Financial Accounting Standards Board

ORIGINAL PRONOUNCEMENTS

AS AMENDED

Statement of Financial Accounting Standards No. 141 (revised 2007)

Business Combinations

Statement of Financial Accounting Standards No. 141 (revised 2007) Business Combinations

STATUS

Issued: December 2007

Effective Date: Prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008

Affects: Deletes ARB 43, Chapter 1A, paragraph 3
Amends APB 14, paragraph 9
Supersedes APB 16
Amends APB 18, paragraph 19(m)
Amends APB 28, paragraph 21 and footnote 3a
Amends APB 29, paragraph 4 and footnote 3a
Amends APB 30, paragraphs 7 and 20
Supersedes AIN-APB 16, Interpretations No. 1 through 39
Adds FAS 2, paragraph 3A
Amends FAS 2, paragraph 12
Adds FAS 5, paragraph 7A
Supersedes FAS 10
Amends FAS 15, footnotes 5 and 16
Supersedes FAS 38
Deletes FAS 45, paragraph 19
Amends FAS 52, paragraph 101
Adds FAS 60, paragraphs 59A through 59E
Amends FAS 68, paragraph 11
Deletes FAS 68, footnote 3
Supersedes FAS 72
Supersedes FAS 79
Amends FAS 86, paragraph 2
Replaces FAS 87, paragraph 74
Deletes FAS 87, paragraphs E15 and E88
Amends FAS 95, paragraph 134(g)
Amends FAS 97, paragraph 6
Replaces FAS 106, paragraph 86
Deletes FAS 106, paragraphs 87 and 88
Amends FAS 109, paragraphs 9(d), 11(h), 13, 16, 26, 30, 37, 45(f), 45(h), 48, 259 through 262, 264, 265(e), and 266 and footnotes 9a and 18a
Adds FAS 109, paragraph 30A and footnote 8a
Replaces FAS 109, paragraph 263
Deletes FAS 109, paragraphs 268 and 269
Amends FAS 113, paragraph 6
Amends FAS 120, paragraph 4
Amends FAS 123(R), paragraph 4
Amends FAS 128, paragraph 59
Replaces FAS 133, paragraph 11(c)
Amends FAS 133, paragraph 29(f)

Supersedes FAS 141
Amends FAS 142, paragraphs 1, 4, 6, 8, 9, 11(b), 16, 21, 33, 35, 44, 45(c), 48, 50, 52, C2, and F1 and footnotes 3, 6, 7, 9, 11, 14, 18, and 21
Deletes FAS 142, paragraph D11 and footnotes 1, 5, 8, and 25
Replaces FAS 142, paragraph 49 and footnote 24
Adds FAS 142, paragraph 6A
Amends FAS 144, paragraphs 5 and D1
Amends FAS 146, paragraph 2
Deletes FAS 146, footnote 2
Supersedes FAS 147
Amends FAS 150, paragraph 16
Deletes FAS 150, footnote 9
Amends FAS 154, paragraphs 2(f) and 24
Amends FAS 157, footnote 2
Amends FAS 159, paragraph 10
Supersedes FIN 4
Supersedes FIN 9
Amends FIN 21, paragraphs 13, 15, 16, and 19
Deletes FIN 21, paragraph 14 and footnote 4
Amends FIN 26, paragraph 5
Amends FIN 45, paragraph 7(c)
Amends FIN 46(R), paragraphs 4(h) and 23
Replaces FIN 46(R), paragraphs 18 through 21 and footnote 16
Deletes FIN 46(R), paragraphs C1 and C8
Adds FIN 48, paragraphs 12A and 12B
Supersedes FSP FAS 141-1/FAS 142-1
Amends FTB 84-1, paragraph 6
Supersedes FTB 85-5

Affected by: Heading following paragraph 22, and paragraphs 30, 60, 68, 68(j), A107, and G3 amended by FSP FAS141(R)-1, paragraphs A1(a), A1(e), A1(f), A1(k), A1(j), A1(q), and A1(r), respectively
Paragraphs 24 and 62 replaced by FSP FAS141(R)-1, paragraphs A1(b) and A1(g), respectively
Paragraphs 24A and 65A added by FSP FAS141(R)-1, paragraphs A1(c) and A1(i), respectively
Paragraphs 25, the heading following paragraph 25, 63, 72(c), and A62 through A65 deleted by FSP FAS141(R)-1, paragraphs A1(d), A1(d), A1(h), A1(l), A1(n), A1(o), and A1(p), respectively
Paragraphs 27 and 77 amended by FSP FIN 48-3, paragraph 13
Paragraphs 44, A126, and D4 through D6 amended by Accounting Standards Update 2010-08, paragraphs A9(a) through A9(e), respectively
Paragraphs 67(b), 68(l), and 70 amended by FAS 165, paragraphs B9(a) through B9(c), respectively
Paragraphs E1 and F2 deleted by FAS 164, paragraphs E11(a) and E11(b), respectively
Paragraphs E7 and E27(b) deleted by Accounting Standards Update 2010-08, paragraphs A9(f) and A9(g), respectively
Paragraph F1 amended by FAS 162, paragraph B3

