Accounting for Business Combinations

4 CPE Hours

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<table>
<thead>
<tr>
<th>Field of Study</th>
<th>Accounting</th>
</tr>
</thead>
<tbody>
<tr>
<td>Level of Knowledge</td>
<td>Overview</td>
</tr>
<tr>
<td>Prerequisite:</td>
<td>General Understanding of FASB ASC</td>
</tr>
<tr>
<td>Advanced Preparation</td>
<td>None</td>
</tr>
<tr>
<td>Recommended CPE hours</td>
<td>4</td>
</tr>
<tr>
<td>Course Qualification</td>
<td>Qualifies for National Registry of CPE Sponsors QAS Self-Study credit</td>
</tr>
<tr>
<td>CPE Sponsor Information</td>
<td>NASBA Registry Sponsor #: 138298</td>
</tr>
<tr>
<td>Publication Date</td>
<td>September 15, 2017</td>
</tr>
<tr>
<td>Expiration Date</td>
<td>September 15, 2018</td>
</tr>
<tr>
<td>Deadline to Complete the Course</td>
<td>One year from the date of purchase to complete the examination and submit it to our office for grading</td>
</tr>
</tbody>
</table>

Contact customer service within five business days of your course purchase date for assistance with returns and cancellations. Customers who cancel orders within five business days of the course purchase date will receive a full refund. After five business days all sales are final and no refunds will be provided.
Table of Contents

Course Overview ................................................................................................................................................................ 1
Learning Objectives .......................................................................................................................................................... 1
Introduction ....................................................................................................................................................................... 1
Definition of a Business ..................................................................................................................................................... 1
Review Questions ............................................................................................................................................................... 3
The Acquisition Method .................................................................................................................................................... 3
Step 1: Identifying the Acquirer ........................................................................................................................................ 3
Step 2: Determining the Acquisition Date ...................................................................................................................... 5
Review Questions ............................................................................................................................................................... 6
Step 3: Recognizing and measuring the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree ............................................................................................................................ 6
Review Questions ............................................................................................................................................................... 12
Review Questions ............................................................................................................................................................. 22
Business Combination Achieved in Stages ................................................................................................................... 22
Step 4: Recognizing and Measuring Goodwill or Gain from a Bargain Purchase ................................................. 23
Measurement Period ......................................................................................................................................................... 28
Subsequent Measurement ................................................................................................................................................ 29
Review Questions ............................................................................................................................................................. 30
Financial Statement Disclosures .................................................................................................................................... 31
Review Questions ............................................................................................................................................................. 39
Illustrative Examples from SEC Filings ........................................................................................................................ 39
Reverse Acquisitions ......................................................................................................................................................... 45
Private Company Alternative ........................................................................................................................................ 48
Income Tax Considerations ......................................................................................................................................... 49
Asset Acquisition vs. Business Combination ............................................................................................................. 51
Review Questions ............................................................................................................................................................. 53
Solutions to Review Questions .................................................................................................................................... 54
Final Exam Questions ....................................................................................................................................................... 59
Glossary of Key Terms ..................................................................................................................................................... 59
Accounting for Business Combinations

Course Overview

This course provides an in-depth overview of the accounting and reporting requirements with respect to business combinations as prescribed by Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 805, Business Combinations. The overall objective of the guidance included within ASC 805 is to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial reports about a business combination and its effects.

Learning Objectives

Upon completion of this course, you will be able to:

- Identify the definition of a business as it relates to a business combination transaction
- List the steps involved in the acquisition method
- Identify the acquisition date for a business combination
- Recognize principles and exceptions in the measurement of assets and liabilities of a business combination
- Differentiate between the various categories of intangible assets
- Recognize how to measure goodwill and gains from bargain purchases
- Identify the measurement period for business combinations
- Recognize financial statement disclosures related to business combinations
- Identify the relief afforded to private entities with respect to accounting for business combinations
- Differentiate between measurement principles of business combinations and asset acquisitions

Introduction

Entities that engage in business combinations are often confronted with various financial reporting issues including, but not limited to, determining whether a transaction represents a business combination (or an asset acquisition), accounting for the consideration transferred in the transaction, as well as measuring and recognizing the fair value of assets acquired and liabilities assumed. However, let's first start at the most fundamental question with respect to this course – what is a business combination?

The FASB ASC Master Glossary defines a business combination as “a transaction or event in which an acquirer obtains control of one or more businesses.” The Glossary goes on to add that an example of a business combination could be a “true merger” or a “merger of equals”. However, before determining if a transaction is in fact a business combination, we have to look more closely at the business combination definition. Within the definition, it’s noted that the transaction relates to one or more “businesses”. At the risk of stating the obvious, the business definition is not always necessarily the same definition of a business in layman’s terms. As such, before diving into an assessment of whether a transaction is considered a business combination, we have to first define what is meant by the term business. Refer to the next section of this course where we explore this definition in additional detail.

Definition of a Business

The FASB ASC Master Glossary 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.” While this definition is seemingly straight-forward, this is not always the case. As a result, the FASB includes additional implementation guidance with respect to this definition.

ASC 805-10-55-4 prescribes simply that a business consists of inputs and processes applied to these inputs that have the ability to create outputs. One key point here is that the inputs, along with the processes, must have
the ability to create outputs, but outputs are not required to be present in order for a set of activities to qualify as a business. Refer to Exhibit 1-1 below which provides a detailed overview of inputs, processes, and outputs.

Exhibit 1-1: Inputs, Processes, and Outputs (ASC 805-10-55-4)

Inputs
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, and the ability to obtain access to necessary materials or rights, and employees.

Processes
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.

Outputs
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.

As previously noted, outputs are not required in order for a set of activities to be considered a business. The only essential elements are inputs and processes applied to those inputs (ASC 805-10-55-5). In fact, a business is not even required to 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 (ASC 805-10-55-5). Furthermore, as you can imagine, the nature of inputs and processes for different entities and different entities within different industries can vary considerably. For example, certain businesses can have many types of inputs, processes, and outputs, whereas other businesses can have very limited inputs and processes that may in turn only produce one single output (ASC 805-10-55-6).

One of the other difficulties encountered in assessing whether a particular set of activities is considered a business relates to development stage entities. These entities, by nature, do not ordinarily have outputs. Again, while having output(s) is not a requirement for a set of activities to be considered a business, these development stage entities may also have limited inputs and processes which may make the assessment of whether it is a business difficult. Accordingly, ASC 805-10-55-7 includes the following questions that can be evaluated in order to determine whether the set of activities constitutes that of a business. Refer to these questions below:

- Have planned principal activities began?
- Does the set of activities have employees, intellectual property, and other inputs and processes that could be applied to those inputs?
- Is there a pursuit of a plan to produce outputs?
- Will it able to obtain access to customers that will purchase the outputs?

While not all of these factors above need to be present in order for a development stage entity to be considered a business, the presence of this will provide a good indication that the set of activities constitutes that of a business. The key point to note in determining whether a particular set of assets and activities in a business should be based on whether the integrated set is capable of being conducted and managed as a business by a market participant (ASC 805-10-55-8). As a result, 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 (ASC 805-10-55-8).

Finally, one additional factor that can be looked to is the presence of goodwill. Simply put, if a particular set of activities has goodwill, it is presumed to be a business. However, a set of activities that is concluded to be a business need not have goodwill (ASC 805-10-55-9).

So what is the primary reason why we have dedicated so much discussion as to whether a set of activities constitutes a business? Well, if an entity acquires assets that are not considered a business, it is accounted for simply as a normal asset acquisition. If the assets and activities constitute that of a business, then the accounting and reporting requirements are much more complex and can be materially different than that of a normal asset acquisition. The next sections of this course will help to explore some of these key differences.

**Review Questions**

1. Which of the following ASC topics prescribes the accounting and disclosure requirements with respect to business combinations?
   a. ASC 805.
   b. ASC 810.
   c. ASC 815.
   d. ASC 850.

**The Acquisition Method**

Assuming that a transaction is concluded to be a business combination, ASC 805 requires that a business combination be accounted for by applying what is referred to as the acquisition method. The FASB replaced the term “purchase method,” which previously was used to describe the method of accounting for business combinations, with the term “acquisition method.” This change resulted primarily from the FASB’s conclusion that a business combination can occur in the absence of a purchase of net assets or equity interests.

The acquisition method includes the following four steps (ASC 805-10-05-4):

- Step 1: Identifying the acquirer
- Step 2: Determining the acquisition date
- Step 3: Recognizing and measuring the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree
- Step 4: Recognizing and measuring goodwill or gain from a bargain purchase

Each of these steps are discussed in more detail in the following sections.

**Step 1: Identifying the Acquirer**

The acquirer in a business combination is the entity that obtains control of the acquiree. Simply put, for each business combination, one of the combining entities is required to be identified as the acquirer (ASC 805-10-25-4). But how exactly is the acquirer identified in a business combination? While the answer to this question may be seemingly obvious at times, in other situations it may not be and may require additional evaluation. Take for example situations where a business combination involves the exchanging of equity interests versus those situations where one party to the transaction pays cash for the other.

When first identifying the acquirer, the general subsections within FASB ASC 810-10, Consolidation – Overall, should first be followed to identify the acquirer (ASC 805-10-25-5). Specifically, entities should first look to assessing whether a controlling financial interest is present. In other words, if Entity A has a controlling financial interest over Entity B as a result of the business combination, then Entity A is concluded to the acquirer in the business combination. While a comprehensive discussion of the requirements with FASB ASC 810 is outside the scope of this course, the topic of control is important for our discussion. Refer to Exhibit 1-2 for an overview of controlling financial interests. Note, the guidance included in the Exhibit is pending content within the ASC on account of the amendments prescribed by Accounting Standards Update (ASU).
Exhibit 1-2: Controlling Financial Interest

ASC 810-10-15-8

For legal entities other than limited partnerships, the usual condition for a controlling financial interest is ownership of a majority voting interest, and, therefore, as a general rule ownership by one reporting entity, directly or indirectly, of more than 50 percent of the outstanding voting shares of another entity is a condition pointing toward consolidation. The power to control may also exist with a lesser percentage of ownership, for example, by contract, lease, agreement with other stockholders, or by court decree.

ASC 810-10-15-8A

Given the purpose and design of limited partnerships, kick-out rights through voting interests are analogous to voting rights held by shareholders of a corporation. For limited partnerships, the usual condition for a controlling financial interest, as a general rule, is ownership by one limited partner, directly or indirectly, of more than 50 percent of the limited partnership’s kick-out rights through voting interests. The power to control also may exist with a lesser percentage of ownership, for example, by contract, lease, agreement with partners, or by court decree.

So what happens if an entity looks to the Consolidation guidance in FASB ASC 810 and is unable to conclude on which party to the transaction is the acquirer? In this situation, an entity should then look to certain factors prescribed within the implementation guidance to FASB ASC 805, specifically paragraphs 11 through 15 of ASC 805-10-55. The considerations outlined in these paragraphs are discussed in detail below. However, one important exception to this next step in assessing who the acquirer is relates to business combinations in which a variable interest entity (VIE) is acquired. In this situation, the primary beneficiary (the entity with power and benefits of the VIE) will always be considered the acquirer (ASC 805-10-25-5).

For a business combination that is effected primarily through the transfer of cash or other assets (or by incurring liabilities), the acquirer is usually the entity that transfers the cash or other assets (or incurs the liabilities) (ASC 805-10-55-11). Simple enough. However, things can get slightly more complex for business combinations that involve the exchange of equity interests. In this situation, the acquirer would normally be the entity which issues its equity interests (ASC 805-10-55-12). However, there may be certain situations when this is not the case, for example, in a reverse acquisition (i.e. the entity issuing the equity interest is in fact determined to be the acquiree. Given some of the complexities in this determination, the implementation guidance outlines additional considerations and pertinent facts that should be considered in identifying the acquirer in a business combination achieved through the exchange of equity interests. This includes the following (ASC 805-10-55-12):

- The relative voting rights in the combined entity after the business combination. 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.
- 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. 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.
- The composition of the governing body of the combined entity. 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.
• The composition of the senior management of the combined entity. The acquirer usually is the combining entity whose former management dominates the management of the combined entity.
• The terms of the exchange of equity interests. 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.

If after evaluating the aforementioned factors, an entity is still unable to make the determination of who in fact is the acquirer and who is the acquiree, it's generally safe to assume that the acquirer usually is the combining entity whose relative size (e.g. assets, revenues, earnings, etc.) is significantly larger than that of the other combining entity or its entities (ASC 805-10-55-13). And still, there are additional challenges when a business combination involves two or more entities. In these situations, not only should the determination of the acquirer include the relative size of the combining entities as noted above, but should also consider which entity in the business combination initiated the combination.

Finally, it’s also important to note that a newly formed entity established to effect the business combination will not necessarily be the acquirer (ASC 805-10-55-15). The FASB notes that 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 should be identified as the acquirer by applying the guidance in ASC 805-10-55-10 through 14. In contrast though, a new entity that transfers cash or other assets or incurs liabilities as consideration may be the acquirer (ASC 805-10-55-15). Refer to Ernst & Young’s (E&Y) views on the identification of the acquirer from their Business Combinations Guide (Financial Reporting Developments - Revised June 2016).

Exhibit 1-3: E&Y – Identifying the Acquirer when the Acquirer is not obvious

The FASB did not provide a hierarchy to explain how to assess factors that influence the identification of the acquirer in a business combination, effectively concluding that no single criterion is more significant than any other. Therefore, the determination of the accounting acquirer will require the exercise of professional judgment based on an evaluation of all factors in aggregate. This may be particularly challenging in situations where the factors are mixed (that is, some of the factors may point to one of the combining entities as the accounting acquirer whereas other factors may point to the other combining entity as the accounting acquirer).

In addition to the factors from ASC 805 discussed below, we believe that a company may consider other relevant factors (e.g., the combined entity’s name, the location of the combined entity’s corporate headquarters or the combined entity’s ticker symbol) that would influence the determination of the accounting acquirer.

We also believe companies should be cautious about approaching the factors as a checklist. For example, the combining entity with the most checks (or factors) may not necessarily be the accounting acquirer.

Step 2: Determining the Acquisition Date

The next step in applying the acquisition method, subsequent to identifying the acquirer, is to determine the acquisition date. Simply put, the acquisition date is the date on which the acquirer obtains control of the acquiree (ASC 805-10-25-6). In general, the date on which the acquirer obtains control of the acquiree is the date on which the acquirer legally transfers the consideration, acquires the assets, and assumes the liabilities of the acquiree (ASC 805-10-25-7). In other words, this is generally considered the closing date of the transaction.

For example, if control is obtained by contract, the acquisition date would be the date the contract is executed or, if control is obtained by an investor as a result of an investee share buy-back, the acquisition date is the date the investor obtains a majority voting interest.

However, there may be certain instances whereby control is obtained either earlier or later than the closing date of the transaction. As a result, there may be situations when the acquisition date precedes the closing date if a written agreement provides that the acquirer obtains control of the acquiree before the actual closing date (ASC
Given the variability in business combination transactions across one entity to the next, entity should always consider all the relevant facts and circumstances when concluding on the acquisition date. Refer to Exhibit 1-4 for an overview of E&Y’s position on acquisition dates that precede the closing date.

Exhibit 1-4: E&Y – Acquisition Date Preceding Closing Date

We believe the acquisition date can precede the closing date only if a written agreement is in place as of the designated date that provides for transfer of control of the acquired entity to the acquirer on that date. The written agreement should provide the acquirer with the ability to make decisions about the operations and financing of the acquired entity without impediment. That is, the selling shareholders should not have continuing rights, as it relates to the operation of the target, other than protective rights or blocking actions. If the acquisition date occurs prior to the consummation date, a liability is recognized, at fair value, for the consideration to be transferred to the selling shareholders. That liability is accreted to the date that the consideration is transferred to an amount equal to the consideration transferred.

If the business combination requires regulatory or shareholder approval (or shareholder approval is sought) by either the acquirer or the acquiree, we do not believe that control transfers until such approval is obtained. However, in the case of shareholder approval and after considering all the relevant facts, if management and the board of directors control sufficient votes to approve the transaction, and thus shareholder approval is considered perfunctory, a transfer of control might be deemed to occur prior to the date of shareholder approval and prior to the closing date, but only if a written agreement as described above exists.

Although the “convenience” exception (i.e., the ability to designate an effective acquisition date) is no longer included in ASC 805, we believe that an acquirer may designate a date other than the date control of the target is obtained as the acquisition date in order to align the date of acquisition for accounting purposes to an accounting close date. However, the difference between the designated acquisition date and the actual acquisition date should be no more than a few days and the results of operations and change in financial position of the target during the intervening period must not be material to the acquirer.

Review Questions

2. Which of the following identifies the first step in the acquisition method when accounting for business combinations?
   a. Determine the acquisition date.
   b. Identifying the acquirer.
   c. Measure goodwill or bargain purchase.
   d. Assess whether the transaction is a business combination.

Step 3: Recognizing and measuring the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree

Once an acquirer has been identified and the acquisition date has been concluded, the next step in the acquisition method relates to actually recognizing and measuring the identifiable assets, liabilities, and any noncontrolling interest in the acquiree. One important point to note first that the guidance for this step is included in FASB ASC 805-20, whereas the previous guidance up to this point has been primarily derived from FASB ASC 805-10. As you’ll note in Step 4 of the acquisition method process, that guidance will be sourced from FASB ASC 805-30.

One of the primary principles of FASB ASC 805 is that obtaining control is a new basis recognition event. As a result, the assets acquired and liabilities assumed, including any noncontrolling interests, are recognized at 100% of their fair value, with limited exceptions, regardless of the percentage of the equity interests acquired.
In order to qualify for this recognition, there are two specific recognition conditions that must be met. These include the following (ASC 805-20-25-2 through 3):

- The identifiable assets acquired and liabilities assumed must meet the definitions of assets and liabilities in FASB Concepts Statement No. 6, *Elements of Financial Statements*, at the acquisition date
- The identifiable assets acquired and liabilities assumed must be part of what the acquirer and the acquiree (or its former owners) exchanged in the business combination transaction rather than the result of separate transactions

Refer to Exhibit 1-5 which provides an overview of the definition of assets and liabilities in FASB Concepts Statement No. 6.

