the carrying amount of the business in determining the gain or loss on disposal. The amount of goodwill to be included in that carrying amount shall be based on the relative fair values of the business to be disposed of and the portion of the reporting unit that will be retained. For example, if a business is being sold for $100 and the fair value of the reporting unit excluding the business being sold is $300, 25 percent of the goodwill residing in the reporting unit would be included in the carrying amount of the business to be sold. However, if the business to be disposed of was never integrated into the reporting unit after its acquisition and thus the benefits of the acquired goodwill were never realized by the rest of the reporting unit, the current carrying amount of that acquired goodwill shall be included in the carrying amount of the business to be disposed of. That situation might occur when the acquired business is operated as a stand-alone entity or when the business is to be disposed of shortly after it is acquired. When only a portion of goodwill is allocated to a business to be disposed of, the goodwill remaining in the portion of the reporting unit to be retained shall be tested for impairment in accordance with paragraphs 19–22 (using its adjusted carrying amount).

11.57 Paragraph B166 of Statement 142 states, in part:

> [T]his Statement requires that the relative-fair-value allocation method [see paragraph 39 of Statement 142 and **11.55**] not be used to allocate goodwill to a business being disposed of if that business was not integrated into the reporting unit after its acquisition. Board members noted that those situations (such as when the acquired business is operated as a stand-alone entity) would be infrequent because some amount of integration generally occurs after an acquisition.

Goodwill Impairment Testing and Disposal of All or a Portion of a Reporting Unit When the Reporting Unit Is Less Than Wholly Owned

11.58 Paragraph 39A of Statement 142 states:

> If a reporting unit is less than wholly owned, the fair value of the reporting unit and the implied fair value of goodwill shall be determined in the same manner as it would be determined in a business combination accounted for in accordance with Statement 141(R). Any impairment loss measured in the second step of the goodwill impairment test shall be attributed to the parent and

> the noncontrolling interest on a rational basis. For example, before Statement 141(R) was effective, generally only the goodwill attributable to the parent was recognized. If the reporting unit includes only goodwill attributable to the parent, the goodwill impairment loss would be attributed entirely to the parent [see **14.74**]. However, if the reporting unit includes goodwill attributable to both the parent and the noncontrolling interest, the goodwill impairment loss would be attributed to both the parent and the noncontrolling interest. Similarly, when all or a portion of a less-than-wholly owned reporting unit is disposed of, the gain or loss on disposal shall be attributed to the parent and the noncontrolling interest.

11.59 When assets of a reporting unit that do not constitute a business (as determined under Statement 141(R)) are disposed of, no amount of goodwill is included in the carrying amount of those assets since goodwill is only associated with a business. Goodwill of the reporting unit may, however, require testing for impairment if the disposal is determined to constitute an event or circumstance requiring testing of goodwill of the reporting unit between annual dates (see **11.26**).

Assessing the Impact of Goodwill Assignments on the Determination of Gain or Loss on Disposal of a Reporting Unit

11.60 Paragraph 39 of Statement 142 provides that "[w]hen a reporting unit is to be disposed of in its entirety, goodwill of that reporting unit shall be included in the carrying amount of the reporting unit in determining the gain or loss on disposal." Questions have arisen concerning subsidiaries (constituting reporting units) that issue separate financial statements when parents have assigned an amount of goodwill to those subsidiaries (reporting units) that is different from the amount recorded in the subsidiaries' separate financial statements. When determining the gain or loss on disposal, an entity should include only the amount of goodwill allocated by the parent to the reporting unit to be disposed of in determining the carrying value of that reporting unit. Since the assignment of goodwill to the reporting unit for Statement 142 impairment testing may not have resulted in a formal entry to the accounts of the reporting unit, an adjustment will be necessary at the parent's consolidated level to reclassify goodwill to or from the reporting unit disposed of to properly calculate the parent's gain or loss on disposal. Example 11-11 illustrates these principles.

Example 11-11
Determining Gain or Loss on Disposal of a Reporting Unit With Goodwill Assigned

Assume the following:

- Company A acquired Company B, resulting in goodwill of $200.
- Company A retained Company B as a separate subsidiary (Subsidiary X) and applied push-down accounting in the separate financial statements of Subsidiary X, recognizing $200 of goodwill in these financial statements.
- Company A determined that Subsidiary X represented a separate reporting unit under Statement 142.
- On the basis of the expected synergies of the acquisition of Company B, Company A assigned $150 of the $200 recorded goodwill to Subsidiary X and $50 to Subsidiary Y, a separate reporting unit of Company A.

Illustration 1 — Company A will dispose of Subsidiary X in its entirety.

In determining the gain or loss on the disposal of Subsidiary X, Company A should consider only the assigned goodwill amount of $150. An adjustment will thus be necessary at the parent's consolidated level to exclude $50 of goodwill from the disposed assets of Subsidiary X in order to appropriately account for the gain or loss on disposal.

Illustration 2 — Company A will dispose of Subsidiary Y in its entirety.

In determining the gain or loss on the disposal of Subsidiary Y, Company A should consider the assigned goodwill amount of $50. An adjustment will thus be necessary at the parent's consolidated level to include $50 of goodwill from Subsidiary X with the disposed assets of Subsidiary Y in order to appropriately account for the gain or loss on disposal.

Note: In both Illustration 1 and Illustration 2, the separate historical financial statements of Subsidiary X and Subsidiary Y would not reflect the parent's consolidated-level adjustments. For example, assume Company C acquires Subsidiary X from Company A and is required to present financial statements of Subsidiary X under SEC Regulation S-X, Rule 3-05, "Financial Statements of Businesses Acquired or to Be Acquired." Subsidiary X's historical financial statements would be presented exclusive of any adjustments made by Company A at its consolidated level related to the assignment of goodwill for Statement 142. Therefore, Subsidiary X's historical financial statements would include $200 of goodwill.

Equity Method Investments

11.61 Paragraph 40 of Statement 142 states:

> The portion of the difference between the cost of an investment and the amount of underlying equity in net assets of an equity method investee that is recognized as goodwill in accordance with paragraph 19(b) of APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock* (equity method goodwill) shall not be amortized. However, equity method goodwill shall not be reviewed for impairment in accordance with this Statement. Equity method investments shall continue to be reviewed for impairment in accordance with paragraph 19(h) of Opinion 18.

Example 11-12
Equity Method Investments

Company A purchased a 30 percent interest in Company B for $1,000 and uses the equity method to account for this investment. The fair value of B's recognized net assets is $2,500. Company A would calculate goodwill related to the equity method investment in B as follows:

Purchase price of 30 percent interest in B	$ 1,000
Company A's underlying equity in B's net assets ($2,500 × 30%)	750
Equity method goodwill to be recorded by A	$ 250*

*Note that the equity method goodwill of $250 is presented as part of the overall investment in B. That is, A would not present the $250 separately as "Goodwill" in its balance sheet. Additionally, the example assumes that the entire excess of the purchase price over Company A's equity in B's assets relates to equity method goodwill. It is possible that this excess could relate to certain of B's other assets or liabilities (e.g., a trademark that is not recognized on the books of B, but is recognized as part of A's initial equity method accounting).

11.62 If the cost of the investment in an equity method investee is less than the acquirer's underlying equity in the net assets, a bargain purchase results. Such difference should be accounted for pursuant to the guidance in paragraphs 36–38 of Statement 141(R).

11.63 In a manner consistent with the principle that goodwill related to an equity method investment should not be amortized, an investor should not recognize amortization expense related to its portion of the indefinite-lived intangible assets of the investee. This is consistent with the guidance in paragraph 16 of Statement 142. In addition, investors should not separately test their basis in the investee's indefinite-lived intangible assets for impairment. Rather, in accordance with paragraph 19(h) of Opinion 18, entities should continue to test the total equity method investment for impairment.

11.64 Issue 08-6 states the following:

> An equity method investor is required to recognize other-than-temporary impairments of an equity method investment in accordance with paragraph 19(h) of Opinion 18. An equity method investor shall not separately test an investee's underlying asset(s) for impairment. However, an equity method investor shall recognize its share of any impairment charge recorded by an investee in accordance with paragraphs 19(b) and 19(c) of Opinion 18 and consider the effect, if any, of the impairment on the investor's basis difference in the assets giving rise to the investee's impairment charge.

11.65 While paragraph 37 of Statement 142 would only require a goodwill impairment loss recognized at a subsidiary level to be recognized in the consolidated financial statements if the goodwill of the reporting unit in which the subsidiary resides is also impaired, this would not apply to equity method investments. If an equity method investee recognizes a goodwill impairment charge, the investor should recognize its share of the impairment in its financial statements in the same manner in which other earnings of the investee are recognized by the investor.

Section 12 — Financial Statement Presentation Requirements

Intangible Assets

12.01 The financial statement presentation requirements for intangible assets, whether acquired individually, with a group of other assets, or in a business combination, are specified in Statement 142.

Presentation of Intangible Assets in the Consolidated Statement of Financial Position

12.02 Paragraph 42 of Statement 142 provides that "[a]t a minimum, all intangible assets shall be aggregated and presented as a separate line item in the statement of financial position. However, that requirement does not preclude presentation of individual intangible assets or classes of intangible assets as separate line items."

Presentation of Intangible Asset Amortization Expense and Impairment Losses in the Consolidated Income Statement

12.03 Paragraph 42 of Statement 142 states, in part:

> The amortization expense and impairment losses for intangible assets shall be presented in income statement line items within continuing operations as deemed appropriate for each entity. Paragraphs 14 and 16 require that an intangible asset be tested for impairment when it is determined that the asset should no longer be amortized or should begin to be amortized due to a reassessment of its remaining useful life. An impairment loss resulting from that impairment test shall not be recognized as a change in accounting principle.

12.04 The SEC staff has emphasized that in determining the appropriate income statement classification of intangible asset amortization expense, entities should consider both (1) cost of sales and (2) selling, general, and administrative expense. Accordingly, classification under a general caption such as "amortization expense," even if within continuing operations, may not be deemed appropriate.

12.05 Factors for entities to consider in determining the appropriate income statement classification of intangible asset amortization expense should include, but are not limited to, the function of the intangible asset and the requirements of SEC Regulation S-X, Rule 5-03. For example, if the entity acquires a patent necessary to produce goods for sale, the amortization expense of the patent would generally be presented as a component of cost of sales or a similar expense category.

12.06 Regarding the appropriate income statement classification of amortization expense for intangible assets specific to acquired technology marketed to others, the SEC staff refers to the guidance in Question 17 of FASB Staff Implementation Guide (Statement 86), which addresses the amortization expense presentation of capitalized software costs. Question 17 provides that "[s]ince the amortization relates to a software product that is marketed to others, the expense would be charged to cost of sales or a similar expense category."

Goodwill

12.07 Statement 142 specifies the financial statement presentation requirements for goodwill recognized in accordance with Statement 141(R).

Presentation of Goodwill in the Consolidated Statement of Financial Position

12.08 Paragraph 43 of Statement 142 provides that "[t]he aggregate amount of goodwill shall be presented as a separate line item in the statement of financial position." The goodwill line item in the statement of financial position includes the noncontrolling interest's share of goodwill, if any.

Presentation of Goodwill Impairment Losses in the Consolidated Income Statement

12.09 Paragraph 43 of Statement 142 states:

> The aggregate amount of goodwill impairment losses shall be presented as a separate line item in the income statement before the subtotal income from continuing operations (or similar caption) unless a goodwill impairment loss is associated with a discontinued operation. A goodwill impairment loss associated with a discontinued operation shall be included (on a net-of-tax basis) within the results of discontinued operations.

Noncontrolling Interest in a Subsidiary

12.10 ARB 51, as amended by Statement 160, provides financial statement presentation requirements for noncontrolling interests. Upon adoption of Statement 160, entities should apply such presentation requirements retrospectively for all previously recognized noncontrolling interests.

Presentation of Noncontrolling Interests in the Consolidated Statement of Financial Position

12.11 As discussed in **7.05**, entities must look to other relevant GAAP to determine whether a financial instrument issued by a subsidiary can be classified in shareholders' equity as required by ARB 51, as amended by Statement 160. For instruments that meet the equity criteria, paragraph 26 of ARB 51, as amended by Statement 160, states:

> The noncontrolling interest shall be reported in the consolidated statement of financial position within equity, separately from the parent's equity. That amount shall be clearly identified and labeled, for example, as noncontrolling interest in subsidiaries (paragraph A3). An entity with noncontrolling interests in more than one subsidiary may present those interests in aggregate in the consolidated financial statements.

12.12 The following example of a consolidated statement of financial position is based on the illustration in paragraph A3 of Statement 160:

Example 12-1

XYZ Co.
Consolidated Statement of Financial Position

	As of December 31:	
	20X9	**20X8**
Assets:		
Total Assets	$ 250,000	$ 225,000
Liabilities:		
Total Liabilities	$ 120,000	$ 100,000
Equity:		
XYZ Co. shareholders' equity:		
Common stock ($1 par value)	10,000	10,000
Additional paid-in capital	24,000	24,000
Retained Earnings	80,000	75,000
Accumulated other comprehensive income	4,000	5,000
Total XYZ Co. shareholders' equity	118,000	114,000
Noncontrolling interest	12,000	11,000
Total Equity	130,000	125,000
Total liabilities and equity	$ 250,000	$ 225,000

Presentation of Noncontrolling Interests in the Consolidated Statement of Income

12.13 Paragraph 29 of ARB 51, as amended by Statement 160, states:

> Revenues, expenses, gains, losses, net income or loss, and other comprehensive income shall be reported in the consolidated financial statements at the consolidated amounts, which include the amounts attributable to the owners of the parent and the noncontrolling interest.

12.14 Paragraph 30 of ARB 51, as amended by Statement 160, states, in part:

> Net income or loss and comprehensive income or loss, as described in paragraph 10 of FASB Statement 130, *Reporting Comprehensive Income*, shall be attributed to the parent and the noncontrolling interest.

12.15 Basic and diluted earnings per share, if presented, are calculated solely on the basis of income attributed to the controlling interest's share of its subsidiaries' income. That is, income attributable to noncontrolling interest is excluded from the computation.

12.16 The following example of a consolidated statement of income is based on the illustration in paragraph A4 of Statement 160.

Example 12-2

XYZ Co.
Consolidated Statement of Income

	12-Months Ended December 31:		
	20X9	**20X8**	**20X7**
Revenues	$ 750,000	$ 600,000	$ 500,000
Costs and expenses	(525,000)	(450,000)	(400,000)
Income from continuing operations, before tax	225,000	150,000	100,000
Income taxes	(78,000)	(50,000)	(35,000)
Income from continuing operations	147,000	100,000	65,000
Loss from discontinued operations, net of tax	(25,000)	—	—
Net income	122,000	100,000	65,000
Less: net income attributable to the noncontrolling interest	(27,800)	(20,000)	(13,500)
Net income attributable to XYZ Co.	$ 94,200	$ 80,000	$ 51,500
Basic and diluted earnings per share:			
Income from continuing operations attributable to XYZ Co. common shareholders	$ 0.07	$ 0.05	$ 0.05
Loss from discontinued operations, net of tax, attributable to XYZ Co. common shareholders	(0.01)	—	—
Net income attributable to XYZ Co. common shareholders	$ 0.06	$ 0.05	$ 0.05
Weighted-average number of shares outstanding	2,000,000	1,750,000	1,250,000
Amounts attributable to XYZ Co. common shareholders*			
Income from continuing operations	132,300	90,000	58,500
Loss from discontinued operations, net of tax	(22,500)	—	—
Net Income	$ 109,800	$ 90,000	$ 58,500

* Table can be displayed on the face of the consolidated income statement or in the notes to the consolidated financial statements.

Presentation of Noncontrolling Interests in the Statement of Consolidated Comprehensive Income

12.17 The following statement of comprehensive income is based on the illustration in paragraph A5 of Statement 160. Note that this information can also be presented on the face of the consolidated statement in which comprehensive income is presented.

Example 12-13

XYZ Co.
Statement of Consolidated Comprehensive Income

	12-Months Ended December 31:		
	20X9	**20X8**	**20X7**
Net Income	$ 122,000	$ 100,000	$ 65,000
Other comprehensive income, net of tax:			
Unrealized holding (loss) gain on available-for-sale securities, net of tax	$ (1,000)	$ 3,000	$ 2,000
Foreign currency translation gains	2,000	1,000	3,000
Total other comprehensive income, net of tax	1,000	4,000	5,000
Comprehensive income	123,000	104,000	70,000
Comprehensive income attributable to the noncontrolling interest	(28,000)	(20,800)	(14,500)
Comprehensive income attributable to XYZ Co.	$ 95,000	$ 83,200	$ 55,500

Presentation of Noncontrolling Interests in the Consolidated Statement of Changes in Shareholders' Equity

12.18 As discussed in **7.05**, a parent must look to other relevant GAAP to determine whether a financial instrument issued by a subsidiary and held by a third party can be classified as permanent equity. If so, the financial instrument is considered a noncontrolling interest that is within the scope of Statement 160, and the parent is required to present the following information as required by paragraph 38(c) of ARB 51, as amended by Statement 160:

> Either in the consolidated statement of changes in equity, if presented, or in the notes to the consolidated financial statements, a reconciliation at the beginning and the end of the period of the carrying amount of total equity (net assets), equity (net assets) attributable to the parent, and equity (net assets) attributable to the noncontrolling interest. That reconciliation shall separately disclose (paragraph A6):
>
> (1) Net income
>
> (2) Transactions with owners acting in their capacity as owners, showing separately contributions from and distributions to owners
>
> (3) Each component of other comprehensive income.

The parent can present the above information in the consolidated statement of changes in shareholders' equity, if presented, or in the notes to the consolidated financial statements.

Statement of Cash Flows

Presentation of Acquisition-Related Costs

12.19 When consummating a business combination, an acquirer frequently incurs acquisition-related costs such as advisory, legal, accounting, and valuation fees. Except for certain debt and equity issuance costs, Statement 141(R) requires that an entity expense all such acquisition-related costs as incurred (see **6.31**).

12.20 In the deliberations before the issuance of Statement 141(R), the FASB determined that acquisition-related costs are not considered part of the fair value exchange between the buyer and the seller of the business, but are separate transactions in which the buyer pays for services that it receives. Further, paragraph 21 of Statement 95 states that "[c]ash flows from operating activities are generally the cash effects of transactions and other events that enter into the determination of net income." As direct acquisition costs accounted for under Statement 141(R) are expensed and enter into the determination of net income, these costs should be reflected as operating cash outflows in the statement of cash flows.

Section 13 — Financial Statement Disclosure Requirements

Business Combination Disclosures

13.01 Paragraph 67 of Statement 141(R) states:

> The acquirer shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of a business combination that occurs either:
>
> a. During the current reporting period; or
>
> b. After the reporting date but before the financial statements are issued.

In addition, any adjustments recognized in the current year related to business combinations that occurred in prior reporting periods must be disclosed as required by Paragraph 71 of Statement 141(R).

13.02 Paragraph 73 of Statement 141(R) states that "[i]f the specific disclosures required by this Statement and other GAAP do not meet the objectives set out in paragraphs 67 and 71, the acquirer shall disclose whatever additional information is necessary to meet those objectives."

General Disclosures

13.03 Paragraphs 68(a)–(e) of Statement 141(R) state that an entity must disclose the following for each material business combination that occurs during the reporting period:

a. The name and a description of the acquiree.

b. The acquisition date. [See **3.01**.]

c. The percentage of voting equity interests acquired.

d. The primary reasons for the business combination and a description of how the acquirer obtained control of the acquiree.

e. A qualitative description of the factors that make up the goodwill recognized, such as expected synergies from combining operations of the acquiree and the acquirer, intangible assets that do not qualify for separate recognition, or other factors.

Consideration Transferred

13.04 Paragraph 68(f) of Statement 141(R) states that an entity must disclose the following for each material business combination that occurs during the reporting period:

> The acquisition-date fair value of the total consideration transferred and the acquisition-date fair value of each major class of consideration, such as: [See **Section 6**.]
>
> (1) Cash
>
> (2) Other tangible or intangible assets, including a business or subsidiary of the acquirer
>
> (3) Liabilities incurred, for example, a liability for contingent consideration
>
> (4) Equity 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.

Contingent Consideration and Indemnification Assets

13.05 Paragraph 68(g) of Statement 141(R) indicates that an entity must disclose the following for each material business combination that occurs during the reporting period:

> For contingent consideration arrangements and indemnification assets: [See **6.22** and **4.47**.]
>
> (1) The amount recognized as of the acquisition date
>
> (2) A description of the arrangement and the basis for determining the amount of the payment
>
> (3) An estimate of the range of outcomes (undiscounted) or, if a range cannot be estimated, that fact and the reasons why a range cannot be estimated. If the maximum amount of the payment is unlimited, the acquirer shall disclose that fact.

13.06 In reporting periods after the acquisition date, paragraph 72(b) requires the following disclosures related to contingent consideration arrangements:

> For each reporting period after the acquisition date until the entity collects, sells, or otherwise loses the right to a contingent consideration asset, or until the entity settles a contingent consideration liability or the liability is cancelled or expires:
>
> (1) Any changes in the recognized amounts, including any differences arising upon settlement
>
> (2) Any changes in the range of outcomes (undiscounted) and the reasons for those changes
>
> (3) The disclosures required by paragraph 32 of Statement 157. [See **13.25**.]

Acquired Receivables

13.07 Paragraph 68(h) of Statement 141(R) states that an entity must disclose the following for each material business combination that occurs during the reporting period:

> For acquired receivables not subject to the requirements of AICPA Statement of Position 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer*:
>
> (1) The fair value of the receivables
>
> (2) The gross contractual amounts receivable
>
> (3) The best estimate at the acquisition date of the contractual cash flows not expected to be collected.
>
> The disclosures shall be provided by major class of receivable, such as loans, direct finance leases in accordance with Statement 13, and any other class of receivables.

Assets Acquired and Liabilities Assumed by Major Class

13.08 Paragraph 68(i) of Statement 141(R) provides that an entity must disclose the following for each material business combination that occurs during the reporting period:

> The amounts recognized as of the acquisition date for each major class of assets acquired and liabilities assumed (paragraph A107).

13.09 Paragraph A107 of Statement 141(R) includes an illustrative example of many of the statement's disclosure requirements, including the following table that discloses the amounts recognized as of the acquisition date for each major class of assets acquired and liabilities assumed:

Recognized amounts of identifiable assets acquired and liabilities assumed

Financial assets	3,500
Inventory	1,000
Property, plant, and equipment	10,000
Identifiable intangible assets	3,300
Financial liabilities	(4,000)
Liabilities arising from contingencies	(1,000)
Total identifiable net assets	12,800

Assets and Liabilities Arising From Contingencies

13.10 Paragraph 68(j) of Statement 141(R) states that an entity must disclose the following for each material business combination that occurs during the reporting period:

> For assets and liabilities arising from contingencies: [See **4.32**.]
>
> (1) The amounts recognized at the acquisition date or an explanation of why no amount was recognized (paragraph 24)
>
> (2) The nature of recognized and unrecognized contingencies
>
> (3) An estimate of the range of outcomes (undiscounted) for contingencies (recognized and unrecognized) or, if a range cannot be estimated, that fact and the reasons why a range cannot be estimated.
>
> An acquirer may aggregate disclosures for assets and liabilities arising from contingencies that are similar in nature.

13.11 Paragraph 72(c) requires the following disclosures related to assets and liabilities arising from contingencies in reporting periods **after** the acquisition date:

> For each reporting period after the acquisition date until the acquirer collects, sells, or otherwise loses the right to recognized assets arising from contingencies, or the acquirer settles recognized liabilities or its obligation to settle them is cancelled or expires:
>
> (1) Any changes in the recognized amounts of assets and liabilities arising from contingencies and the reasons for those changes
>
> (2) Any changes in the range of outcomes (undiscounted) for both recognized and unrecognized assets and liabilities arising from contingencies and the reasons for those changes.