Other Interpretive Release: FASB Staff Position FAS 141(R)-1

Issues Discussed by FASB Emerging Issues Task Force (EITF)

Affects: Nullifies EITF Issues No. 85-8, 85-42, 88-16, 88-19, 89-19, 90-12, 92-9, 93-7, 95-3, 95-8, 96-7, 97-8, 97-15, 98-1, 98-3, 99-12, 99-15, 01-3, 02-17, 04-1, and 04-2 and Topics No. D-54, D-87, and D-100
Partially nullifies EITF Issues No. 90-5 and 90-13

Resolves EITF Issues No. 84-35 and 86-14
Modifies EITF Issues No. 87-12, 87-21, 96-5, 97-2, 98-11, 99-7, 00-19, 01-2, and 02-11 and Topic No. D-101

Interpreted by: No EITF Issues

Related Issues: EITF Issues No. 85-41, 91-5, 02-5, 02-7, 02-13, 04-3, 08-6, 08-7, 09-2, and 09-4

SUMMARY

Why Is the FASB Issuing This Statement?

The objective of this Statement 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. To accomplish that, this Statement establishes principles and requirements for how the acquirer:

a. Recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree
b. Recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase
c. Determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination.

What Is the Scope of This Statement?

This Statement applies to all transactions or other events in which an entity (the acquirer) obtains control of one or more businesses (the acquiree), including those sometimes referred to as "true mergers" or "mergers of equals" and combinations achieved without the transfer of consideration, for example, by contract alone or through the lapse of minority veto rights. This Statement applies to all business entities, including mutual entities that previously used the pooling-of-interests method of accounting for some business combinations. It does not apply to:

a. The formation of a joint venture
b. The acquisition of an asset or a group of assets that does not constitute a business
c. A combination between entities or businesses under common control
d. A combination between not-for-profit organizations or the acquisition of a for-profit business by a not-for-profit organization.

How Will This Statement Improve Current Accounting Practice?

This Statement replaces FASB Statement No. 141, *Business Combinations.* This Statement retains the fundamental requirements in Statement 141 that the acquisition method of accounting (which Statement 141 called the *purchase method*) be used for all business combinations and for an acquirer to be identified for each business combination. This Statement defines the acquirer as the entity that obtains control of one or more businesses in the business combination and establishes the acquisition date as the date that the acquirer achieves control. Statement 141 did not define the acquirer, although it included guidance on identifying the acquirer, as does this Statement. This Statement's scope is broader than that of Statement 141, which applied only to business combinations in which control was obtained by transferring consideration. By applying the same method of accounting—the acquisition method—to all transactions and other events in which one entity obtains control over one or more other businesses, this Statement improves the comparability of the information about business combinations provided in financial reports.

This Statement retains the guidance in Statement 141 for identifying and recognizing intangible assets separately from goodwill. The main features of this Statement and the more significant improvements it makes to how the acquisition method was applied in accordance with Statement 141 are described below.

Recognizing and Measuring the Identifiable Assets Acquired, the Liabilities Assumed, and Any Noncontrolling Interest in the Acquiree

This Statement requires an acquirer to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date, with limited exceptions specified in the Statement. That replaces Statement 141's cost-allocation process, which required the cost of an acquisition to be allocated to the individual assets acquired and liabilities assumed based on their estimated fair values. Statement 141's guidance resulted in not recognizing some assets and liabilities at the acquisition date, and it also resulted in measuring some assets and liabilities at amounts other than their fair values at the acquisition date. For example, Statement 141 required the acquirer to include the costs incurred to effect the acquisition (acquisition-related costs) in the cost of the acquisition that was allocated to the assets acquired and the liabilities assumed. This Statement requires those costs to be recognized separately from the acquisition. In addition, in accordance with Statement 141, restructuring costs that the acquirer expected but was not obligated to incur were recognized as if they were a liability assumed at the acquisition date. This Statement requires the acquirer to recognize those costs separately from the business combination. Therefore, this Statement improves the relevance, completeness, and representational faithfulness of the information provided in financial reports about the assets acquired and the liabilities assumed in a business combination.