**Exhibit 1-5: Definition of Assets and Liabilities**

**Asset**

Probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.

**Liability**

Probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.

The first condition is fairly self-explanatory. In order for an asset or liability to be recognized, the asset or liability recorded must first meet the respective definition. However, the second condition, regarding the assets acquired and liabilities assumed being part of what the acquirer and acquiree exchanged in the business combination (rather than a separate transaction), merits further discussion.

FASB ASC 805 notes that in some situations, the acquirer and the acquiree in a business combination 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 (ASC 805-10-25-20). In either situation, the acquirer is required to identify any amounts that are not part of what the acquirer and the acquiree exchanged in the business combination. In other words, amounts that are not part of the exchange for the acquiree. The overall principle here is that the acquirer should only recognize the consideration, as part of applying the acquisition method, only the consideration transferred for the acquiree and the assets acquired and liabilities assumed in the exchange for the acquiree. As a result, separate transactions should be accounted for in accordance with other relevant GAAP (ASC 805-10-25-20).

Further to the points above, FASB ASC 805 prescribes that a transaction entered into by or on behalf of the acquirer or primarily for the benefit of the acquirer or the combined entity, rather than primarily for the benefit of the acquiree before the combination, is likely to be a separate transaction (ASC 805-10-25-21). The following are examples of instances where separate transactions would not be included in the business combination (ASC 805-10-25-21):

- 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
- A transaction that reimburses the acquiree or its former owners for paying the acquirer’s acquisition-related costs

**Classifying or Designating**

FASB ASC 805 requires that at the acquisition date (determined in Step 2 of the acquisition method process), an acquirer should classify or designate the identifiable assets acquired and liabilities assumed as necessary in order to apply appropriate other GAAP (ASC 805-20-25-6). As a result, the acquirer should make these classifications or designations on the basis of the following (ASC 805-20-25-6):
• Contractual terms
• Economic conditions
• Operating or accounting policies
• Other pertinent conditions that exist at the acquisition date

While an acquirer can look to other GAAP for the appropriate accounting measurement for the assets acquired or liabilities assumed, there are certain situations wherein an acquirer is required to make classifications or designations on the pertinent conditions that are referenced above. This includes, but is not limited to, the following (ASC 805-20-25-7):

• Classification of particular investments in securities as trading, available for sale, or held to maturity
• Designation of a derivative instrument as a hedging instrument
• Assessment of whether an embedded derivative should be separated from the host contract

It's also important to note that there are a couple exceptions to the overall principle outlined above that an acquirer should refer to other GAAP for the classification and designation. This includes the classification of a lease contract as either an operating lease or a capital lease as well as the classification of a contract written by an entity that is either an insurance or reinsurance contract or a deposit contract (ASC 805-20-25-8). For these two exceptions, an acquirer should classify these contracts on the basis of the contractual terms and other facts at the inception of the contract (ASC 805-20-25-8).

Recognizing Assets Acquired and Liabilities Assumed

Once the process has been completed for designating and classifying assets acquired and liabilities assumed with respect to a business combination, the next step involves the actual recognition and measurement of those assets and liabilities. Given that all assets and liabilities are not measured the same, the FASB provides guidance certain of these assets and liabilities within ASC 805-20, with additional interpretive guidance as necessary within ASC 805-20-55. Refer to each of the respective sections which address some of the key measurement recognition principles.

Identifiable Intangible Assets

FASB ASC 805 prescribes that identifiable intangible assets acquired in a business combination should be recorded separately from goodwill. But what is meant by the term “identifiable”? In this regard, an intangible asset is identifiable if it meets either the separability criterion or the contractual-legal criterion. With respect to separability, an acquired intangible asset meets this criterion if there is evidence of exchange transactions for that type of asset or an asset of a similar type, even if those exchanges are infrequent and regardless of whether the acquiring company has been involved in them (ASC 805-20-55-4). Furthermore, if the acquired intangible asset is capable of being separated from the acquired business, the intangible asset still meets the separability criterion for separate recognition regardless of whether management has the intent to separate it. Even if the acquiring company believes that separating the intangible asset would be uneconomical, it is the capability of being separated, rather than the probability of being separated, that is determinative.

With respect to the contractual-legal criterion, this criteria can actually be met even if the asset is not transferable or separable from the acquiree or from other rights and obligations (ASC 805-20-55-2). Hence, this is why, as previous stated, an identifiable intangible asset need only meet one of the criterion. In order to provide additional understanding to entities of the contractual-legal criterion, the FASB included additional examples within the respective implementation guidance. Refer to Exhibit 1-6 below which provides three examples in which the contractual-legal criterion is met.
**Exhibit 1-6: Contractual-Legal Criterion Examples (ASC 805-20-55-2)**

An acquiree leases a manufacturing facility under an operating lease that has terms that are favorable relative to market terms. The lease terms explicitly prohibit transfer of the lease (through either sale or sublease). The amount by which the lease terms are favorable compared with the pricing of current market transactions for the same or similar items is an intangible asset that meets the contractual-legal criterion for recognition separately from goodwill, even though the acquirer cannot sell or otherwise transfer the lease contract.

An acquiree owns and operates a nuclear power plant. The license to operate that power plant is an intangible asset that meets the contractual-legal criterion for recognition separately from goodwill, even if the acquirer cannot sell or transfer it separately from the acquired power plant. An acquirer may recognize the fair value of the operating license and the fair value of the power plant as a single asset for financial reporting purposes if the useful lives of those assets are similar.

An acquiree owns a technology patent. It has licensed that patent to others for their exclusive use outside the domestic market, receiving a specified percentage of future foreign revenue in exchange. Both the technology patent and the related license agreement meet the contractual-legal criterion for recognition separately from goodwill even if selling or exchanging the patent and the related license agreement separately from one another would not be practical.

Within FASB ASC 805, the FASB also provides a fairly lengthy listing of examples of intangible assets that are considered identifiable. In other words, these are intangible assets that meet either the separability criterion or the contractual-legal criterion. ASC 805-20-55-13 notes the following types of categories of intangible assets:

- Marketing-related
- Customer-related
- Artistic-related
- Contract-based
- Technology-based

Each of the above categories is discussed in additional detail below.

Marketing-related intangible assets include, but are not limited to, the following (ASC 805-20-55-14):

- Trademarks
- Tradenames
- Service markets
- Collective marks
- Certification marks
- Trade dress (unique color, shape, package design, etc.)
- Newspaper mastheads
- Internet domain names
- Noncompetition agreements

The FASB notes within FASB ASC 805 that each of the above marketing-related intangible assets arise from contractual or other legal rights (ASC 805-20-55-12). As a result, because they meet the contractual-legal criterion, they are considered identifiable. However, this is not to suggest that these examples above cannot also meet the separability criterion as well. It’s important to note that while they may in fact be separable, this is not a condition for meeting the contractual-legal criterion (ASC 805-20-55-12).

Moving onto customer-related identifiable intangible assets, these can include any of the following (ASC 805-20-55-20):
- Customer lists
- Order or production backlog
- Customer contracts and related customer relationships
- Noncontractual customer relationships

The examples above are a little bit of a mixed bag of identifiable intangible assets because some only meet the contractual-legal criterion, and some only meet the separability criterion. For example, customer lists and noncontractual customer relationships are types of identifiable intangible assets because they can be separable. Customer lists, for example, generally do not arise from contractual or other legal rights, and are frequently leased or exchanged (ASC 805-20-55-21). The same can be said for noncontractual customer relationships. The FASB notes that exchange transaction 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 (ASC 805-20-55-27).

While we note that customer lists and noncontractual customer relationships are identifiable because they meet the separability criterion, the other two examples (order or production backlog and customer contracts and related customer relationships) are considered identifiable because they meet the contractual-legal criterion. Order or production backlog meets this contractual-legal hurdle because it arises from contracts (even cancellable ones) such as purchase or sales orders (ASC 805-20-55-22). Similarly, if an entity has relationships with its customers through purchase or sales orders, the customer relationships also arise from contractual rights and therefore meet the contractual-legal criterion (ASC 805-20-55-25).

Refer to a few examples of the application of this guidance presented above in Exhibit 1-7 below.
Exhibit 1-7: Customer Related Identifiable Intangible Assets

Case A: Five-Year Supply Agreement (ASC 805-20-55-54)

Target has a five-year agreement to supply goods to Customer. Both Target and Acquirer believe that Customer will renew the agreement at the end of the current contract. The agreement is not separable. The agreement, whether cancelable or not, meets the contractual-legal criterion. Additionally, because Target establishes its relationship with Customer through a contract, not only the agreement itself but also Target's customer relationship with Customer meet the contractual-legal criterion.

Case B: One Customer, Contract in One of Two Lines of Business (ASC 805-20-55-55)

Target manufactures goods in two distinct lines of business: sporting goods and electronics. Customer purchases both sporting goods and electronics from Target. Target has a contract with Customer to be its exclusive provider of sporting goods but has no contract for the supply of electronics to Customer. Both Target and Acquirer believe that only one overall customer relationship exists between Target and Customer. The contract to be Customer's exclusive supplier of sporting goods, whether cancelable or not, meets the contractual-legal criterion. Additionally, because Target establishes its relationship with Customer through a contract, the customer relationship with Customer meets the contractual-legal criterion. Because Target has only one customer relationship with Customer, the fair value of that relationship incorporates assumptions about Target's relationship with Customer related to both sporting goods and electronics. However, if Acquirer determines that the customer relationships with Customer for sporting goods and for electronics are separate from each other, Acquirer would assess whether the customer relationship for electronics meets the separability criterion for identification as an intangible asset.

Case C: Purchase and Sales Orders (ASC 805-20-55-56)

Target does business with its customers solely through purchase and sales orders. At December 31, 20X5, Target has a backlog of customer purchase orders from 60 percent of its customers, all of whom are recurring customers. The other 40 percent of Target's customers also are recurring customers. However, as of December 31, 20X5, Target has no open purchase orders or other contracts with those customers. Regardless of whether they are cancelable or not, the purchase orders from 60 percent of Target's customers meet the contractual-legal criterion. Additionally, because Target has established its relationship with 60 percent of its customers through contracts, not only the purchase orders but also Target's customer relationships meet the contractual-legal criterion. Because Target has a practice of establishing contracts with the remaining 40 percent of its customers, its relationship with those customers also arises through contractual rights and therefore meets the contractual-legal criterion even though Target does not have contracts with those customers at December 31, 20X5.

Case D: Cancelable Contracts (ASC 805-20-55-57)

Target has a portfolio of one-year motor insurance contracts that are cancelable by policyholders. Because Target establishes its relationships with policyholders through insurance contracts, the customer relationship with policyholders meets the contractual-legal criterion.

Moving now to artistic-related intangible assets, examples of these include the following (ASC 805-20-55-29):

- Plays, operas, ballets
- Books, magazines, newspapers, other literary works
- Musical works such as compositions, song lyrics, advertising jingles
- Pictures, photographs
- Video and audiovisual material, including motion pictures or files, music videos, television programs
Simply put, artistic-related intangible assets are identifiable because they arise from contractual or legal rights such as those provided by copyright (ASC 805-20-55-30). As a result, a holder can transfer a copyright, either in whole through an assignment or in part through a licensing agreement.

Next, contract-based intangible assets include, but are not limited to, the following (ASC 805-20-55-31):

- Licensing, royalty, standstill agreements
- Advertising, construction, management, service or supply contracts
- Lease agreements (whether the acquiree is the lessee or the lessor)
- Construction permits
- Franchise agreements
- Operating and broadcast rights
- Servicing contracts such as mortgage servicing contracts
- Employment contracts
- Use rights such as drilling, water, air, timber cutting, and route authorities

As is clearly evident given the fact that these intangible assets are contract-based, they are identifiable in that they meet the contractual-legal criterion.

Finally, the last category of identifiable intangible assets relate to those that are technology-based. Examples of these types of intangible assets include, but are not limited to, the following (ASC 805-20-55-38):

- Patented technology
- Computer software and mask works
- Unpatented technology
- Databases, including title plants
- Trade secrets, such as secret formulas, processes, recipes

Similar to the previous discussion of customer-related intangible assets, the technology-based intangibles are a mixed bag of those meeting the separability criterion and those meeting the contractual-legal criterion. For example, patented technology, computer software and mask works, and trade secrets are examples of identifiable intangible assets that meet the contractual-legal criterion, whereas unpatented technology and databases meet the separability criterion.

**Review Questions**

3. Which of the following is an example of a customer-related intangible asset?
   a. Noncompetition agreement.
   b. Tradenames.
   c. Patented technology.
   d. Order or production backlog.

4. In order for an asset acquired or liability assumed to be considered identifiable, it must meet the definition of an asset or liability within which of the following FASB Concept Statements?

**Operating Leases**

Continuing with our discussion of the recognition of assets acquired and liabilities assumed in a business combination, we'll next discuss operating leases. Up to this point, we have focused primarily on the current guidance within the ASC and have not addressed pending content which will be effective upon the effective date of certain ASUs. With respect to operating leases, this is an area where there has been significant
amendments to the lease accounting literature which will be effective for public companies for fiscal years, and interim periods, beginning after December 15, 2018. As a result, the guidance with respect to operating leases recognized in a business combination will change significantly on account of the amendments in ASU 2016-02, Leases (Topic 842). To illustrate this change, refer to the guidance prescribed below presented in Exhibit 1-8 which shows both the before and after effects of the ASU.

**Exhibit 1-8: Operating Leases in a Business Combination**

**ASC 805-20-25-11 (Current)**
The acquirer shall recognize no assets or liabilities related to an operating lease in which the acquiree is the lessee except as required by paragraphs 805-20-25-12 through 25-13.

**ASC 805-20-25-11 (Pending Content subsequent to ASU 2016-02)**
The acquirer shall recognize assets or liabilities related to an operating lease in which the acquiree is the lessee as required by paragraphs 805-20-25-10A and 805-20-25-28A.

**ASC 805-20-25-12 (Current)**
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.

**ASC 805-20-25-12 (Pending Content subsequent to ASU 2016-02)**
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. If the acquiree is a lessor, 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. If the acquiree is a lessee, the acquirer shall adjust the measurement of the acquired right-of-use asset for any favorable or unfavorable terms in accordance with paragraph 805-20-30-24.

It’s important to note the stark difference in the recognition of an operating lease in the pending content above versus the current guidance wherein an operating lease is not recognized.

**Recognition Exceptions**
Recall that in general, an asset or liability is recognized in a business combination if the asset or liability meets the respective definition in CON6 is met as of the acquisition date, and the asset or liability is determined to be part of the business combination. Once an entity determines that recognition in the business combination is appropriate in light of these requirements, the asset or liability generally is measured at fair value in accordance with the principles of FASB ASC 820, *Fair Value Measurement*.

However, there are certain exceptions to this overall recognition principle and relates specifically to the following:

- Assets and liabilities arising from contingencies (FASB ASC 450,805)
- Income taxes (FASC ASC 740)
- Employee benefits (FASB ASC 710, 712, 715)
- Indemnification assets (FASB ASC 805)

While a comprehensive discussion of these exceptions is outside the scope of course, the key principle here is
that instead of defaulting to recognizing the above items at fair value (i.e. in accordance with FASB ASC 820), the recognition of these items is based on other applicable GAAP as referenced parenthetically above. Additionally, while not included above given the ASC content is pending, there will also be a recognition exception for leases upon the effective date of ASU 2016-02 previously discussed. To this end, an entity should refer to guidance within FASB ASC 842 for the recognition and measurement of leases in a business combination.

Measuring Assets Acquired and Liabilities Assumed

In the previous sections, we discussed the recognition of the assets acquired and liabilities assumed in a business combination. In this section, we move more into the actual measurement of those assets and liabilities that have been previously recognized.

The overall measurement principle, outlined in ASC 805-20-30-1, is that an acquirer should measure identifiable assets acquired, liabilities assumed, and any noncontrolling interests in the acquiree at the acquisition date fair value. The application of this overall measurement principle is outlined within ASC 805-20-30, however, there are specific exceptions to this measurement principle (similar to the previously discussed exceptions to the recognition principle) which are also outlined within ASC 805-20-30. Each of these topics are discussed in additional detail below.

Assets with Uncertain Cash Flows

This topic relates primarily to those accounts that generally carry an associated valuation allowance account such as receivables. ASC 805-20-30-4 prescribes that an acquirer should not recognize a separate valuation allowance as of the acquisition date for assets with uncertain cash flows. This is due to the fact that the uncertainty with respect to the future cash flows are included in the fair value measure. As a result, for those receivables or loans that have a component that are deemed to not be collectible, the receivables or loans would be measured at the fair value (i.e. the amount the acquirer expects to receive).

Assets Subject to Operating Leases in Which the Acquiree is the Lessor

ASC 805-20-30-5 requires that an acquirer should measure, separately from the lease contract, the acquisition-date fair value of an asset that is subject to an operating lease in which the acquiree is the lessor. Said another way, the fair value of the asset should be the same regardless of whether it is subject to an operating lease.

Highest and Best Use

The overall guidance in FASB ASC 805 requires that all tangible and intangible assets be measured at fair value, unless a specific measurement exception exists. This is true whether or not the acquirer intends to use the asset to its highest and best use. When an entity does not intend to use an asset at its highest and best use, it is regarded commonly as a defensive asset. As defined by the ASC Master Glossary, a defensive asset is an acquired asset in which an entity does not intend to actively use the asset but intends to hold (i.e. lock up) the asset to prevent others from obtaining access to the asset. Refer to Exhibit 1-9 which provides an overview of the accounting requirement with respect to defensive assets.