Goodwill

13.12 Paragraphs 68(k)–(l) of Statement 141(R) indicates that an entity must disclose the following for each material business combination that occurs during the reporting period:

> k. The total amount of goodwill that is expected to be deductible for tax purposes.
>
> l. If the acquirer is required to disclose segment information in accordance with FASB Statement No. 131, *Disclosures About Segments of an Enterprise and Related Information*, the amount of goodwill by reportable segment. If the assignment of goodwill to reporting units required by Statement 142 has not been completed as of the date the financial statements are issued, the acquirer shall disclose that fact.

Transactions Recognized Separately From the Business Combination

13.13 Paragraphs 68(m)–(n) of Statement 141(R) states that an entity must disclose the following for each material business combination that occurs during the reporting period:

> m. For transactions that are recognized separately from the acquisition of assets and assumptions of liabilities in the business combination (paragraph 57): [See **3.28–3.39**.]
>
> (1) A description of each transaction
>
> (2) How the acquirer accounted for each transaction
>
> (3) The amounts recognized for each transaction and the line item in the financial statements in which each amount is recognized
>
> (4) If the transaction is the effective settlement of a preexisting relationship, the method used to determine the settlement amount.
>
> n. The disclosure of separately recognized transactions required by paragraph 68(m) shall include the amount of acquisition-related costs, the amount recognized as an expense and the line item or items in the income statement in which those expenses are recognized. The amount of any issuance costs not recognized as an expense and how they were recognized also shall be disclosed. [See **6.31**.]

13.14 The disclosures specified in paragraph 68 of Statement 141(R) are only required for business combinations that occur during a reporting period or after the reporting date, but before issuance of the financial statements. Therefore, entities would not be required to disclose the amount of acquisition-related costs incurred before the consummation of a business combination (unless consummation occurs after the reporting date, but before the financial statements have been issued, in which case the guidance in paragraph 70 would be applicable; see **13.23**). SEC registrants, however, must consider the guidance in Regulation S-X, Rule 5-03, to determine whether material acquisition costs need to be separately presented on the face of the income statement or disclosed in the footnotes to the financial statements.

Bargain Purchases

13.15 Paragraph 68(o) of Statement 141(R) provides that an entity must disclose the following for each material business combination that occurs during the reporting period:

> In a **bargain purchase** (paragraphs 36–38): [See **5.42**.]
>
> (1) The amount of any gain recognized in accordance with paragraph 36 and the line item in the income statement in which the gain is recognized
>
> (2) A description of the reasons why the transaction resulted in a gain.

Partial Acquisitions

13.16 Paragraphs 68(p)–(q) of Statement 141(R) state that an entity must disclose the following for each material business combination that occurs during the reporting period:

> p. For each business combination in which the acquirer holds less than 100 percent of the equity interests in the acquiree at the acquisition date: [See **7.07**.]
>
> (1) The fair value of the noncontrolling interest in the acquiree at the acquisition date
>
> (2) The valuation technique(s) and significant inputs used to measure the fair value of the noncontrolling interest.

q. In a business combination achieved in stages: [See **1.28**.]

(1) The acquisition-date fair value of the equity interest in the acquiree held by the acquirer immediately before the acquisition date

(2) The amount of any gain or loss recognized as a result of remeasuring to fair value the equity interest in the acquiree held by the acquirer before the business combination (paragraph 48) and the line item in the income statement in which that gain or loss is recognized.

Additional Disclosures by a Public Business Enterprise

13.17 Paragraph 9 of Statement 131 defines "public business enterprises" as follows:

> Public business enterprises are those business enterprises that have issued debt or equity securities or are conduit bond obligors for conduit debt securities [Footnote 1a] that are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local or regional markets), that are required to file financial statements with the Securities and Exchange Commission, or that provide financial statements for the purpose of issuing any class of securities in a public market.
>
> > Footnote 1a — Conduit debt securities refers to certain limited-obligation revenue bonds, certificates of participation, or similar debt instruments issued by a state or local governmental entity for the express purpose of providing financing for a specific third party (the conduit bond obligor) that is not a part of the state or local government's financial reporting entity. Although conduit debt securities bear the name of the governmental entity that issues them, the governmental entity often has no obligation for such debt beyond the resources provided by a lease or loan agreement with the third party on whose behalf the securities are issued. Further, the conduit bond obligor is responsible for any future financial reporting requirements.

13.18 Paragraph 68(r) of Statement 141(R) states:

> If the acquirer is a public business enterprise, as described in paragraph 9 of Statement 131:
>
> (1) The amounts of revenue and earnings of the acquiree since the acquisition date included in the consolidated income statement for the reporting period
>
> (2) The revenue and earnings 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 (supplemental pro forma information)
>
> (3) If comparative financial statements are presented, the revenue and earnings 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 (supplemental pro forma information).
>
> If disclosure of any of the information required by this subparagraph is impracticable, the acquirer shall disclose that fact and explain why the disclosure is impracticable. This Statement uses the term impracticable with the same meaning as impracticability in paragraph 11 of Statement 154.

13.19 "Impracticability" is defined in paragraph 11 of Statement 154 as follows:

> It shall be deemed impracticable to apply the effects of a change in accounting principle retrospectively only if any of the following conditions exist:
>
> a. After making every reasonable effort to do so, the entity is unable to apply the requirement.
>
> b. Retrospective application requires assumptions about management's intent in a prior period that cannot be independently substantiated.

> c. Retrospective application requires significant estimates of amounts, and it is impossible to distinguish objectively information about those estimates that:
>
> (1) Provides evidence of circumstances that existed on the date(s) at which those amounts would be recognized, measured, or disclosed under retrospective application, and
>
> (2) Would have been available when the financial statements for that prior period were issued. [Footnote omitted]

13.20 Tax benefits of net operating losses of an acquiree before a business combination would not be reflected in the pro forma results of operations in the presentation of the supplemental pro forma information required by Paragraph 68(r) of Statement 141(R) because they would be recognized as either (1) a deferred tax asset in the identification of assets acquired or (2) additional goodwill if a deferred tax asset is not recognized because it is more likely than not that the tax benefits will not be realized. However, disclosures of amounts and expiration dates of net operating losses and reasons for significant variations in the customary relationships between income tax expense and pretax accounting income should be included with presentations of pro forma results of operations.

Immaterial Business Combinations

13.21 Paragraph 69 of Statement 141(R) states:

> For individually immaterial business combinations occurring during the reporting period that are material collectively, the acquirer shall disclose the information required by paragraphs 68(e)–68(r) in the aggregate. [See **13.03–13.20**.]

13.22 Materiality under Statement 141(R) is not the same as significance under Regulation S-X, Rule 3-05. Therefore, registrants must separately determine what financial statement disclosures are required under Statement 141(R) for an individually material business combination (or for individually immaterial business combinations that are collectively material) in the period presented.

Business Combinations Completed After the Balance Sheet Date

13.23 Paragraph 70 of Statement 141(R) provides that "[i]f the acquisition date of a business combination is after the reporting date but before the financial statements are issued, the acquirer shall disclose the information required by paragraph 68 [see **13.03–13.20**] unless the initial accounting for the business combination is incomplete at the time the financial statements are issued. In that situation, the acquirer shall describe which disclosures could not be made and the reason why they could not be made." (See **13.24**.)

Initial Accounting for the Business Combination Is Not Complete

13.24 Paragraph 72(a) of Statement 141 requires an acquirer to disclose the following information for each material business combination. For individually immaterial business combinations that are material collectively and for which the initial accounting for the business combination is not complete, the information must be disclosed in the aggregate. The paragraph states as follows:

> If the initial accounting for a business combination is incomplete (paragraph 51) for particular assets, liabilities, noncontrolling interests, or items of consideration and the amounts recognized in the financial statements for the business combination thus have been determined only provisionally:
>
> (1) The reasons why the initial accounting is incomplete
>
> (2) The assets, liabilities, equity interests, or items of consideration for which the initial accounting

is incomplete

(3) The nature and amount of any measurement period adjustments recognized during the reporting period in accordance with paragraph 55. [See **3.21**.]

Statement 157 Disclosure Considerations (Postcombination)

13.25 Some assets acquired and liabilities assumed (e.g., contingent consideration arrangements classified as liabilities; see **13.06**) may be measured to fair value on a recurring basis after the business combination. In such instances, the following fair value disclosures from paragraph 32 of Statement 157 are required in the postcombination financial statements:

> For assets and liabilities that are measured at fair value on a recurring basis in periods subsequent to initial recognition (for example, trading securities), the reporting entity shall disclose information that enables users of its financial statements to assess the inputs used to develop those measurements and for recurring fair value measurements using significant unobservable inputs (Level 3), the effect of the measurements on earnings (or changes in net assets) for the period. To meet that objective, the reporting entity shall disclose the following information for each interim and annual period (except as otherwise specified) separately for each major category of assets and liabilities:
>
> a. The fair value measurements at the reporting date
>
> b. The level within the fair value hierarchy in which the fair value measurements in their entirety fall, segregating fair value measurements using quoted prices in active markets for identical assets or liabilities (Level 1), significant other observable inputs (Level 2), and significant unobservable inputs (Level 3)
>
> c. For fair value measurements using significant unobservable inputs (Level 3), a reconciliation of the beginning and ending balances, separately presenting changes during the period attributable to the following: [Footnote omitted]
>
> (1) Total gains or losses for the period (realized and unrealized), segregating those gains or losses included in earnings (or changes in net assets), and a description of where those gains or losses included in earnings (or changes in net assets) are reported in the statement of income (or activities)
>
> (2) Purchases, sales, issuances, and settlements (net)
>
> (3) Transfers in and/or out of Level 3 (for example, transfers due to changes in the observability of significant inputs)
>
> d. The amount of the total gains or losses for the period in subparagraph (c)(1) above included in earnings (or changes in net assets) that are attributable to the change in unrealized gains or losses relating to those assets and liabilities still held at the reporting date and a description of where those unrealized gains or losses are reported in the statement of income (or activities)
>
> e. In annual periods only, the valuation technique(s) used to measure fair value and a discussion of changes in valuation techniques, if any, during the period.

Interim Financial Information

13.26 Statement 141(R) does not reduce the disclosure requirements for interim financial information of a public business enterprise. Those in paragraphs 67–73 of Statement 141(R) should be applied in the period in which the business combination occurs. Further, the supplemental pro forma information required by paragraph 68(r) (see **13.18**) should be presented for the current year, the current interim period, and cumulative interim periods from the acquisition date through the end of the current year.

13.27 For SEC registrants, S-X, Rule 10-01(b)(4), provides the following guidance related to pro forma disclosures for material business combinations:

> Where a material business combination accounted for as a purchase has occurred during the current fiscal year, pro forma disclosure shall be made of the results of operations for the current year up to the date of the most recent interim balance sheet provided (and for the corresponding period in the preceding year) as though the companies had combined at the beginning of the period being reported on. This pro forma information shall at a minimum show revenue, income before extraordinary items and the cumulative effect of accounting changes, including such income on a per share basis, and net income and net income per share.

Goodwill and Intangible Assets Disclosures

Disclosures in the Period of Acquisition

13.28 Paragraph 44 of Statement 142 states:

> For intangible assets acquired either individually or as part of a group of assets (in either an asset acquisition or business combination), the following information shall be disclosed in the notes to the financial statements in the period of acquisition:
>
> a. For intangible assets subject to amortization:
>
> (1) The total amount assigned and the amount assigned to any major **intangible asset class** [defined in Appendix F of Statement 142 as "[a] group of intangible assets that are similar, either by their nature or by their use in the operations of an entity"]
>
> (2) The amount of any significant residual value, in total and by major intangible asset class
>
> (3) The weighted-average amortization period, in total and by major intangible asset class
>
> b. For intangible assets not subject to amortization, the total amount assigned and the amount assigned to any major intangible asset class
>
> c. The amount of research and development assets acquired in a transaction other than a business combination and written off in the period and the line item in the income statement in which the amounts written off are aggregated.
>
> This information shall be disclosed separately for each material business combination or in the aggregate for individually immaterial business combinations that are material collectively if the aggregate fair values of intangible assets acquired, other than goodwill, are significant.

Disclosures, Including Segment Information, in Each Period Presented

13.29 Paragraph 45 of Statement 142 states:

> The following information shall be disclosed in the financial statements or the notes to the financial statements for each period for which a statement of financial position is presented:
>
> a. For intangible assets subject to amortization:
>
> (1) The gross carrying amount and accumulated amortization, in total and by major intangible asset class
>
> (2) The aggregate amortization expense for the period
>
> (3) The estimated aggregate amortization expense for each of the five succeeding fiscal years
>
> b. For intangible assets not subject to amortization, the total carrying amount and the carrying amount for each major intangible asset class

c. The changes in the carrying amount of goodwill during the period showing separately:

(1) The gross amount and accumulated impairment losses at the beginning of the period

(2) Additional goodwill recognized during the period, except goodwill included in a disposal group that, on acquisition, meets the criteria to be classified as held for sale in accordance with Statement 144

(3) Adjustments resulting from the subsequent recognition of deferred tax assets during the period in accordance with paragraphs 30 and 30A of Statement 109, as amended

(4) Goodwill included in a disposal group classified as held for sale in accordance with Statement 144 and goodwill derecognized during the period without having previously been reported in a disposal group classified as held for sale

(5) Impairment losses recognized during the period in accordance with this Statement

(6) Net exchange differences arising during the period in accordance with FASB Statement No. 52, *Foreign Currency Translation*

(7) Any other changes in the carrying amounts during the period

(8) The gross amount and accumulated impairment losses at the end of the period.

Entities that report segment information in accordance with Statement 131 shall provide the above information about goodwill in total and for each reportable segment and shall disclose any significant changes in the allocation of goodwill by reportable segment. If any portion of goodwill has not yet been allocated to a reporting unit at the date the financial statements are issued, that unallocated amount and the reasons for not allocating that amount shall be disclosed.

Intangible Assets Subject to Renewal or Extension

13.30 Paragraphs 13–15 of FSP FAS 142-3 state that the following disclosures are required for intangible assets whose terms are subject to renewal or extension:

13. For a recognized intangible asset, an entity shall disclose information that enables users of financial statements to assess the extent to which the expected future cash flows associated with the asset are affected by the entity's intent and/or ability to renew or extend the arrangement.

14. In addition to the required disclosures in paragraphs 44 and 45 of Statement 142 [see **13.28–13.29**], an entity shall disclose the following, where applicable:

a. The entity's accounting policy on the treatment of costs incurred to renew or extend the term of a recognized intangible asset

b. In the period of acquisition or renewal, the weighted-average period prior to the next renewal or extension (both explicit and implicit), by major intangible asset class

c. For an entity that capitalizes renewal or extension costs, the total amount of costs incurred in the period to renew or extend the term of a recognized intangible asset for each period for which a statement of financial position is presented, by major intangible asset class.

15. AICPA Statement of Position 94-6, *Disclosure of Certain Significant Risks and Uncertainties*, provides guidance on when an entity is required to provide disclosures about an estimate. In determining whether disclosures about an estimate are required, the criterion in paragraph 13(b) of SOP 94-6 shall be considered met if the effect of a change in either (a) the useful life or (b) the expected likelihood of renewal or extension of an intangible asset would be material to the financial statements, either individually or in aggregate by major intangible asset class.

Intangible Asset Impairments

13.31 Paragraph 46 of Statement 142 states:

> For each impairment loss recognized related to an intangible asset, the following information shall be disclosed in the notes to the financial statements that include the period in which the impairment loss is recognized:
>
> a. A description of the impaired intangible asset and the facts and circumstances leading to the impairment
>
> b. The amount of the impairment loss and the method for determining fair value
>
> c. The caption in the income statement or the statement of activities in which the impairment loss is aggregated
>
> d. If applicable, the segment in which the impaired intangible asset is reported under Statement 131.

Goodwill Impairments

13.32 Paragraph 47 of Statement 142 states:

> For each goodwill impairment loss recognized, the following information shall be disclosed in the notes to the financial statements that include the period in which the impairment loss is recognized:
>
> a. A description of the facts and circumstances leading to the impairment
>
> b. The amount of the impairment loss and the method of determining the fair value of the associated reporting unit (whether based on quoted market prices, prices of comparable businesses, a present value or other valuation technique, or a combination thereof)
>
> c. If a recognized impairment loss is an estimate that has not yet been finalized (refer to paragraph 22), that fact and the reasons therefore and, in subsequent periods, the nature and amount of any significant adjustments made to the initial estimate of the impairment loss.

Disclosure Considerations Regarding Reporting Unit Determinations

13.33 Section II.L.5 of the SEC's Current Accounting and Disclosure Issues in the Division of Corporation Finance (as updated November 30, 2006) indicates the following:

> Given the impact the identification of reporting units can have on the determination of a goodwill impairment charge, registrants should consider providing disclosure in the critical accounting estimates section of MD&A. This disclosure may be particularly important when the amount of goodwill is material. The disclosure should address how the reporting units were identified, how goodwill is allocated to reporting units, and whether there have been any changes in the number of reporting units, or the manner in which goodwill was allocated. If such changes have taken place, they should be explained.

Noncontrolling Interest in a Subsidiary Disclosures

13.34 Paragraph 5 of Statement 160 indicates that the presentation and disclosure requirements in paragraphs 38 and 39 of ARB 51, as amended by Statement 160, must be applied retrospectively for all periods presented. Retrospective treatment applies to the presentation and disclosure requirements only and not to the accounting for transactions before the adoption of Statement 160 (e.g., prior measurements of gains or losses on deconsolidations).

13.35 Paragraphs 38(a)–(c) of ARB 51, as amended by Statement 160, provide the following disclosure requirements for a parent with one or more less-than-wholly-owned subsidiaries (see examples of financial statement presentation in **12.11–12.18**):

a. Separately, on the face of the consolidated financial statements, the amounts of consolidated net income and consolidated comprehensive income and the related amounts of each attributable to the parent and noncontrolling interest (paragraphs A4 and A5).

b. Either in the notes or on the face of the consolidated income statement, amounts attributable to the parent for the following, if reported in the consolidated financial statements (paragraph A4):

   (1) Income from continuing operations

   (2) Discontinued operations

   (3) Extraordinary items.

c. Either in the consolidated statement of changes in equity, if presented, or in the notes to consolidated financial statements, a reconciliation at the beginning and the end of the period of the carrying amount of total equity (net assets), equity (net assets) attributable to the parent, and equity (net assets) attributable to the noncontrolling interest. That reconciliation shall separately disclose (paragraph A6):

   (1) Net income

   (2) Transactions with owners acting in their capacity as owners, showing separately contributions from and distributions to owners

   (3) Each component of other comprehensive income.

Changes in a Parent's Ownership Interest in a Subsidiary

13.36 Paragraph 38(d) of ARB 51, as amended by Statement 160, provides the following disclosure requirement:

> In notes to the consolidated financial statements, a separate schedule that shows the effects of any changes in a parent's ownership interest in a subsidiary on the equity attributable to the parent (paragraph A7).

13.37 Paragraph A7 of Statement 160 includes the following example to highlight this disclosure requirement:

> **Additional Disclosure If a Parent's Ownership Interest in a Subsidiary Changes during the Period**
>
> This schedule illustrates the requirements in paragraph 38(d) that ABC Co. present in notes to the consolidated financial statements a separate schedule that shows the effects of changes in ABC Co.'s ownership interest in its subsidiary on ABC Co.'s equity. This schedule is only required if the parent's ownership interest in a subsidiary changes in any periods presented in the consolidated financial statements.

Example 13-1

ABC Co.
Notes to Consolidated Financial Statements
Net Income Attributable to ABC Co. and Transfers (to) From the Noncontrolling Interest
Year Ended December 31

The purpose of this schedule is to disclose the effects of changes in ABC Co.'s ownership interest in its subsidiary on ABC Co.'s equity.

	20X3	**20X2**	**20X1**
Net income attributable to ABC Co.	$ 37,500	$ 22,000	$ 30,000
Transfers (to) from the noncontrolling interest			
Increase in ABC Co.'s paid-in capital for sale of 2,000 Subsidiary A common shares	—	10,000	—
Decrease in ABC Co.'s paid-in capital for purchase of 1,000 Subsidiary A common shares	(8,000)	—	—
Net transfers (to) from noncontrolling interest	(8,000)	10,000	—
Change from net income attributable to ABC Co. and transfers (to) from noncontrolling interest	$ 29,500	$ 32,000	$ 30,000

13.38 Note that if the parent's ownership interest changes, paragraph 34 of ARB 51, as amended by Statement 160, requires that the entity reallocate accumulated other comprehensive income, if any, between the parent and the noncontrolling interest. However, the separate schedule, as illustrated above, should exclude the effects of this reallocation.

Excess Losses

13.39 Statement 160 amends ARB 51 to require losses to be attributed to the noncontrolling interest even if a deficit balance results (see **7.18**). Paragraph 6 of Statement 160 states:

> If, in the year of adoption, an entity's consolidated net income attributable to the parent would have been significantly different had the previous requirement in paragraph 15 of ARB 51 been applied, the entity shall disclose pro forma consolidated net income attributable to the parent and pro forma earnings per share as if the previous requirement in paragraph 15 of ARB 51 had been applied in the year of adoption.

Other

Deconsolidations

13.40 A parent deconsolidates a subsidiary when a controlling interest no longer exists. Paragraph 39 of ARB 51, as amended by Statement 160, provides the following disclosure requirements by the parent when a subsidiary is deconsolidated:

> a. The amount of any gain or loss recognized in accordance with paragraph 36 [see **7.27**]
>
> b. The portion of any gain or loss related to the remeasurement of any retained investment in the former subsidiary to its fair value
>
> c. The caption in the income statement in which the gain or loss is recognized unless separately presented on the face of the income statement.

Under paragraph 39(a) the former parent is not required to disclose the gain or loss amount as if Statement 160 had been applied (pro forma) for dispositions before adoption of Statement 160. See **13.34**.

Income Taxes

13.41 See **8.74–8.76** for income tax disclosures related to business combinations.

Section 14 — Transition Requirements and Other Adoption Considerations

Statement 141(R)

14.01 Statement 141(R) is effective prospectively for fiscal years beginning on or after December 15, 2008. Early adoption is not permitted. Paragraph 75 of Statement 141(R) states:

> 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.

14.02 Therefore, Statement 141(R) will generally only affect the accounting for business combinations that are consummated after its effective date, with two exceptions:

- Certain income tax balances recognized in prior business combinations (see **14.03–14.10**).
- Business combinations between two or more mutual entities that were accounted for by using the purchase method (see **14.39–14.45**).

Example 14-1
Effective Date

Company A, which has a December 31 year-end, obtains control of Company X on November 30, 2008, in a transaction accounted for as a business combination under Statement 141. Company A does not finalize its business combination accounting before its fiscal year-end on December 31, 2008. That is, A's allocation period extends into 2009.

Because the acquisition date of X preceded the effective date of Statement 141(R), A must account for this business combination in accordance with Statement 141, with an exception for certain income tax balances (as described in **14.03–14.10**).

Income Taxes

14.03 Paragraph 77 of Statement 141(R) provides the following transition guidance regarding certain income tax balances:

> For business combinations in which the acquisition date was before the effective date of this Statement, the acquirer shall apply the requirements of Statement 109, as amended by this Statement, prospectively. That is, the acquirer shall not adjust the accounting for prior business combinations for previously recognized changes in acquired tax uncertainties or previously recognized changes in the valuation allowance for acquired deferred tax assets. However, after the effective date of this Statement:
>
> a. The acquirer shall recognize, as an adjustment to income tax expense (or a direct adjustment to contributed capital in accordance with paragraph 26 of Statement 109), changes in the valuation allowance for acquired deferred tax assets.
>
> b. The acquirer shall recognize changes in the acquired income tax positions in accordance with Interpretation 48, as amended by this Statement.

Changes in the Valuation Allowance for Acquired Deferred Tax Assets

14.04 In some business combinations, the acquirer recognizes, as of the acquisition date, a valuation allowance related to certain acquired deferred tax assets.

14.05 Before Statement 141(R), the acquirer generally accounted for any subsequent decrease in the valuation allowance that is related to acquired deferred tax assets as a reduction of goodwill related to the acquisition, regardless of whether such a decrease occurred during the allocation period or thereafter. If no goodwill remained related to the acquisition, the acquirer then reduced other noncurrent intangible assets to zero and recorded any remaining credit as a reduction of income tax expense. Increases in valuation allowances were generally recorded as a component of income tax expense under Statement 141, which is consistent with the accounting under Statement 141(R).

14.06 Upon adopting Statement 141(R), the acquirer must record all adjustments of valuation allowances related to acquired deferred tax assets in accordance with paragraph 30A (added by Statement 141(R)) of Statement 109, including adjustments to deferred tax valuation allowances recorded as part of business combinations consummated before the effective date of Statement 141(R). Paragraph 30A of Statement 109 requires the following:

> The effect of a change in a valuation allowance for an acquired entity's deferred tax asset shall be recognized as follows:
>
> a. Changes within the measurement period [footnote omitted] [see **3.16**] that result from new information about facts and circumstances that existed at the acquisition date shall be recognized through a corresponding adjustment to goodwill. However, once goodwill is reduced to zero, an acquirer shall recognize any additional decrease in the valuation allowance as a bargain purchase in accordance with paragraphs 36–38 of Statement 141(R). [See **5.42**.]
>
> b. All other changes shall be reported as a reduction or increase to **income tax expense** (or a direct adjustment to contributed capital as required by paragraph 26). [Emphasis added]

Changes in Acquired Income Tax Positions

14.07 In some business combinations, the acquirer records a liability associated with tax uncertainties that exist at the time of, or that arise in connection with, a business combination.

14.08 Before Statement 141(R), the acquirer generally recorded subsequent adjustments to uncertain tax positions arising from a business combination through goodwill, in accordance with Issue 93-7, regardless of whether such adjustments occurred during the allocation period or thereafter. If goodwill attributable to the acquisition was reduced to zero, the acquirer then reduced other noncurrent intangible assets related to that acquisition to zero and recorded any remaining credit as a reduction of income tax expense.

14.09 Upon adopting Statement 141(R), the acquirer must record all changes to acquired tax positions in accordance with paragraph 12B (added by Statement 141(R)) of Interpretation 48, including adjustments to acquired tax positions recorded as part of business combinations consummated before the effective date of Statement 141(R). Paragraph 12B of Interpretation 48 states:

> The effect of a change to an acquired tax position, or those that arise as a result of the acquisition, shall be recognized as follows:
>
> a. Changes within the measurement period that result from new information about facts and circumstances that existed as of the acquisition date shall be recognized through a corresponding adjustment to goodwill. However, once goodwill is reduced to zero, the remaining portion of that adjustment shall be recognized as a gain on a bargain purchase in accordance with paragraphs 36–38 of Statement 141(R). [See **5.42**.]
>
> b. All other changes in acquired income tax positions shall be accounted for in accordance with this Interpretation.

14.10 Under Statement 141(R), the acquirer generally records all changes in the acquired tax position outside of the measurement period as a reduction or increase to income tax expense.

Example 14-2
Allocation (Measurement) Period Ends Before the Adoption of Statement 141(R)

Company A, a calendar-year-end company, acquired 100 percent of Company M on July 1, 2007, in a transaction accounted for as a business combination under Statement 141. As part of the transaction, A recorded (1) goodwill of $500 and (2) a deferred tax asset of $100 related to M's operating loss carryforwards, with a full valuation allowance of $100.

On September 30, 2008, after the allocation period, A changed its estimate of the deferred tax asset valuation allowance to $75. Under Statement 141, A adjusted its business combination accounting by crediting goodwill for $25.

Company A adopts Statement 141(R) on January 1, 2009. On March 31, 2009, A again changes its deferred tax asset valuation allowance, this time to $30. Under Statement 141(R), A records the entire adjustment of $45 ($75 – $30) as a credit to income tax expense.

While this example illustrates changes in a valuation allowance that are related to an acquired entity's deferred tax assets, the same approach would be used if the balance were an uncertain tax position (liability).

Example 14-3
Allocation (Measurement) Period Ends After the Adoption of Statement 141(R)

Company B, a calendar-year-end company, acquired 100 percent of Company N on October 1, 2008, in a transaction accounted for as a business combination under Statement 141. For the fiscal year ended December 31, 2008, B disclosed that it recorded provisional amounts for goodwill and an uncertain tax position (liability) of $200 and $80, respectively.

Company B adopted Statement 141(R) on January 1, 2009. On March 31, 2009, B disclosed in its interim financial statements that it had finalized its accounting for the business combination and determined the uncertain tax position to be $70. Because B's adjustment was (1) made during the allocation period and (2) a result of new information about facts and circumstances that existed as of the acquisition date, B recorded the offsetting credit of $10 ($80 – $70) to goodwill under Statement 141.

On November 30, 2009, B obtains new facts about the uncertain tax position indicating the appropriate balance to be $100. Therefore, B adjusts the uncertain tax position upward by $30, with the offsetting debit recorded to income tax expense. Because the measurement period has ended for the acquisition accounted for under Statement 141, B must account for all such changes under Statement 141(R), which results in accounting for such effects through income tax expense.

While the above example illustrates changes in an uncertain tax position that arises as a result of a business combination, the same approach would be used if the balance were a valuation allowance related to an acquired entity's deferred tax assets.

Contingent Consideration

14.11 Under Statement 141, the acquirer generally recorded the contingent consideration when the contingency was resolved and the consideration was issued or became issuable. Distributions upon resolution of contingencies based on earnings (commonly referred to as "earnout" arrangements) resulted in an additional cost of the acquired business, while contingencies based on securities prices did not.

14.12 Under Statement 141(R), the acquirer must record all contingent consideration arrangements at fair value on the acquisition date. In addition, the acquirer must remeasure all contingent consideration arrangements classified as liabilities to fair value through the income statement until their resolution. Contingent consideration arrangements classified as equity are not remeasured, and the amount recorded is not reversed, even if the contingency is not met.

14.13 The acquirer's method of accounting for contingent consideration arrangements depends on the acquisition date. The acquirer would account for a contingent consideration arrangement entirely under Statement 141 if the acquisition date is before the effective date of Statement 141(R). This holds true even if the contingency is resolved and the consideration is paid or payable after the effective date of Statement 141(R).

Example 14-4
Contingent Consideration

On December 1, 2008, Company A (a calendar-year-end company) acquired 100 percent of Company B for $1 million. Company A agrees to pay an additional $250,000 if the earnings of B (to be operated after the acquisition as a separate subsidiary of A) equal or exceed a specified target for the 12-month period after the acquisition. Because the contingent arrangement was included in a transaction accounted for in accordance with Statement 141 and based on earnings in future periods, A did not initially record the contingent consideration as part of the cost of the business combination.

Because the business combination is **consummated** before A's adoption of Statement 141(R) (January 1, 2009), A is not permitted to record the contingent consideration at fair value upon the adoption of Statement 141(R) and would continue to apply Statement 141. That is, A would adjust the cost of acquiring B for any amounts paid out upon resolution of the contingency.

Restructuring and Exit Costs of the Acquiree

14.14 Under Statement 141, if the criteria in Issue 95-3 were met, the acquirer recognized liabilities as of the acquisition date for plans to exit an activity, involuntarily terminate employees, or relocate employees of an acquiree. In addition, if the ultimate costs expended were less than the recorded liability, the acquirer could adjust the cost of the business combination (and, most likely, goodwill) even if the allocation period had ended.

14.15 Under Statement 141(R), the acquirer can only recognize liabilities for plans to exit an activity or relocate employees of an acquiree if the acquiree has a current plan in place and the criteria in Statement 146 are satisfied as of the acquisition date. This would also be the case for one-time termination benefits (as described in paragraph 2(a) of Statement 146) that are not part of an ongoing benefit arrangement. In addition, adjustments to a recorded liability that are based on facts and circumstances arising after the acquisition date are recorded in the income statement (see **3.19**).

14.16 Under Statement 141(R), the acquirer may be able to recognize liabilities as of the acquisition date for termination benefits to be paid under an ongoing benefit arrangement between the acquiree and its employees. Examples of ongoing benefit arrangements would include preexisting plans or other contractual arrangements. Paragraph 28 of Statement 141(R) provides an exception to its recognition and measurement principles for these types of liabilities, which would be within the scope of Statement 88 and Issue 96-5.

14.17 The acquirer's accounting for its plans to exit an activity, involuntarily terminate employees, or relocate employees of an acquiree depends on the acquisition date. The acquirer would account for a restructuring or exit liability entirely under Statement 141 and Issue 95-3 if the acquisition date is before the effective date of Statement 141(R). This holds true even if the ultimate costs to settle the liability are paid or payable after the acquirer adopts Statement 141(R).

Example 14-5
Restructuring and Exit Costs of the Acquiree

On November 1, 2008, Company X (a calendar-year-end company) acquired 100 percent of Company Y. In accordance with Issue 95-3, X recorded a $2 million liability as of the acquisition date for its plans to exit an activity of Y.

Because the business combination is consummated before X's adoption of Statement 141(R) (January 1, 2009), X would continue to apply Issue 95-3. Company X can adjust the cost of the business combination if the ultimate cost paid for its exit plans is less than the $2 million recorded liability, even if the allocation period has ended and X has already adopted Statement 141(R). Further, upon adoption of Statement 141(R), X should not eliminate the recognized exit liability even if that liability does not satisfy the recognition criteria in Statement 141(R).

Acquisition-Related Costs Incurred on Current Transactions

14.18 When consummating a business combination, an acquirer frequently incurs incremental and direct costs, such as advisory, legal, accounting, and valuation fees. Under Statement 141, such costs are capitalized as a cost of the business combination. Statement 141(R) significantly changes the accounting for these acquisition-related costs by requiring that they be expensed as incurred. (See **6.31**.)

14.19 Note that because the costs to issue debt or equity securities in connection with a business combination are recognized in accordance with other applicable GAAP, Statement 141(R) does not modify the accounting for these costs. Such costs are generally recorded on the balance sheet under the other applicable GAAP.

14.20 Questions have arisen about how an entity that is incurring acquisition-related costs (before adopting Statement 141(R)) for a business combination should account for these costs when the acquisition date is not expected to occur until the first annual reporting period beginning on or after December 15, 2008 (i.e., the effective date of Statement 141(R)). The following are two alternatives for accounting for these costs.

- **Alternative A: Expense Acquisition-Related Costs as Incurred** — Proponents of this alternative believe that since the acquisition date is expected to occur in the first annual reporting period beginning on or after December 15, 2008, the acquisition-related costs would be expensed as incurred in accordance with the effective date and transition guidance in Statement 141(R).
- **Alternative B: Defer Acquisition-Related Costs Until the First Annual Reporting Period Beginning on or After December 15, 2008** — Proponents of this alternative believe that because early application of Statement 141(R) is prohibited, any acquisition-related costs incurred before the first annual reporting period beginning on or after December 15, 2008, should be deferred until the entity adopts Statement 141(R). Views differ, however, on the subsequent treatment of those costs. Some hold that such costs should be expensed in the first annual reporting period beginning on or after December 15, 2008, while others subscribe to retrospective application and maintain that an entity should apply the guidance in Statement 154 on reporting a change in accounting principle.

14.21 We understand that on the basis of the transition guidance in Statement 141(R), the SEC staff will not object to recording acquisition costs in a manner consistent with either of the above alternatives, provided that an entity appropriately discloses its accounting policy in accordance with Opinion 22 and applies it consistently to all such costs.

14.22 While historically many acquisition-related costs have been billed at the closing of the transaction or soon thereafter, an entity should ascertain that it is accruing such costs as they are incurred. An entity must continue to differentiate acquisition-related costs from other costs incurred in connection with an acquisition (such as costs to issue debt or equity securities). The entity should continue to account for these other costs in accordance with other applicable GAAP.

14.23 An entity may need to use judgment in determining whether a transaction is expected to have an acquisition date in the first annual reporting period beginning on or after December 15, 2008. An entity may need to evaluate many factors as part of this determination, such as required shareholder and regulatory approval as well as the intention of the parties. Judgments reached should be evaluated and documented.

Goodwill Impairment Considerations

Identifying Additional Reporting Units

14.24 Statement 142 requires an entity to assign all recorded goodwill to its reporting units. Paragraph 30 of Statement 142 defines a reporting unit as follows:

> A reporting unit is an operating segment or one level below an operating segment (referred to as a component). [Footnote omitted] A component of an operating segment is a reporting unit if the component constitutes a business[18] for which discrete financial information is available and segment management [footnote omitted] regularly reviews the operating results of that component. . . . The relevant provisions of Statement 131 and related interpretive literature shall be used to determine the reporting units of an entity.
>
> 18 Emerging Issues Task Force Issue No. 98-3, "Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business," includes guidance on determining whether an asset group constitutes a business.

14.25 Before Statement 142 was amended by Statement 141(R), footnote 18 of Statement 142 referred to Issue 98-3, which required that a business consist of a set of activities and assets that are self-sustaining and that have inputs, processes, and outputs. Footnote 18 now refers to the definition of a business in Statement 141(R). To qualify as a business under Statement 141(R), a set of activities and assets no longer has to be self-sustaining; it only has to be **capable** of producing outputs. That is, certain development-stage entities may now qualify as businesses under Statement 141(R).

14.26 Statement 142 also requires that the entity test goodwill for impairment at the reporting-unit level at least annually. Paragraph 28 of Statement 142 explains that "[g]oodwill of a reporting unit shall be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount [including goodwill]."

14.27 We believe that although the transition provisions of Statement 141(R) do not explicitly state to do so, an entity adopting Statement 141(R) should, because of Statement 141(R)'s broadened definition of a business, consider whether additional components of an operating segment (i.e., reporting units) exist. Paragraph 36 of Statement 142 requires that if the entity identifies new reporting units upon adopting Statement 141(R), it must determine, on this same date, whether any of its previously recorded goodwill should be reassigned to the new reporting unit(s). Paragraph 36 states that "goodwill shall be reassigned to the reporting units affected using a relative fair value allocation approach."

14.28 Because the entity must look for interim goodwill impairment indicators at the reporting-unit level, we believe that the entity should identify any new reporting units and reallocate goodwill as necessary **immediately upon adopting Statement 141(R)**. We believe that on this same date, the entity should also assess whether the relative fair value of each reporting unit (used to reallocate goodwill) is greater or less than the carrying amount of the affected reporting units. That is, the entity should evaluate whether the reporting unit is impaired and whether it must perform step 2 of the goodwill impairment test (see **11.32**).

Editor's Note: The FASB made conforming amendments to Interpretation 46(R) such that the definition of a business in Interpretation 46(R) and Statement 141(R) are the same. The broadened definition of a business may now enable a variable interest entity to qualify for the business scope exemption in paragraph 4(h) of Interpretation 46(R). However, before applying the business scope exemption, an enterprise is still required to consider if any of the considerations in paragraph 4(h)(1)–(4) of Interpretation 46(R) exist (these were not amended by Statement 141(R)).

Applying Statement 157 to Goodwill Impairment Tests

14.29 Entities must test goodwill and indefinite-lived intangible assets for impairment at least annually, as described in **11.02** and **10.41**, respectively.

14.30 In February 2008, the FASB issued FSP FAS 157-2, which defers the effective date of Statement 157 for certain nonfinancial assets and liabilities until fiscal years beginning on or after November 15, 2008. Reporting units measured at fair value under step 1 of the goodwill impairment test and indefinite-lived intangible assets recorded at fair value in a business combination or for impairment assessment are within the scope of the FSP FAS 157-2 deferral.

14.31 Paragraph 27 of Statement 142 permits an entity that meets certain criteria to carry forward a reporting unit's fair value amount from its prior-year goodwill impairment test (see **11.47–11.48**). In a similar manner, an entity may also be able to carry forward fair value measurements of indefinite-lived intangible assets (see **10.54**). We believe that during the first annual period after its full adoption of Statement 157, an entity, before carrying forward any of its prior-year calculations, should also consider whether those calculations properly take into account the measurement provisions of Statement 157. However, we do not believe that the initial and full adoption of Statement 157, by itself, would create an impairment indicator that would require the entity to perform an interim impairment test for goodwill or indefinite-lived intangible assets.

14.32 As discussed in **3.56**, Statement 157's fair value measurement guidance requires that the entity maximize the use of observable inputs. An entity should consider using the following (not all-inclusive) when determining whether a fair value measurement of the reporting unit is consistent with the measurement principles of Statement 157:

- A valuation method that is consistent with the market approach. Examples include the (1) guideline public company method, (2) guideline transaction method, (3) past subject company transaction method, and (4) market capitalization method.
- Implied control premiums (i.e., premiums above market capitalization) — to calculate the fair value of a reporting unit, provided that these premiums are consistent with market participant assumptions and industry and market data.

- Observable market inputs — to calculate the discount rate used in a discounted cash flow model.
- Market participant assumptions — to calculate long-term growth rates used in a discounted cash flow model.

Additional Considerations for Less Than Wholly Owned Reporting Units

14.33 See **14.65–14.75** for additional goodwill impairment considerations that an entity should take into account upon adopting Statement 160.

SAB 74 Disclosures

14.34 SEC registrants must comply with SAB Topic 11.M (SAB 74), which requires a registrant to provide certain disclosures when its adoption of a new accounting standard is expected to have a material effect on its financial position and results of operations.[1]

14.35 The notes to the financial statements should (1) notify the reader about the issuance of a standard that the registrant will be required to adopt in the future and (2) help the reader assess the impact the standard will have on the financial statements of the registrant when it is adopted.

14.36 In the context of Statement 141(R), the registrant should consider providing the following SAB 74 disclosures:

- A brief description of Statement 141(R), including the registrant's required date of adoption (see **14.01**).
- The impact that the registrant's adoption of Statement 141(R) is expected to have on its financial statements, unless this impact is unknown or not reasonably estimable, in which case the registrant should state this fact. The registrant should consider disclosing the following items:
  - Any remaining valuation allowances for deferred tax assets acquired in prior business combinations and the impact that future adjustments to these allowances will have on the registrant's financial statements (see **14.04–14.06**).
  - Any remaining uncertain tax positions (liabilities) related to prior business combinations and the impact that future adjustments to these liabilities will have on the registrant's financial statements (see **14.07–14.10**).
  - Any accumulated transaction costs, the transition method it will apply, and the overall impact on the financial statements (see **14.18–14.23**).
  - Any additional reporting units that may be identified upon adoption of Statement 141(R), as well as any anticipated goodwill impairments (see **14.24–14.28**).
  - Any impact the full adoption of Statement 157 will have on the entity's goodwill impairment tests, as well as any anticipated goodwill impairments (see **14.29–14.32**).
  - Other anticipated effects of Statement 141(R) on future business combinations or step 2 of the goodwill impairment rest.
- The potential impact of other significant matters that the registrant believes might result from the adoption of Statement 141(R) (e.g., planned or intended changes in business practices).

Private entities should also generally provide the disclosures required by SAB 74.

1 SAB 74 also indicates that even if the registrant's adoption of a new standard is not expected to have a material effect, it is encouraged to disclose this fact.

SEC Amendments

14.37 At the 2008 AICPA National Conference on Current SEC and PCAOB Developments, Craig C. Olinger, deputy chief accountant in the SEC's Division of Corporation Finance, acknowledged in a question-and-answer session that certain guidance in Regulation S-X conflicts with the guidance in Statements 141(R) and 160. He indicated that in such cases, until the SEC finalizes amendments to Regulation S-X, an entity should apply the guidance in Statements 141(R) and 160. In addition, at the July 8, 2008, SEC Regulations Committee meeting, the SEC staff acknowledged that there are a number of conflicts between published SEC Staff Accounting Bulletins and Statements 141(R) and 160 that the SEC staff is currently addressing.

14.38 On December 9, 2008, the SEC's Division of Corporation Finance released a *Financial Reporting Manual*. The new manual supersedes the Division's *Accounting Disclosure Rules and Practices: An Overview* (also known as the "SEC Staff Training Manual"), which had not been updated since 2000. The *Financial Reporting Manual* provides helpful insight into how the SEC staff applies SEC rules and regulations covering, for example, SEC registrants' and acquired business' financial statements, as well as pro forma financial statements.

Mutual Entities

14.39 Paragraph 3(m) of Statement 141(R) defines a mutual entity as "an entity other than an investor-owned entity that provides dividends, lower costs, or other economic benefits directly to its owners, members, or participants." Examples of mutual entities include mutual insurance companies, credit unions, and cooperatives.

14.40 Before Statement 141(R), mutual entities were within the scope of Statements 141 and 147 but the effective date of these statements was indefinitely deferred for these entities. Therefore, these entities never applied Statement 141 or 147 and did not account for goodwill and intangible assets recognized in business combinations under Statement 142. Rather, they applied the guidance in Opinion 16 and Statement 72.

14.41 Business combinations between two or more mutual entities are now within the scope of Statement 141(R). Statement 141(R) also (1) nullifies Statement 147; (2) eliminates the pooling-of-interest method of accounting for business combinations between two or more mutual entities; (3) amends the scope of Statement 142 to include goodwill and intangible assets recognized in business combinations between two or more mutual entities; and (4) provides transitional accounting guidance on goodwill and intangible assets recognized by a mutual entity, under the purchase method, in a transaction consummated before the effective date of Statement 141(R) (see **14.01**).

14.42 Except as discussed in **14.43**, paragraph A134 of Statement 141(R) prohibits mutual entities from adjusting "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" the effective date of Statement 141(R). However, paragraph A134 allows for adjustments to the purchase price allocation for the resolution of contingent consideration arrangements and allocation-period adjustments.

14.43 Paragraph A132 of Statement 141(R) provides the following transitional accounting guidance on goodwill and intangible assets that mutual entities recognized, under the purchase method, in business combinations consummated before the effective date of Statement 141(R):

> a. The entity shall reclassify to goodwill *(reclassified goodwill)* amounts that do not meet the criteria in paragraph 3(k) of this Statement for recognition separately from goodwill. Therefore, the entity shall reclassify to goodwill:
>
> (1) The carrying amount of acquired intangible assets that do not meet the criteria in paragraph 3(k) of this Statement for recognition separately from goodwill.
>
> (2) The carrying amount of *unidentifiable intangible assets* that do not meet the criteria in paragraph 3(k) of this Statement for recognition separately from goodwill. Statement 72 described *unidentifiable intangible assets* as the amount by which the fair value of the liabilities assumed exceeds the fair value of tangible and identified intangible assets acquired.
>
> (3) Any deferred tax liabilities related to the intangible assets or unidentifiable intangible assets also shall be reclassified to goodwill if the amortization of the intangible assets or the unidentifiable intangible assets is not deductible for tax purposes.
>
> b. The entity shall reclassify to intangible assets the carrying amount of any intangible asset that:
>
> (1) Meets the definition of identifiable in paragraph 3(k) of this Statement
>
> (2) Has been recognized but reported on the face of the statement of financial position in goodwill (or as goodwill and intangible assets) or as unidentifiable intangible assets; and
>
> (3) Has been separately accounted for (that is, separate accounting records have been maintained). An entity would be deemed to have maintained separate accounting records if there is a separate general ledger account or other subsidiary ledger (such as a spreadsheet or similar ledger account) to which periodic amortization charges, impairment charges, and other accounting entries were posted. An entity shall not "carve out" from goodwill any intangible assets that had not been identified and measured at fair value (as defined or described in Statement 141 or Opinion 16) in the initial recording of the business combination and subsequently accounted for separately from goodwill.
>
> c. The entity shall write off and recognize in earnings the amount of any unamortized deferred credit related to an excess over cost arising from either a business combination accounted for before applying this Statement or an investment accounted for by the equity method before applying this Statement.

14.44 Mutual entities should apply the transitional impairment and disclosure guidance in paragraphs 53–61 in Statement 142, which include a requirement to test indefinite-lived intangible assets and goodwill for impairment upon adoption of Statements 141(R) and 142 (i.e., fiscal periods beginning on or after December 15, 2008).