Exhibit 1-9: Defensive Assets (ASC 805-20-30-6)

To protect its competitive position, or for other reasons, the acquirer may intend not to use an acquired nonfinancial asset actively, or it may not intend to use the asset according to its highest and best use. For example, that might be the case for an acquired research and development intangible asset that the acquirer plans to use defensively by preventing others from using it. Nevertheless, the acquirer shall measure the fair value of the nonfinancial asset in accordance with Subtopic 820-10 assuming its highest and best use by market participants in accordance with the appropriate valuation premise, both initially and for purposes of subsequent impairment testing.

Noncontrolling Interests
Given certain situations, there may be difficulty in appropriately measuring the fair value of an acquirer's noncontrolling interest in an acquiree at the acquisition date. However, let’s take a step back and establish an understanding of what exactly is meant by the term “noncontrolling interest”. Simply put, a noncontrolling interest is the equity in a subsidiary not attributable, directly or indirectly, to a parent. 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 whereas in other situations, 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 (ASC 805-20-30-7). Refer to the interpretive guidance from E&Y from their Business Combination guide with respect to estimating fair value of a noncontrolling interest in Exhibit 1-10 below, and the particular challenges when measuring noncontrolling interest for private companies.

**Exhibit 1-10: Estimating Fair Value of a Noncontrolling Interest – E&Y Views**

When the target is a public company, determining the fair value of any noncontrolling interest generally is straightforward. In these situations, the fair value of the noncontrolling interest typically is determined directly based on the observable quoted share price of the target as of the acquisition date times the quantity of shares that constitute the noncontrolling interest.

However, when the target is a private company, determining the fair value of the noncontrolling interest often requires further consideration as quoted share prices generally are not available for the equity instruments that make up the NCI. When active markets and observable prices do not exist, valuation techniques, as described in greater depth in ASC 820 and our FRD, Fair value measurement, are needed to estimate the fair value of the noncontrolling interest. In certain instances, companies may undertake more than one valuation approach (e.g., both a market approach and an income approach) as ASC 820 indicates valuation techniques that are appropriate in the circumstances and for which sufficient data is available should be used in determining fair value. The choice as to which approach or approaches to use should consider the availability of relevant inputs and their relative subjectivity.

While the use of valuation techniques to determine the fair value of a noncontrolling interest in a private company involves significant judgment, the transaction price paid by the acquirer for the controlling interest can provide information regarding the equity value of the target company as a whole, which may be useful in estimating the fair value of the noncontrolling interest. However, in order to properly consider the transaction price paid for the controlling interest when estimating the fair value of NCI in a private company, one must have a detailed understanding of the transaction, including whether (i) the price paid for the controlling interest includes a premium, (ii) the noncontrolling interest would also benefit from the acquirer obtaining control and (iii) the shares purchased by the acquirer have additional features or rights that are not shared by the NCI.

**Contingent Consideration**

Business combinations may often include provisions for additional consideration to be transferred to the former shareholders in the future if certain future events occur or certain conditions are met. This additional consideration is commonly referred to as contingent consideration. Buyers and sellers often use these arrangements when they cannot reach agreement on the consideration for the business being targeted for acquisition. For example, an acquirer may promise to deliver cash, other assets or additional equity interests to former owners of an acquired business after the acquisition date if certain specified events occur or conditions are met in the future. This form of contingent consideration is frequently based on earnings or instrument price changes over specified periods after the date of the acquisition.

The guidance prescribed within FASB ASC 805 requires that an acquirer recognize contingent consideration obligations as of the acquisition date as part of the consideration transferred in exchange for the acquired business in a business combination. The FASB concluded that the recognition event for contingent consideration in a business combination is the actual agreement to make contingent payments and not the
actual achievement of the contingency. As a result, the FASB does not believe that the delayed recognition of contingent consideration fairly represents the economic consideration at the acquisition date. Accordingly, the initial measurement of contingent consideration obligations is the fair value of the obligations, based on circumstances that exist as of the acquisition date.

While we have laid out the overall principles with respect to contingent consideration above, let’s look more specifically at examples of contingent consideration. Refer to Exhibit 1-11 which provides a view from KPMG from their publication “Accounting for Business Combinations and Noncontrolling Interests” (January 2016) of examples of contingent consideration along with descriptions of each.

**Exhibit 1-11: Forms of Contingent Consideration**

**Contingent Consideration Based on Earnings**
Consideration may be contingent on maintaining or achieving specified earnings levels in future periods. An acquirer may be required to issue additional shares of its common shares to the former shareholders of the acquiree if earnings of the acquiree reach a certain level for a specified period.

**Contingent Consideration Based on Components of Earnings**
Consideration could be contingent on components of earnings such as revenue growth, cost containment, or EBITDA. An acquirer may be required to pay additional consideration to the acquiree’s previous owners based on the number of units or dollar amount of sales of specified products sold by the acquirer for the five-year period following the acquisition date.

**Contingent Consideration That Represents a Guarantee of Security Price**
Contingent consideration is sometimes issued to guarantee the price of securities issued by the acquirer in an acquisition. This type of guarantee is generally in the form of an agreement by the acquirer to issue additional shares of shares, cash, or other consideration if the market (fair) value of the acquirer’s securities issued to the former shareholders of the acquiree does not reach the guaranteed value by a specified date or maintain the guaranteed value for a stipulated period of time.

**Redeemable Preferred Shares and Put Options**
A guarantee of the value of shares issued as consideration in a business combination may be embedded in the securities, i.e., the shares unconditionally issued at the date of acquisition are puttable for the guaranteed value at the option of the holder (i.e., the holder may demand cash in exchange for the shares). Alternatively, in addition to the shares issued to effect the combination, an acquirer could issue put options that give the holder the right to return the shares to the acquirer for the guaranteed value.

**Below-Market Guarantee**
A purchase agreement may include an arrangement for the purchaser to issue additional consideration to the seller that guarantees a minimum value or security price at a future date that is less than the value or security price at the date the securities are issued (below-market guarantee).

**Contingent Consideration That Does Not Guarantee Security Price**
The purchase agreement may include an arrangement for the acquirer to issue additional consideration to the seller based on security prices at a future date, but does not result in a guarantee of the total value of the consideration issued by the acquirer. An acquirer may agree to issue a fixed amount of additional shares should the fair value of the shares originally issued be less than a target value at a specified future date.

Simply put, the contingent consideration issued with respect to a business combination is classified as either equity or a liability, at the acquisition date, based on applicable GAAP (ASC 805-30-25-6). As a result, an entity will need to refer outside of FASC ASC 805 for guidance on how to record contingent consideration. Specifically, an entity will need to refer to FASB ASC 480-10, *Distinguishing Liabilities from Equity*, and FASB
ASC 815-40, *Derivatives and Hedging – Contracts in Equity's Own Equity*, and other applicable GAAP as a result. While a comprehensive discussion of this evaluation between whether contingent consideration represents that of a liability or equity is outside the scope of this course, an entity should, in general, consider the following questions when determining the classification.

- Will the arrangement be settled only in cash?
- Is the arrangement within the scope of FASB ASC 480?
- Is the arrangement indexed to the entity’s own stock?
- Does the instrument meet the equity classification requirements under FASB ASC 815?

**Exceptions to the Measurement Principle**

Recall that the overall measurement principle is that an acquirer should measure identifiable assets acquired, liabilities assumed, and any noncontrolling interests in the acquiree at the acquisition date fair value. However, similar to how there were exceptions to the recognition principle outlined in the previous section, there are also specific exceptions to the measurement principle. These include the following areas:

- Income taxes
- Employee benefits
- Indemnification assets
- Reacquired rights
- Share-based payment awards
- Assets held for sale
- Certain assets and liabilities arising from contingencies

A discussion of some of these specific exceptions are included in the following sections.

**Income Taxes**

Simply put, income taxes that are related to a business combination are not measured at fair value in accordance with FASB ASC 820. ASC 805-740-30-1 states that an acquirer should measure a deferred tax asset or a deferred tax liability arising from the assets acquired and liabilities assumed in a business combination in accordance with ASC 740-10, *Income Taxes*.

**Employee Benefits**

Similar to the requirements presented above with respect to income taxes, an acquirer should also measure an asset (if any) or liability related to the acquiree’s employee benefit arrangements in accordance with other GAAP (ASC 805-20-30-14). Refer to Exhibit 1-12 below for an overview of the measurement requirements with respect to pension and postretirement benefits other than pensions.

**Exhibit 1-12: Employee Benefits (ASC 805-20-30-15)**

Guidance on defined benefit pension plans is presented in Subtopic 715-30. Guidance on defined benefit other postretirement plans is presented in Subtopic 715-60. Paragraphs 805-20-25-23 and 805-20-25-25 require an acquirer to recognize as part of a business combination an asset or a liability representing the funded status of a single-employer defined benefit pension or postretirement plan. In determining that funded status, the acquirer shall exclude the effects of expected plan amendments, terminations, or curtailments that at the acquisition date it has no obligation to make. The projected benefit obligation assumed shall reflect any other necessary changes in assumptions based on the acquirer’s assessment of relevant future events.

In addition to the guidance above with respect to pensions and other postretirement benefits other than pensions, FASB ASC 805 also points to other GAAP related to other employee benefit arrangements. This includes the following types of benefit arrangements with references to the applicable GAAP:
Indemnification Assets

The selling shareholders of an acquiree may provide an indemnification to an acquirer for uncertainties about the settlement amounts of assets acquired or liabilities assumed by the acquirer. Indemnifications often require the acquiree’s selling shareholders to reimburse the acquirer for some or all of the costs incurred by the acquirer in connection with an assumed contingency. From the standpoint of an acquirer, this indemnification arrangement is an acquired asset that is recognized in connection with the business combination.

The overall principle with respect to indemnifications is that an indemnification asset is recognized on the same basis as is the indemnified item (ASC 805-20-25-27). While these indemnification arrangements are ordinarily included in the actual acquisition agreement, they may also occur as a result of a separate agreement not related to the actual business combination. As such, whether such an arrangement should be accounted for as part of the business combination or as a separate transaction requires evaluation of all facts and circumstances of the arrangements.

Reacquired Rights

As a part of certain business combinations, an acquirer may reacquire a right that it had previously granted to the acquiree to use one or more of the acquirer’s recognized or unrecognized assets (ASC 805-20-25-14). An example of this type of reacquired right could be a right to use the acquirer’s trade name under a franchise agreement or a right to use the acquirer’s technology under a technology licensing agreement (ASC 805-20-25-14). It’s also important to note that a reacquired right is an identifiable intangible asset that an acquirer should recognize separately from goodwill.

With respect to the measurement requirements of reacquired rights, an acquirer in a business combination should measure the value of a reacquired right on the basis of the remaining contractual term of the related contract regardless of whether market participants would consider potential contractual renewals in determining its fair value (ASC 805-20-30-20).

Share-Based Payment Awards

It is common in business combinations for share-based payments held by employees of the acquiree to be exchanged for similar equity instruments of the acquirer. Simply put, a liability or equity instrument that is issued to replace the previous liability or equity instrument should be accounted for in accordance with FASB ASC 718, Stock Compensation. Refer to Exhibit 1-13 which provides additional accounting requirements with respect to share-based payments awards exchanged in conjunction with a business combination.
An acquirer may exchange its share-based payment awards for awards held by employees of the acquiree. This Topic refers to such awards as replacement awards. Exchanges of share options or other share-based payment awards in conjunction with a business combination are modifications of share-based payment awards in accordance with Topic 718. If the acquirer is obligated to replace the acquiree awards, either all or a portion of the fair-value-based measure of the acquirer’s replacement awards shall be included in measuring 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. For example, for purposes of applying this requirement, the acquirer is obligated to replace the acquiree’s awards if replacement is required by any of the following:

- The terms of the acquisition agreement
- The terms of the acquiree’s awards
- Applicable laws or regulations.

In situations in which acquiree awards would expire as a consequence of a business combination and the acquirer replaces those awards even though it is not obligated to do so, all of the fair-value-based measure of the replacement awards shall be recognized as compensation cost in the post combination financial statements. That is, none of the fair value-based measure of those awards shall be included in measuring the consideration transferred in the business combination.

To determine the portion of a replacement award that is part of the consideration transferred for the acquiree, the acquirer shall measure both the replacement awards granted by the acquirer and the acquiree awards as of the acquisition date in accordance with Topic 718. The portion of the fair-value-based measure of the replacement award that is part of the consideration transferred in exchange for the acquiree equals the portion of the acquiree award that is attributable to precombination service.

The acquirer shall attribute a portion of a replacement award to postcombination service if it requires postcombination service, regardless of whether employees had rendered all of the service required in exchange for their acquiree awards before the acquisition date. The portion of a nonvested replacement award attributable to postcombination service equals the total fair-value-based measure of the replacement award less the amount attributed to precombination service. Therefore, the acquirer shall attribute any excess of the fair-value-based measure of the replacement award over the fair value of the acquiree award to postcombination service.

Given the complexity of the guidance above, the FASB includes several examples to help illustrate the specific requirements with respect to share-based payments involved in a business combination. Refer to Exhibit 1-14 which provides expansive discussion of the accounting requirements through several illustrative examples included within the implementation guidance of FASB ASC 805.
Exhibit 1-14: Acquirer Replacement Awards (ASC 805-30-55-17 thru 20)

The following Cases illustrate the guidance referred to in paragraph 805-30-55-6 for replacement awards that the acquirer was obligated to issue. The Cases assume that all awards are classified as equity and that the awards have only an explicit service period. As discussed in paragraphs 805-30-55-8 through 55-9, the acquirer also must take any implicit or derived service periods into account in determining the requisite service period for a replacement award. In these Cases, the acquiring entity is referred to as Acquirer and the acquiree is referred to as Target:

Awards that require no postcombination services that are exchanged for acquiree awards for which employees:

Have rendered the required service as of the acquisition date (Case A)

Have not rendered all of the required service as of the acquisition date (Case D)

Awards that require postcombination services that are exchanged for acquiree awards for which employees:

Have rendered the required service as of the acquisition date (Case B)

Have not rendered all of the required service as of the acquisition date (Case C)

Case A: No Required Postcombination Service, All Requisite Service for Acquiree Awards Rendered as of Acquisition Date

Acquirer issues replacement awards of $110 (fair-value-based measure) at the acquisition date for Target awards of $100 (fair-value-based measure) at the acquisition date. No postcombination services are required for the replacement awards, and Target'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 Target's awards ($100) at 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, Acquirer immediately recognizes $10 as compensation cost in its postcombination financial statements.

Case B: Postcombination Service Required, All Requisite Service for Acquiree Awards Rendered as of Acquisition Date

Acquirer exchanges replacement awards that require one year of postcombination service for share-based payment awards of Target for which employees had completed the requisite service period before the business combination. The fair-value-based measure of both awards is $100 at the acquisition date. When originally granted, Target's awards had a requisite service period of four years. As of the acquisition date, the Target employees holding unexercised awards had rendered a total of seven years of service since the grant date. Even though Target employees had already rendered all of the requisite service, Acquirer attributes a portion of the replacement award to postcombination compensation cost in accordance with paragraphs 805-30-30-12 through 30-13 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 (4 years) to the total service period (5 years). Thus, $80 ($100× 4÷ 5 years) is attributed to the precombination service period and therefore 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 Acquirer’s postcombination financial statements in accordance with Topic 718.

**Case C: Postcombination Service Required, All Requisite Service for Acquiree Awards Not Rendered as of Acquisition Date**

Acquirer exchanges replacement awards that require one year of postcombination service for share-based payment awards of Target 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 at the acquisition date. When originally granted, the awards of Target had a requisite service period of four years. As of the acquisition date, the Target employees had rendered two years’ 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 Target's 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 (2 years) to the greater of the total service period (3 years) or the original service period of Target's award (4 years). Thus, $50 ($100 x 2 ÷ 4 years) is attributable to precombination service and therefore included in the consideration transferred for the acquiree. The remaining $50 is attributable to postcombination service and therefore recognized as compensation cost in Acquirer’s postcombination financial statements.

**Case D: No Required Postcombination Service, All Requisite Service for Acquiree Awards Not Rendered as of Acquisition Date**

Assume the same facts as in Case C, except that Acquirer exchanges replacement awards that require no postcombination service for share-based payment awards of Target for which employees had not yet rendered all of the requisite service as of the acquisition date. The terms of the replaced Target awards did not eliminate any remaining requisite service period upon a change in control. (If the Target awards had included a provision that eliminated any remaining requisite service period upon a change in control, the guidance in Case A 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 (2 years) to the greater of the total service period (2 years) or the original service period of Target's award (4 years). Thus, $50 ($100 x 2 ÷ 4 years) is attributable to precombination service and therefore 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, Acquirer recognizes the entire $50 immediately as compensation cost in the postcombination financial statements.

**Assets Held for Sale**

Simply put, those long-lived assets that are acquired in a business combination that meet the held for sale requirements should be measured at fair value less cost to sell. This is consistent with the guidance prescribed by ASC 360-10. While this exception is fairly close to the fair value measurement principle, the costs to sell is the primary distinction and what drives this to be considered an exception. As a reminder, costs to sell are those incremental direct costs to transact a sale. Specifically, it is the costs that result directly from and are essential to a sale transaction and that would not have been incurred by the entity had the decision to sell not been made (ASC 360-10-35-38). Examples of these costs include broker commissions, legal and title transfer fees, and closing costs that must be incurred before legal title can be transferred (ASC 360-10-35-38). It’s
important to note that these costs exclude expected future losses associated with the operations of a long-lived asset while it is classified as held for sale (ASC 360-10-35-38).

Certain Assets and Liabilities Arising from Contingencies
The final exception to the fair value measurement principle relates to preacquisition contingencies. ASC 805-20-30-23 prescribes that the measurement of assets and liabilities should be at an amount that can be reasonably estimated by applying the guidance within ASC Topic 450, Contingencies.

Review Questions
5. Which of the following is an example of an exception to the recognition principle?
   a. Assets held for sale.
   b. Reacquired rights.
   c. Share-based payments awards.
   d. Income taxes.

6. Which of the following measurement principle exceptions states that an acquirer should refer to the guidance within ASC 710 & ASC 712?
   a. Employee benefits.
   b. Assets held for sale.
   c. Share-based payments awards.
   d. Indemnification assets.