14.45 Mutual entities with long-term customer-relationship intangible assets should also follow the transitional accounting guidance in paragraph A133 of Statement 141(R):

> [T]he provisions of Statement 144 apply to long-term customer-relationship intangible assets, except for servicing assets, recognized in the acquisition of a financial institution. Examples of long-term customer-relationship intangible assets include depositor- and borrower-relationship intangible assets, credit cardholder intangible assets, and servicing assets. Servicing assets, however, are accounted for in accordance with [Statement 140], as amended.

Entities Emerging From Bankruptcy

14.46 The FASB issued FSP SOP 90-7-1 in response to the conflicting guidance in SOP 90-7 and Statements 141(R) and 160 regarding the early adoption of new accounting standards. Before the effective date of the FSP, SOP 90-7 required an entity that applies fresh-start reporting to early adopt all accounting standards that will become effective within 12 months of the entity's emergence from bankruptcy. FSP SOP 90-7-1, which became effective on April 24, 2008, amends SOP 90-7 by giving an entity emerging from bankruptcy the option to early adopt a new accounting standards as long as the standard permits early adoption. Therefore, because Statements 141(R) and 160 specifically prohibit such early adoption, an entity emerging from bankruptcy may not early adopt these statements in its fresh-start reporting.

Example 14-6
Emergence From Bankruptcy

Company A emerges from bankruptcy and adopts fresh-start accounting on July 1, 2008. After allocating the reorganization value, A determines that its tax-deductible goodwill is in excess of its book goodwill.

Before Statement 141(R), no deferred tax assets were recognized as of the acquisition date if tax-deductible goodwill exceeded book goodwill. A tax benefit was recognized for this difference only after it was realized on the income tax return. However, under Statement 141(R), a deferred tax asset should be recognized for this difference as of the acquisition date.

Because A emerges from bankruptcy before the effective date of Statement 141(R), A is prohibited from recognizing a deferred tax asset related to the excess of its tax-deductible goodwill over book goodwill (i.e., A is prohibited from early adopting Statement 141(R) under FSP SOP 90-7-1).

If A had emerged from bankruptcy after the effective date of Statement 141(R), A could have recognized a deferred tax asset related to the excess of its tax-deductible goodwill over its book goodwill.

Statement 160

14.47 Statement 160 is effective for fiscal years beginning on or after December 15, 2008. Early adoption is prohibited. An entity must apply Statement 160 as follows:

- Accounting provisions — **prospectively**.
- Presentation and disclosure provisions — **retrospectively** for all periods presented.

14.48 An entity is not permitted to revise transactions or allocations of income and losses between the parent and the noncontrolling interest that occur before the entity adopts Statement 160.

Noncontrolling Interests That Are Within the Scope of Statement 160

14.49 Paragraph 25 of ARB 51, as amended by Statement 160, defines a noncontrolling interest as "[t]he portion of **equity** (net assets) in a subsidiary not attributable, directly or indirectly, to a parent" (emphasis added).

14.50 Paragraph 27 of ARB 51, as amended by Statement 160, states, in part, "Only a financial instrument issued by a subsidiary that is classified as equity in the subsidiary's financial statements can be a noncontrolling interest in the consolidated financial statements."

14.51 Upon adopting Statement 160, an entity must consult other GAAP to determine whether the financial instruments held by the noncontrolling shareholders can be classified as permanent equity. Such GAAP may include Statements 133 and 150, Topic D-98, and ASR 268 (FRR Section 211).

14.52 Generally, the presentation requirements of Statement 160 regarding the statement of financial position will only affect less complex financial instruments held by noncontrolling interests. More complex financial instruments (e.g., those with put or call options) are less likely to be affected by Statement 160. If dictated by other GAAP, an entity should continue to classify such instruments in either mezzanine (or temporary) equity or liabilities under other GAAP.

Calculation of Earnings per Share

14.53 Statement 160 requires that (1) the noncontrolling interest be classified as a separate part of shareholders' equity and (2) consolidated net income include amounts attributable to both the parent and the noncontrolling interest. However, as described in paragraph B75 of Statement 160, the FASB did not intend to change the methods that entities use to calculate earnings-per-share data. Paragraph B75 states, in part:

> [A]lthough amounts for both the parent and the noncontrolling interest are reported in consolidated net income, the Board decided the calculation of earnings-per-share data in consolidated financial statements that include subsidiaries that are less than wholly owned should be based on amounts attributable to the parent's owners. Thus, this Statement [160] amends Statement 128 so that earnings-per-share data will continue to be calculated the same way they were calculated before this Statement was issued, based on amounts attributable to the parent's owners.

14.54 Paragraph 9 of Statement 128, as amended by Statement 160, states, in part:

> For purposes of computing EPS in consolidated financial statements (both basic and diluted), if one or more less-than-wholly-owned subsidiaries are included in the consolidated group, income from continuing operations and net income shall exclude the income attributable to the noncontrolling interest in subsidiaries.

Changes in a Parent's Ownership Interest in a Subsidiary

14.55 Paragraph 33 of ARB 51 (added by Statement 160) requires that "[c]hanges in a parent's ownership interest while the parent retains its controlling financial interest in its subsidiary shall be accounted for as **equity transactions**" (emphasis added). However, Statement 160 indicates that a decrease in a parent's ownership interest that results in a loss of control is a significant economic event and that any retained noncontrolling interest (by the former parent) is remeasured at **fair value** on the date control is lost.

14.56 Before Statement 160's amendments, the parent entity accounted for changes in its ownership interests as follows:

- For **increases** in ownership that resulted in the parent's obtaining control or increasing its controlling interest, the parent followed the guidance in paragraph 14 of Statement 141, which required it to apply **purchase accounting** and step up the subsidiary's net assets to fair value for the acquired interest. In many instances, the parent recorded additional goodwill associated with the purchase of additional ownership interests even after control was obtained.
- For **decreases** in ownership that did not result in a loss of control, the parent either (1) recognized a **gain or loss** for the transaction or (2) recorded the change in ownership as a capital transaction. Entities often referred to the guidance in SAB Topic 5.H (SAB 51) to determine whether gain or loss recognition was appropriate.[2]

2 Refer to **14.37** for discussion of the SEC staff's plans to update SEC Staff Accounting Bulletins that conflict with Statements 141(R) and 160.

- For **decreases** in ownership that resulted in a loss of control, the former parent recorded any retained noncontrolling investment on the basis of the carrying amount of the former subsidiary. That is, the retained noncontrolling investment was not remeasured to fair value on the date control was lost.

14.57 Because of Statement 160's revisions, the parent's accounting for changes in its ownership interest in a subsidiary may differ before and after it adopts Statement 160. However, because Statement 160 requires prospective application of its accounting requirements, the parent should not revise its accounting for transactions that occurred before it adopted Statement 160.

14.58 If the parent adopts Statement 160 and subsequently purchases an additional ownership interest in its subsidiary, it cannot further step up the subsidiary's net assets to fair value to the extent of the additional interest acquired, nor can it record additional goodwill (as it previously did under Statement 141). In other words, the parent will never fully step up to fair value a partial controlling interest in its subsidiary that was acquired prior to the adoption of Statement 160. See section **14.66–14.72** for a discussion of the impact of reporting units that are less than wholly owned on goodwill impairment testing.

Example 14-7
Parent Purchases Noncontrolling Interest in Its Subsidiary After Adopting Statement 160

Before adopting Statement 160, Parent X purchased an 80 percent controlling interest in Subsidiary Y. In accordance with Statement 141, X recorded Y's net assets acquired at (1) 80 percent fair value and (2) 20 percent carrying value.

After adopting Statement 160, X purchases an additional 20 percent interest in Y. Accordingly, X accounts for its increase in ownership interest as an equity transaction between the parent and the noncontrolling interest (see **7.20–7.23**). That is, X does not apply additional purchase accounting and step up Y's net assets to fair value for the additional 20 percent interest it acquired. Instead, the difference between the cash consideration paid and the carrying amount of the noncontrolling interest is recorded as an adjustment to X's additional paid-in capital. Parent X is not permitted to adjust the basis of Y's net assets when it purchases or sells ownership interests in Y but retains control over Y.

Attributing Net Income or Loss to the Parent and the Noncontrolling Interest

14.59 ARB 51 requires that net income or loss and comprehensive income or loss be attributed to the parent and the noncontrolling interest. However, neither ARB 51 nor Statement 160 provides detailed guidance on how the entity should attribute these amounts to the parent and the noncontrolling interest. Paragraph B38 of Statement 160 states, in part:

> The Board, therefore, decided to require that net income and comprehensive income be attributed to the parent and the noncontrolling interest but not provide detailed guidance for making the attribution. The Board observed that entities were making attributions before this Statement [160] was issued and that those attributions generally were reasonable and appropriate. Therefore, the Board decided that detailed guidance was not needed.

Attribution of Losses That Exceed the Carrying Amount of the Noncontrolling Interest in a Subsidiary

14.60 Before Statement 160, paragraph 15 of ARB 51[3] stated:

> In the unusual case in which losses applicable to the minority interest in a subsidiary exceed the minority interest in the equity capital of the subsidiary, such excess and any further losses applicable to the minority interest should be charged against the majority interest, as there is no obligation of the

3 Not-for-profit organizations are not within the scope of Statement 160 and would continue to apply the guidance in paragraph 15 of ARB 51.

> minority interest to make good such losses. However, if future earnings do materialize, the majority interest should be credited to the extent of such losses previously absorbed.

14.61 Statement 160 amends ARB 51's guidance on the allocation of losses to the noncontrolling interest in a subsidiary (formerly referred to as the "minority interest") by (1) deleting paragraph 15 of ARB 51 and (2) adding paragraph 31 of ARB 51, which revises this guidance. The revised guidance requires an entity to allocate losses to the noncontrolling interest "even if that attribution results in a deficit noncontrolling interest balance." Therefore, when a subsidiary has incurred losses, the accounting for the allocation of those losses to the noncontrolling interest will differ before and after adoption of Statement 160 if the losses exceed the carrying amount of the noncontrolling interest.

14.62 Because Statement 160 requires prospective application of its accounting requirements, an entity should not revise its historical allocations of losses (or income) between the parent and the noncontrolling interest.

14.63 In the year in which it adopts Statement 160, an entity should also consider the following disclosure requirement in paragraph 6:

> If, in the year of adoption, an entity's consolidated net income attributable to the parent would have been significantly different had the previous requirement in paragraph 15 of ARB 51 been applied, the entity shall disclose pro forma consolidated net income attributable to the parent and pro forma earnings per share as if the previous requirement in paragraph 15 of ARB 51 had been applied in the year of adoption.

Example 14-8

Attribution of Losses That Exceed the Carrying Amount of the Noncontrolling Interest in a Subsidiary — Transition to Statement 160

Case A

Parent X has not adopted Statement 160. Parent X holds an 80 percent controlling interest in Subsidiary Y and allocates Y's profits and losses to the parent and the noncontrolling interest on the basis of relative ownership interests, or 80 percent and 20 percent, respectively. As of December 31, 20X1, the carrying amount of Y's equity was $120, of which $100 is attributable to the parent and $20 is a noncontrolling interest in Y.

During 20X2, Y incurred losses of $180. If X were to allocate 20 percent of Y's 20X2 losses ($36) to the noncontrolling interest, the carrying amount of the noncontrolling interest would be negative. Therefore, X only allocated $20, or 11 percent, of the 20X2 losses to the noncontrolling interest. Parent X absorbed the remaining $160 of losses, which included $16 ([180 × 20%] – $20) of losses that would have otherwise been allocated to the noncontrolling interest if the carrying amount had not reached $0.

In contrast, if Statement 160 had been applied to this period, X would have been required to allocate $36, or 20 percent, of the 20X2 losses to the noncontrolling interest. However, X cannot revise its allocation of profits and losses between the parent and the noncontrolling interest that it made before adopting Statement 160, including the 20X2 allocation described above.

14.64 The carrying amount of the noncontrolling interest will sometimes be $0 upon adoption of Statement 160 because the parent has previously absorbed losses on behalf of the noncontrolling shareholders. We believe that an entity cannot, after adopting Statement 160, allocate future profits of the subsidiary so that the parent is first credited to the extent of the previous losses it absorbed. This is supported by the fact that Statement 160 (1) deleted the guidance in paragraph 15 of ARB 51 (see **14.61**) and (2) requires prospective application of its accounting requirements.

Example 14-9
Attribution of Losses That Exceed the Carrying Amount of the Noncontrolling Interest in a Subsidiary — Transition to Statement 160

Case B

Assume the same facts as in Example 14-8. In addition, assume that Parent X adopts Statement 160 on January 1, 20X3, and that Y records net income of $80 for 20X3. In accordance with the transition provisions of Statement 160, the 20X3 profits would be allocated pursuant to X's allocation method, which in this case is based on relative ownership interests (i.e., 80 percent for the controlling interest and 20 percent for the noncontrolling shareholders). Therefore, net income would be allocated as follows: $64 to X and $16 to the noncontrolling interest. Parent X would not recover (be credited for) the extra $16 of losses it absorbed on behalf of the noncontrolling shareholders during 20X2.

Goodwill Impairment Considerations

Goodwill Impairment Testing When the Reporting Unit Is Less Than Wholly Owned

14.65 Step 1 of the goodwill impairment test is to compare the fair value of the reporting unit with its carrying amount, including goodwill (see **11.32**).

14.66 Before Statement 160, the fair value and carrying amount of the reporting unit in step 1 generally would not include the portion attributable to the noncontrolling interest. For example, if the parent held an 80 percent ownership interest in a reporting unit, it would have reduced the overall fair value and carrying amount of the reporting unit for the 20 percent interest held by the noncontrolling shareholders. Also, because Statement 141 prescribed the "partial goodwill" method (see **A.26**), the entire goodwill amount was attributable to the parent and was included in the carrying amount of the reporting unit used in step 1 of the test.

14.67 Upon adopting Statement 160, an entity determines the fair value of the reporting unit in the same manner as it would in a business combination accounted for under Statement 141(R). That is, the entity calculates the **full fair value** of the reporting unit even if the parent does not have a 100 percent ownership interest in the reporting unit. Similarly, the entity uses the full carrying amount of the reporting unit.

14.68 If an entity has a less than wholly owned reporting unit and calculates the difference between the fair value and carrying amount of that reporting unit in step 1 immediately before and after adoption of Statement 160, the excess of the fair value over the carrying amount (i.e., "cushion"), if any, will be greater after the entity adopts Statement 160. This cushion is due to Statement 160's revisions to how the fair value and carrying amount of that reporting unit are calculated in step 1 of the goodwill impairment test. In other words, all else being equal, the adoption of Statement 160 could create additional cushion in step 1 of the goodwill impairment test, as illustrated in Example 14-10.

Example 14-10
Step 1 of the Goodwill Impairment Test

Parent X is a calendar-year-end company. On December 31, 2008, X purchased an 80 percent controlling interest in Subsidiary Y (a separate reporting unit) for $1,000 and accounted for the transaction under Statement 141. The fair value of Y's identifiable net assets was $800, the book value of Y's net assets was $500, and the fair value of Y is $1,250 (assume that there is no implied control premium) as of the acquisition date. In accordance with Statement 141 (see **Example A-4**), X recognized acquired net assets of $740* and goodwill of $360** as of the acquisition date.

The following illustrates step 1 of the goodwill impairment test for Y if it were performed before and after X adopts Statement 160 on January 1, 2009.

Step 1
Before Statement 160

Fair value of reporting unit	$ 1,000	Consideration paid by X for an 80 percent interest in Y
Carrying amount of reporting unit	1,000	X's basis in Y, calculated as ([$800 × 80%] + $360)
Difference	$ 0	

Step 1
After Statement 160

Fair value of reporting unit	$ 1,250	Fair value of the entire reporting unit
Carrying amount of reporting unit	1,100	Total carrying amount of Y, calculated as ($740 + $360)
Difference	$ 150	

Parent X has additional "cushion" of $150 because of Statement 160's revisions to how the fair value and carrying amount of the reporting unit are calculated in step 1 of the goodwill impairment test.

* Calculated as ([$800 × 80%] + [$500 × 20%]).

** Calculated as ($1,000 – [$800 × 80%]).

14.69 If an entity fails step 1 of the goodwill impairment test (i.e., the carrying amount of the reporting unit is greater than its fair value), it must then perform step 2. In step 2, the entity calculates the reporting unit's implied fair value of goodwill and compares it with the carrying amount of goodwill to measure the amount of the impairment loss (see **11.32**).

14.70 Before Statement 160, the entity used Statement 141's purchase method of accounting to calculate the implied fair value of goodwill. The parent allocated its portion of the fair value of the reporting unit from step 1 (see **11.32**) to its share of the reporting unit's net identifiable assets. Any residual amount was considered goodwill attributable to the parent, which was then compared with the carrying amount of goodwill. Statement 141 prescribed the "partial goodwill" method, which only includes goodwill attributable to the parent.

14.71 Upon adopting Statement 160, the entity uses Statement 141(R)'s acquisition method of accounting to calculate the implied fair value of goodwill. Statement 141(R) prescribes the "full goodwill" approach. That is, goodwill includes amounts attributable to the parent and the noncontrolling interest. All else being equal, the implied fair value of goodwill will increase upon adoption of Statement 160 when a reporting unit is less than wholly owned.

14.72 Note, however, that there are many recognition and measurement differences between Statement 141 and Statement 141(R), which may also cause the implied fair value of goodwill to differ upon adoption of Statement 160. For example, it is likely that more acquired contingencies will be included at fair value in the reporting unit's net identifiable assets balance in accordance with Statement 141(R), which will increase the implied fair value of goodwill.

Example 14-11
Step 2 of the Goodwill Impairment Test

Assume the same facts as in Example 14-10. Although it is not required to do so, the following illustrates what X's step 2 goodwill impairment test for Y would look like immediately before and after X adopts Statement 160 on January 1, 2009.

Step 2 **Before Statement 160**		
Fair value of reporting unit	$ 1,000	From step 1 in Example 14-10
Fair value of reporting unit's identifiable net assets	640	Calculated as ($800 × 80%)
Implied fair value of goodwill	$ 360	Goodwill recorded by Parent Co.

Step 2 **After Statement 160**		
Fair value of reporting unit	$ 1,250	From step 1 in Example 14-10
Fair value of reporting unit's identifiable net assets	$ 800	Calculated as ($800 × 100%)*
Implied fair value of goodwill	$ 450	

All else being equal, Statement 160's revisions to step 2 of the goodwill impairment test result in an increase in the implied fair value of goodwill of $90 ($450–$360). This increase is attributable to X's application of the "full goodwill" approach, which includes goodwill attributable to the noncontrolling interest. Note that X would not adjust the carrying amount of its goodwill upon adopting Statement 160.

* Note that this amount would be calculated in accordance with Statement 141(R). In this example, it is assumed that the fair value of the identifiable net assets ($800) is the same under Statements 141 and 141(R). However, as discussed in **Appendix A**, many of the recognition and measurement provisions in Statement 141 and 141(R) are different, which could result in different amounts recorded for the fair value of the identifiable net assets.

Attributing Goodwill Impairments to the Parent and the Noncontrolling Interest

14.73 Statement 160 amends Statement 142's guidance on attributing goodwill impairments to the parent and the noncontrolling interest. Paragraph 39A of Statement 142 (added by Statement 160) requires that "[a]ny impairment loss measured in the second step of the goodwill impairment test shall be attributed to the parent and the noncontrolling interest on a rational basis."

14.74 For business combinations consummated before the effective date of Statements 141(R) and 160, the entity only recognized goodwill attributable to the parent. In cases in which a reporting unit contains only goodwill associated with a pre–Statement 141(R) business combination, a "rational" method generally would be for the entity to attribute 100 percent of all impairment losses to the parent, both before and after the entity adopts Statement 160.

14.75 For business combinations consummated after the effective date of Statements 141(R) and 160, the entity recognizes goodwill attributable to the parent and the noncontrolling interest. That is, the entity applies the "full goodwill" approach in Statement 141(R). "Rational" methods for allocating goodwill impairment losses to the parent and the noncontrolling interest may include the following:

- Allocate impairment losses on the basis of the relative fair values, **as of the acquisition date**, of the parent and the noncontrolling interest. Because of a possible control premium, the amount of impairment loss attributed to the parent, as a percentage of its ownership interest, may be higher than the amount attributed to the noncontrolling interest.

- Allocate impairment losses on the basis of the relative fair values, **as of the impairment testing date**, of the parent and the noncontrolling interest. Because of a possible control premium, the amount of impairment loss attributed to the parent, as a percentage of its ownership interest, may be higher than the amount attributed to the noncontrolling interest.
- Allocate impairment losses in a manner consistent with how the entity allocates net income and losses of the reporting unit (subsidiary) between the parent and the noncontrolling interest (e.g., on the basis of the relative ownership interests of the parent and the noncontrolling shareholders).

Additional Considerations

14.76 See **14.24–14.32** for additional goodwill impairment considerations that an entity should take into account upon adopting Statements 141(R) and 157.

SAB 74 Disclosures

14.77 SEC registrants must comply with SAB Topic 11.M (SAB 74), which requires a registrant to provide certain disclosures when its adoption of a new accounting standard is expected to have a material effect on its financial position and results of operations.[4]

14.78 The notes to the financial statements should (1) notify the reader about the issuance of a standard that registrants will be required to adopt in the future and (2) help the reader assess the impact the standard will have on the financial statements of the registrant when it is adopted.

14.79 In the context of Statement 160, the registrant generally should consider providing the following SAB 74 disclosures:

- A brief description of Statement 160, including the registrant's required date of adoption (see **14.47**).
- The impact that the registrant's adoption of Statement 160 is expected to have on its financial statements, unless this impact is unknown or not reasonably estimable, in which case this should be stated. The registrant should consider disclosing the following items:
    - Changes in the presentation of the noncontrolling interest on the consolidated statement of financial position, consolidated income statement, and consolidated statement of changes in equity (see **12.08–12.18**).
    - Any changes in how the entity allocates net income or losses between the parent and the noncontrolling interest (e.g., if the carrying amount of the noncontrolling interest in an unprofitable subsidiary is $0) (see **14.60–14.64**).
    - Any effects that Statements 160 and 157 will have on the entity's goodwill impairment tests, including future allocations of any goodwill impairments between the parent and the noncontrolling interest (see **14.65–14.75**).
    - Other anticipated impacts of Statement 160 on future transactions between the parent and the noncontrolling shareholders.
- The potential impact of other significant matters that the registrant believes might result from the adoption of Statement 160 (e.g., planned or intended changes in business practices).

14.80 Private entities should also generally provide the disclosures required by SAB 74.

4 See footnote 1.

SEC Amendments

14.81 See **14.37** for the SEC's plans to update Regulation S-X and various SEC Staff Accounting Bulletins that conflict with Statement 160 as of the date of this publication. See also **14.38** regarding the SEC's recent release of its *Financial Reporting Manual*.

Appendix A — Differences Between Statements 141 and 141(R)

A.01 This Appendix discusses key differences between the guidance in Statement 141 (including related interpretive guidance and practices) and the new guidance in Statement 141(R).

Scope

A.02 The table below highlights differences between the standards.

Statement 141	Statement 141(R)
Entities followed a purchase model (i.e., an acquisition of net assets that constitute a business or an acquisition of equity interests in a business that results in control over that entity). Mutual entities did not follow the guidance in Statement 141 because its effective date was deferred until interpretive guidance was issued for transactions involving such entities.	Entities follow a control model (i.e., any transaction or event in which an entity obtains control over a business). Mutual entities are included in its scope. However, like Statement 141's scope, its scope excludes (1) formations of joint ventures, (2) asset acquisitions that do not constitute a business, (3) combinations of entities under common control, and (4) combinations of not-for-profit organizations or acquisitions of a for-profit business by a not-for-profit organization. (See **Section 1**.)

A.03 The scope changes in Statement 141(R) helped drive the terminology switch from "purchase method" to "acquisition method." Under Statement 141, a business combination occurred when an entity acquired net assets that constituted a business or acquired equity interests of an entity and obtained control of that entity. Under Statement 141(R), a business combination can occur via any transaction or event in which the acquirer obtains control of one or more businesses, not just via an acquisition. For example, Company A holds a majority voting interest in Company B, but does not control that entity because another investor has minority veto rights. If such minority veto rights lapse and as a result Company A gains control of Company B, the acquisition method of accounting for a business combination applies at that time in accordance with Statement 141(R), even though no consideration was transferred (see paragraph 49 of Statement 141(R)).

A.04 For mutual entities, Statement 141 essentially deferred the effective date of the standard until interpretative guidance for such transactions was issued. Before the issuance of Statement 141(R), no such interpretive guidance was issued. Mutual entities are explicitly included in the scope of Statement 141(R), with no deferred effective date, and therefore such entities must now account for business combinations in accordance with that guidance.

Definition of a Business

A.05 The table below highlights differences between the standards.

Statement 141	Statement 141(R)
Issue 98-3 defined a business and provided related application guidance. An entity needed inputs, processes, and outputs to qualify as a business.	The definition of a business is broadened and clarified with additional application guidance. An entity no longer needs to have outputs or be self-sustaining to qualify as a business. Issue 98-3 is nullified. (See **1.08–1.11**.)

A.06 Statement 141(R) nullifies Issue 98-3 and incorporates its definition of a business, with some important modifications. For example, to qualify as a business under Statement 141(R), an entity no longer has to be "self-sustaining," and a group of assets no longer needs to have outputs. That is, development-stage entities can be businesses under Statement 141(R). As a result, some transactions that would have been accounted for as asset acquisitions under Statement 141 will instead be business combinations under Statement 141(R).

Determining the Acquisition Date

A.07 The table below highlights differences between the standards.

Statement 141	Statement 141(R)
Business combinations were accounted for on the date the transaction closed or the date the acquirer obtained control of the acquiree. In certain circumstances, a convenience date exception allowed an acquisition date to be designated at the end of a month or accounting period.	Business combinations are accounted for on the acquisition date, which is the date the acquirer obtains control of the acquiree. However, this date may not necessarily be the closing date of the transaction. There is no convenience date exception. (See **3.01–3.03**.)

A.08 Like those under Statement 141, business combinations under Statement 141(R) should be recorded as of the date the acquirer obtains control of the acquiree, generally referred to as the "acquisition date."

A.09 The acquisition date is important because under Statement 141(R), on this date:

- The fair value of the assets acquired, liabilities assumed, and noncontrolling interests is measured (see **3.13**).
- The fair value of the acquired business is measured (see **5.39**).
- The fair value of the acquirer's equity securities issued to the seller is measured (see **6.04**).
- The acquirer begins consolidating the acquired business's balance sheet, results of operations, and cash flows.

Measurement Date for Marketable Equity Securities of the Acquirer Issued to Effect a Business Combination

A.10 The table below highlights differences between the standards.

Statement 141	Statement 141(R)
The value of the acquirer's marketable equity securities were measured over the period of a few days before and after the terms of the business combination were agreed to and announced in accordance with Issue 99-12.	The acquirer's equity securities issued as consideration in a business combination are measured at fair value as of the acquisition date. (See **6.04**.)

A.11 Statement 141(R) requires that equity securities of the acquirer, issued as consideration in a business combination, be recorded at fair value as of the acquisition date. Under Statement 141, in conjunction with Issue 99-12, the acquirer's equity securities were valued over a period of a few days before and after the terms of the business combination were agreed to and announced. Because the value of securities may change significantly between the date the terms of the transaction are agreed to and announced and the acquisition date, the amounts recorded as consideration might differ substantially under Statement 141(R) from those that would have been recorded under Statement 141.

Example A-1
Measurement Date for Marketable Equity Securities of the Acquirer Issued to Effect a Business Combination

Company A agrees to and announces the purchase of Company B on January 10, 20X8. Company A issues 100,000 shares of its common stock to the shareholders of Company B as part of the consideration transferred. Company A obtains control of Company B on March 1, 20X8 (the acquisition date). The table below illustrates the accounting for equity interests issued by the acquirer under Statement 141 and Statement 141(R).

Statement 141	Statement 141(R)
Company A recorded the value of the equity interests issued by the acquirer in purchase accounting on the basis of the average market price of its common shares a few days before and after the transaction is agreed to and announced. Company A determined that two days before and two days after the transaction is a reasonable time frame and calculates the value of the shares in accordance with Issue 99-12 as follows:	Company A records the value of the shares in the acquisition accounting on the basis of the market value on the date it obtains control of Company B, March 1, 20X8.

Date	Market Price
1/8/X8	$ 25
1/9/X8	21
1/10/X8	20
1/11/X8	24
1/12/X8	25
Average market price	23
Shares issued	100,000
Measurement of consideration transferred	$ 2,300,000

Date	Market Price
3/1/X8	$ 18
Shares Issued	100,000
Measurement of consideration transferred	$ 1,800,000

Provisional Measurement of Assets Acquired and Liabilities Assumed

A.12 The table below highlights differences between the standards.

Statement 141	Statement 141(R)
Under prevailing practice, changes to the provisional measurement of assets acquired and liabilities assumed were recognized prospectively as a change in estimate.	Comparative information for prior periods must be revised. (See **3.21**.)

A.13 The measurement period is the period after the consummation of a business combination during which the acquirer gathers information necessary to complete the business combination accounting (e.g., determines the fair value of assets acquired and liabilities assumed). The measurement period under Statement 141(R) is generally the same as the *allocation period* of Statement 141. The measurement period for a particular asset or liability ends as soon as the acquirer receives the necessary information about the facts and circumstances that existed as of the acquisition date. In addition, the measurement period is limited to one year from the acquisition date.

A.14 Statement 141(R) requires an acquirer to revise comparative prior-period information for any adjustments to provisional amounts recorded as of the acquisition date. In addition, the acquirer can only adjust provisional amounts if it receives new information about facts and circumstances that existed as of the acquisition date. Statement 141(R)'s requirement to revise comparative information for prior-period financial information represents a significant change from prior prevailing practice, in which adjustments to provisional amounts were generally accounted for prospectively as a change in accounting estimate when the new information was received.

Example A-2
Adjustments to Provisional Measurement Made During the Measurement Period

Company A acquires 100 percent of Company M on November 1, 20X9. Company A has a fiscal year-end of December 31. As part of the acquisition of Company M, Company A hired an independent appraisal firm to value the assets acquired and liabilities assumed (the "net assets"). This appraisal is not complete before Company A issues its financial statements for the year ended December 31, 20X9. Therefore, Company A records the assets acquired and liabilities assumed at provisional amounts when filing its December 31, 20X9, financial statements. As part of this provisional allocation, the acquired property, plant, and equipment (PP&E) is assigned a value of $450,000. This PP&E has a remaining useful life of three years as of the acquisition date and depreciation is recorded on a straight-line basis. Company A receives the final appraisal of the net assets on April 1, 20Y0. In the appraisal, the fair value of the PP&E as of the acquisition date is determined to be $480,000.

Under Statement 141(R), Company A is required to retrospectively adjust its 20X9 financial information as follows:

- PP&E is increased on December 31, 20X9, by $28,333, calculated as the $30,000 increase in the fair value of the PP&E, less $1,667 of additional depreciation expense that would have been recorded had the revised fair value been used as of the acquisition date.
- Goodwill is decreased by $30,000 on December 31, 20X9.
- Depreciation expense for the year ended December 31, 20X9, is increased by $1,667, representing the additional depreciation expense for 20X9 on the basis of the revised fair value of the PP&E.

Under Statement 141, Company A would have recorded all of these adjustments on April 1, 20Y0, and recognized the incremental depreciation expense prospectively as a change in accounting estimate.

Adjustments to Valuation Allowances for Acquired Deferred Tax Assets and Uncertain Tax Positions

A.15 The table below highlights differences between the standards.

Statement 141	Statement 141(R)
Adjustments were generally recorded to goodwill (not subject to the up-to-one-year allocation period). If no goodwill remained, other noncurrent intangible assets would first be reduced to zero, then the remaining amount recorded as a reduction of income tax expense.	Adjustments that occur after the measurement period are generally recorded as a component of income tax expense. Adjustments during the measurement period would generally be recorded as a component of goodwill unless the adjustment relates to an identifiable event that occurred after the business combination. In that case, the adjustment would be recorded to income tax expense. (See **14.03**.)

A.16 Under Statement 141, decreases in a valuation allowance for acquired deferred tax assets and all changes uncertain tax position balances were generally recorded through goodwill, regardless of whether such changes occurred during the allocation period or thereafter. However, under Statement 141, increases in valuation allowances were recorded as a component of income tax expense. Statement 141(R) requires that any adjustments to an acquired entity's valuation allowances for deferred tax assets and uncertain tax position balances that occur after the measurement period are recorded as a component of income tax expense. This requirement under Statement 141(R) applies to all business combinations, regardless of the consummation date. In other words, this requirement is the one transition provision that could affect the future accounting for business combinations consummated before Statement 141(R)'s effective date.

Example A-3
Adjustments to Acquired Deferred Tax Assets

Company A acquires 100 percent of Company M. As part of the acquisition, Company A acquired $1 million of deferred tax assets (DTAs) previously recorded by Company M and recognized a $400,000 valuation allowance due to uncertainty around the realization of the DTAs.

Scenario 1 — Six months after the acquisition closes and within the allocation/measurement period, Company A determines that, based on facts and circumstances that existed at the acquisition date, Company M should have recorded $100,000 less of a valuation allowance against the acquired deferred tax assets.

Statement 141	Statement 141(R)
Under Statement 141, decreases to valuation allowances on DTAs were generally recorded to goodwill regardless of whether the changes relate to facts and circumstances existing at the acquisition date. Valuation allowance on DTAs $100,000 Goodwill $100,000	Because the decrease to the valuation allowance on the DTAs is within the one-year measurement period and related to facts and circumstances that existed as of the acquisition date, such adjustment was recorded to goodwill as follows: Valuation allowance on DTAs $100,000 Goodwill $100,000 Had the adjustment to the valuation allowances on DTA's related to an identifiable event occurring **after** the acquisition date, Company A would have recorded the following entry: Valuation allowance on DTAs $100,000 Income tax expense $100,000

Scenario 2 — Eighteen months after the acquisition closes, Company A determines that Company M should have recorded $100,000 less of a valuation allowance against the acquired DTAs.

Statement 141	Statement 141(R)
Decreases to the valuation allowance on DTAs were not subject to the up-to-one-year allocation period and therefore were generally recorded against goodwill. Therefore, Company A recorded the following entry: Valuation allowance on DTAs $100,000 Goodwill $100,000	Adjustments to the valuation allowance on DTAs occurring outside the one-year measurement period are recorded to the income statement. Therefore, Company A recorded the following entry: Valuation allowance on DTAs $100,000 Income tax expense $100,000

Recognition of Deferred Tax Assets

A.17 The table below highlights differences between the standards.

Statement 141	Statement 141(R)
No deferred tax assets were recognized as of the acquisition date if tax deductible goodwill exceeded goodwill recorded as part of the purchase accounting for book purposes.	Deferred tax assets should be recognized as part of the acquisition accounting if tax deductible goodwill exceeds goodwill recorded as part of the acquisition accounting for book purposes. (See **8.45**.)

Acquisition-Related Costs

A.18 The table below highlights differences between the standards.

Statement 141	Statement 141(R)
Direct costs of the acquisition were capitalized as part of the business combination accounting (i.e., generally in goodwill).	Direct costs of the acquisition are accounted for separately from the business combination and generally expensed as incurred. (See **6.31**.)

A.19 Direct and incremental costs incurred as a result of the business combination (e.g., deal fees for legal, accounting, and investment banking services) must be expensed as incurred, which is a significant change from Statement 141. Costs incurred for the issuance of debt or equity securities to effect the combination are not within the scope of Statement 141(R) and would be accounted for in accordance with other applicable GAAP. Statement 141(R) also stipulates that an agreement by the acquirer to reimburse the acquiree or its former owners for paying the acquirer's acquisition-related costs is a transaction that is separate from the business combination. In other words, these costs must be expensed and excluded from the acquisition method accounting.

Partial Acquisitions

A.20 The table below highlights differences between the standards.

Statement 141	Statement 141(R)
Only the controlling interest's portion of the assets acquired and liabilities assumed were recorded at fair value as part of purchase accounting.	When control is obtained, 100 percent of the assets and liabilities of the acquiree are recorded by the acquirer at fair value. This is true even if less than 100 percent of the acquiree is obtained. (See **1.27**.)

A.21 Statement 141(R) requires companies to record 100 percent of the fair value of assets acquired and liabilities assumed when control is obtained, even if less than 100 percent of a business is acquired. This differs from Statement 141 and its related interpretive guidance, which required that only the controlling interest's share of the assets acquired and liabilities assumed be recognized at fair value and the remainder at book value. The FASB reasoned that once an acquirer obtains control of an entity, it controls all of an asset, not just a portion of it.

A.22 As a basic example, if the fair value of the acquired business's net assets was $10 million and the acquirer purchased 80 percent of the business, Statement 141(R) would require the acquirer to consolidate $10 million worth of net assets in its financial statements as of the acquisition date. However, if under prior GAAP the net assets acquired had a book value of $6 million as of the acquisition date, the acquirer would consolidate only $9.2 million of net assets (80 percent of $10 million plus 20 percent of $6 million).

A.23 Under Statement 141(R), the acquisition of a less-than-100 percent controlling interest in another entity will most likely result in a greater amount of depreciation and amortization expense in the postcombination income statement than would have been recognized under Statement 141.

Initial Measurement of the Noncontrolling Interest in a Subsidiary

A.24 The table below highlights differences between the standards.

Statement 141	Statement 141(R)
The noncontrolling interest (previously "minority interest") was recorded at its carrying value. No goodwill was allocated to the noncontrolling interest.	The noncontrolling interest's share of the fair value of net assets acquired is recorded, including its share of goodwill. (See **7.11**.)

A.25 Statement 141 referred to noncontrolling interests as "minority interests," but the meaning of the terms is the same. A noncontrolling interest is the portion of a subsidiary's equity that is attributable to the owners of the subsidiary, other than its parent or its parent's affiliates, when the subsidiary is controlled by its parent and is included in its parent's consolidated financial statements. Typically, noncontrolling interests represent less than a 50 percent interest in an entity. However, a noncontrolling shareholder in a variable interest entity might own more than 50 percent of the voting stock of the entity (even up to 100 percent) because the controlling entity exercises control by other means.

A.26 The noncontrolling interest will be measured initially at fair value (instead of book value, as previously required), which represents its share in the fair value of the identifiable assets acquired and liabilities assumed, plus its share of goodwill.

Example A-4
Acquisition of a Controlling Interest but Not 100 Percent of an Entity

Company A acquires 80 percent of Company B on June 1, 20X9 for $90. On the acquisition date, the fair value of 100 percent of Company B's net assets is $100 and the book value is $60. The fair value of the noncontrolling interest is $22.

Statement 141	Statement 141(R)
Company A would have consolidated $92 of net assets, calculated as follows: Controlling interest = $100 × 80% = $80 Noncontrolling interest = $ 60 × 20% = 12 $92 Company A would have recognized $10 of goodwill ($90 – [100 × 80%]).	Company A will consolidate $100 of net assets and will recognize goodwill of $12 ([$90 + 22] – 100). The noncontrolling interest will be recorded at $22.

Recognition of Liabilities Associated With Restructuring or Exit Activities of the Acquiree

A.27 The table below highlights differences between the standards.

Statement 141	Statement 141(R)
Estimated costs were recorded as a liability in the purchase price allocation if the criteria in Issue 95-3 were met.	Generally, only costs that meet the criteria in Statement 146 as of the acquisition date are included in the business combination accounting; all others are accounted for separately from the business combination. (See **4.28**.)

A.28 Costs that an acquirer expects to incur in the future that are related to its plans to exit an activity, involuntarily terminate employees, or relocate employees of an acquiree will not be assumed liabilities of the acquiree. In this regard, Statement 141(R) significantly changes Statement 141 and its related interpretive guidance, under which acquirers generally recorded liabilities for restructuring costs as long as the criteria in Issue 95-3 were met. Under Statement 141(R), if the acquiree has recorded liabilities in accordance with Statement 146 related to plans in place to exit an activity, involuntarily terminate employees, or relocate employees, such amounts will be considered liabilities assumed by the acquirer.

Reacquired Rights

A.29 The table below highlights differences between the standards.

Statement 141	Statement 141(R)
Rights were recorded as an identifiable intangible asset apart from goodwill and measured at fair value in accordance with Issue 04-1.	Rights are recorded as an identifiable intangible asset apart from goodwill. Value is based on the remaining contractual term (i.e., value does not take into account whether market participants would consider renewals). The asset should be amortized over the remaining contractual period. (See **5.31**.)

A.30 In a business combination, the acquirer may reacquire a right that had previously been granted to the acquiree (e.g., a license or franchise). Statement 141and Issue 04-1 stipulated that reacquired rights were identifiable intangible assets that must be recognized apart from goodwill. Statement 141(R) incorporates much of the guidance from Issue 04-1. However, the Board added guidance to Statement 141(R) stating that the asset would be measured on the basis of the remaining contractual term, regardless of whether market participants would take into account renewals in the fair value determination. Under Statement 141 and its related interpretive guidance, the fair value determination may have included expected renewal periods. Therefore, in these situations, reacquired rights represent an exception to the fair value measurement principle in Statement 141(R). In addition, Statement 141(R) requires that the asset, once acquired, be amortized over the remaining contractual period. Finally, if the intangible asset is sold to a third party, the carrying amount would be included in the gain or loss on sale.

In-Process Research & Development (IPR&D)

A.31 The table below highlights differences between the standards.

Statement 141	Statement 141(R)
The fair value of acquired IPR&D with no alternative future use was included in the purchase price allocation but was immediately expensed.	The fair value of acquired IPR&D is capitalized as an indefinite-lived intangible asset until completion or abandonment of the associated project. Upon project completion, the IPR&D asset is accounted for as a finite-lived intangible asset and amortized over the related product's estimated useful life. If the project is abandoned, the asset is expensed immediately if there is no alternative future use for it. Any costs incurred postacquisition are expensed as incurred. (See **5.26–5.30**.)

A.32 Research and development (R&D) expenditures may result in the development of certain intangible assets by the acquired entity that would be expensed as incurred in accordance with Statement 2 (unless they had an alternative future use). In other words, an acquired entity would probably not record any assets on its books before the consummation of a business combination related to R&D. However, the acquired IPR&D may represent an identifiable intangible asset to the acquirer.

A.33 Statement 141 required acquired IPR&D assets to be valued in the purchase price allocation and then immediately expensed. Under Statement 141(R), acquired IPR&D assets are not immediately expensed. Rather, acquired IPR&D is accounted for as an indefinite-lived intangible asset until completion or abandonment of the associated R&D efforts. Therefore, these assets would not be amortized, but would be tested for impairment at least annually. Once the R&D activities are completed, the assets would be amortized over the related product's useful life. If the project is abandoned, the assets would be written off if they have no alternative future use.

A.34 Statement 141(R) does not change the accounting for R&D expenditures incurred outside of a business combination. Therefore, any R&D expenditures incurred after the acquisition date that relate to an acquired IPR&D project would generally be expensed as incurred.

Example A-5
Acquired IPR&D

Company A acquires Company B for $2 million. The fair value of the assets acquired and liabilities assumed is as follows:

Investments	$ 900,000
Building	500,000
IPR&D	**500,000**
Liabilities	(100,000)
Net assets	$ 1,800,000
Cost	2,000,000
Goodwill	$ 200,000

The allocation of assets acquired, liabilities assumed, and goodwill recorded is the same under Statement 141 and Statement 141(R). However, under Statement 141, Company A would have immediately expensed the $500,000 in the postcombination income statement. Under Statement 141(R), the $500,000 would not be immediately expensed and the asset would be recorded in postcombination periods until it is (1) fully amortized, (2) written off because of abandonment of the R&D efforts, or (3) deemed impaired.

Preacquisition Contingencies

A.35 The table below highlights differences between the standards.

Statement 141	Statement 141(R)
Contractual/Noncontractual *Initial Recognition* — Amounts were recognized at fair value, if determinable, during the allocation period. If fair value was not determinable, Statement 5 was followed if its recognition criteria were met as of the acquisition date. *Subsequent Accounting* — No specific guidance was provided.	**Contractual** *Initial Recognition* — Amounts are recognized at fair value as of the acquisition date. (See **4.32**). *Subsequent Accounting* — Liabilities are measured at the greater of (1) the acquisition-date fair value or (2) the amount that would be recorded under Statement 5. Assets are measured at the lower of (1) the acquisition-date fair value or (2) the best estimate of the future settlement amount. (See **4.34–4.35**).
	Noncontractual *Initial Recognition* — Amounts are recognized at fair value as of the acquisition date if it is more likely than not that the contingency meets the definition of an asset or liability in Concepts Statement 6. (See **4.32**.) *Subsequent Accounting* — Same accounting as for contractual contingencies.

A.36 Under Statement 141(R), an acquirer must first determine whether contingent assets acquired and liabilities assumed are contractual or noncontractual. All contractual contingencies are recognized at fair value as of the acquisition date. Noncontractual contingencies are recognized at fair value only if it is more likely than not, as of the acquisition date, that the contingency gives rise to an asset or liability, as defined in Concepts Statement 6. In other words, an acquirer recognizes a noncontractual contingent liability at fair value as of the acquisition date if there is a greater than 50 percent chance that the acquirer has assumed a present obligation. An acquirer should account for a noncontractual contingency that does not meet this criterion in accordance with other GAAP (e.g., Statement 5). Statement 141 did not distinguish between contractual and noncontractual contingencies. Under Statement 141, such preacquisition contingencies were generally accounted for under Statement 5, which often meant that no amount was recorded as of the acquisition date.

A.37 Under Statement 141(R), when new information about the outcome of a contingency is obtained, a contingent liability recognized as of the acquisition date should subsequently be measured at the higher of the acquisition-date fair value or the amount that would be recognized under Statement 5. Similarly, a contingent asset recognized as of the acquisition date should subsequently be measured at the lower of the acquisition-date fair value or the best estimate of its future settlement amount. An acquirer would not derecognize the contingent asset or liability if it subsequently falls below the more-likely-than-not threshold. Rather, a contingent asset would be derecognized when it is collected or sold or when its rights are lost, whereas a contingent liability would be derecognized when it is settled or the obligation to settle is canceled or expires.

Editor's Note: On December 15, 2008, the FASB issued proposed FSP FAS 141(R)-a, which would amend Statement 141(R) to require that preacquisition contingencies generally be measured at fair value as of the acquisition date if such amounts can be reasonably determined. It is expected that the guidance in the proposed FSP would result in the recognition of more contingent assets and liabilities at fair value than the guidance in Statement 141, but fewer than the current Statement 141(R) guidance. This Roadmap will be updated for the final guidance once it is issued by the FASB.

Contingent Consideration

A.38 The table below highlights differences between the standards.

Statement 141	Statement 141(R)
Initial Recognition — Amounts that were determinable as of the acquisition date were included in the cost of the acquired business. *Subsequent Accounting for Liabilities and Equity* — Distributions upon resolution of contingencies that were based on (1) earnings resulted in additional cost of the acquired business or (2) securities prices did not change the recorded cost of the acquired business.	*Initial Recognition* — Amounts are recorded at their acquisition-date fair value regardless of whether the consideration is classified as a liability or equity. (See **6.23**.) *Subsequent Accounting for Liabilities* — Amounts are remeasured to fair value as of each reporting date until the contingency is resolved. The changes in fair value are recognized in earnings unless the arrangement is a hedging instrument for which Statement 133, as amended by Statement 141(R), requires changes to be recognized in other comprehensive income. (See **6.25** and **6.27**.) *Subsequent Accounting for Equity* — Amounts are not remeasured. (See **6.26**.)

A.39 Contingent consideration represents obligations of the acquirer to transfer additional assets (e.g., cash) or equity interests to the former owners of the acquired entity if specified future events occur or conditions are met. Under Statement 141, contingent consideration was generally recorded when the contingency was resolved. Therefore, nothing was typically recorded as of the acquisition date for contingent consideration arrangements. Under Statement 141(R), the fair value of all contingent consideration is recorded in the acquisition method accounting as of the acquisition date. Arrangements classified as liabilities are also required to be remeasured to fair value at the end of each reporting period until their settlement, with changes in fair value generally recognized in earnings.