Business Combination Achieved in Stages
In certain situations, an acquirer sometimes obtains control of an acquiree where it previously held an equity interest immediately before the acquisition. As an example, assume that Entity ABC owned a 25% noncontrolling interest in Entity XYZ, and then at a later date, purchased an additional 35% interest. The combined percentage ownership now effectively provides Entity ABC control over Entity XYZ. In this situation, this is referred to as a business combination that is achieved in stages, or, also referred to as a step acquisition.

The important principle to note with respect to these type of acquisitions is that, prior to obtaining control over an entity and accounting for transaction as a business combination, any ownership interest held prior to obtaining control should be subject to existing accounting literature (i.e. other GAAP). For example, if an entity has significant influence over another entity, but does not have control, the accounting for that arrangement is subject to the guidance prescribed by ASC 323, Investments – Equity Method and Joint Ventures.

Alternatively, if an entity has a noncontrolling interest in another entity and does not have significant influence, that arrangement would likely be accounted for under the cost method prescribed by ASC 325-20, Investments – Other, Cost Method Investments.

Recall that by definition, a business combination is a transaction or event in which an acquirer obtains control of one or more businesses. As a result, only when the acquirer obtains control of one of more of these business are the accounting requirements prescribed by FASB ASC 805 triggered. In other words, when this control takes place that is when a business combination is deemed to have occurred.

When a business combination achieved in stages occurs, the acquirer is required to 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 (ASC 805-10-25-10). Additionally, in prior reporting periods, the acquirer may have recognized changes in the value of its equity interest in other comprehensive income. If so, the amount that was recognized in other comprehensive income should be reclassified and included in the calculation of gain or loss as of the acquisition date (ASC 805-10-25-10). Refer to Exhibit 1-15 below which provides the FASB’s Basis for Conclusions with respect to this remeasurement of the previously held equity interest.
Exhibit 1-15: FASB Basis for Conclusions (B384, B389)

In a business combination achieved in stages, the acquirer remeasures its previously held equity interest at its acquisition-date fair value and recognizes the related gain or loss in earnings (paragraph 48). 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.

The Boards understand that the required treatment of a previously held equity investment in a step acquisition is different from the initial recognition of gains or losses on available-for-sale securities. However, the Boards noted that changes in the value of available-for-sale securities are recognized in net income when the securities are derecognized. In a business combination achieved in stages, the acquirer derecognizes its investment asset in an entity in its consolidated financial statements when it achieves control. Thus, the Boards concluded that it is appropriate to recognize any resulting gain or loss in net income at the acquisition date.

Step 4: Recognizing and Measuring Goodwill or Gain from a Bargain Purchase

Goodwill is defined within the ASC Master Glossary as an asset representing the future economic benefits arising from other assets acquired in a business combination, or an acquisition by a not-for-profit entity that are not individually identified and separately recognized. Said another way, goodwill represents the residual amount.

Included within FASB Statement 141(r), Business Combinations, the pre-codification literature that was applicable prior to the issuance of ASC 805, the FASB provides additional context with respect to what goodwill represents and how it is accounted for in a business combination. Refer to Exhibit 1-16 below which provides additional insight from the FASB in its Basis for Conclusions with respect to goodwill.

Exhibit 1-16: FASB Basis for Conclusions for FAS 141(r) – B320 & B321

The FASB noted that goodwill cannot be exchanged for something else of value to the entity and it cannot be used to settle the entity’s liabilities. Goodwill also lacks the capacity singly to produce future net cash inflows, although it can—in combination with other assets—produce cash flows. Thus, the future benefit associated with goodwill generally is more nebulous and may be less certain than the benefit associated with most other assets. Nevertheless, goodwill generally provides future economic benefit. Concepts Statement 6 observes that “anything that is commonly bought and sold has future economic benefit, including the individual items that a buyer obtains and is willing to pay for in a ‘basket purchase’ of several items or in a business combination” (paragraph 173).

For the future economic benefit embodied in goodwill to qualify as an asset, the acquirer must control that benefit. The FASB observed that the acquirer’s control is demonstrated by means of its ability to direct the policies and management of the acquiree. The FASB also observed that the past transaction or event necessary for goodwill to qualify as the acquirer’s asset is the transaction in which it obtained the controlling interest in the acquiree.

Simply put, goodwill should be measured by an acquirer as of the acquisition date. There are two components to the goodwill calculation an entity should be familiar with. One component is the aggregate of the following:

- The consideration transferred which generally requires acquisition-date
The fair value of any noncontrolling interest in the acquiree

In a business combination achieved in stages, the acquisition-date fair value of the acquirer’s previously held equity interest in the acquiree

The second component is the net of the acquisition-date amounts of the identifiable assets acquired and liabilities assumed and measured in accordance with the measurement principles previously discussed.

In order to calculate goodwill, an entity would calculate the excess of the first component above over the second component. In other words, the residual consideration (in total) transferred in exchange for the assets acquired and liabilities assumed. Hence, the residual. However, let’s address what are some examples of consideration transferred. These include, but are not limited to, the following (ASC 805-30-30-7):

- Cash
- Other assets
- A business or a subsidiary of the acquirer
- Contingent consideration
- Common or preferred equity instruments
- Options
- Warrants
- Member interests of mutual entities

It’s important to note that the consideration transferred may include assets or liabilities of the acquirer that have carrying amounts that differ from their fair values at the acquisition date, such as nonmonetary assets or a business of the acquirer (ASC 805-30-30-8). If this is the case, the acquirer is required to remeasure the transferred assets or liabilities to their fair values as of the acquisition date and recognize the resulting gains or losses, if any, in earnings (ASC 805-30-30-8). However, sometimes the transferred assets or liabilities remain within the combined entity after the business combination and the acquirer therefore retains control of them. In these situations, the acquirer is required to measure those assets and liabilities at their carrying amounts immediately before the acquisition date and should not recognize a gain or loss in earnings on assets or liabilities it controls both before and after the business combination (ASC 805-30-30-8).

Additional considerations for calculating goodwill occur when either the business combination involves an exchange only of equity interests or a business combination in which no consideration is transferred. The accounting requirements with respect to each of these are addressed in Exhibit 1-17 below.

**Exhibit 1-17: Measurement of Goodwill**

**Exchange Only of Equity Interests**

In a business combination in which the acquirer and the acquiree (or its former owners) exchange only equity interests, the acquisition-date fair value of the acquiree’s equity interests may be more reliably measurable than the acquisition-date fair value of the acquirer’s equity interests. If so, the acquirer shall determine the amount of goodwill by using the acquisition-date fair value of the acquiree’s equity interests instead of the acquisition-date fair value of the equity interests transferred.

**No Consideration Transferred**

To determine the amount of goodwill in a business combination in which no consideration is transferred, the acquirer shall use the acquisition-date fair value of the acquirer’s interest in the acquiree determined using a valuation technique in place of the acquisition-date fair value of the consideration transferred (see paragraph 805-30-30-1(a)(1)).

The implementation guidance in ASC 805-30 also provides additional guidance with respect to applying the acquisition method to combination of mutual entities (an entity other than an investor-owned entity that
provides dividends, lower costs, or other economic benefits directly and proportionately to its owners, members, or participants). Simply put, when two mutual entities combine, the fair value of the equity or member interests in the acquiree may be more readily measurable than the fair value of the member interests transferred by the acquirer (ASC 805-30-55-3). In this situation, ASC 805 requires the acquirer to determine the amount of goodwill by using the acquisition-date fair value of the acquiree’s equity interests instead of the acquisition-date fair value of the acquirer’s equity interests transferred as consideration (ASC 805-30-55-3). Additionally, the acquirer in a combination of mutual entities is required to recognize the acquiree’s net assets as a direct addition to capital or equity in its statement of financial position, not as an addition to retained earnings, which is consistent with the way in which other types of entities apply the acquisition method (ASC 805-30-55-3). Refer to Exhibit 1-18 below which provides additional insight and measurement requirements with respect to mutual entities.

**Exhibit 1-18: Mutual Entities (ASC 805-30-55-4 through 5)**

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

A fair value measurement of a mutual entity should include the assumptions that market participants would make about future member benefits as well as any other relevant assumptions market participants would make about the mutual entity. For example, an estimated cash flow model may be used to determine the fair value of a mutual entity. The cash flows used as inputs to the model should be based on the expected cash flows of the mutual entity, which are likely to reflect reductions for member benefits, such as reduced fees charged for goods and services.

**Gain from Bargain Purchase**

ASC 805 notes that on some occasions, an acquirer will make a bargain purchase of a business wherein the fair value of the net assets acquired exceeds the amount of consideration transferred. In the FASB’s Basis for Conclusions in FASB Statement 141(r), B371 notes that “the Boards consider bargain purchases to be anomalous transactions – business entities and their owners generally do not knowingly and willingly sell assets or businesses at price below their fair values. However, bargain purchases have occurred and are likely to continue to occur.”

When a bargain purchase occurs, there is an inherent economic gain for the acquirer as a result. Said another way, at the acquisition date, the acquirer is better off by the amount by which the fair value of what is acquired exceeds the fair value of the consideration transferred. Refer to Exhibit 1-19 for an overview of E&Y’s view on bargain purchases from their Business Combinations guide.
Exhibit 1-19: E&Y’s Views on Bargain Purchases

Because bargain purchases are rare, we believe that an important aspect of the reassessment process is for the acquirer to be able to understand why there is a bargain purchase — why the seller would be willing to sell its business at an amount less than what a market participant would be willing to pay. Usually, a seller acts in an economically rational manner given the fiduciary responsibility that it has to its shareholders. Examples of factors that may individually or in aggregate justify a bargain gain include the following:

- The transaction was a “forced” or “distressed” sale. Bargain purchases are most common when there is a “forced” or “distressed” sale.
- The seller was required to sell the business in a less than an optimal period of time.
- The transaction was not subject to a competitive bidding process. Transactions subject to a competitive bidding process generally are less likely to result in a bargain gain because the business typically would be sold at fair value.
- The purchase price was “fixed” prior to the closing date of the transaction and the fair value of the net identifiable assets acquired increased during the intervening period thereby creating the bargain purchase.
- The buyer cannot sell the individual assets acquired or settle the individual liabilities assumed immediately after the acquisition at an amount equal to or greater than their acquisition-date fair value. For example, if the acquirer in a bargain purchase transaction records an asset for $10 because it includes company-specific synergies in the valuation of the asset, but a market participant would pay only $8 if the acquirer were to immediately sell that asset, then that would suggest that the fair value of the asset is really $8. On the other hand, if a market participant would pay $10 for the asset, the acquirer’s conclusion that it had a bargain purchase may be appropriate. Companies should consider these factors as they think about how to disclose the bargain gain in the notes to their financial statements.

So while we have touched on the rarity with which these bargain purchases occur in practice – when they do occur, how is an entity required to account for the transaction as compared to a more common business combination that results in the recording of goodwill (i.e. consideration transferred is greater than net assets received)? ASC 805-30-25-2 prescribes that an entity should recognize a gain in earnings on the acquisition date. However, before recognizing this gain and moving on, there are additional requirements prescribed by ASC 805.

Because companies may be motivated to recognize a gain in earnings on account of an acquisition, and in turn, shortcut the identification of assets within the business combination (i.e. recording less value for assets and more for gain), ASC 805-30-25-4 specifically prescribes that before recognizing a gain on a bargain purchase, the acquirer is required to reassess whether it has correctly identified all of the assets acquired and all of the liabilities assumed and should recognize any additional assets or liabilities that are identified in that review. Simply put, the FASB is emphasizing that when an entity believes they have a bargain purchase, they need to go back and double check all of their evaluations of assets acquired and liabilities assumed. Furthermore, as part of this reassessment, an acquirer is required to also review the procedures used to measure the amount recognized at the acquisition date for all of the following (ASC 805-30-30-5):

- The identifiable assets acquired and liabilities assumed
- The noncontrolling interest in the acquiree, if any
- For a business combination achieved in stages, the acquirer’s previously held equity interest in the acquiree
- The consideration transferred
As is clearly evident, the purpose of reassessment is to challenge all valuations to ensure that consideration paid, assets acquired, liabilities assumed, as well as any noncontrolling interests are properly measured. Refer to Exhibit 1-20 which provides E&Y’s view on certain procedures that should be performed with respect to this reassessment.

**Exhibit 1-20: Bargain Purchase Reassessment**

In performing the required reassessment, the acquirer reevaluates all aspects of the transaction, including whether:

- The resulting gain represents management’s best estimate of the economic effect of the transaction based on all information that existed as of the acquisition date
- There are any aspects of the transaction that should be accounted for separately from the business combination, such as:
  - Preexisting relationships that were settled as a result of the business combination
  - Transactions (contractual or noncontractual) entered into at or near the same time as the business combination that are primarily for the benefit of the combined entity
  - The payment of transaction costs by the seller on behalf of the acquirer
- All assets acquired were evaluated for any contingencies that could prohibit recognition as of the acquisition date
- All identified intangible assets met either the contractual-legal or separability criterion of ASC 805
- Conclusions reached with respect to assumed pension obligations were appropriate
- Preacquisition contingencies (e.g., legal contingencies or potential tax exposures) of the target were properly identified, measured and recognized
- All leases and other executory contracts were evaluated for any off-market components that should be recognized as of the acquisition date
- Conclusions reached with respect to the accounting for acquired or assumed deferred taxes were appropriate
- The buyer assessed the reasonableness of the fair value determinations by reviewing the procedures performed to measure the fair value of the consideration transferred, assets acquired, liabilities assumed and any noncontrolling interest, including whether:
  - The fair value measurements reflect all available information as of the acquisition date
  - The significant assumptions (e.g., prospective financial information, discount rate, royalty rate, control premium, as applicable) used in the fair value calculation are reasonable and reflect the appropriate level of risk for the transaction (e.g., if management’s estimate of the prospective financial information was deemed to be aggressive, then the discount rate should be increased to reflect the additional level of risk)
  - Any entity-specific synergies were inappropriately included in the initial valuation of any assets acquired or liabilities assumed (e.g., could the buyer immediately sell the asset or transfer the liability to a market participant at their recorded values)

As you likely guessed, when a bargain purchase occurs and a gain is recognized on the business combination, there is no associated goodwill recorded. Goodwill is only recorded when the consideration transferred exceeds that of the net assets acquired.

In order to help illustrate the accounting requirements with respect to a bargain purchase, the FASB includes an example within its implementation guidance. Refer to Exhibit 1-21 for an illustration of this example.
Exhibit 1-21: Bargain Purchase Example (ASC 805-30-55-15 through 16)

On January 1, 20X5, the acquiring entity, or Acquirer, acquires 80 percent of the equity interests of the acquiree, or Target, a private entity, in exchange for cash of $150. Because the former owners of Target needed to dispose of their investments in Target by a specified date, they did not have sufficient time to market Target to multiple potential buyers.

The management of Acquirer initially measures the separately recognizable identifiable assets acquired and the liabilities assumed as of the acquisition date in accordance with the requirements of the Business Combinations Topic. The identifiable assets are measured at $250, and the liabilities assumed are measured at $50. Acquirer engages an independent consultant who determines that the fair value of the 20 percent noncontrolling interest in Target is $42.

The amount of Target's identifiable net assets ($200, calculated as $250– $50) exceeds the fair value of the consideration transferred plus the fair value of the noncontrolling interest in Target. Therefore, Acquirer reviews the procedures it used to identify and measure the assets acquired and liabilities assumed and to measure the fair value of both the noncontrolling interest in Target and the consideration transferred. After that review, Acquirer decides that the procedures and resulting measures were appropriate. Acquirer measures the gain on its purchase of the 80 percent interest as follows.

<table>
<thead>
<tr>
<th></th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Identifiable net assets acquired ($250-$50)</td>
<td>200</td>
</tr>
<tr>
<td>Less: Fair Value of the consideration transferred for Acquirer's 80 percent interest in Target, plus Fair value of noncontrolling interest in Target</td>
<td>150 42</td>
</tr>
<tr>
<td></td>
<td>192</td>
</tr>
<tr>
<td>Gain on bargain purchase of 80 percent interest</td>
<td>8</td>
</tr>
</tbody>
</table>

Acquirer would record its acquisition of Target in its consolidated financial statements as follows.

<table>
<thead>
<tr>
<th></th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Identifiable assets acquired</td>
<td>$250</td>
</tr>
<tr>
<td>Cash</td>
<td>$150</td>
</tr>
<tr>
<td>Liabilities assumed</td>
<td>50</td>
</tr>
<tr>
<td>Gain on the bargain purchase</td>
<td>8</td>
</tr>
<tr>
<td>Equity-noncontrolling interest in Target</td>
<td>42</td>
</tr>
</tbody>
</table>

Measurement Period

It’s a fact that at the time all of the assets acquired and liabilities assumed are measured at fair value at the acquisition date, not to mention all of the consideration required related to the various measurement exceptions, an entity generally does not have all of the information necessary to record the entire transaction. For some small and less complex business combinations, it may be the case that the acquirer has all of the necessary information and no further adjustments are necessary on account of new or revised information. In other large and complex business combinations, it may take months, or even up to a year or longer to flesh out all of the various aspects of the transaction and ensure that all the assets are recorded appropriately. Simply put, completing the measurement process for a large and complex business combination takes time, and Day 1, everything will likely not be ready to go and measured accordingly.

Given these inherent challenges, ASC 805 affords some flexibility in this respect. Specifically, the FASB notes in ASC 805-10-25-13 that if the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the acquirer should report in its financial statements provisional amounts for the items for which the accounting is incomplete. Furthermore, during the measurement period the acquirer should adjust the provisional amounts recognized at the acquisition date to reflect new information obtained about facts and circumstances that existed as of the acquisition date that, if
known, would have affected the measurement of the amounts recognized as of that date (ASC 805-10-25-13).