Indemnification Assets

A.40 The table below highlights differences between the standards.

Statement 141	Statement 141(R)
Lack of guidance resulted in diverse accounting for indemnification assets.	Entities generally measure an indemnification asset at the same amount as its associated liability (less any contractual limitations or an allowance for collectibility), even if this measurement is not fair value. (See **4.46**.)

A.41 In a business combination, the seller may indemnify the acquirer for the resolution of a contingency or uncertainty that relates to a specific asset or liability. For example, the seller may indemnify the acquirer for specified losses over a certain dollar threshold when the losses are associated with a lawsuit that predated the business combination. In such a case, the acquirer has acquired an indemnification asset as part of the business combination. Statement 141(R) requires that the asset be measured on the same basis as the liability (less any contractual limitations or an allowance for collectibility), even if this measure is not fair value.

Example A-6
Indemnification Assets

On June 15, 20X9, Company A acquired 100 percent of Company B. Before the acquisition, Company B had a $1 million liability related to an uncertain tax position that was recognized in accordance with Interpretation 48. In applying the acquisition method of accounting, Company A must follow Interpretation 48 and, therefore, recognize a $1 million liability related to Company B's uncertain tax position (Company A agreed with Company B's analysis of the uncertain tax position). As part of the acquisition, the former owners of Company B agreed to indemnify Company A for any losses related to the tax position (including the $1 million liability recognized by Company A). Statement 141(R) requires that Company A record an indemnification asset at the same amount as the liability: $1 million (this assumes that collectibility is not in doubt), even though this amount most likely does not represent fair value (i.e., the measurement requirements of Interpretation 48 are not fair-value based).

Step Acquisitions

A.42 The table below highlights differences between the standards.

Statement 141	Statement 141(R)
An acquirer with a preexisting equity interest in the acquiree only recorded the fair value of the incremental interest that was acquired. The remaining noncontrolling interest was recorded at historical book value.	An acquirer records 100 percent of the fair value of the acquiree once control is obtained. A gain or loss is recognized on the preexisting equity interest held by the acquirer. Once an acquirer obtains control of the acquiree, subsequent transactions are recorded within equity and do not result in a remeasurement event. (See **5.41**.)

A.43 "Step acquisitions" occur when control of a business is obtained after the acquirer already owns a noncontrolling interest in the acquiree's equity. Under Statement 141(R), in a step acquisition, the acquirer's preexisting interest in the acquiree is remeasured to its fair value, with a resulting gain or loss recorded in the income statement upon consummation of the business combination. After the preexisting interest is remeasured to fair value, it is included in the fair value of the entire business acquired.

A.44 Furthermore, once control is obtained, acquisitions and dispositions of noncontrolling interests in the subsidiary are accounted for as equity transactions under Statement 160 (i.e., as long as control is retained, subsequent acquisitions and dispositions of equity interests will not result in a gain or loss).

Example A-7
Step Acquisitions

Company A purchases a 35 percent interest in Company F for $2 million on January 1, 20X8. Company A uses the equity method to account for its 35 percent interest in Company F. Company A's equity in the income of Company F from January 1, 20X8, to the end of December 31, 20X9, is $500,000; as a result, the book value of Company A's interest in Company F as of December 31, 20X9, is $2.5 million.

On December 31, 20X9, Company A purchases an additional 40 percent interest in Company F for $4 million. On this date, the total fair value of Company F is $10 million (assuming there is no control premium) and the fair value of 35 percent of Company F is $3.5 million.

Statement 141	Statement 141(R)
On December 31, 20X9, Company A accounts for the acquisition of control of Company F as a business combination in which the fair value of the additional 40 percent interest acquired is recorded. The previously held 35 percent interest was not remeasured on this date. The remaining 25 percent noncontrolling interest was recorded by Company A at its historical cost.	On December 31, 20X9, Company A's existing 35 percent interest in Company F is remeasured to $3.5 million, resulting in a gain of $1 million ($3.5 million less the $2.5 million book value) in the income statement. In addition, Company A would then account for the acquisition of control of Company F as a business combination in which the fair values of the controlling interest and noncontrolling interests are $7.5 million and $2.5 million, respectively.

Valuation Allowance for Assets Recorded at Fair Value

A.45 The table below highlights differences between the standards.

Statement 141	Statement 141(R)
Generally, assets were recognized at present value less allowances for uncollectibility and collection costs.	Assets are recognized at fair value in accordance with Statement 157, with no separate valuation allowance. (See **4.03**.)

A.46 Separate valuation allowances are not recognized on assets that are recorded at fair value as of the acquisition date. Statement 141(R) requires that receivables, including loans receivable, be recorded at fair value. Fair value measurements incorporate assumptions about collection risk, obviating the need for a separate valuation allowance. Thus, the impact of an uncollectible receivable becoming collectible after the acquisition date is not recorded until receipt of payment.

A.47 Under Statement 141, acquired loans and receivables were generally recorded at the present value of amounts to be received, which were determined using appropriate interest rates less allowances for uncollectibility and collection costs, if necessary. However, for loans within its scope, SOP 03-3 may have limited the amount of an acquiree's allowance for loan losses that could be carried forward in a business combination.

Assets That an Acquirer Intends Not to Use or Use in a Way Other Than Their Highest and Best Use

A.48 The table below highlights differences between the standards.

Statement 141	Statement 141(R)
Practice was diverse; typically assets were assigned no value, or their value related only to the period of expected use.	Assets are recorded at fair value pursuant to Statement 157 and according to their highest and best use. (See **4.02** and **5.09**.)

A.49 An acquirer may decide not to use an acquired asset for competitive or other reasons. For example, an acquirer may decide not to use an acquired brand name because it believes that its own brand is better positioned in the marketplace. If an acquirer decides not to use an acquired asset, but would defend such asset if a competitor attempted to use the asset, it is still generally required to recognize the asset and measure it at fair value in accordance with Statement 157. This valuation would need to reflect the asset's highest and best use, from a market participant's point of view, both as of the acquisition date and in subsequent impairment tests. Practice was diverse under Statement 141, and such assets were typically assigned either no value or a value that related only to the period of expected use.

Bargain Purchase (an Excess of Fair Value of Acquired Net Assets Over Cost)

A.50 The table below highlights differences between the standards.

Statement 141	Statement 141(R)
The excess of the fair value of the net assets acquired over the fair value of the consideration transferred (negative goodwill) reduced certain noncurrent assets on a pro rata basis. Any amount of the excess that remained after these assets were reduced to zero was recognized as an *extraordinary* gain.	A gain is recognized in the period the acquisition occurs. The gain is calculated as the excess of the fair value of the net assets acquired over the sum of (1) the fair value of the consideration transferred, (2) the fair value of any previously held equity interests, and (3) the fair value of any noncontrolling interests. There is no pro rata reduction of certain noncurrent assets. (See **5.42–5.45**.)

A.51 While not expected to be common, a bargain purchase occurs under Statement 141(R) when the aggregate of the fair value of the (1) consideration transferred, (2) noncontrolling interests in the acquiree, and (3) acquirer's previously held equity interest in the acquiree is less than the fair value of the net assets acquired. A bargain purchase may occur if, for example, the acquired entity is purchased in a forced liquidation or distress sale.

A.52 Statement 141(R) requires the acquiring entity to double-check its calculations before concluding that a bargain purchase exists. If the same conclusion is reached, any further excess is recognized as a gain in the income statement as of the acquisition date.

A.53 Under Statement 141, no gain was recorded until certain other noncurrent assets acquired (e.g., intangible, long-lived, and other noncurrent assets) were reduced to zero. Also, any gains from bargain purchases were classified as extraordinary under current Statement 141, whereas under Statement 141(R) they are not considered extraordinary gains.

Example A-8
Bargain Purchase

Company A acquires Company B for $500,000. The fair value of the assets acquired and liabilities assumed are as follows:

Investments	$ 900,000
Building	500,000
Trademark	500,000
Liabilities	(100,000)
Net assets	$ 1,800,000
Cost	500,000
Excess	$ 1,300,000

Under Statement 141, Company A would have reduced, on a pro rata basis, certain noncurrent assets (i.e., the building and trademark) and then recorded the remaining excess ($300,000) as an extraordinary gain as follows:

Account	**Fair Value**	**Value After Pro Rata Reduction**
Investments	$ 900,000	$ 900,000
Building	500,000	0
Trademark	500,000	0
Liabilities	(100,000)	(100,000)
Net Assets	$ 1,800,000	$ 800,000
Cost	500,000	500,000
Excess	$ 1,300,000	$ 300,000

Under Statement 141(R), Company A will record the entire excess ($1.3 million) as a gain.

Note: This example is not intended to illustrate the expected magnitude of a gain from a bargain purchase.

Leveraged Buyouts

A.54 The table below highlights differences between the standards.

Statement 141	Statement 141(R)
The guidance in Issue 88-16 was followed.	The acquisition method of accounting in Statement 141(R) is followed. (See **1.25**.)

A.55 While Statement 141(R) eliminates the complex accounting for leveraged buyouts, it does not impact the accounting for a leveraged recapitalization transaction.

Share-Based Payment Awards Exchanged for Awards Held by the Acquiree's Employees

A.56 The table below highlights differences between the standards.

Statement 141	Statement 141(R)
Value of acquirer's replacement awards recorded as part of total consideration transferred — Calculated as the amount attributable to any service period that was executed before the acquisition date, regardless of whether the acquirer was obligated to exchange the awards. Such amount did not include the excess of the fair value of the replacement awards over the fair value of the replaced awards. This fair value was measured on the basis of the terms of the replacement awards, even if such awards were not fully vested on the acquisition date.	*Value of acquirer's replacement awards recorded as part of total consideration transferred* — If an obligation exists, the acquisition-date fair value of the replaced awards is multiplied by the ratio of the past service period to the greater of (1) the total service period or (2) the original service period (see **6.12–6.16**).
Value of acquirer's replacement awards recognized as compensation cost — Calculated as the amount attributable to the portion of the service period that occurred after the acquisition date, as well as any excess of the fair value of the replacement awards over the fair value of the replaced awards.	*Value of acquirer's replacement awards recognized as compensation cost* — If an obligation exists, calculated as the excess of the total fair value of the replacement awards less the amount recorded as part of the total consideration transferred. The acquirer recognizes this amount as compensation cost over the postacquisition service period (see **6.15**).

A.57 Statement 141 and its related interpretations required exchanges of employee stock options to be included in the purchase price even if the acquirer was not obligated to exchange the awards. Statement 141(R) generally limits this accounting to situations in which the acquirer is obligated to replace such awards. Note that fair value as described above is determined in accordance with Statement 123(R).

A.58 The method under Statement 141(R) prevents an acquirer that accelerates vesting of replacement awards as part of the exchange from reducing total compensation cost in future periods. Any excess fair value of the replacement awards will still be recorded by the acquirer as compensation cost.

Pension and Other Postretirement Benefit Obligations

A.59 The table below highlights differences between the standards.

Statement 141	Statement 141(R)
If the plan of the acquiree was expected to be terminated or curtailed postacquisition, such expectations **should have** been considered when the entity measured the acquisition-date projected and accumulated postretirement benefit obligations that were assumed by the acquirer.	If the plan of the acquiree is expected to be terminated or curtailed postacquisition, such expectations **should not** be considered when the entity measures the acquisition-date projected and accumulated postretirement benefit obligations that are assumed by the acquirer. (See **4.43**.)

A.60 Under Statement 141(R), any changes to an acquiree's defined benefit plans that an acquirer is not required to make do not affect the amount recorded in the acquisition method accounting. Rather, any such amendments that are made by the acquirer to the acquiree's defined benefit plans affect the postcombination financial statements.

Disclosure Additions, Modifications, and Deletions

A.61 The table below highlights differences between the standards.

Statement 141	Statement 141(R)
Specific minimum disclosure requirements were specified in paragraphs 51–58.	Overall objectives are specified for disclosure of information that would be useful to users in evaluating the financial effects of a business combination. Specific disclosures are indicated that will generally be required to meet those objectives. See paragraphs 67 and 71.
No specific disclosures were required for acquired receivables other than the amount assigned to receivables.	Specific disclosure requirements are indicated for acquired receivables, including fair value, gross contractual amount, and best estimate of contractual cash flows not expected to be collected. See paragraph 68(h).
Basic disclosures were required for the amount of contingent consideration. See paragraph 51(f).	Expanded disclosures of contingent consideration are required that include a description of the arrangement, basis for determining the amount, and an estimate of the range of outcomes. See paragraph 68(g).
Disclosure of supplemental pro forma information was required for public companies as if the business combination was completed at the beginning of the earliest reporting period presented. See paragraph 54.	Disclosure of supplemental pro forma information is required for public companies as if the business combination was completed at the beginning of the annual reporting period, current interim period, and cumulative interim periods. See paragraph 68(r).
No specific disclosures were required for contingent assets or liabilities other than the amounts assigned.	Specific disclosures are required for acquired contingencies, including amounts recognized or an explanation of no recognition, the nature of amounts recognized or unrecognized, and the estimated range of outcomes. See paragraph 68(j).
No disclosures were required for acquisition-related costs.	Disclose acquisition-related costs and the line item in which they are recognized. See paragraph 68(n).
Noncontrolling interests were not accounted for at fair value.	The fair value of the noncontrolling interest, and the valuation techniques and significant inputs used to measure the fair value, must be disclosed. See paragraph 68(p).
No specific disclosures were required for previously held interests in acquisitions achieved in stages.	Specific information on the previously held interests, and the gain or loss associated with acquisitions achieved in stages, must be disclosed. See paragraph 68(q).
Disclosures were required for an extraordinary gain related to a business combination, including a description of the nature of the principal items entering into the determination of an extraordinary gain. See paragraph 56.	Disclosure is required of the amount of any gain recognized in a bargain purchase, the line item in the income statement where it is recognized, and a description of the reasons why the transaction resulted in a gain. See paragraph 68(o).
No specific disclosures were required for transactions that were recognized separately.	Specific disclosures are required for transactions that are recognized separately from the business combination. See paragraph 68(m).
Disclosures were required of the amount of IPR&D assets acquired and written off in the period. See paragraph 51(g).	IPR&D assets are accounted for as intangible assets, with disclosures as required by Statement 142.
Disclosure requirements for interim periods were reduced. See paragraph 58.	Disclosure requirements are not reduced for interim periods.

Appendix B — Differences Between Pre-Amended ARB 51 and Statement 160

B.01 While Statement 160 amends ARB 51's guidance on accounting for noncontrolling interests and deconsolidations, including related presentation and disclosures, it carries forward without reconsideration much of the existing guidance on the consolidation model and policies. This appendix compares the previous guidance in ARB 51 with the new guidance in Statement 160.

Presentation of Noncontrolling Interests — Consolidated Statement of Financial Position

B.02 The table below highlights the differences between the standards.

Pre-amended ARB 51	Statement 160
Classify as a liability or mezzanine (or temporary) equity.	Classify as a separate component of shareholders' equity. (See **12.11**.)

B.03 Referred to as a "minority interest" in Statement 141, a noncontrolling interest is the portion of a subsidiary's equity that is attributable to the owners of the subsidiary other than its parent or its parent's affiliates. (That subsidiary is controlled by its parent and is included in its parent's consolidated financial statements.) Typically, a noncontrolling interest holder owns less than 50 percent of an entity; however, there are exceptions. For example, in the case of a variable interest entity under Interpretation 46(R), a noncontrolling interest holder might own more than 50 percent of the voting stock of the entity (even up to 100 percent) because the controlling entity exercises control by other means.

B.04 While Statement 160 requires that noncontrolling interests be recorded in permanent equity, certain noncontrolling interests may need to be classified outside of permanent equity under other accounting literature (e.g., Statement 150, ASR 268 (FRR Section 211), Topic D-98). (See **7.05–7.06**.) For noncontrolling interests now considered part of permanent equity, the parent must apply Statement 160's presentation requirements retrospectively for all periods presented. The reclassification of noncontrolling interests to shareholders' equity may affect key financial statement ratios (e.g., debt-to-equity, return-on-equity).

Example B-1
Consolidated Statement of Financial Position Presentation Under Statement 160

XYZ Co.
Consolidated Balance Sheets
(in millions)

	December 31, 20X9	**December 31, 20X8**
ASSETS		
Total assets	$ 200	$ 180
LIABILITIES		
Total liabilities	$ 120	$ 110
~~**Minority interest**~~	~~25~~	~~20~~
SHAREHOLDERS' EQUITY		
Common stock	15	15
Additional paid-in capital	30	30
Retained earnings	10	5
Total XYZ Co. shareholders' equity	55	50
Noncontrolling interest	25	20
Total shareholders' equity	80	70
Total liabilities and shareholders' equity	$ 200	$ 180

Presentation of Noncontrolling Interests — Consolidated Statement of Income

B.05 The table below highlights the differences between the standards.

Pre-amended ARB 51	Statement 160
Record the noncontrolling interest's share of earnings (or losses) as a deduction (or addition) used in determining consolidated net income.	Allocate consolidated net income to the parent and the noncontrolling interest. (See **12.13**.)

B.06 Before Statement 160, the parent generally presented net income attributable to the noncontrolling interest on a single line item in the consolidated statement of income, between the deduction for income taxes and income from continuing operations. As shown in Example B-2 below, Statement 160 requires the parent to present net income attributable to the noncontrolling interest on a single line item *after* consolidated net income in the consolidated statement of income. Therefore, consolidated net income now includes amounts attributable to both the controlling and the noncontrolling interests.

B.07 Statement 160 changes neither the methods used to allocate net income between the parent and the noncontrolling interest (except as indicated in **B.12** below) nor the methods for calculating earnings per share (EPS) (i.e., basic and diluted EPS is still calculated solely on the basis of net income attributed to the parent). However, because of the change in presentation, Statement 160 now requires the parent to disclose its share of the following consolidated amounts: (1) income from continuing operations, (2) discontinued operations, and (3) extraordinary items.

Example B-2
Consolidated Statement of Income Presentation Under Statement 160

XYZ Co.
Consolidated Statement of Income for the Year Ended December 31

Pre-amended ARB 51	**20X9**	**Statement 160**	**20X9**
Revenues	$ 725,000	Revenues	$ 725,000
Costs and expenses	(525,000)	Costs and expenses	(525,000)
Income from continuing operations, before tax	200,000	Income from continuing operations, before tax	200,000
Income taxes	(78,000)	Income taxes	(78,000)
Minority interest	(27,800)	Net income	122,000
Net income	$ 94,200	**Less: Net income attributable to the noncontrolling interest**	(27,800)
		Net income attributable to XYZ Co.	$ 94,200

B.08 Statement 160 also requires a similar allocation of comprehensive income between the parent and the noncontrolling interest. (For an illustrative consolidated statement of comprehensive income, see **12.17**.)

Changes in the Parent's Ownership Interest in a Subsidiary When There Is No Change in Control

B.09 The table below highlights the differences between the standards.

Pre-amended ARB 51	Statement 160
Account for increases in ownership under the purchase method. Recognize decreases as sales of a portion of the subsidiary that may result in gain or loss recognition.	Record as an equity transaction. No additional purchase accounting is applied, and no gains or losses are recognized. (See **7.21**.)

B.10 Under Statement 160, the parent accounts for changes in its ownership interest in a subsidiary when it has, and will continue to maintain, control of the subsidiary as equity transactions. The parent can no longer recognize a gain or loss in consolidated net income or comprehensive income on such transactions (i.e., no more SAB 51 (SAB Topic 5.H) gains or losses), nor is the parent permitted to step up a portion of the subsidiary's net assets to fair value to the extent of any additional interests acquired (i.e., no additional acquisition method accounting is permitted).

B.11 Under Statement 160, any difference between the consideration paid or received and the book value of those interests is recorded as an adjustment to the controlling interest's equity (additional paid-in capital). Also, it may be necessary to reallocate accumulated other comprehensive income between the parent and the noncontrolling interest. These changes must be applied prospectively; prior transactions cannot be changed.

Example B-3
Changes in the Parent's Ownership Interest in a Subsidiary When There Is No Change in Control

Parent X owns 80 percent of Subsidiary A before entering into the following two transactions. Because the transactions are independent, X is not required to account for them as a single transaction.

Year 1 Transaction

- Parent X purchases an additional 20 percent interest in A for $50.
- Immediately before the transaction, the book value of A's net assets is $100, of which $80 is allocated to X and $20 is allocated to the noncontrolling interest.
- As of the transaction date, the fair value of A's identifiable net assets is $200.

Parent X accounts for this transaction in the consolidated financial statements as follows:

Pre-amended ARB 51			Statement 160		
	Debit	**Credit**		**Debit**	**Credit**
Fair value of A's assets	$ 20		Noncontrolling interest	$ 20	
Noncontrolling interest	20		APIC	30	
Goodwill	10		Cash		$ 50
Cash		$ 50			
To record the step up to fair value for the acquisition of the remaining 20 percent noncontrolling interest ([$200 × 20%] – $20 book value). Goodwill is calculated as ($50 – [$200 × 20%]).			To record the difference between (1) the carrying value of the noncontrolling interest and (2) the cash paid to acquire the noncontrolling interest as additional paid in capital (APIC).		

Year 2 Transaction

- Subsidiary A issues additional stock to unrelated parties for total proceeds of $90.
- After the transaction, X's ownership interest in A is diluted from 100 percent to 70 percent.
- After the transaction, the book value of A's net assets is $200, of which $140 (70 percent) is allocated to X and $60 (30 percent) is allocated to the noncontrolling interest.

Parent X accounts for this transaction in the consolidated financial statements as follows:

Pre-amended ARB 51			Statement 160		
	Debit	**Credit**		**Debit**	**Credit**
Cash	$ 90		Cash	$ 90	
Noncontrolling interest		$ 60	Noncontrolling interest		$ 60
Gain		30	APIC		30
To record the noncontrolling interest and gain resulting from the issuance of stock. This example assumes that the criteria for gain recognition are met.			To record the noncontrolling interest resulting from the issuance of stock. The difference between the cash received and carrying value of the interest in Subsidiary A is recorded in APIC.		

Accumulated Net Losses Attributable to the Noncontrolling Interest

B.12 The table below highlights the differences between the standards.

Pre-amended ARB 51	Statement 160
Generally, limited to the carrying amount of the noncontrolling interest.	No longer limited to the carrying amount of the noncontrolling interest. Noncontrolling interest could have a negative carrying balance. (See **7.18**.)

B.13 Unlike the pre-amended ARB 51, Statement 160 allows accumulated losses attributable to the noncontrolling interest to exceed their equity interests in the subsidiary. That is, a noncontrolling interest can be in a debit position (i.e., a negative noncontrolling interest). While this change is prospective, Statement 160 requires pro forma disclosures, in the year of adoption, of any significant impact this change would have had on the controlling interest's share of net income and earnings per share. (See **14.63**.)

Parent Deconsolidates a Subsidiary but Retains a Noncontrolling Investment

B.14 The table below highlights the differences between the standards.

Pre-amended ARB 51	Statement 160
No remeasurement of retained noncontrolling investment.	Remeasure retained noncontrolling investment to fair value on the date control is lost. (See **7.24**.)

B.15 In some instances, a parent deconsolidates a subsidiary but retains a noncontrolling investment in that former subsidiary (e.g., a parent sells only 75 percent of a wholly owned subsidiary). Before Statement 160, the former parent measured its retained noncontrolling investment as a percentage of the subsidiary's book value on the date control was lost. In other words, the former parent's new investment balance was derived from the carrying value of the former subsidiary and no gain or loss was recognized in connection with the retained investment. Under Statement 160, the former parent's retained noncontrolling investment is remeasured to fair value on the date control is lost, thereby affecting the overall gain or loss on deconsolidation of the former subsidiary.

Example B-4
Parent Deconsolidates a Subsidiary but Retains a Noncontrolling Investment

On January 1, 20X9, Parent X sells 75 percent of its wholly owned subsidiary (Y) to an unrelated third party for $250. Assume that (1) the book value of Y is $100 immediately before the transaction; (2) X's retained 25 percent investment in Y has a fair value of $75 as of January 1, 20X9; and (3) the fair value of 100 percent of Y is $325 as of January 1, 20X9.