While the above paragraphs refer to changes in amounts recorded as of the acquisition date, it’s also important
to note that an acquirer may also need to recognize additional assets or liabilities if new information is obtained
about facts and circumstances that existed at the acquisition date that, if known, would have resulted in the
recognition of these assets and liabilities (ASC 805-10-25-14). This measurement period effectively ends when
an acquirer is able to determine that it has obtained all necessary information that existed at the acquisition date
(or that the information is unavailable)

Also of importance is the fact that the FASB does not allow an unlimited period of time wherein an entity can
make these adjustments. Specifically, the FASB prescribes in ASC 805-10-25-14 that this measurement period
should not exceed one year.

Adjustments during the Measurement Period

An entity who acquire a business in a business combination should perform a careful evaluation of any
adjustments made to provisional amounts recognized. To that end, the acquirer performs this evaluation to
determine whether the potential adjustment is the result of information that existed as of the acquisition date
or whether the potential adjustment is the result of events occurring subsequent to the acquisition date. Key
factors to assess in this respect are the time in which additional information is obtained and whether the acquirer
can identify a reason for a change to provisional amounts (ASC 805-10-30-2). Obviously, information that is
obtained shortly after the acquisition date is more likely to reflect circumstances that existed at the acquisition
date than information obtained several months later (ASC 805-10-30-3).

When adjustments are concluded to be necessary to the provision amounts recorded at the acquisition date, an
acquirer should ordinarily recognize an increase or decrease in a provisional amount for an asset or liability by
means of either an increase or decrease in goodwill (ASC 805-10-25-16). New information, as noted above,
can also result in changes to provisional amounts as well. In fact, new information obtained during the
measurement period sometimes may result in an adjustment to the provisional amount of more than one asset
or liability. For example, an acquirer might have assumed a liability to pay damages related to an accident in
one of the acquiree’s facilities, part or all of which are covered by the acquiree’s liability insurance policy. If the
acquirer obtains new information during the measurement period about the acquisition-date fair value of that
liability, the adjustment to goodwill resulting from a change to the provisional amount recognized for the
liability would be offset (in whole or in part) by a corresponding adjustment to goodwill resulting from a change
to the provisional amount recognized for the claim receivable from the insurer (ASC 805-10-25-16).

The primary takeaway with respect to these provisional amount adjustments during this measurement period
is that the acquirer should recognize these adjustments as if the accounting for the business combination had
been completed at the acquisition date (ASC 805-10-25-17). Accordingly, an acquirer is required to revise
comparative information for prior periods presented within its financial statements as necessary (ASC 805-10-
25-17).

Subsequent Measurement

Generally speaking, an acquirer should subsequently measure the related assets and liabilities assumed or
incurred in a business combination in accordance with applicable GAAP (ASC 805-10-35-1). However, while
this requirement is true in most circumstances, ASC 805 does specifically prescribe certain exceptions to this
general principle. These exceptions include the following (ASC 805-10-35-1):

- Reacquired rights
- Assets and liabilities arising from contingencies
- Indemnification assets
- Contingent consideration

Each of these exceptions are discussed in additional detail below.

Reacquired Rights
Recall that as a part of certain business combinations, an acquirer may reacquire a right that it had previously granted to the acquiree to use one or more of the acquirer's recognized or unrecognized assets. As previously noted, an example of this type of reacquired right could be a right to use the acquirer's trade name under a franchise agreement or a right to use the acquirer's technology under a technology licensing agreement (ASC 805-20-25-14). Reacquired right are an identifiable intangible asset that an acquirer should recognize separately from goodwill.

With respect to subsequent measurement, a reacquired right should be amortized over the remaining contractual period in which the right was granted (ASC 805-20-35-2).

**Assets and Liabilities Arising from Contingencies**

While the FASB calls out these preacquisition contingencies as an exception to the general subsequent measurement principle in the GAAP, the specific guidance provided is quite cryptic. In fact, the FASB only states that an acquirer should develop a systematic and rational basis for subsequently measuring and accounting for assets and liabilities arising from contingencies depending on their nature (ASC 805-20-35-3). In other words, it’s likely safe to conclude that the subsequent accounting for these types of preacquisition contingencies should be fairly consistent with the initial recognition and measurement.

**Indemnification Assets**

ASC 805-20-35-4 states that at each subsequent reporting date, the acquirer should measure an indemnification asset on the same basis as the indemnified liability or asset, subject to any contractual limitations on its amount. Furthermore, for an indemnification asset that is not subsequently measured at its fair value, the asset should be measured based on management’s assessment of the collectibility of the indemnification asset.

**Contingent Consideration**

FASB ASC 805 notes that some changes in the fair value of contingent consideration that the acquirer recognizes after the acquisition date may be the result of additional information about facts and circumstances that existed at the acquisition date that the acquirer obtained after that date (ASC 805-30-35-1). These changes are considered measurement period adjustments. However, there are other changes resulting from events after the acquisition date (e.g. meeting an earnings target, reaching a specified share price, or reaching a milestone on a research and development project). With respect to these types of changes, these are not considered to be measurement period adjustments (ASC 805-30-35-1).

The way in which changes in the fair value of contingent consideration that are not measurement period adjustments are handled depends primarily on whether the contingent consideration is classified as equity or an assets or liability. The subsequent measurements requirements for each is discussed below (ASC 805-30-35-1):

- Contingent consideration classified as equity should not be remeasured and its subsequent settlement should be accounted for within equity
- Contingent consideration classified as an asset or a liability should be remeasured to fair value at each reporting date until the contingency is resolved. Furthermore, the changes in fair value should be recognized in earnings unless the arrangement is a hedging instrument for which ASC 815 requires the changes to be initially recognized in other comprehensive income

**Review Questions**

7. Which of the following identifies the residual amount attributable to a business combination once all assets and liabilities have been identified and measured?
   a. Contingent consideration.
   b. Goodwill.
   c. Options.
   d. Warrants.
8. Which of the following identifies a specific measurement exception with respect to subsequent measurement?
   a. Contingent consideration.
   b. Share-based payments.
   c. Employee benefits.
   d. Income taxes.

**Financial Statement Disclosures**

The FASB noted in its Basis for Conclusions (B401) within FAS 141(r) that “because a business combination often results in a significant change to an entity’s operations, the nature and extent of the information disclosed about the transaction bear on users’ abilities to assess the effects of such changes on postcombination earnings and cash flows.” Accordingly, the disclosures requirements prescribed ASC 805 are extensive.

Included within the disclosure requirements of ASC 805 are general disclosure requirements along with disclosure requirements specific to assets acquired, liabilities assumed, and noncontrolling interest as well disclosure related to goodwill and bargain purchase gains and consideration transferred. As you can note, the amount of disclosures can vary depending on the business combination.

**General Disclosure Requirements**

The general disclosure requirements are presented in 1-22 below and are applicable for those business combinations occurring during a current reporting period or after the reporting date but before the financial statements are issued.
Exhibit 1-22: General Disclosure Requirements

805-10-50-1
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

b. After the reporting date but before the financial statements are issued or are available to be issued (as discussed in Section 855-10-25).

805-10-50-2
To meet the objective in the preceding paragraph, the acquirer shall disclose the following information for each business combination that occurs during the reporting period:

a. The name and a description of the acquiree

b. The acquisition date

c. The percentage of voting equity interests acquired

d. The primary reasons for the business combination and a description of how the acquirer obtained control of the acquiree

e. For transactions that are recognized separately from the acquisition of assets and assumptions of liabilities in the business combination (see paragraph 805-10-25-20), all of the following:
   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.

f. The disclosure of separately recognized transactions required in (e) 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.

g. In a business combination achieved in stages, all of the following:
   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 immediately before the business combination (see paragraph 805-10-25-10) and the line item in the income statement in which that gain or loss is recognized
   3. The valuation technique(s) used to measure the acquisition-date fair value of the equity interest in the acquiree held by the acquirer immediately before the business combination
   4. Information that enables users of the acquirer’s financial statements to assess the inputs used to develop the fair value measurement of the equity interest in the acquiree held by the acquirer immediately before the business combination.

h. If the acquirer is a public entity, all of the following:
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. If comparative financial statements are not presented, 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 as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period (supplemental pro forma information). For example, for a calendar year-end entity, disclosures would be provided for a business combination that occurs in 20X2, as if it occurred on January 1, 20X1. Such disclosures would not be revised if 20X2 is presented for comparative purposes with the 20X3 financial statements (even if 20X2 is the earliest period presented).

4. The nature and amount of any material, nonrecurring pro forma adjustments directly attributable to the business combination(s) included in the reported pro forma revenue and earnings (supplemental pro forma information).

If disclosure of any of the information required by (h) is impracticable, the acquirer shall disclose that fact and explain why the disclosure is impracticable. In this context, the term impracticable has the same meaning as in paragraph 250-10-45-9.

As you can note from the overall disclosure requirements presented in the exhibit below, the number of disclosures are extensive, and for public business entities, the disclosures are even more extensive. It’s also important to note that while certain public business entities may conclude it’s impractical to contain certain disclosure information as required, they will be required to fully disclose this fact and the reasons for why it is impracticable.

Furthermore, while the disclosures above relate to material business combination of an entity, several immaterial business combinations occurring during a reporting period which aggregate to a material amount would also have certain disclosure requirements. This would include the disclosures prescribed in (e) through (h) in Exhibit 1-22 above. In other words, the following information need not be disclosed for immaterial business combinations that collectively amount to a material amount:

- The name and a description of the acquiree
- The acquisition date
- The percentage of voting equity interests acquired
- The primary reasons for the business combination and a description of how the acquirer obtained control of the acquire

In addition, while the disclosure above include those business combinations that occur after the reporting date but before the financial statements are issued (or are available to be issued), there may be certain situations where the initial accounting for the business combination is incomplete (ASC 805-10-50-4). In these situations, the acquirer should describe which disclosures can be made and the reasons why other disclosures cannot be made (ASC 805-10-50-4).

Finally, in addition to the disclosures prescribed above for new business combinations, entities are also required to disclose information that enables users of its financial statements to evaluate the financial effects of adjustments recognized in the current period for business combinations that occurred in the current period and previous reporting periods (ASC 805-10-50-5). In other words, this would relate to adjustments being made during the measurement period (previously discussed) on account of new information had it existed at the acquisition date.
Disclosures for Assets, Liabilities, and Noncontrolling Interest

In addition to the previously discussed general disclosure requirements, there are also specific disclosure requirements with respect to identifiable assets acquired, liabilities assumed, and any noncontrolling interest. Note, the general disclosure requirements were included in subtopic 10 whereas these specific disclosure requirements are included in subtopic 20. Refer to Exhibit 1-23 for an overview of these disclosure requirements.
Exhibit 1-23: Disclosures for Assets, Liabilities, and Noncontrolling Interest

805-20-50-1

Paragraph 805-10-50-1 identifies one of the objectives of disclosures about a business combination. To meet that objective, the acquirer shall disclose all of the following information for each business combination that occurs during the reporting period:

a. For indemnification assets, all of the following:
   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.

b. For acquired receivables not subject to the requirements of Subtopic 310-30, all of the following:
   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 financing leases in accordance with Subtopic 840-30, and any other class of receivables.

c. The amounts recognized as of the acquisition date for each major class of assets acquired and liabilities assumed (see Example 5 [paragraph 805-10-55-37]).

d. For contingencies, the following disclosures shall be included in the footnote that describes the business combination:
   1. For assets and liabilities arising from contingencies recognized at the acquisition date:
      i. The amounts recognized at the acquisition date and the measurement basis applied (that is, at fair value or at an amount recognized in accordance with Topic 450 and Section 450-20-25)
      ii. The nature of the contingencies
   2. For contingencies that are not recognized at the acquisition date, the disclosures required by Topic 450 if the criteria for disclosures in that Topic are met.

An acquirer may aggregate disclosures for assets and liabilities arising from contingencies that are similar in nature.

e. For each business combination in which the acquirer holds less than 100 percent of the equity interests in the acquiree at the acquisition date, both of the following:
   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.

Similar to the general disclosure requirements previously presented, these specific disclosure requirements are also applicable for those immaterial business combinations that collectively are considered material. However, when this occurs, all of the information prescribed in Exhibit 1-20 should be disclosed. In other words, the
disclosures are not less extensive on account of the business combination being immaterial similar to how they are for the general disclosure requirements.

**Disclosures for Goodwill, Bargain Purchase, and Consideration Transferred**

The final set of disclosure requirements in addition to those described in the previous sections relate to goodwill, bargain purchase, and consideration transferred. Similar to the previous sections, these disclosure requirements are presented in Exhibit 1-24 below.
Exhibit 1-24: Disclosures for Goodwill, Bargain Purchase, and Consideration Transferred

805-30-50-1

Paragraph 805-10-50-1 identifies one of the objectives of disclosures about a business combination. To meet that objective, the acquirer shall disclose all of the following information for each business combination that occurs during the reporting period:

a. 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.

b. The acquisition-date fair value of the total consideration transferred and the acquisition-date fair value of each major class of consideration, such as the following:
   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.

c. For contingent consideration arrangements, all of the following:
   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.

d. The total amount of goodwill that is expected to be deductible for tax purposes.

e. If the acquirer is required to disclose segment information in accordance with Subtopic 280-10, the amount of goodwill by reportable segment. If the assignment of goodwill to reporting units required by paragraphs 350-20-35-41 through 35-44 has not been completed as of the date the financial statements are issued or are available to be issued (as discussed in Section 855-10-25), the acquirer shall disclose that fact.

f. In a bargain purchase (see paragraphs 805-30-25-2 through 25-4), both of the following:
   1. The amount of any gain recognized in accordance with paragraph 805-30-25-2 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.

805-30-50-2

For individually immaterial business combinations occurring during the reporting period that are material collectively, the acquirer shall disclose the information required by the preceding paragraph in the aggregate.

805-30-50-4

Paragraph 805-10-50-5 identifies the second objective of disclosures about the effects of business combinations that occurred in the current or previous reporting periods. To meet the objective in that paragraph, the acquirer shall disclose the following information for each material business combination or in the aggregate for individually immaterial business combinations that are material collectively:
a. 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, all of the following:

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 Section 820-10-50.

b. A reconciliation of the carrying amount of goodwill at the beginning and end of the reporting period as required by paragraph 350-20-50-1.

As you can note from these disclosure requirements, they are also fairly extensive and provide significant information regarding consideration transferred as well as goodwill and bargain purchase conclusions. Similar to the other disclosures previously presented, these disclosures are required for collectively material business combinations that are individually immaterial.

**Other Disclosures**

While ASC 805 prescribes the specific disclosure requirements with respect to business combinations, it’s also important to note that other ASC topics may also prescribe specific disclosure requirements as it relates to a business combination. For example, within ASC 350, Intangibles – Goodwill and Other, there are specific disclosure requirements for intangible assets acquired as a result of a business combination. These additional disclosure requirements are summarized in Exhibit 1-25 below.

**Exhibit 1-25: Intangible Asset Disclosures – Business Combination**

**350-30-50-1**

For intangible assets acquired either individually or as part of a group of assets (in either an asset acquisition, a business combination, or an acquisition by a not-for-profit entity), 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, all of the following:

1. The total amount assigned and the amount assigned to any major intangible asset class
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 or an acquisition by a not-for-profit entity and written off in the period and the line item in the income statement in which the amounts written off are aggregated.

d. For intangible assets with renewal or extension terms, the weighted-average period before the next renewal or extension (both explicit and implicit), by major intangible asset class.

This information also shall be disclosed separately for each material business combination or acquisition by a not-for-profit entity or in the aggregate for individually immaterial business combinations or acquisitions by a not-for-profit entity that are material collectively if the aggregate fair values of intangible assets acquired, other than goodwill, are significant.
**Review Questions**

9. Which of the following identifies a general disclosure requirement with respect to business combinations?
   a. Amount of indemnification assets recognized at the acquisition date.
   b. Acquisition date fair value of total consideration transferred.
   c. Total amount of goodwill expected to be deductible for tax purposes.
   d. The percentage of voting interests acquired.

10. Which of the following identifies a specific disclosure requirement with respect to goodwill, bargain purchase, and/or consideration transferred for a business combination?
    a. A description of why the transaction resulted in a gain.
    b. Fair value of acquired receivables.
    c. The primary reasons for the business combination and a description of how the acquirer obtained control of the acquiree.
    d. Amounts of revenue and earnings of the acquiree since the acquisition date included in the consolidated income statement for the reporting period.

**Illustrative Examples from SEC Filings**

In order to help illustrate some of the accounting and disclosure requirements, this section provides for a few examples of SEC filers and their related disclosures of business combination activity. Refer to Exhibit 1-26 which provides a disclosure from the 3M Company and Exhibit 1-27 which provides the disclosure for Caterpillar. Note that while 3M elected to provide a tabular presentation of its 2015 acquisitions, Caterpillar elected to not use a tabular format. It should be noted that both methods are acceptable so long as the information provided satisfies the respective disclosure requirements. Exhibit 1-28 provides a recent disclosure for Intel. In this example, note the difference in the disclosures between the acquisitions it concludes are immaterial versus the acquisition it calls out specifically (Altera Corporation). It’s also interesting to note the disclosure for Intel which notes that the acquisition closed subsequent to its year end and that the company is continuing to perform the respective valuation assets acquired and liabilities assumed.

As a disclaimer, these examples do not serve to suggest these are best practices with respect to business combination disclosures. These are only presented for purposes of illustrating the respective guidance.
Exhibit 1-26: Business Combination Disclosure Example – 3M Company

Form 10-K for the fiscal year ended December 31, 2015 (Note 2)

3M makes acquisitions of certain businesses from time to time that are aligned with its strategic intent with respect to, among other factors, growth markets and adjacent product lines or technologies.

The impact on the consolidated balance sheet of the purchase price allocations related to 2015 acquisitions and assigned weighted-average intangible asset lives, including adjustments relative to other acquisitions within the measurement period, follows. The allocation of purchase consideration related to the August 2015 Capital Safety and Polypore Separations Media acquisitions is considered preliminary, primarily with respect to certain tax-related assets and liabilities. 3M expects to finalize the allocation of purchase price within the one year measurement-period following these acquisitions. Adjustments to preliminary allocations primarily related to the identification and valuation of certain indefinite-lived intangible assets (further discussed below). The change to provisional amounts resulted in an immaterial impact to results of operations in the fourth quarter of 2015, a portion of which relates to earlier quarters in the measurement period.

<table>
<thead>
<tr>
<th>2015 Acquisition Activity</th>
<th>Capital Safety</th>
<th>Polypore Separations Media</th>
<th>Other</th>
<th>Total</th>
<th>Finite-Lived Intangible-Asset Weighted-Average Lives (Years)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Millions)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Asset (Liability)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>$ 66</td>
<td>$ 30</td>
<td>$ 7</td>
<td>$ 103</td>
<td></td>
</tr>
<tr>
<td>Inventory</td>
<td>63</td>
<td>35</td>
<td>4</td>
<td>102</td>
<td></td>
</tr>
<tr>
<td>Other current assets</td>
<td>10</td>
<td>1</td>
<td>1</td>
<td>12</td>
<td></td>
</tr>
<tr>
<td>Property, plant, and equipment</td>
<td>36</td>
<td>128</td>
<td>7</td>
<td>171</td>
<td></td>
</tr>
<tr>
<td>Purchased finite-lived intangible assets:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Customer related intangible assets</td>
<td>445</td>
<td>270</td>
<td>40</td>
<td>755</td>
<td>16</td>
</tr>
<tr>
<td>Patents</td>
<td>44</td>
<td>11</td>
<td>7</td>
<td>62</td>
<td>7</td>
</tr>
<tr>
<td>Other technology-based intangible assets</td>
<td>85</td>
<td>42</td>
<td>1</td>
<td>128</td>
<td>7</td>
</tr>
<tr>
<td>Definite-lived tradenames</td>
<td>26</td>
<td>6</td>
<td>1</td>
<td>33</td>
<td>16</td>
</tr>
<tr>
<td>Other amortizable intangible assets</td>
<td>—</td>
<td>—</td>
<td>2</td>
<td>2</td>
<td>4</td>
</tr>
<tr>
<td>Purchased indefinite-lived intangible assets</td>
<td>520</td>
<td>—</td>
<td>—</td>
<td>520</td>
<td></td>
</tr>
<tr>
<td>Purchased goodwill</td>
<td>1,764</td>
<td>636</td>
<td>95</td>
<td>2,495</td>
<td></td>
</tr>
<tr>
<td>Accounts payable and other liabilities, net of other assets</td>
<td>(105)</td>
<td>(122)</td>
<td>(5)</td>
<td>(232)</td>
<td></td>
</tr>
<tr>
<td>Interest bearing debt</td>
<td>(766)</td>
<td>—</td>
<td>—</td>
<td>(766)</td>
<td></td>
</tr>
<tr>
<td>Deferred tax asset/(liability)</td>
<td>(464)</td>
<td>—</td>
<td>—</td>
<td>(471)</td>
<td></td>
</tr>
<tr>
<td>Net assets acquired</td>
<td>$ 1,724</td>
<td>$ 1,037</td>
<td>$ 153</td>
<td>$ 2,914</td>
<td></td>
</tr>
<tr>
<td>Supplemental information:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash paid</td>
<td>$ 1,758</td>
<td>$ 1,037</td>
<td>$ 154</td>
<td>$ 2,949</td>
<td></td>
</tr>
<tr>
<td>Less: Cash acquired</td>
<td>34</td>
<td>—</td>
<td>1</td>
<td>35</td>
<td></td>
</tr>
<tr>
<td>Cash paid, net of cash acquired</td>
<td>$ 1,724</td>
<td>$ 1,037</td>
<td>$ 153</td>
<td>$ 2,914</td>
<td></td>
</tr>
</tbody>
</table>
3M completed one acquisition (Treo Solutions, LLC) during 2014, the impact of which on the consolidated balance sheet was not considered material. Separately, as discussed in Note 6, during 2014, 3M (via Sumitomo 3M Limited) purchased Sumitomo Electric Industries, Ltd.’s 25 percent interest in 3M’s consolidated Sumitomo 3M Limited subsidiary for 90 billion Japanese Yen. Because 3M already had a controlling interest in this consolidated subsidiary, this transaction was separately recorded as a financing activity in the statement of cash flows.

There were no acquisitions that closed during 2013.

Goodwill resulting from business combinations is largely attributable to the existing workforce of the acquired businesses and synergies expected to arise after 3M’s acquisition of these businesses. Pro forma information related to acquisitions was not included because the impact on the Company’s consolidated results of operations was not considered to be material.

In addition to business combinations, 3M periodically acquires certain tangible and/or intangible assets and purchases interests in certain enterprises that do not otherwise qualify for accounting as business combinations. These transactions are largely reflected as additional asset purchase and investment activity.
Exhibit 1-27: Business Combination Disclosure Example - Caterpillar

Form 10-K for the fiscal year ended December 31, 2015 (Note 24)

RDS Manufacturing, Inc.

In December 2015, we acquired 100 percent of the stock of RDS Manufacturing, Inc. (RDS). RDS, located in Broken Arrow, Oklahoma, is a privately owned manufacturer of highly engineered turbomachinery parts, primarily for the turbine engine and aerospace markets. The acquisition of RDS is expected to help grow our turbine business and deepen our manufacturing expertise. The purchase price, net of $1 million of acquired cash and $5 million of trade receivables due from Caterpillar, was approximately $85 million. We paid $74 million at closing with an additional $11 million to be paid in December 2017.

The transaction was financed with available cash. Tangible assets acquired of $28 million, recorded at their fair values, were primarily inventories of $12 million and property, plant and equipment of $16 million. Liabilities assumed as of the acquisition date were $2 million, which represented their fair values. Goodwill of $59 million, substantially all of which is deductible for income tax purposes, represented the excess of the consideration transferred over the net assets recognized and represented the estimated future economic benefits arising from other assets acquired that could not be individually identified and separately recognized. Factors that contributed to a purchase price resulting in the recognition of goodwill include RDS's strategic fit into our manufacturing and product portfolio and the acquired assembled workforce. The results of the acquired business for the period from the acquisition date are included in the accompanying consolidated financial statements and are reported in the Energy & Transportation segment. Assuming this transaction had been made at the beginning of any period presented, the consolidated pro forma results would not be materially different from reported results.

Rail Product Solutions, Inc.

In October 2015, we acquired 100 percent of the stock in privately owned Rail Product Solutions, Inc. (RPS) from Amsted Rail Company, Inc. RPS is a leading North American provider of mission critical track fastening products and integrated fastening systems. The acquisition of RPS expands our portfolio of track related products and allows us to provide more comprehensive solutions to our customers. The purchase price was approximately $165 million, consisting of $166 million paid at closing less an estimated net working capital adjustment of $1 million anticipated to be finalized in 2016.

The transaction was financed with available cash. Tangible assets acquired of $41 million, recorded at their fair values, were primarily receivables of $9 million, inventories of $6 million, property, plant and equipment of $17 million and an investment in an unconsolidated affiliated company of $9 million. Finite-lived intangible assets acquired of $82 million were primarily customer relationships and are being amortized on a straight-line basis over a weighted average period of approximately 15 years. Liabilities assumed as of the acquisition date were $11 million, which represented their fair values. Goodwill of $53 million, substantially all of which is deductible for income tax purposes, represented the excess of the consideration transferred over the net assets recognized and represented the estimated future economic benefits arising from other assets acquired that could not be individually identified and separately recognized. Factors that contributed to a purchase price resulting in the recognition of goodwill include RPS’s strategic fit into our product and services portfolio and the acquired assembled workforce. The results of the acquired business for the period from the acquisition date are included in the accompanying consolidated financial statements and are reported in the Energy & Transportation segment. Assuming this transaction had been made at the beginning of any period presented, the consolidated pro forma results would not be materially different from reported results.

Johan Walter Berg AB

In September 2013, we acquired 100 percent of the stock of Johan Walter Berg AB (Berg). Berg is a leading manufacturer of mechanically and electrically driven propulsion systems and marine controls for ships. Headquartered in Öckerö Islands, Sweden, Berg has designed and manufactured heavy-duty marine
thrusters and controllable pitch propellers since 1929. Its proprietary systems are employed in maritime applications throughout the world that require precise maneuvering and positioning. With the acquisition, Caterpillar will transition from selling only engines and generators to providing complete marine propulsion package systems. The purchase price, net of $9 million of acquired cash, was approximately $169 million. The purchase price included contingent consideration, payable in 2016. The contingent consideration was based on the revenues achieved by Berg in the period from January 1, 2013 to December 31, 2015 and had a fair value of approximately $7 million on the acquisition date. As of December 31, 2015, no payment is expected to be made.

The transaction was financed with available cash. Tangible assets as of the acquisition date were $82 million, recorded at their fair values, and primarily included cash of $9 million, receivables of $13 million, inventories of $32 million and property, plant and equipment of $28 million. Finite-lived intangible assets acquired of $70 million included developed technology, customer relationships and trade names. The finite lived intangible assets are being amortized on a straight-line basis over a weighted-average amortization period of approximately 11 years. Liabilities assumed as of the acquisition date were $87 million, recorded at their fair values, and primarily included accounts payable of $19 million, customer advances of $31 million and net deferred tax liabilities of $15 million. Goodwill of $113 million, non-deductible for income tax purposes, represented the excess of the consideration transferred over the net assets recognized and represented the estimated future economic benefits arising from other assets acquired that could not be individually identified and separately recognized. Factors that contributed to a purchase price resulting in the recognition of goodwill include Berg’s strategic fit into our product portfolio, the opportunity to provide worldwide support to marine operators for a complete, optimized propulsion package, and the acquired assembled workforce. The results of the acquired business for the period from the acquisition date are included in the accompanying consolidated financial statements and are reported in the Energy & Transportation segment. Assuming this transaction had been made at the beginning of any period presented, the consolidated pro forma results would not be materially different from reported results.
During 2015, we completed eight acquisitions qualifying as business combinations in exchange for aggregate consideration (net of cash acquired) of $1.0 billion, a substantial majority of which was cash consideration. Substantially all of the consideration was allocated to goodwill and other intangible assets, such as acquisition-related developed technology and acquisition-related customer relationships. Included in these acquisitions is our acquisition of Lantiq Semiconductor (Lantiq), intended to extend Intel's success in cable home gateways into DSL and fiber markets. We acquired Lantiq in the second quarter of 2015 for net cash consideration of $345 million, substantially all of which was allocated to goodwill and intangible assets, such as acquisition-related developed technology and acquisition-related customer relationships. The operating results of Lantiq are included in our Client Computing Group operating segment.

During 2014, we completed eight acquisitions qualifying as business combinations in exchange for aggregate consideration of $963 million, substantially all cash consideration. A substantial majority of the consideration was allocated to goodwill and acquisition-related developed technology intangible assets. Included in these acquisitions is our acquisition of the Axxia Networking Business (Axxia business) of Avago Technologies Limited, intended to accelerate growth in the mobile wireless base station business. We acquired the Axxia business in the fourth quarter of 2014 for net cash consideration of $650 million, substantially all of which was allocated to goodwill and acquisition-related developed technology intangible assets. The operating results of the Axxia business are included in our Data Center Group (DCG) operating segment.

During 2013, we completed 12 acquisitions qualifying as business combinations in exchange for aggregate net cash consideration of $925 million. Most of the consideration was allocated to goodwill and acquisition-related developed technology intangible assets. Included in these acquisitions is our acquisition of Stonesoft Oyj (Stonesoft), intended to expand our network security solutions, specifically addressing next-generation firewall products. We acquired Stonesoft in the third quarter of 2013 for net cash consideration of $381 million, substantially all of which was allocated to goodwill and acquisition-related developed technology intangible assets. Stonesoft's operating results are included in our software and services operating segments.

Acquisitions completed in 2015, 2014, and 2013, both individually and in the aggregate, were not significant to our results of operations. For information on the assignment of goodwill to our operating segments, see "Note 10: Goodwill" and for information on the classification of intangible assets, see "Note 11: Identified Intangible Assets."

Acquisition of Altera Corporation

During the second quarter of 2015, we entered into a definitive agreement to acquire Altera Corporation (Altera) in an all-cash transaction. The transaction closed on December 28, 2015, subsequent to our fiscal 2015 year-end. Altera is a global semiconductor company that designs and sells programmable semiconductors and related products, including programmable logic devices, which incorporate field-programmable gate array (FPGAs) and complex programmable logic devices, and highly integrated System-on-Chip (SoC) devices. This acquisition is expected to expand our reach within the compute continuum, as the combination of our leading-edge products and manufacturing process with Altera's leading FPGA technology is expected to enable new classes of platforms that meet customer needs in the data center and Internet of Things market segments.

Upon completion of the acquisition, each outstanding share of Altera common stock and, subject to certain exceptions, each share of Altera common stock underlying vested stock option awards, restricted stock unit awards and performance-based restricted stock unit awards were converted into the right to receive $54.00 per share in cash, without interest. During the third and fourth quarters of 2015, we issued
$9.5 billion in aggregate principal amount of senior unsecured debt, and in the first quarter of 2016 we borrowed $4.0 billion against our short-term credit facility, in order to fund a portion of the total purchase price (net of cash acquired) of $14.5 billion. For more information on our indebtedness, see "Note 15: Borrowings."

Since the closing of this acquisition occurred subsequent to our fiscal year-end, the allocation of the purchase price to the underlying assets acquired and liabilities assumed is subject to a formal valuation process, which has not yet been completed. We will reflect the preliminary valuation of the net assets acquired and the operational results of Altera beginning December 28, 2015, the close date of the transaction, in our first quarter of 2016. The purchase price allocation will be finalized as soon as practicable within the measurement period, but not later than one year following the acquisition close date.

Although the purchase price allocation for this acquisition and pro forma financial information is not yet available, we expect a substantial majority of the purchase price will be allocated to goodwill and acquisition-related developed technology and other identified intangible assets. Additionally, we assumed $1.5 billion of aggregate principal amount of Altera's outstanding indentures. Altera became a new Intel operating segment called the Programmable Solutions Group upon acquisition.

### Reverse Acquisitions

Up until this point in the course, we have discussed primarily those business combinations where in a transaction that includes equity consideration, the issuing entity is deemed of the acquirer. However, there may be instances where the entity that issues the securities is considered the acquiree, not the acquirer. This is what is referred to as a reverse acquisition. Before reviewing the accounting and reporting requirements with respect to reverse acquisitions, let's first review an example of a reverse acquisition. Refer to Exhibit 1-29 below which provides an example of a reverse acquisition.

#### Exhibit 1-29: Reverse Acquisition

A private operating entity may want to become a public entity but not want to register its equity shares. To become a public entity, the private entity will arrange for a public entity to acquire its equity interests in exchange for the equity interests of the public entity. In this situation, the public entity is the legal acquirer because it issued its equity interests, and the private entity is the legal acquiree because its equity interests were acquired. However, application of the guidance in paragraphs 805-10-55-11 through 55-15 results in identifying the public entity as the acquiree for accounting purposes (the accounting acquiree) and the private entity as the acquirer for accounting purposes (the accounting acquirer).

### Recognition and Measurement

While the FASB devotes a specific subtopic (40) to reverse acquisitions, all of the recognition principle outlined in subtopic 10, 20, and 30 are applicable (all of which have been discussed extensively in this course) apply to the accounting for reverse acquisitions. One important point to note and emphasize is that in order for a business combination to be accounted for as a reverse acquisition, the accounting acquiree must meet the definition of a business.

With respect to the actual measurement in a reverse acquisition, 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 would have had to issue to give the owners of the legal parent the same percentage equity interest in the combined entity that results from the reverse acquisition (ASC 805-40-30-2). In order to help illustrate this guidance, refer to the example below from the implementation guidance in ASC 805-40.

Facts (ASC 805-40-55-3 thru 7)
Entity B, the legal subsidiary, acquires Entity A, the entity issuing equity instruments and therefore the legal parent, on September 30, 20X6. These Cases ignore the accounting for any income tax effects. Cases A and B share all of the following information and assumptions. The statements of financial position of Entity A and Entity B immediately before the business combination are as follows.

<table>
<thead>
<tr>
<th>Entity A (Legal Parent, Accounting Acquirer)</th>
<th>Entity B (Legal Subsidiary, Accounting Acquirer)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current assets $500</td>
<td>Current liabilities $300</td>
</tr>
<tr>
<td>Noncurrent assets $1,300</td>
<td>Noncurrent liabilities $400</td>
</tr>
<tr>
<td>Total assets $1,800</td>
<td>Total liabilities $700</td>
</tr>
<tr>
<td>Shareholders’ equity</td>
<td></td>
</tr>
<tr>
<td>Retained earnings $800</td>
<td>Issued equity</td>
</tr>
<tr>
<td>100 common shares $300</td>
<td>60 common shares</td>
</tr>
<tr>
<td>60 common shares $600</td>
<td></td>
</tr>
<tr>
<td>Total shareholders’ equity $1,100</td>
<td>Total liabilities and shareholders’ equity $1,800</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

On September 30, 20X6, Entity A issues 2.5 shares in exchange for each common share of Entity B. All of Entity B’s shareholders exchange their shares in Entity B. Therefore, Entity A issues 150 common shares in exchange for all 60 common shares of Entity B. The fair value of each common share of Entity B at September 30, 20X6, is $40. The quoted market price of Entity A’s common shares at that date is $16. The fair values of Entity A’s identifiable assets and liabilities at September 30, 20X6, are the same as their carrying amounts, except that the fair value of Entity A’s noncurrent assets at September 30, 20X6, is $1,500.