The table below illustrates how the guidance in the pre-amended ARB 51 would differ from that in Statement 160 regarding (1) calculation of the gain/loss on deconsolidation and (2) measurement of the carrying value of X's retained investment as of the transaction date.

	Pre-amended ARB 51	Statement 160
Cash proceeds	$ 250	$ 250
Retained noncontrolling investment in Y	25	75
	275	325
Less: Current book value of Y	(100)	(100)
Gain on Sale	**$ 175**	**$ 225**

Carrying value for former parent's retained investment

B.16 In addition, Statement 160 requires the parent to consider whether multiple arrangements should be accounted for as a single transaction. (See **7.31**.) This requirement is intended to prevent companies from minimizing earnings implications when disposing of a subsidiary (e.g., a parent that intended to sell a 100-percent-owned subsidiary at a loss). Without this requirement, the parent may attempt to structure the sale in two transactions in a way that minimizes the sale's negative effect on earnings. In the first transaction, for example, the parent may sell 49 percent. Since the parent retains control, the loss would be recorded in equity and there would be no effect on earnings. In the second transaction, the parent may sell the remaining 51 percent. However, since the parent now loses control, this portion of the loss is recorded in the income statement.

Disclosure of Changes in Equity That Are Attributable to the Noncontrolling Interest

B.17 The table below highlights the differences between the standards.

Pre-amended ARB 51	Statement 160
No such disclosures were required because entities recorded noncontrolling interests outside of shareholders' equity.	Disclose either in the consolidated statement of changes in equity, if presented, or in the notes to the consolidated financial statements, (1) changes in total equity, (2) changes in equity that are attributable to the parent, and (3) changes in equity that are attributable to the noncontrolling interest. (See **13.35**.)

B.18 Statement 160 does not explicitly state which entities must present a separate consolidated statement of changes in equity. Generally, only SEC registrants are required to present such a statement.

Disclosure of Effects of Changes in the Parent's Ownership Interest

B.19 The table below highlights the differences between the standards.

Pre-amended ARB 51	Statement 160
No specific disclosure requirement.	Disclose the effects on equity that are attributable to the parent in a separate schedule in the footnotes to the consolidated financial statements. (See **13.36–13.38**.)

B.20 This separate schedule is only required for periods in which the parent's ownership interest in its subsidiary changes. In addition, the schedule excludes changes in accumulated other comprehensive income that are attributable to the parent, a key difference from the disclosure of changes in equity that are attributable to the noncontrolling interest. (See **B.17**.)

Appendix C — Differences Between U.S. GAAP and IFRSs

C.01 This Appendix discusses key differences between the following standards:

- Statement 141(R) and IFRS 3(R) — accounting for business combinations.
- Statement 160 and IAS 27(R) — accounting for noncontrolling interests, changes in a parent's ownership interest, and deconsolidations.
- Statement 142 and both IAS 36 and IAS 38 — accounting for intangible assets and goodwill.

Differences Between Statement 141(R) and IFRS 3(R)

C.02 Although the issuance of Statement 141(R) and IFRS 3(R) marked the completion of the most significant convergence project to date between the FASB and IASB, some differences remain between the standards.

C.03 The differences discussed in this section can be categorized as follows: (1) different conclusions reached during the joint business combinations convergence project and (2) differences outside the scope of the joint business combinations convergence project that stem primarily from references to other FASB or IASB standards. The boards intend to address some of the latter differences in future convergence projects (e.g., leases, consolidations, fair value, and postemployment benefits).

Different Conclusions Reached During the Joint Business Combinations Convergence Project

Effective Date and Transition

C.04 The table below highlights differences between the standards.

Statement 141(R)	IFRS 3(R)
Apply prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Early adoption is **prohibited**. (See **14.01**.)	Apply prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after July 1, 2009. Early adoption is **permitted**.

C.05 The boards originally intended to make the effective dates of the respective standards approximately the same. However, because of delays in the issuance of the final standards, as well as the IASB's promise to give its constituents at least an 18-month transition period for newly issued standards, the IASB pushed back its effective date. Early adoption is permitted by the IASB partially because the revisions to the existing guidance in IFRS 3 were not as significant as the revisions to Statement 141. Entities electing to early adopt IFRS 3(R) must also early adopt IAS 27(R) and consequential amendments to IAS 28(R) and IAS 31(R) at the same time.

Scope

C.06 The table below highlights differences between the standards.

Statement 141(R)	IFRS 3(R)
Scope exception for combinations between not-for-profit organizations or acquisitions of a for-profit business by a not-for-profit organization. (See **1.47**.)	No scope exception for combinations between not-for-profit organizations or acquisitions of a for-profit business by a not-for-profit organization.
The primary beneficiary of a variable interest entity (VIE) under Interpretation 46(R) that meets the definition of a business must apply Statement 141(R) upon initial consolidation of the VIE. (See **1.17–1.21**.)	The IASB does not have a variable interest consolidation model that is equivalent to the FASB's Interpretation 46(R).

C.07 Unlike U.S. GAAP, IFRSs generally do not have scope limitations for not-for-profit organizations.

C.08 While not part of international convergence, a project on the FASB's agenda addresses accounting for mergers and acquisitions involving not-for-profit organizations, as well as subsequent accounting for goodwill and other intangible assets for such entities. In October 2006, the FASB released two exposure drafts: *Not-for-Profit Organizations: Mergers and Acquisitions* and *Not-for-Profit Organizations: Goodwill and Other Intangible Assets Acquired in a Merger or Acquisition.* In May 2008, the FASB requested comments, due in July 2008, on potential revisions to the exposure drafts and expects to issue final standards in the first half of 2009.

C.09 A long-term goal of the FASB and IASB is convergence of their respective consolidation models and guidance, but they have made no significant progress to date. See **C.31** below for a comparison of the definition of control under U.S. GAAP and IFRSs. (Note that the definitions fall outside the scope of the joint business combinations convergence project.) On December 18, 2008, the IASB issued an exposure draft, ED 10, *Consolidated Financial Statements*, which would modify the definition of control under IFRS. This exposure document was not issued as part of a joint convergence project with the FASB.

C.10 Transactions between entities under common control are not in the scope of Statement 141(R) and IFRS 3(R). Under U.S. GAAP, Appendix D of Statement 141(R) provides supplemental guidance on accounting for these transactions (see **1.41–1.42**). Under IFRSs, there is currently no specific guidance on accounting for common control transactions. However, in December 2007 the IASB added a project on this topic to its agenda. In the absence of specific guidance, entities reporting under IFRSs and that are involved in common control transactions should select an appropriate accounting policy by using the hierarchy described in paragraphs 10–12 of IAS 8. Because the hierarchy permits the consideration of pronouncements of other standard-setting bodies, the guidance on common control transactions in U.S. GAAP may be applied in practice.

Noncontrolling Interests — Initial Measurement

C.11 The table below highlights differences between the standards.

Statement 141(R)	IFRS 3(R)
Measure at fair value. Disclose valuation techniques and significant inputs used. (See **7.07** and **13.16**.)	Measure at fair value **or** proportionate share of the fair value of the acquiree's identifiable net assets (i.e., no goodwill attributed). Disclose (1) measurement basis used and (2) if measured at fair value, valuation techniques and significant inputs used.

C.12 The IASB gives entities two options, on an acquisition-by-acquisition-basis, for measuring the noncontrolling interest in a business combination where control is obtained but less than 100 percent of the business acquired. The first is to measure the noncontrolling interest at its proportionate share of the fair value of the acquiree's identifiable net assets, which is consistent with prior requirements in IFRS 3. The second is to measure the noncontrolling interest at fair value, which is consistent with the FASB's Statement 141(R) requirement. Fair value measurements of the noncontrolling interest, under either standard, include goodwill attributable to the noncontrolling interest.

Example C-1

Comparison of the IASB's Options for Measuring Noncontrolling Interests

Company A acquires 65 percent of Company B in a business combination for $750 in cash, which represents the fair value of the controlling interest and includes a control premium. The fair value of the noncontrolling interest is $350, so for purposes of this example assume that the total fair value of Company B is $1,100 ($750 + $350).* As of the acquisition date, the fair value of Company B's identifiable net assets acquired (i.e., assets acquired net of liabilities assumed) is $800.

The following table illustrates the difference between measuring the noncontrolling interest at (1) fair value, as required under Statement 141(R) and one of two options available to entities applying IFRS 3(R) and (2) the proportionate share of the fair value of the acquiree's identifiable net assets, which is the other option available to entities applying IFRS 3(R):

	Fair Value	Proportionate Share of Acquiree's Identifiable Net Assets
Net Assets Acquired	$ 800	$ 800
Total Goodwill	**$ 300****	**$ 230**†
Goodwill Attributed to the Controlling Interest	(230)†	(230)
Goodwill Attributed to the Noncontrolling Interest	$ 70	$ 0‡
Noncontrolling Interest	**$ 350**	**$ 280**^

Note: This example is intended to highlight the difference between the values of the noncontrolling interest under the two acceptable methodologies under IFRS 3(R). It is not intended to illustrate the manner in which goodwill is calculated. See Example 5-4 for an illustrative example of the calculation of goodwill under Statement 141(R), which would be similar under IFRS 3(R).

* The fair value of an entity as a whole will not always equal the sum of the fair value of the controlling interest and noncontrolling interest.

** Fair value of Company B ($1,100) less fair value of Company B's identifiable net assets acquired ($800).

† Fair value of 65 percent of Company B ($750) less fair value of 65 percent of Company B's identifiable net assets acquired ($800 × 65%, or $520). Under the fair value scenario, the controlling interest's share of goodwill is not 65 percent of the total amount of goodwill because of the presence of a control premium.

‡ Under this option, the noncontrolling interest does not include any value related to the goodwill.

^ Fair value of 35 percent of Company B's identifiable net assets acquired ($800 × 35%).

Acquired Contingencies — Initial Measurement

C.13 The table below highlights differences between the standards.

Statement 141(R)	IFRS 3(R)
Recognize assets acquired and liabilities assumed that arise from contractual contingencies at fair value. Recognize assets acquired and liabilities assumed that arise from noncontractual contingencies at fair value if the contingency meets the more-likely-than-not threshold. (See **4.32**.)	Recognize a contingent liability at fair value if it (1) is a present obligation that arises from a past event and (2) can be measured reliably.

C.14 Statement 141(R) and IFRS 3(R) differ in three key ways on the initial measurement of acquired contingencies. First, contingent assets are not recognized under IFRS 3(R). Second, Statement 141(R) has a recognition threshold for noncontractual contingencies (i.e., the contingency must more likely than not give rise to an asset or a liability in accordance with Concepts Statement No. 6 to be recognized) while IFRS 3(R) does not have a similar threshold for contingent liabilities. This difference may result in more contingent liabilities being recognized under IFRS 3(R) than under Statement 141(R). Finally, IFRS 3(R) has a reliability threshold for determining the fair value measurement of a contingent liability, while Statement 141(R), which refers to Statement 157's fair value measurement guidance, does not have a similar threshold.

C.15 On December 15, 2008, the FASB issued proposed FSP FAS 141(R)-a, which would amend Statement 141(R) to require that preacquisition contingencies generally be measured at fair value as of the acquisition date if such amounts can be reasonably determined. It is expected that the guidance in the proposed FSP would result in the recognition of more contingent assets and liabilities at fair value than the guidance in Statement 141, but fewer than the current Statement 141(R) guidance. This Roadmap will be updated for the final guidance once it is issued by the FASB.

Example C-2
Initial Measurement of an Assumed Noncontractual Contingency — Statement 141(R) and IFRS 3(R)

On January 1, 20X9, Company A acquires Company B in a business combination. As of the acquisition date, Company B is defending a pending lawsuit in which the plaintiffs are claiming their property was contaminated by pollutants from Company B's neighboring factory. The plaintiffs have asserted a claim of $100 million for the costs of the cleanup, and Company A believes that there is only a 30 percent chance that the combined companies will be found liable in a court of law.

Because Company A estimates that it does not have a greater than 50 percent chance of being found liable for this noncontractual contingency, under Statement 141(R) the more-likely-than-not recognition threshold is not met, and Company A would not record an assumed liability as of the acquisition date. In subsequent periods, Company A would follow the accounting guidance in Statement 5.

Under IFRS 3(R), because the contingency is a present obligation that arises from a past event and can be measured reliably, Company A would recognize a liability as of the acquisition date measured at fair value. Uncertainty about the outcome of the lawsuit, as well as other adjustments such as discounting, would be factored into the liability's fair value measurement. As a result, the fair value of the liability as of the acquisition date will most likely be less than the total estimated future claims of $100 million. Unlike Statement 141(R), IFRS 3(R) does not have a more-than-likely-than-not recognition threshold for assumed contingencies.

Acquired Contingencies Recognized as of the Acquisition Date — Subsequent Measurement

C.16 The table below highlights differences between the standards.

Statement 141(R)	IFRS 3(R)
For a contingent asset, record the lower of its acquisition-date fair value or the best estimate of its future settlement amount. For a contingent liability, record the higher of its acquisition-date fair value or the amount that would be recognized under Statement 5. (See **4.34–4.35**.)	For a contingent liability, until the liability is settled, cancelled, or expired, record the higher of the amount calculated under IAS 37 or the acquisition-date fair value less cumulative amortization recognized under IAS 18 (if appropriate).

C.17 Both Statement 141(R) and IFRS 3(R) contain specific guidance on the subsequent measurement of acquired contingencies. Because the guidance is not fully converged, however, accounting can differ as a result of the models for contingencies under U.S. GAAP (Statement 5) and IFRSs (IAS 37).

C.18 Note that the IASB has a project on its agenda to reconsider the guidance on the recognition and measurement of liabilities, including contingent liabilities, under IAS 37. A final standard is not expected until the second half of 2009. Also, the FASB's agenda includes a project to reconsider the disclosure requirements for contingencies in Statements 5 and 141(R). A final standard, if issued, would be effective for fiscal years no sooner than those ending after December 15, 2009. This project may also include a second phase in which the recognition and measurement requirements for contingencies would be reconsidered.

Operating Leases in Which the Acquiree Is the Lessor

C.19 The table below highlights differences between the standards.

Statement 141(R)	IFRS 3(R)
Recognize an intangible asset or liability apart from the acquired asset (that is subject to an operating lease in which the acquiree is the lessor) if the terms of the lease are favorable or unfavorable, respectively, relative to current market terms or prices. (See **4.18**.)	Recognize favorable or unfavorable terms of the operating lease, relative to current market terms or prices, as part of the fair value of the acquired asset (that is subject to an operating lease in which the acquiree is the lessor); the acquirer does not present a separate intangible asset or liability.

C.20 Both Statement 141(R) and IFRS 3(R) require the acquirer to recognize favorable or unfavorable terms of the acquiree's operating leases. However, the acquirer's presentation of the recognized amounts differs under Statement 141(R) and IFRS 3(R) when the acquiree is the lessor. Under Statement 141(R), the acquirer presents the value of the favorable or unfavorable terms separately from the acquired asset (that is subject to an operating lease in which the acquiree is the lessor), whereas under IFRS 3(R), when a cost model is followed, the acquirer presents the value of the favorable or unfavorable terms as part of the fair value of the acquired asset subject to the lease. Despite the difference in presentation, IAS 16's requirement for entities to depreciate or amortize separately each significant portion of plant, property, and equipment is likely to result in similar depreciation or amortization expense over the life of the lease under U.S. GAAP and IFRSs. In other words, the depreciable lives and depreciation methods for the building and the favorable or unfavorable component of the operating lease may differ.

Example C-3 **Acquired Operating Lease in Which the Acquiree Is the Lessor and the Terms Are Favorable to Market**
Company C acquires Company D in a business combination. Company D has been leasing a portion of its warehouse to a third party under a long-term lease agreement that is not renewable and expires five years after the acquisition date. As of the acquisition date, the lease is favorable by $10 million relative to current market prices for similar properties in the area. The acquired warehouse has an acquisition-date fair value of $75 million (valued "as if vacant," which excludes the value of the favorable lease; see **5.37**) and a remaining useful life of 20 years.
Under Statement 141(R), Company C would record two identifiable assets acquired as of the acquisition date as follows: (1) a building with a fair value of $75 million and (2) a finite-lived intangible asset with a fair value of $10 million. The building and intangible asset would be amortized over their remaining useful lives of 20 and 5 years, respectively.
Under IFRS 3(R), Company C would generally record a single asset for the building at $85 million as of the acquisition date. However, paragraph 43 of IAS 16 states that in the calculation of subsequent depreciation expense, the amount attributable to the building ($75 million) must be depreciated separately, using a 20-year life, from the amount attributable to the favorable lease ($10 million), which would use a 5-year life. Depreciation expense would be recorded in accordance with IAS 16.

Contingent Consideration Classified as a Liability — Subsequent Measurement

C.21 The table below highlights differences between the standards.

Statement 141(R)	IFRS 3(R)
Record at fair value. (See **6.25**.)	Record financial instruments that are within the scope of IAS 39 at fair value. Otherwise, use the best-estimate approach under IAS 37 or follow other IFRSs as appropriate.

C.22 When a contingent consideration arrangement is classified as a liability, the acquirer remeasures the liability each reporting period until the contingency is resolved. In practice, under both Statement 141(R) and IFRS 3(R), subsequent fluctuations in the recorded liability are generally recognized in earnings. Under IAS 37, the acquirer measures liabilities using the best estimate of the expenditures it expects to incur in the future to settle the obligation, which can also be discounted if that amount is material to the overall estimate.

C.23 A difference is outlined in **C.34** between U.S. GAAP and IFRSs in the initial classification of a contingent consideration arrangement as either a liability or equity.

Disclosures — Pro Forma Financial Information

C.24 The table below highlights differences between the standards.

Statement 141(R)	IFRS 3(R)
Required only for public business enterprises (unless impracticable); comparable prior-period disclosures must be presented. (See **13.18**.)	Required for all acquirers for the current period only, unless impracticable to do so.

C.25 The FASB cited cost-benefit concerns as the reason for its position that pro forma disclosures should not be required for private business enterprises. The IASB carried forward its prior guidance in IFRS 3 because it currently has a project on its agenda to reconsider the application of all IFRSs to smaller, nonlisted entities. The IASB released an exposure draft (*IFRS for Small and Medium-sized Entities*) in February 2007 that, among other things, proposes to eliminate pro forma disclosures for nonlisted companies that are acquirers in a business combination. The pro forma information required by IFRS 3(R) is as follows:

> (i) the amounts of revenue and profit or loss of the acquiree since the acquisition date included in the consolidated statement of comprehensive income for the reporting period; and
>
> (ii) the revenue and profit or loss 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.

C.26 The IASB elected not to require disclosure of comparable prior-period information because of the potential costs and difficulties involved in obtaining the needed information in certain situations. For example, it may be costly and difficult for an acquirer to obtain the acquiree's financial information, prepared in accordance with IFRS, if the acquiree is based in a foreign country that has not adopted IFRSs.

Disclosures — Gain or Loss Recognized After the Acquisition Date for Net Assets Acquired

C.27 The table below highlights differences between the standards.

Statement 141(R)	IFRS 3(R)
No disclosure requirement.	Disclosure required of amount and explanation of any gain or loss recognized in the current period that relates to identifiable assets acquired and liabilities assumed in a business combination (only if size and nature of amount is relevant to understanding the postcombination results).

C.28 The IASB carried forward this disclosure requirement from IFRS 3. Statement 141(R) does not have a similar disclosure requirement; however, under U.S. GAAP, significant gains or losses recognized by the combined entity related to the acquired assets and assumed liabilities (e.g., impairment of a long-lived asset under Statement 144 after the acquisition date) are likely to be disclosed under the requirements of other accounting literature. In other words, it is likely that U.S. GAAP disclosures of such gain and loss information will be similar to IFRSs disclosures when all the other disclosure requirements in U.S. GAAP (other than Statement 141(R)) are taken into account.

Disclosures — Goodwill

C.29 The table below highlights differences between the standards.

Statement 141(R)	IFRS 3(R)
Entities that apply segment reporting under Statement 131 are required to disclose the amount of goodwill allocated to each segment, as of the acquisition date, for each material business combination (or in the aggregate for individually immaterial business combinations that are material in the aggregate). (See **13.29**.)	No requirement to disclose goodwill allocated to each cash-generating unit as of the acquisition date.

C.30 IAS 36, which applies to all entities (i.e., both private and public business enterprises), contains a requirement to disclose goodwill for each cash-generating unit as of the *balance sheet date* if the amounts are significant relative to the entity's total goodwill. Statement 142 requires a similar disclosure of goodwill by reportable segments as of each balance sheet date, but only for entities within the scope of Statement 131 (i.e., public business enterprises).

Differences Outside the Scope of the Joint Business Combinations Convergence Project

Definition of Control

C.31 The table below highlights differences between the standards.

Statement 141(R)	IFRS 3(R)
Control refers to a controlling financial interest, generally through ownership of a majority voting interest. Definition is from ARB 51, as amended and interpreted by Interpretation 46(R), which is not converged with IFRSs. (See **1.03**.)	Control refers to the power to govern the financial and operating policies of an entity to obtain benefits from its activities. Definition is from IAS 27, which is not converged with U.S. GAAP.

On December 18, 2008, the IASB issued an exposure draft, ED 10, *Consolidated Financial Statements*, which would modify the definition of control under IFRS. This exposure document was not issued as part of a joint convergence project with the FASB.

Definition of Fair Value

C.32 The table below highlights differences between the standards.

Statement 141(R)	IFRS 3(R)
Fair value is defined as the price that would be received to sell an asset or that would be paid to transfer a liability in an orderly transaction between market participants as of the measurement date. Definition is from paragraph 5 of Statement 157, which is not converged with IFRSs. (See **3.40–3.58**.)	Fair value is defined as the amount for which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arm's-length transaction. Definition is not converged with U.S. GAAP.

C.33 Note that the IASB is currently working on a project to develop a consistent definition of fair value among all IFRSs as well as develop fair value measurement guidance. The definition and guidance would be substantially converged with the FASB's Statement 157. The IASB expects to issue an exposure draft in 2009 and a final standard in 2010.

Contingent Consideration — Initial Classification

C.34 The table below highlights differences between the standards.

Statement 141(R)	IFRS 3(R)
Classify as a liability or equity in accordance with existing standards (e.g., Statement 150), which are not converged with IFRSs. (See **6.22**.)	Classify as a liability or equity in accordance with existing standards (e.g., IAS 32 and IAS 39), which are not converged with U.S. GAAP.

Deferred Taxes and Uncertain Tax Positions

C.35 The table below highlights differences between the standards.

Statement 141(R)	IFRS 3(R)
Recognize and measure in accordance with Statement 109 and Interpretation 48, which are not converged with IFRSs. (See **Section 8**.)	Recognize and measure deferred taxes in accordance with IAS 12, which is not converged with U.S. GAAP. IAS 12 does not contain specific guidance on accounting for uncertain tax positions.

Employee Benefits

C.36 The table below highlights differences between the standards.

Statement 141(R)	IFRS 3(R)
Recognize and measure in accordance with existing standards (e.g., Statements 87 and 106), which are not converged with IFRSs. (See **4.41–4.45**.)	Recognize and measure in accordance with IAS 19, which is not converged with U.S. GAAP.

Share-Based Payment Awards — Initial Measurement

C.37 The table below highlights differences between the standards.

Statement 141(R)	IFRS 3(R)
Recognize and measure in accordance with Statement 123(R), which is not converged with IFRSs. (See **4.49**.)	Recognize and measure in accordance with IFRS 2, which is not converged with U.S. GAAP.

Replacement Share-Based Payment Awards — Allocation of Amounts to Consideration Transferred

C.38 The table below highlights differences between the standards.