Case A: All the Shares of the Legal Subsidiary Are Exchanged (ASC 805-40-55-8 thru 17)

This Case illustrates the accounting for a reverse acquisition if all of the shares of the legal subsidiary, the accounting acquirer, are exchanged in a business combination. The accounting illustrated in this Case includes the calculation of the fair value of the consideration transferred, the measurement of goodwill and the calculation of earnings per share (EPS). As a result of the issuance of 150 common shares by Entity A (legal parent, accounting acquiree), Entity B’s shareholders own 60 percent of the issued shares of the combined entity, that is, 150 of 250 issued shares. The remaining 40 percent are owned by Entity A’s shareholders. If the business combination had taken the form of Entity B issuing additional common shares to Entity A’s shareholders in exchange for their common shares in Entity A, Entity B would have had to issue 40 shares for the ratio of ownership interest in the combined entity to be the same. Entity B’s shareholders would then own 60 of the 100 issued shares of Entity B—60 percent of the combined entity. As a result, the fair value of the consideration effectively transferred by Entity B and the group’s interest in Entity A is $1,600 (40 shares with a per-share fair value of $40). The fair value of the consideration effectively transferred should be based on the most reliable measure. In this Case, the quoted market price of Entity A’s shares provides a more reliable basis for measuring the consideration effectively transferred than the estimated fair value of the shares in Entity B, and the consideration is measured using the market price of Entity A’s shares—100 shares with a per-share fair value of $16. Goodwill is measured as the excess of the fair value of the consideration effectively transferred
Accounting for Business Combinations  47

(the group’s interest in Entity A) over the net amount of Entity A’s recognized identifiable assets and liabilities, as follows.

<table>
<thead>
<tr>
<th></th>
<th>$</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consideration effectively transferred</td>
<td></td>
<td>1,600</td>
</tr>
<tr>
<td>Net recognized values of Entity A’s identifiable assets and liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current assets</td>
<td>500</td>
<td></td>
</tr>
<tr>
<td>Noncurrent assets</td>
<td>1,500</td>
<td></td>
</tr>
<tr>
<td>Current liabilities</td>
<td>(300)</td>
<td></td>
</tr>
<tr>
<td>Noncurrent liabilities</td>
<td>(400)</td>
<td>(1,300)</td>
</tr>
<tr>
<td>Goodwill</td>
<td></td>
<td>300</td>
</tr>
</tbody>
</table>

The consolidated statement of financial position immediately after the business combination is as follows

<table>
<thead>
<tr>
<th></th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current assets ($700 + $500)</td>
<td>1,200</td>
</tr>
<tr>
<td>Noncurrent assets ($3,000 + $1,500)</td>
<td>4,500</td>
</tr>
<tr>
<td>Goodwill</td>
<td>300</td>
</tr>
<tr>
<td>Total assets</td>
<td>6,000</td>
</tr>
<tr>
<td>Current liabilities ($600 + $300)</td>
<td>900</td>
</tr>
<tr>
<td>Noncurrent liabilities ($1,100 + $400)</td>
<td>1,500</td>
</tr>
<tr>
<td>Total liabilities</td>
<td>2,400</td>
</tr>
</tbody>
</table>

Shareholders’ equity

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Retained earnings</td>
<td>1,400</td>
</tr>
<tr>
<td>Issued equity</td>
<td></td>
</tr>
<tr>
<td>250 common shares ($600 + $1,600)</td>
<td>2,200</td>
</tr>
<tr>
<td>Total shareholders’ equity</td>
<td>3,600</td>
</tr>
<tr>
<td>Total liabilities and shareholders’ equity</td>
<td>6,000</td>
</tr>
</tbody>
</table>

In accordance with paragraph 805-40-45-2(c) through (d), the amount recognized as issued equity interests in the consolidated financial statements ($2,200) is determined by adding the issued equity of the legal subsidiary immediately before the business combination ($600) and the fair value of the consideration effectively transferred, measured in accordance with paragraph 805-40-30-2 ($1,600). However, the equity structure appearing in the consolidated financial statements (that is, the number and type of equity interests issued) must reflect the equity structure of the legal parent, including the equity interests issued by the legal parent to effect the combination.

Entity B’s earnings for the annual period ended December 31, 20X5, were $600, and the consolidated earnings for the annual period ended December 31, 20X6, are $800. There was no change in the number of common shares issued by Entity B during the annual period ended December 31, 20X5, and during the period from January 1, 20X6, to the date of the reverse acquisition on September 30, 20X6. EPS for the annual period ended December 31, 20X6, is calculated as follows.
Restated EPS for the annual period ending December 31, 20X5, is $4.00 (calculated as the earnings of Entity B of 600 divided by the 150 common shares Entity A issued in the reverse acquisition).

**Private Company Alternative**

Up until this point in the course, we have focused primarily on those accounting and disclosure requirements for business combinations with respect to public business entities. However, it’s important to note that there are certain reliefs within the accounting guidance for business combinations for that of private companies. These specific alternative requirements can be found within ASC 805-10-25 and were brought about by amendments prescribed by ASU 2014-18, *Business Combinations*, effective for fiscal years beginning after December 15, 2015.

Before discussing those alternative requirements for private companies, let’s review information included within the scope section of ASC 805-20. In this section, it’s noted that a private company may make an accounting policy election to apply the accounting alternative and should apply this alternative to all future transactions within the scope of ASC 805. Also of note is that if an entity elects to apply this alternative, the entity must also apply the accounting alternative for the amortization of goodwill as prescribed by ASC 350. In other words, instead of testing goodwill for impairment as is required for public business entities, private companies have the option to amortize goodwill over its useful life.

So what is the accounting alternative specifically? Simply put, a private entity that elects the accounting alternative is not required to recognize, separately from goodwill, customer-related intangible assets unless they are capable of being sold or licensed independently from other assets of the business, as well as noncompetition agreements. As you can likely note, entities that apply this alternative to future business combination transactions will likely separately recognize fewer intangible assets as compared to entities that do not apply this alternative. Additionally, entities that apply this alternative will, compared to entities that do not, record additional goodwill as these specific intangible identifiable will be subsumed within goodwill. Refer to Exhibit 1-30 which provides additional insights into the FASB’s conclusions with respect to these amendments.
Exhibit 1-30: Accounting Alternative - FASB Basis for Conclusions

BC13: Users of private company financial statements, including lenders and equity investors, had mixed views about the usefulness of information on the fair value of intangible assets. Some users indicated that they generally disregard intangible assets and the associated amortization and do not consider intangible assets any differently than goodwill in their analysis. Other users indicated that they do consider the information, fair value, and subsequent impairments of intangible assets to be decision-useful information in some circumstances. Users often had similar views when describing the attributes of intangible assets they find most relevant (legally protected, separately transferable, and capable of providing discrete cash flows) but did not all agree on which specific intangible assets are most relevant. Many users noted that the relevance of intangible assets differed from acquisition to acquisition and among industries.

BC17. The PCC and the Board decided that an entity within the scope of this Update can elect not to separately identify and recognize (a) customer-related intangible assets that are not capable of being sold or licensed independently from the other assets of a business and (b) noncompetition agreements. Customer-related intangible assets often will not meet the criterion for recognition. Customer-related intangible assets that may meet the criterion for recognition include mortgage servicing rights, commodity supply contracts, core deposits, and customer information (for example, names and contact information).

BC18: The PCC and the Board concluded that assessing whether a customer-related intangible asset is capable of being sold or licensed independently from the other assets of a business will not be costly to reporting entities that adopt this alternative because it generally is clear that most customer-related intangible assets do not meet the criterion for recognition. The examples of customer-related intangible assets that may meet the criterion for recognition (mortgage servicing rights, commodity supply contracts, core deposits, and customer information) represent relationships and information that often can be sold to third parties without input from the customer or their agreement to the transfer. If the transfer of a customer relationship is dependent on the decisions of a customer, it would be clear that a reporting entity is not capable of selling that customer-related intangible asset separately from the other assets of the business. Furthermore, the PCC and the Board noted that private companies generally are aware of whether their customer-related intangible assets can be sold and transferred to another entity even if the private company has no intention of selling the customer-related intangible assets.

Income Tax Considerations

In one of the final sections of the course, we explore some of the income tax considerations with respect to business combinations. Income tax guidance related to business combinations is included within ASC 805-740, and like other areas of ACS 805, has recognition, measurement, and disclosure requirements. While a comprehensive review of all of the guidance under ASC 805-740 is outside the scope of this course given the complexity of income tax considerations, we will touch on a few of the more important topic areas.

Overview

Simply put, the income tax recognition and measurement requirements prescribed within ASC 805-740 are incremental to the overall guidance with ASC 805 and require that deferred tax liabilities and deferred tax assets (with related valuation allowance) be recognized in a business combination to account the difference in tax bases and the recognized values of assets acquired and liabilities assumed (ASC 805-740-05-01).

Recognition Principles

As noted above, deferred tax liabilities and deferred tax assets should be recognized to account for temporary differences, carryforwards, as well as other income tax uncertainties existing at the acquisition date (ASC 805-740-25-2). The main principle to emphasize here is that the tax bases used in the calculation of deferred tax assets and liabilities should be based on those requirements prescribed by ASC 740, Income Taxes.

In a taxable business combination, the consideration paid is assigned to the assets acquired and liabilities
assumed for financial reporting and tax purposes. However, it’s important to note that the amounts recognized for particular assets and liabilities may differ for financial reporting and tax purposes. As a result, when this occurs, these deferred tax liabilities and deferred tax assets are recognized for the deferred tax consequences of those temporary differences. As an example, a portion of the amount of goodwill for financial reporting may be allocated to some other asset for tax purposes, and amortization of that other asset may be deductible for tax purposes (ASC 805-740-25-6).

With respect to goodwill, for tax purposes, amortization of goodwill is deductible in some tax jurisdictions (ASC 805-740-25-8). In those tax jurisdictions, the reported amount of goodwill and the tax basis of goodwill are each separated into two components as of the acquisition date for purposes of deferred tax calculations. The first component of each equals the lesser of goodwill for financial reporting or tax-deductible goodwill. The second component of each equals the remainder of each, that is, the remainder, if any, of goodwill for financial reporting or the remainder, if any, of tax-deductible goodwill. (ASC 805-740-25-8).

There are also additional recognition exceptions with respect to replacement awards that are classified as equity. The income tax reporting requirements for these also varies based on whether the award does and does not result in postcombination tax deductions under the current tax law. For a replacement award classified as equity that ordinarily would result in postcombination tax deductions under current tax law, an acquirer shall recognize a deferred tax asset for the deductible temporary difference that relates to the portion of the fair-value-based measure attributed to precombination employee service and therefore included in consideration transferred in the business combination (ASC 805-740-25-10). Alternatively, for a replacement award classified as equity that ordinarily would not result in tax deductions under current tax law, an acquirer shall recognize no deferred tax asset for the portion of the fair-value-based measure attributed to precombination service and thus included in consideration transferred in the business combination (ASC 805-740-25-10).

Finally, the other additional recognition exception outlined in ASC 805-740 relates to the allocation of consolidated tax expense to the acquired entity after the acquisition. Under the principles outlined in ASC 740, the FASB provides general guidance on the allocation of consolidated tax expense to the separate financial statements of members of a consolidated group. However, under certain conditions, ASC 805 permits an acquired entity to retain its preacquisition historical basis in separately issued financial statements after an acquisition (ASC 805-740-25-12).

Measurement
In general, an acquirer should measure a deferred tax asset or deferred tax liability arising from the assets acquired and liabilities assumed in a business combination in accordance with ASC 740 and should not discount these deferred tax assets or liabilities, with the exception of leveraged leases (ASC 805-740-30-1). Refer to Exhibit 1-31 below which provides additional guidance with respect to the measurement of income taxes related to business combinations.

Exhibit 1-31: Income Tax Measurement in Business Combinations (ASC 805-740-30-23)
The tax law in some tax jurisdictions may permit the future use of either of the combining entities' deductible temporary differences or carryforwards to reduce taxable income or taxes payable attributable to the other entity after the business combination. If the combined entity expects to file a consolidated tax 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 valuation allowance 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).

With respect to subsequent measurement principles of income taxes related to business combinations, the same overall principle holds true here that these deferred tax assets and deferred tax liabilities should be subsequent
measured and accounted with ASC 740 (i.e. other GAAP). Recall, this is similar to the subsequent measurement of assets acquired and liabilities assumed in a business combination, in that other GAAP is the primary source of the guidance for this process.

Disclosures

Aside from those disclosures already presented in this course, and those disclosures required by ASC 740, there is one additional disclosures requirement with respect to income taxes related to a business combination. This additional disclosure requirement relates to a change in the acquirer’s valuation allowance as a result of a business combination. ASC 740 requires disclosure of adjustments of the beginning-of-the-year balance of a valuation allowance because of a change in circumstances that causes a change in judgment about the realizability of the related deferred tax asset in future years (ASC 805-740-50-1). This type of disclosure specifically includes 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.

Asset Acquisition vs. Business Combination

In this final section of the course, we explore some of the key differences in that of an asset acquisition versus a business combination. To that end, one of the important determinations to be made when considering whether a transaction is a business combination is concluding that it is not simply an asset acquisition. The key distinction between an asset acquisition and that of a business combination is whether or not the assets acquired and liabilities assumed constitute a business (as previously defined). Simply put, if an acquisition does not involve a business, it is not a business combination. In turn, it is simply an asset acquisition.

Included within E&Y Business Combination guide is a good overview of how certain items are accounted with respect to an asset acquisition versus a business combination. For example, goodwill only arises in a business combination and cannot arise in that of an asset acquisition. Refer to an overview of these other items presented in Exhibit 1-32 below.
<table>
<thead>
<tr>
<th>Item</th>
<th><strong>Business Combination</strong></th>
<th><strong>Asset Acquisition</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Transaction costs</strong></td>
<td>Expensed as incurred.</td>
<td>Capitalized as a component of the cost of the assets acquired.</td>
</tr>
<tr>
<td><strong>In-process research and development (IPR&amp;D) assets</strong></td>
<td>Capitalized as an indefinite-lived intangible asset, regardless of whether the IPR&amp;D asset has an alternative future use.</td>
<td>Expensed unless the IPR&amp;D has an alternative future use.</td>
</tr>
<tr>
<td><strong>Measurement of nonfinancial assets</strong></td>
<td>Generally recognized at fair value if recognition criteria in ASC 805-20-25-10 are met.</td>
<td>Recognized in accordance with other applicable GAAP, for example ASC 350. Any excess consideration transferred over the fair value of the nonfinancial assets is allocated to these assets based on the ASC 350 relative fair value requirement.</td>
</tr>
<tr>
<td><strong>Goodwill</strong></td>
<td>Only arises in a business combination.</td>
<td>Not recognized in an asset acquisition. Any excess consideration transferred over the fair value of the net assets acquired is allocated on a relative fair value basis to the identifiable net assets other than “non-qualifying” assets.</td>
</tr>
<tr>
<td><strong>Consideration transferred is less than the fair value of the net assets acquired (bargain purchases)</strong></td>
<td>Recognized as a gain in earnings on the acquisition date.</td>
<td>No gain is recognized in earnings. The excess fair value over the consideration transferred is allocated on a relative fair value basis to the net identifiable assets acquired other than “non-qualifying” assets.</td>
</tr>
<tr>
<td><strong>Assembled workforce</strong></td>
<td>Not recognized as a separate intangible asset but rather subsumed into goodwill.</td>
<td>Recognized separately as an intangible asset. For intangible assets that are acquired individually or within a group of assets, the FASB observed that the asset recognition criteria in Concepts Statement 5 are met even though the contractual-legal criterion or separability criterion has not been met.</td>
</tr>
<tr>
<td><strong>Acquired contingencies</strong></td>
<td>Preacquisition contingent assets and liabilities are recognized at the acquisition date at fair value if the acquisition-date fair value of the asset or liability can be determined during the measurement period. Otherwise, the contingent asset or liability is accounted for in accordance with ASC 450.</td>
<td>Preacquisition contingent assets and liabilities are accounted for in accordance with ASC 450.</td>
</tr>
</tbody>
</table>
### Leases classification
- Reassessment of lease classification is not required unless the lease contract has been significantly modified.
- Reassessment of lease classification is required by a new lessee.

### Contingent consideration
- Recognized at its acquisition-date fair value as part of the consideration transferred.
- Generally recognized when the contingency is resolved (i.e., when the contingent consideration is paid or becomes payable).

### Deferred Taxes
- Generally recorded on most temporary book/tax differences of assets acquired and liabilities assumed.
- Because goodwill is not recognized in an asset acquisition, the measurement of deferred income tax assets acquired and liabilities assumed in an asset acquisition will usually require an iterative approach that affects the measurement of other individual assets and assumed liabilities in the net asset group. The measurement of deferred taxes on temporary differences in an asset acquisition is determined using the simultaneous equations method described in ASC 740.

### Review Questions

11. Which of the following ASUs exempted private entities from recognizing certain customer-related intangible assets in a business combination?
   - b. ASU 2016-08.
   - c. ASU 2016-10.
   - d. ASU 2016-12.

12. Which of the following statements is correct with respect to a business combination compared to an asset acquisition?
   - a. Transaction costs are capitalized as a component of the transaction.
   - b. In-process R&D is expensed unless it has an alternative future use.
   - c. Contingent consideration is recognized at its acquisition date fair value.
   - d. Assembled workforce is recognized separately as an intangible asset.
Solutions to Review Questions

1. Which of the following ASC topics prescribes the accounting and disclosure requirements with respect to business combinations?
   a. ASC 805.
      Correct. ASC 805 prescribes the accounting and disclosure requirements with respect to business combinations. The guidance within ASC 805 includes an overall section, guidance for measuring assets and liabilities, goodwill, as well as guidance on reverse acquisitions. The guidance in ASC 805 is largely derived from the previous FAS 141(r) statement.
   b. ASC 810.
      Incorrect. ASC 810 prescribes the accounting and disclosure requirements with respect to consolidations. This includes the control of partnerships and other entities as well as research and development arrangements.
   c. ASC 815.
      Incorrect. ASC 815 prescribes the accounting and disclosure requirements with respect to derivatives and hedging. This includes embedded derivatives, fair value hedges, cash flow hedges, and net investment hedges.
   d. ASC 850.
      Incorrect. ASC 850 prescribes the accounting and disclosure requirements with respect to related party disclosures. This ASC topic includes a subtopic that also addresses common interest realty associations for real estate transactions.