Statement 141(R)	IFRS 3(R)
If the acquirer is obligated to replace the acquiree's awards: • Recognize the excess of the fair value of acquirer's replacement award over acquiree's award in postcombination earnings. • Allocate remainder of replacement award to consideration transferred on the basis of the ratio of the *past service period* to the greater of the total service period or original service period.	If the acquirer is obligated to replace the acquiree's awards: • Recognize the excess of the fair value of acquirer's replacement award over acquiree's award in postcombination earnings. • Allocate remainder of replacement award to consideration transferred on the basis of the ratio of the *vesting period completed* (which can include both service and performance conditions) to the greater of the total service period or original vesting period.
Formula used to allocate remainder of replacement award is not consistent with IFRS 3(R) formula because of differences between Statement 123(R) and IFRS 2, which are not converged. (See **6.10–6.16**.)	Formula used to allocate remainder of replacement award is not consistent with Statement 141(R) formula because of differences between Statement 123(R) and IFRS 2, which are not converged.

Disclosures — Acquired Contingencies

C.39 The table below highlights differences between the standards.

Statement 141(R)	IFRS 3(R)
Unlike IFRS 3(R), and because of existing differences between Statement 5 and IAS 37, disclosure is not required of major assumptions made about future events or the amount of expected reimbursements.	Disclosure is required of major assumptions made about future events and the amount of expected reimbursements, if any, pursuant to paragraph 85 of IAS 37. IAS 37 is not converged with U.S. GAAP.

Differences Between Statement 160 and IAS 27(R)

C.40 Statement 160 and IAS 27(R) were issued as part of the joint business combinations convergence project between the FASB and IASB. Both standards amend the previous accounting for noncontrolling interests, changes in a parent's ownership interest, and deconsolidations, and are substantially converged, with one exception related to the effective date.

C.41 This section does not discuss differences between ARB 51 and IAS 27 related to the respective consolidation models and policies because the boards carried forward much of the existing guidance without reconsideration. Such differences may be addressed in a future convergence project.

C.42 The table below indicates differences related to the effective dates of Statement 160, which amends ARB 51, and IAS 27(R).

Statement 160	IAS 27(R)
Effective for fiscal years beginning on or after December 15, 2008. Early adoption is **prohibited**. (See **14.47**.)	Effective for fiscal years beginning on or after July 1, 2009. Early adoption is **permitted**.

Note that entities electing to early adopt IAS 27(R) must also adopt IFRS 3(R) at the same time.

Differences Between Statement 142 and IAS 36/38

C.43 The differences discussed below relate to areas of accounting for goodwill and other intangible assets that were not within the primary scope of the joint business combinations convergence project. The main sources of guidance on these areas are Statement 142 under U.S. GAAP, and IAS 36 and IAS 38 under IFRSs. In certain circumstances, accounting for specific transactions (e.g., advertising costs) is prescribed by other literature. Guidance for such circumstances is noted below.

Level of Impairment Testing for Goodwill

C.44 The table below highlights differences between Statement 142 and IAS 36.

Statement 142	IAS 36
Reporting unit — either an operating segment or one level below. (See **11.05**.)	*Cash generating unit (CGU)* — the lowest level at which internal management monitors goodwill. This level cannot be larger than an operating segment.

C.45 The level at which goodwill impairment testing is completed could differ under U.S. GAAP and IFRSs. The lowest level at which an entity may test goodwill for impairment under U.S. GAAP is one level below the operating segment, whereas under IFRSs, the lowest level for testing is not specifically prescribed. The only requirement stated under IFRSs is that the level of testing must not be larger than an operating segment level.

C.46 Paragraph 30 of Statement 142 provides the following guidance for identifying reporting units:

> A reporting unit is an operating segment or one level below an operating segment (referred to as a component). A component of an operating segment is a reporting unit if the component constitutes a business for which discrete financial information is available and segment management regularly reviews the operating results of that component. However, two or more components of an operating segment shall be aggregated and deemed a single reporting unit if the components have similar economic characteristics. An operating segment shall be deemed to be a reporting unit if all of its components are similar, if none of its components is a reporting unit, or if it comprises only a single component. The relevant provisions of Statement 131 and related interpretive literature shall be used to determine the reporting units of an entity. [Footnotes omitted]

C.47 Under IFRSs, the CGU is the level at which goodwill is tested for impairment under IAS 36. Paragraph 6 of IAS 36 defines a CGU as "the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets."

C.48 In addition, paragraph 80 of IAS 36 states:

> For the purpose of impairment testing, goodwill acquired in a business combination shall, from the acquisition date, be allocated to each of the acquirer's cash-generating units, or groups of cash generating units, that is expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units or groups of units. Each unit or group of units to which the goodwill is so allocated shall:
>
> (a) represent the lowest level within the entity at which the goodwill is monitored for internal management purposes; and
>
> (b) not be larger than an operating segment determined in accordance with IFRS 8, *Operating Segments.*

Goodwill Impairment Testing

C.49 The table below highlights the significant difference between Statement 142 and IAS 36.

Statement 142	IAS 36
A two-step test is performed: *Step 1* — Fair value of the reporting unit is compared with its carrying amount, including goodwill. If fair value is greater than carrying amount, step 2 is skipped because goodwill is not impaired. *Step 2* — The "implied fair value" of reporting unit goodwill is compared with its carrying amount. If the carrying amount exceeds the implied fair value of goodwill, then an impairment loss is recognized in an amount equal to that excess. (See **11.32**.)	The recoverable amount of a CGU (higher of (1) fair value less costs to sell and (2) value in use) is compared with the carrying amount. The impairment loss is allocated by (1) reducing any goodwill of the CGU and then (2) reducing the carrying amount of other assets of the CGU on a pro rata basis.

C.50 Under U.S. GAAP, paragraphs 19 and 20 of Statement 142 outline the following two-step method for testing goodwill for impairment:

Step 1

- Determine whether the fair value of the reporting unit is less than its carrying amount, including goodwill.
- If the fair value of the reporting unit is less, proceed to step 2.
- If the fair value of the reporting unit is not less, perform no additional testing of goodwill for impairment.

Step 2

- Determine the implied fair value of goodwill of the reporting unit by allocating the fair value of the reporting unit used in step 1 to all the assets and liabilities of that reporting unit (including any recognized and unrecognized intangible assets) as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the price paid to acquire the reporting unit.
- Compare the implied fair value of goodwill to the carrying amount of goodwill to determine whether goodwill is impaired. If the carrying amount exceeds the implied fair value of goodwill, an impairment loss is recognized in an amount equal to that excess.

C.51 Under IFRSs, the recoverable amount of a CGU (higher of (1) fair value less costs to sell and (2) value in use) is compared with the carrying amount of the CGU. Paragraph 104 of IAS 36 states that if the recoverable amount of the CGU is less than the carrying amount of the CGU, "the impairment loss shall be allocated to reduce the carrying amount of the assets of the unit (group of units) in the following order:

(a) first, to reduce the carrying amount of any goodwill allocated to the cash-generating unit (group of units); and

(b) then, to the other assets of the unit (group of units) pro rata on the basis of the carrying amount of each asset in the unit (group of units)."

Paragraph 105 of IAS 36 further states:

> In allocating an impairment loss in accordance with paragraph 104, an entity shall not reduce the carrying amount of an asset below the highest of:
>
> (a) its fair value less costs to sell (if determinable);
>
> (b) its value in use (if determinable); and
>
> (c) zero.

C.52 In accordance with paragraph 60 of IAS 36, such reductions in carrying amounts are treated as impairment losses on individual assets.

Impairment Testing of Indefinite-Lived Intangible Assets

C.53 The table below highlights differences between Statement 142 and IAS 36.

Statement 142	IAS 36
The fair value of the asset is compared with its carrying amount. An impairment loss is recognized for the amount by which the carrying amount exceeds the fair value. (See **10.41**.)	The recoverable amount of the asset (higher of (1) fair value less costs to sell and (2) value in use) is compared with its carrying amount. An impairment loss is recognized for the amount by which the carrying amount exceeds the recoverable amount.

C.54 Under U.S. GAAP, an intangible asset that is not subject to amortization is tested for impairment by comparing the fair value of the intangible asset with the carrying amount. Under IFRSs, the recoverable amount is compared with the carrying amount.

C.55 Paragraph 17 of Statement 142 states, in part:

> If the carrying amount of an intangible asset exceeds its fair value, an impairment loss shall be recognized in an amount equal to that excess. After the impairment loss is recognized, the adjusted carrying amount of the intangible asset shall be its new accounting basis. Subsequent reversal of a previously recognized impairment loss is prohibited.

C.56 In addition, under U.S. GAAP, Issue 02-7 provides guidance on grouping certain indefinite-lived intangible assets for impairment testing. Under IFRSs there is no comparable guidance.

C.57 Under IFRSs, an intangible asset with an indefinite useful life is generally tested for impairment by comparing its recoverable amount to its carrying amount. If the recoverable amount is less than the carrying amount, an impairment loss is recognized for the excess. Unlike U.S. GAAP, paragraph 114 of IAS 36 allows for the subsequent reversal of an impairment loss on an intangible asset with an indefinite useful life (not including goodwill). The paragraph states:

> An impairment loss recognized in prior periods for an asset other than goodwill shall be reversed if, and only if, there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss recognized. If this is the case, the carrying amount of the asset shall, except as described in paragraph 117, be increased to its recoverable amount. That increase is a reversal of an impairment loss.

C.58 In addition, paragraph 117 of IAS 36 states:

> The increased carrying amount of an asset other than goodwill attributable to a reversal of an impairment loss shall not exceed the carrying amount that would have been determined (net of amortisation or deprecation) had no impairment loss been recognised for the asset in prior years.

Intangible Asset Revaluations

C.59 The table below highlights differences between Statement 142 and IAS 38.

Statement 142	IAS 38
No revaluation of intangible assets is permitted (other than for impairments).	Intangible assets may be accounted for at historical cost (less accumulated amortization and impairments) or pursuant to a revaluation model (permitted in limited situations).

C.60 Under U.S. GAAP, intangible assets are carried at cost less accumulated amortization and impairments, and revaluation of the amount initially recognized is not allowed. A similar cost model is generally used under IFRSs to account for intangible assets; however, if an intangible asset has a quoted market price in an active market (which is rare), then the entity must make an accounting policy choice whether to use the revaluation model or the cost model.

C.61 The revaluation model is applied after the intangible asset has been initially recognized at cost. Under the revaluation model, the intangible asset is carried at a revalued amount, which is fair value as of the revaluation date, less any subsequent accumulated amortization and any subsequent accumulated impairments. Paragraphs 85 and 86 of IAS 38 indicate that revaluation increases and decreases are recognized either in equity or the income statement. The paragraphs state:

- If an intangible asset's carrying amount is increased as a result of a revaluation, the increase shall be credited directly to equity under the heading of revaluation surplus. However, the increase shall be recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognized in profit or loss.
- If an intangible asset's carrying amount is decreased as a result of a revaluation, the decrease shall be recognised in profit or loss. However, the decrease shall be debited directly to equity under the heading of revaluation surplus to the extent of any credit balance in the revaluation surplus in respect of that asset.

Internally Developed Intangible Assets

C.62 The table below highlights differences between Statement 142 and IAS 38.

Statement 142	IAS 38
Generally, costs incurred to develop, maintain, or restore intangible assets are recognized as an expense when incurred. Exceptions include costs associated with computer software intended to be sold, Web site development, and computer software for internal use.	Internally developed intangible assets shall be recognized only if (1) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity and (2) the cost of the asset can be measured reliably.

C.63 Paragraph 10 of Statement 142 states that "[c]osts of internally developing, maintaining, or restoring intangible assets (including goodwill) that are not specifically identifiable, that have indeterminate lives, or that are inherent in a continuing business and related to an entity as a whole, shall be recognized as an expense when incurred." IAS 38, however, requires the recognition of internally developed intangible assets if they are incurred in the "development phase" and (1) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity and (2) the cost of the asset can be measured reliably.

C.64 In a business combination, an acquirer shall recognize an intangible asset for certain costs that may have been expensed by the acquiree. Paragraph 15 of Statement 141(R) states that "the acquirer recognizes the acquired identifiable intangible assets, such as a brand name, a patent, or a customer relationship, that the acquiree did not recognize as assets in its financial statements because it developed them internally and charged the related costs to expense." Under IFRS 3(R), the same notion would apply and such assets would be recognized in the acquisition method accounting.

Advertising Costs

C.65 The table below highlights differences between SOP 93-7 and IAS 38.

SOP 93-7	IAS 38
Advertising costs are either expensed as incurred or expensed the first time the advertising takes place. Exceptions include (1) direct-response advertising and (2) expenditures for advertising costs that are incurred after recognizing revenues related to those costs (e.g., cooperative advertising).	Advertising costs are generally expensed as incurred unless the expenditure relates to prepayment for the delivery of goods and services (i.e., TV commercials not yet aired). In such cases, a prepaid asset would generally be recognized.

C.66 Under U.S. GAAP, advertising costs are accounted for pursuant to SOP 93-7. Typically, they are expensed either as incurred or when the advertising first takes place unless the costs relate to either (1) direct-response advertising or (2) expenditures for advertising costs that are incurred after recognizing revenues related to those costs (e.g., cooperative advertising). Enterprises may elect to expense advertising costs either as incurred, or the first time the advertising takes place, as long as the accounting policy is consistently applied to similar kinds of advertising expenses. Paragraph 26 of SOP 93-7 notes that "the first time advertising takes place" would include "the first public showing of a television commercial for its intended purpose and the first appearance of a magazine advertisement for its intended purpose." Similarly, under IFRSs, advertising costs are expensed as incurred. The one exception is for costs that relate to the prepayment of advertising for which the advertising services have not yet been rendered (e.g., a television commercial not yet aired). A prepaid asset would be recognized for such costs only until an entity has gained a right to access the related goods or has received the related services.

Appendix D — Glossary of Standards and Regulations

FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements* — an amendment of ARB No. 51

FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* — Including an amendment of FASB Statement No. 115

FASB Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* — an amendment of FASB Statements No. 87, 88, 106, and 132(R)

FASB Statement No. 157, *Fair Value Measurements*

FASB Statement No. 154, *Accounting Changes and Error Corrections*

FASB Statement No. 150, *Accounting for Certain Financial Instruments With Characteristics of Both Liabilities and Equity*

FASB Statement No. 147, *Acquisitions of Certain Financial Institutions* — an amendment of FASB Statements No. 72 and 144 and FASB Interpretation No. 9

FASB Statement No. 146, *Accounting for Costs Associated With Exit or Disposal Activities*

FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*

FASB Statement No. 142, *Goodwill and Other Intangible Assets*

FASB Statement No. 141(R), *Business Combinations*

FASB Statement No. 141, *Business Combinations*

FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* — a replacement of FASB Statement 125

FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*

FASB Statement No. 131, *Disclosures About Segments of an Enterprise and Related Information*

FASB Statement No. 130, *Reporting Comprehensive Income*

FASB Statement No. 128, *Earnings per Share*

FASB Statement No. 123(R), *Share-Based Payment*

FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made*

FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*

FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan* — an amendment of FASB Statements No. 5 and 15

FASB Statement No. 112, *Employers' Accounting for Postemployment Benefits* — an amendment of FASB Statements No. 5 and 43

FASB Statement No. 109, *Accounting for Income Taxes*

FASB Statement No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*

FASB Statement No. 95, *Statement of Cash Flows*

FASB Statement No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*

FASB Statement No. 87, *Employers' Accounting for Pensions*

FASB Statement No. 86, *Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed*

FASB Statement No. 72, A*ccounting for Certain Acquisitions of Banking or Thrift Institutions* — an amendment of APB Opinion No. 17, an interpretation of APB Opinions 16 and 17, and an amendment of FASB Interpretation No. 9

FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises*

FASB Statement No. 57, *Related Party Disclosures*

FASB Statement No. 52, *Foreign Currency Translation*

FASB Statement No. 43, *Accounting for Compensated Absences*

FASB Statement No. 13, *Accounting for Leases*

FASB Statement No. 5, *Accounting for Contingencies*

FASB Statement No. 2, *Accounting for Research and Development Costs*

FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* — an interpretation of FASB Statement No. 109

FASB Interpretation No. 46(R), *Consolidation of Variable Interest Entities* — an interpretation of ARB No. 51

FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Guarantees of Indebtedness of Others* — an interpretation of FASB Statements No. 5, 57, and 107 and rescission of FASB Interpretation No. 34

FASB Interpretation No. 37, *Accounting for Translation Adjustments Upon Sale of Part of an Investment in a Foreign Entity* — an interpretation of FASB Statement No. 52

FASB Interpretation No. 21, *Accounting for Leases in a Business Combination* — an interpretation of FASB Statement No. 13

FASB Interpretation No. 4, *Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method* — an interpretation of FASB Statement No. 2

FASB Technical Bulletin No. 85-5, *Issues Relating to Accounting for Business Combinations, Including Costs of Closing Duplicate Facilities of an Acquirer, Stock Transactions Between Companies Under Common Control, Downstream Mergers, Identical Common Shares for a Pooling of Interests, Pooling of Interests by Mutual and Cooperative Enterprises*

FASB Concepts Statement No. 6, *Elements of Financial Statements*

FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*

FASB Concepts Statement No. 4, *Objectives of Financial Reporting by Nonbusiness Organizations*

Question 2 of FASB Staff Implementation Guide (Statement 131), "Segment Information: Guidance on Applying Statement 131"

Question 17 of FASB Staff Implementation Guide (Statement 86), "Computer Software: Guidance on Applying Statement 86"

FASB Staff Position (FSP) No. FAS 157-2, "Effective Date of FASB Statement No. 157"

FASB Staff Position (FSP) No. FAS 142-3, "Determination of the Useful Life of Intangible Assets"

Proposed FASB Staff Position (FSP) No. FAS 142-d, "Amortization and Impairment of Acquired Renewable Intangible Assets"

Proposed FASB Staff Position (FSP) No. FAS 141(R)-a, "Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise From Contingencies"

FASB Staff Position (FSP) No. FIN 45-2, "Whether FASB Interpretation No. 45 Provides Support for Subsequently Accounting for a Guarantor's Liability at Fair Value"

FASB Staff Position (FSP) No. SOP 90-7-1, "An Amendment of AICPA Statement of Position 90-7"

EITF Issue No. 08-7, "Accounting for Defensive Intangible Assets"

EITF Issue No. 08-6, "Equity Method Investment Accounting Considerations"

EITF Issue No. 07-5, "Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock"

EITF Issue No. 04-4, "Allocation of Goodwill to Reporting Units for a Mining Enterprise"

EITF Issue No. 04-3, "Mining Assets: Impairment and Business Combinations"

EITF Issue No. 04-2, "Whether Mineral Rights Are Tangible or Intangible Assets"

EITF Issue No. 04-1, "Accounting for Preexisting Relationships Between the Parties to a Business Combination"

EITF Issue No. 03-9, "Determination of the Useful Life of Renewable Intangible Assets Under FASB Statement No. 142"

EITF Issue No. 02-17, "Recognition of Customer Relationship Intangible Assets Acquired in a Business Combination"

EITF Issue No. 02-13, "Deferred Income Tax Considerations in Applying the Goodwill Impairment Test in FASB Statement No. 142"

EITF Issue No. 02-7, "Unit of Accounting for Testing Impairment of Indefinite-Lived Intangible Assets"

EITF Issue No. 02-5, "Definition of 'Common Control' in Relation to FASB Statement No. 141"

EITF Issue No. 01-5, "Application of FASB Statement No. 52 to an Investment Being Evaluated for Impairment That Will Be Disposed Of"

EITF Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock"

EITF Issue No. 99-12, "Determination of the Measurement Date for the Market Price of Acquirer Securities Issued in a Purchase Business Combination"

EITF Issue No. 98-4, "Accounting by a Joint Venture for Businesses Received at Its Formation"

EITF Issue No. 98-3," Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business"

EITF Issue No. 96-16, "Investor's Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights"

EITF Issue No. 96-5, "Recognition of Liabilities for Contractual Termination Benefits or Changing Benefit Plan Assumptions in Anticipation of a Business Combination"

EITF Issue No. 95-3, "Recognition of Liabilities in Connection With a Purchase Business Combination"

EITF Issue No. 93-7, "Uncertainties Related to Income Taxes in a Purchase Business Combination"

EITF Issue No. 88-16, "Basis in Leveraged Buyout Transactions"

EITF Issue No. 86-9, "IRC Section 338 and Push-Down Accounting"

EITF Topic No. D-108, "Use of the Residual Method to Value Acquired Assets Other Than Goodwill"

EITF Topic No. D-101, "Clarification of Reporting Unit Guidance in Paragraph 30 of FASB Statement No. 142"

EITF Topic No. D-98, "Classification and Measurement of Redeemable Securities"

EITF Topic No. D-97, "Push-Down Accounting"

APB Opinion No. 29, *Accounting for Nonmonetary Transactions*

APB Opinion No. 23, *Accounting for Income Taxes — Special Areas*

APB Opinion No. 22, *Disclosure of Accounting Policies*

APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*

APB Opinion No. 17, *Intangible Assets*

APB Opinion No. 16, *Business Combinations*

APB Opinion No. 12, *Omnibus Opinion — 1967*

Accounting Research Bulletin No. 51, *Consolidated Financial Statements*

AICPA Statement of Position 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer*

AICPA Statement of Position 94-6, *Disclosure of Certain Significant Risks and Uncertainties*

AICPA Statement of Position 93-7, *Reporting on Advertising Costs*

AICPA Statement of Position 90-7, *Financial Reporting by Entities in Reorganization Under the Bankruptcy Code*

AICPA Practice Bulletin 14, *Accounting and Reporting by Limited Liability Companies and Limited Liability Partnerships*

SEC Staff Accounting Bulletin Topic 2.A.5, "Adjustments to Allowances for Loan Losses in Connection With Business Combinations" (SAB 61)

SEC Staff Accounting Bulletin Topic 2.A.6, "Debt Issue Costs" (SAB 77)

SEC Staff Accounting Bulletin Topic 5.A, "Expenses of Offering"

SEC Staff Accounting Bulletin Topic 5.H, "Accounting for Sales of Stock by a Subsidiary" (SAB 51)

SEC Staff Accounting Bulletin Topic 5.J, "Push Down Basis of Accounting Required in Certain Limited Circumstances" (SAB 54)

SEC Staff Accounting Bulletin Topic 5.L, "LIFO Inventory Practices" (SAB 58)

SEC Staff Accounting Bulletin Topic 6.G, "Accounting Series Releases 177 and 286 — Relating to Amendments to Form 10-Q, Regulation S-K, and Regulation S-X Regarding Interim Financial Reporting"

SEC Staff Accounting Bulletin Topic 11.M, "Miscellaneous Disclosure" (SAB 74)

SEC Regulation S-X, Rule 1-02, "Definition of Terms Used in Regulation S-X"

SEC Regulation S-X, Rule 3-05, "Financial Statements of Businesses Acquired or to Be Acquired"

SEC Regulation S-X, Rule 4-08, "General Notes to Financial Statements"

SEC Regulation S-X, Rule 5-03, "Income Statements"

SEC Regulation S-X, Rule 10-01, "Interim Financial Statements"

SEC Regulation S-X, Rule 11-01, "Presentation Requirements"

SEC Regulation S-K, Item 303, "Management's Discussion and Analysis of Financial Condition and Results of Operations"

SEC Regulation S-K, Item 512, "Undertakings"

SEC Regulation S-K, Item 601, "Exhibits"

SEC Accounting Series Release No. 268 (FRR Section 211), *Redeemable Preferred Stocks*

IFRS 8, *Operating Segments*

IFRS 3 (revised 2008), *Business Combinations* (IFRS 3(R))

IFRS 3, *Business Combinations*

IFRS 2, *Share-based Payment*

IAS 39, *Financial Instruments: Recognition and Measurement*

IAS 38, *Intangible Assets*

IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*

IAS 36, *Impairment of Assets*

IAS 27 (revised 2008), *Consolidated and Separate Financial Statements* (IAS 27(R))

IAS 27, *Consolidated and Separate Financial Statements*

IAS 19, *Employee Benefits*

IAS 18, *Revenue*

IAS 16, *Property, Plant and Equipment*

IAS 12, *Income Taxes*

IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*