2. Which of the following identifies the first step in the acquisition method when accounting for business combinations?
   a. Determine the acquisition date.
      Incorrect. Determining the acquisition date is the second step in the acquisition method when accounting for business combinations. Subsequent to determining the acquisition date, the next step in the process involves recognizing and measuring the identifiable assets acquired, liabilities assumed, and any noncontrolling interest, if applicable.
   b. Identifying the acquirer.
      Correct. Identifying the acquirer is the first step in the acquisition method. The acquirer in a business combination is the entity that obtains control of the acquiree. Simply put, for each business combination, one of the combining entities is required to be identified as the acquirer.
   c. Measure goodwill or a bargain purchase.
      Incorrect. Measuring goodwill or a bargain purchase is the last step in the acquisition method. This step is performed after the acquirer has recognized and measured the identifiable assets acquired, liabilities assumed, and any noncontrolling interest, if applicable.
   d. Assess whether the transaction is a business combination.
      Incorrect. Assessing whether the transaction is a business combination is performed before the acquisition method is applied. The acquisition method is used to account for a business combination, but an entity should first make the determination whether the transaction is in fact a business combination.

3. Which of the following is an example of a customer-related intangible asset?
   a. Noncompetition agreement.
      Incorrect. A noncompetition agreement is an example of a marketing related intangible asset. Another example of a marketing related intangible asset is internet domain names.
   b. Tradenames.
      Incorrect. Tradenames is an example of a marketing related intangible asset. Another example of a marketing related intangible asset is trademarks.
   c. Patented technology.
      Incorrect. Patented technology is an example of a technology-based intangible asset. Another example of a technology-based intangible asset is databases.
d. Order or production backlog.
Correct. Order or production backlog is an example of a customer-related intangible asset. Another example of a customer-related intangible asset is noncontractual customer relationships.

4. In order for an asset acquired or liability assumed to be considered identifiable, it must meet the definition of an asset or liability within which of the following FASB Concept Statements?
      Incorrect. Concepts Statement No. 1 is related to the objectives of financial reporting by business enterprises. It does not outline the definitions of assets or liabilities for purposes of measuring the assets and liabilities as a result of a business combination.
      Incorrect. Concepts Statement No. 2 is related to the qualitative characteristics of accounting information. It does not outline the definitions of assets or liabilities for purposes of measuring the assets and liabilities as a result of a business combination.
      Correct. Concepts Statement No. 6 is related to the elements of financial statements and includes the definitions of assets or liabilities for purposes of measuring the assets and liabilities as a result of a business combination. This Concepts Statement is a replacement of Concepts Statement No. 3.
      Incorrect. Concepts Statement No. 1 is related to using cash flow information and present value measurements. It does not outline the definitions of assets or liabilities for purposes of measuring the assets and liabilities as a result of a business combination.

5. Which of the following is an example of an exception to the recognition principle?
   a. Assets held for sale.
      Incorrect. Assets held for sale is an exception to the measurement principle, not the recognition principle. Long-lived assets that are acquired in a business combination that meet the held for sale requirements should be measured at fair value less cost to sell.
   b. Reacquired rights.
      Incorrect. Reacquired rights is an exception to the measurement principle, not the recognition principle. An acquirer in a business combination should measure the value of a reacquired right on the basis of the remaining contractual term of the related contract regardless of whether market participants would consider potential contractual renewals in determining its fair value.
   c. Share-based payments awards.
      Incorrect. Share-based payments awards is an exception to the measurement principle, not the recognition principle. A liability or equity instrument that is issued to replace the previous liability or equity instrument should be accounted for in accordance with FASB ASC 718.
   d. Income taxes.
      Correct. Income taxes is an exception to the recognition principle. Income taxes should be recognized in a business combination in accordance with the requirements prescribed by ASC 740.

6. Which of the following measurement principle exceptions states that an acquirer should refer to the guidance within ASC 710 & ASC 712?
   a. Employee benefits.
      Correct. The measurement principle exceptions for employee benefits include one-time termination benefits in connection with exit or disposal activities (ASC 420), compensated absences (ASC 710), deferred compensation costs (ASC 710), and nonretirement postemployment benefits (ASC 712).
   b. Assets held for sale.
Incorrect. The measurement principle exception with respect to assets held for sale state that long-lived assets that are acquired in a business combination that meet the held for sale requirements should be measured at fair value less cost to sell.

3. Share-based payments awards.
   Incorrect. The measurement principle exception with respect to share-based payments state that a liability or equity instrument that is issued to replace the previous liability or equity instrument should be accounted for in accordance with FASB ASC 718.

4. Indemnification assets.
   Incorrect. The overall principle with respect to indemnifications is that an indemnification asset is recognized on the same basis as is the indemnified item. While these indemnification arrangements are ordinarily included in the actual acquisition agreement, they may also occur as a result of a separate agreement not related to the actual business combination. Indemnifications are not measured in accordance with ASC 710 or ASC 712.

7. Which of the following identifies the residual amount attributable to a business combination once all assets and liabilities have been identified and measured?
   a. Contingent consideration.
      Incorrect. Contingent consideration is a form of consideration in a business combination that is to be transferred to the former shareholders in the future if certain future events occur or certain conditions are met.
   b. Goodwill.
      Correct. Goodwill is defined within the ASC Master Glossary as an asset representing the future economic benefits arising from other assets acquired in a business combination, or an acquisition by a not-for-profit entity that are not individually identified and separately recognized. It is also commonly referred to as a residual amount.
   c. Options.
      Incorrect. A stock option is a benefit in the form of an option given by a company to an employee to buy stock in the company at a discount or at a stated fixed price. It does not relate to a residual amount attributable to a business combination once all assets and liabilities have been identified and measured.
   d. Warrants.
      Incorrect. A warrant is a security that entitles the holder to buy the underlying stock of the issuing company at a fixed price called exercise price until the expiration date. It does not relate to a residual amount attributable to a business combination once all assets and liabilities have been identified and measured.

8. Which of the following identifies a specific measurement exception with respect to subsequent measurement?
   a. Contingent consideration.
      Correct. The way in which changes in the fair value of contingent consideration that are not measurement period adjustments are handled depends primarily on whether the contingent consideration is classified as equity or an assets or liability. Subsequent measurement of contingent consideration is considered an exception to the subsequent measurement guidance in ASC 805.
   b. Share-based payments.
      Incorrect. Share-based payments are a measurement principle exception, not a subsequent measurement exception. The measurement principle exception with respect to share-based payments state that a liability or equity instrument that is issued to replace the previous liability or equity instrument should be accounted for in accordance with FASB ASC 718.
   c. Employee benefits.
      Incorrect. Employee benefits are a measurement principle exception, not a subsequent measurement exception. The measurement principle exceptions for employee benefits include one-time termination benefits in connection with exit or disposal activities (ASC 420),
compensated absences (ASC 710), deferred compensation costs (ASC 710), and nonretirement postemployment benefits (ASC 712).

d. Income taxes.
Incorrect. Incomes taxes are both a recognition and measurement principle exception, not a subsequent measurement exception. Income taxes should be recognized and measured in a business combination in accordance with the requirements prescribed by ASC 740.

9. Which of the following identifies a general disclosure requirement with respect to business combinations?
   a. Amount of indemnification assets recognized at the acquisition date.
      Incorrect. The amount of indemnification assets recognized at the acquisition date is not a general disclosure requirement, but is instead a specific disclosure requirement with respect assets, liabilities, and noncontrolling interest.
   b. Acquisition date fair value of total consideration transferred.
      Incorrect. The acquisition date fair value of total consideration transferred is not a general disclosure requirement, but is instead a specific disclosure requirement with respect goodwill, bargain purchase, and consideration transferred.
   c. Total amount of goodwill expected to be deductible for tax purposes.
      Incorrect. The total amount of goodwill expected to be deductible for tax purposes is not a general disclosure requirement, but is instead a specific disclosure requirement with respect goodwill, bargain purchase, and consideration transferred.
   d. The percentage of voting interests acquired.
      Correct. A disclosure of the percentage voting interests acquired is an example of a general disclosure requirement. An additional example of a general disclosure requirement is the primary reasons for the business combination and a description of how the acquirer obtained control of the acquiree.

10. Which of the following identifies a specific disclosure requirement with respect to goodwill, bargain purchase, and/or consideration transferred for a business combination?
    a. A description of why the transaction resulted in a gain.
       Correct. A description of the transaction resulted in a gain (i.e. a bargain purchase) is a specific disclosure requirement with respect to goodwill, bargain purchase, and consideration transferred. An additional example of a specific disclosure requirement in this area is the amount of contingent consideration recognized.
    b. Fair value of acquired receivables.
       Incorrect. The fair value of acquired receivables is a disclosure requirement with respect to assets, liabilities, and noncontrolling interest. An additional example of this specific disclosure requirement is the amounts recognized as of the acquisition date for each major class of assets acquired and liabilities assumed.
    c. The primary reasons for the business combination and a description of how the acquirer obtained control of the acquiree.
       Incorrect. The primary reasons for the business combination and a description of how the acquirer obtained control is a general disclosure requirement. An additional example of a general disclosure requirement is the name and a description of the acquiree.
    d. Amounts of revenue and earnings of the acquiree since the acquisition date included in the consolidated income statement for the reporting period.
       Incorrect. This is an example of a general disclosure requirement. An additional example of a general disclosure requirement is the acquisition date and the percentage of voting equity interests acquired as a result of the business combination.

11. Which of the following ASUs exempted private entities from recognizing certain customer-related intangible assets in a business combination?
Correct. A private entity that elects the accounting alternative is not required to recognize, separately from goodwill, customer-related intangible assets unless they are capable of being sold or licensed independently from other assets of the business, as well as noncompetition agreements. Entities that apply this alternative to future business combination transactions will likely separately recognize fewer intangible assets as compared to entities that do not apply this alternative.

b. ASU 2016-08.
Incorrect. ASU 2016-08 clarified implementation guidance with respect to principal versus agent considerations in revenue recognition. This update primarily made targeted amendments to the ASC 606 implementation guidance to address those situations when another party, in addition to the entity, is involved in providing a good or a service to a customer.

c. ASU 2016-10.
Incorrect. ASU 2016-10 was released to improve the existing guidance with respect to identifying performance obligations and licensing considerations related to revenue recognition. These amendments only clarify aspects with respect to identifying performance obligations and the related implementation guidance around licensing.

d. ASU 2016-12.
Incorrect. This particular ASU affected only narrow aspects of ASC 606 to include assessing the collectability criterion, presentation of sales taxes and other taxes collected from customers, noncash considerations, contract modifications at transition, completed contracts at transition, as well as other technical corrections with respect to transition disclosures.

12. Which of the following statements is correct with respect to a business combination compared to an asset acquisition?

a. Transaction costs are capitalized as a component of the transaction.
   Incorrect. This is the applicable accounting guidance for an asset acquisition, not a business combination. For a business combination, transaction costs are expensed as incurred.

b. In-process R&D is expensed unless it has an alternative future use.
   Incorrect. This is the applicable accounting guidance for an asset acquisition, not a business combination. For a business combination, in-process R&D is capitalized as an indefinite-lived intangible asset, regardless of whether the IPR&D asset has an alternative future use.

c. Contingent consideration is recognized at its acquisition date fair value.
   Correct. This is the applicable accounting guidance for a business combination and not an asset acquisition. For an asset acquisition, contingent consideration is generally recognized when the contingency is resolved (i.e., when the contingent consideration is paid or becomes payable.

d. Assembled workforce is recognized separately as an intangible asset.
   Incorrect. This is the applicable accounting guidance for an asset acquisition, not a business combination. For a business combination, assembled workforce is not recognized as a separate intangible asset but rather subsumed into goodwill.
**Glossary of Key Terms**

**Acquirer**
The business or businesses that the acquirer obtains control of in a business combination. This term also includes a nonprofit activity or business that a not-for-profit acquirer obtains control of in an acquisition by a not-for-profit entity.

**Acquiree**
The entity that obtains control of the acquiree in a business combination.

**Acquisition Date**
The date on which the acquirer obtains control of the acquiree.

**Business**
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.

**Business Combination**
A transaction or other event in which an acquirer obtains control of one or more businesses. Transactions sometimes referred to as true mergers or mergers of equals also are business combinations.

**Fair Value**
The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

**Goodwill**
An asset representing the future economic benefits arising from other assets acquired in a business combination or an acquisition by a not-for-profit entity that are not individually identified and separately recognized.

**Identifiable intangible asset**
An intangible asset that 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. In addition, it 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.

**Noncontrolling Interest**
The portion of equity (net assets) in a subsidiary not attributable, directly or indirectly, to a parent. A noncontrolling interest is sometimes called a minority interest.

**Reverse Acquisition**
An acquisition in which the entity that issues securities (the legal acquirer) is identified as the acquiree for accounting purposes. The entity whose equity interests are acquired (the legal acquiree) must be the acquirer for accounting purposes for the transaction to be considered a reverse acquisition.
Final Exam Questions

1. Which of the following is defined 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.
   b. Entity.
   c. Organization.
   d. Corporation.

2. A particular set of activities is generally presumed to be a business if which of the following is present?
   a. Inputs.
   b. Processes.
   c. Goodwill.
   d. Outputs.

3. ASC 805 prescribes a business combination be accounted for by applying which of the following methods?
   a. Fair value method.
   b. Purchase accounting method.
   c. Cash equivalent method.
   d. Acquisition method.

4. Which of the following steps in the acquisition method involves recognizing and measuring the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree?
   a. Step 1.
   b. Step 2.
   c. Step 3.
   d. Step 4.

5. The acquisition date in a business combination is the date on which an acquirer obtains which of the following?
   a. Cash consideration.
   b. Equity interests.
   c. Control.
   d. Voting rights.

6. With respect to a business combination, an intangible asset is generally considered identifiable if it meets which of the following recognition criteria?
   a. It’s material.
   b. It can be sold.
   c. It’s separable.
   d. Its value can be determined.

7. Which of the following is an example of a contract-based intangible asset?
   a. Patented technology.
   b. Plays, operas, and ballets.
   c. Certification marks.
   d. Operating and broadcasting rights.
8. When measuring assets acquired and liabilities assumed in a business combination, the overall principle is that an acquirer should measure these items at which of the following?
   a. Acquisition-date fair value.
   b. Book value.
   c. Fair less costs to sell.

9. Which of the following terms identify provisions for additional consideration to be transferred to the former shareholders in the future if certain future events occur or certain conditions are met?
   a. Uncertain cash flow.
   b. Contingent consideration.
   c. Goodwill.
   d. Delayed consideration.

10. With respect to one of the measurement principle exceptions, which of the following types of transactions should be measured in accordance with ASC 712?
    b. Reacquired rights.
    c. Income taxes.
    d. Nonretirement postemployment benefits.

11. Which of the following terms is also commonly used to describe a business combination in stages?
    a. Staggered acquisition.
    b. Step acquisition.
    c. Delayed acquisition.
    d. Phased acquisition.

12. Which of the following is the last step in the acquisition method process?
    a. Identifying the acquisition date.
    b. Identifying the acquirer.
    c. Recognizing and measuring goodwill or gain from bargain purchase.
    d. Recording post acquisition measurement adjustments.

13. The FASB prescribes that the measurement period of a business combination should not exceed what period of time?
    a. 3 months.
    b. 6 months.
    c. 9 months.
    d. 12 months.

14. When adjustments are concluded to be necessary to the provision amounts recorded at the acquisition date of a business combination, an acquirer should ordinarily recognize an increase or decrease in a provisional amount for an asset or liability by means of either an increase or decrease to which of the following?
    a. Intangible assets.
    b. Goodwill.
    c. Liabilities assumed.
    d. Comprehensive income.
15. Which of the following identifies a general disclosure requirement?
   a. The name and description of the acquiree.
   b. The amount of indemnification assets recognized.
   c. A description of the arrangement for handing indemnification assets.
   d. The nature of any known contingencies.

16. Which of the following identifies a disclosure requirement specific to assets, liabilities, and noncontrolling interest?
   a. The acquisition-date fair value of the equity interest in the acquiree held by the acquirer immediately before the acquisition date.
   b. An estimate of the range of outcomes related to indemnification assets if a range can be estimated.
   c. 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.
   d. The amount of any gain recognized and the line item in the income statement in which the gain is recognized.

17. Which of the following identifies a disclosure requirement specific to goodwill, bargain purchase, and considerations transferred?
   a. The fair value of the noncontrolling interest in the acquiree at the acquisition date.
   b. The valuation technique(s) and significant inputs used to measure the fair value of the noncontrolling interest.
   c. The best estimate at the acquisition date of the contractual cash flows not expected to be collected.
   d. A reconciliation of the carrying amount of goodwill at the beginning and end of the reporting period.

18. Which of the following events during a business combination requires the acquirer to reassess whether it has correctly identified all of the assets acquired and all of the liabilities assumed?
   a. The presence of goodwill.
   b. The business combination involves contingent consideration.
   c. A potential gain on a bargain purchase.
   d. The acquiree is a public business entity.

19. Which of the following identifies a situation where the entity that issues the securities is considered the acquiree, not the acquirer?
   a. Reverse acquisition.
   b. Modified business combination.
   c. Reverse business combination.
   d. Shareholder buyback.

20. On account of ASU 2014-08, private entities, if they elect the accounting alternative, are exempted from measuring which of the following with to a business combination?
   a. Technology-related intangible assets.
   b. Customer-related intangible assets.
   c. Indemnification assets.
   d. Noncontrolling interests.

21. Which of the following subtopics under ASC 805 provide incremental accounting guidance with respect to income taxes in a business combination?
   a. Subtopic 10.
   b. Subtopic 55.
   c. Subtopic 740.
   d. Subtopic 50.
22. Which of the following statements is correct with respect to an asset acquisition compared to a business?
   a. Transaction costs are capitalized as a component of the cost.
   b. Deferred taxes are recorded on most temporary book/tax differences of assets acquired and liabilities assumed.
   c. Contingent consideration is recorded at its acquisition-date fair value as part of the consideration transferred.
   d. Nonfinancial assets are generally recognized at fair value.