This Statement also requires the acquirer in a business combination achieved in stages (sometimes referred to as a *step acquisition*) to recognize the identifiable assets and liabilities, as well as the noncontrolling interest in the acquiree, at the full amounts of their fair values (or other amounts determined in accordance with this Statement). In accordance with Statement 141 and related interpretative guidance, an entity that acquired another entity in a series of purchases (a step acquisition) identified the cost of each investment, the fair value of the underlying identifiable net assets acquired, and the goodwill on each step. Statement 141 did not provide guidance on measuring the noncontrolling interest's share of the consolidated subsidiary's assets and liabilities at the acquisition date. The result of applying Statement 141's guidance on recognizing and measuring assets and liabilities in a step acquisition was to measure them at a blend of historical costs and fair values—a practice that provided less relevant, representationally faithful, and comparable information than will result from applying this Statement. In addition, this Statement's requirement to measure the noncontrolling interest in the acquiree at fair value will result in recognizing the goodwill attributable to the noncontrolling interest in addition to that attributable to the acquirer, which improves the completeness of the resulting information and makes it more comparable across entities.

Assets and liabilities arising from contingencies

This Statement improves the completeness of the information reported about a business combination by changing the requirements for recognizing assets acquired and liabilities assumed arising from contingencies. Statement 141 permitted deferred recognition of preacquisition contingencies until the recognition criteria for FASB Statement No. 5, *Accounting for Contingencies,* were met. This Statement requires an acquirer to recognize assets acquired and liabilities assumed arising from *contractual contingencies* as of the acquisition date, measured at their acquisition-date fair values. An acquirer is required to recognize assets or liabilities arising from all other contingencies (*noncontractual contingencies*) as of the acquisition date, measured at their acquisition-date fair values, only if it is **more likely than not** that they meet the definition of an asset or a liability in FASB Concepts Statement No. 6, *Elements of Financial Statements.* If that criterion is not met at the acquisition date, the acquirer instead accounts for a noncontractual contingency in accordance with other applicable generally accepted accounting principles, including Statement 5, as appropriate.

This Statement provides specific guidance on the subsequent accounting for assets and liabilities arising from contingencies acquired or assumed in a business combination that otherwise would be in the scope of Statement 5. It requires that an acquirer continue to report an asset or a liability arising from a contingency recognized as of the acquisition date at its acquisition-date fair value absent new information about the possible outcome of the contingency. When new information is obtained, the acquirer evaluates that new information and measures a liability at the higher of its acquisition-date fair value or the amount that would be recognized if applying Statement 5, and measures an asset at the lower of its acquisition-date fair value or the best estimate of its future settlement amount.

Recognizing and Measuring Goodwill or a Gain from a Bargain Purchase

This Statement requires the acquirer to recognize goodwill as of the acquisition date, measured as a residual, which in most types of business combinations will result in measuring goodwill as the excess of the consideration transferred plus the fair value of any noncontrolling interest in the acquiree at the acquisition date over the fair values of the identifiable net assets acquired.

Statement 141 also required goodwill to be recognized and measured as a residual. However, as described below, this Statement improves the way in which an acquirer's obligations to make payments conditioned on the outcome of future events (often called *contingent consideration*) are recognized and measured, which in turn improves the measure of goodwill. This Statement also includes in the definition of contingent consideration arrangements that give the acquirer the right to the return of previously transferred consideration if specified conditions are met.

This Statement requires the acquirer to recognize contingent consideration at the acquisition date, measured at its fair value at that date. Under Statement 141, in contrast, contingent consideration obligations usually were not recognized at the acquisition date. Rather, they usually were recognized when the contingency was resolved and consideration was issued or became issuable. In addition, the issuance of additional securities or distribution of additional cash or other assets upon resolution of contingencies based on reaching particular earnings levels was recognized as an adjustment to the accounting for the business combination, but issuance of shares or distribution of assets upon resolution of contingencies based on security prices was recognized differently. This Statement therefore improves the representational faithfulness and completeness of the information provided about an acquirer's obligations and rights under contingent consideration arrangements.

A bargain purchase

This Statement defines a *bargain purchase* as a business combination in which the total acquisition-date fair value of the identifiable net assets acquired exceeds the fair value of the consideration transferred plus any noncontrolling interest in the acquiree, and it requires the acquirer to recognize that excess in earnings as a gain attributable to the acquirer. In contrast, Statement 141 required the "negative goodwill" amount to be allocated as a pro rata reduction of the amounts that otherwise would have been assigned to particular assets acquired. This Statement therefore improves the representational faithfulness and completeness of the information provided about both the acquirer's earnings during the period in which it makes a bargain purchase and the measures of the assets acquired in the bargain purchase.

What Other Changes Does This Statement Make to Existing Accounting Pronouncements?

This Statement makes significant amendments to other Statements and other authoritative guidance. For example, this Statement supersedes FASB Interpretation No. 4, *Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method,* which required research and development assets acquired in a business combination that have no alternative future use to be measured at their acquisition-date fair values and then immediately charged to expense. Therefore, the acquirer will recognize separately from goodwill the acquisition-date fair values of research and development assets acquired in a business combination, which improves the representational faithfulness and completeness of the information provided in financial reports about the assets acquired in a business combination.

This Statement amends FASB Statement No. 109, *Accounting for Income Taxes,* to require the acquirer to recognize changes in the amount of its deferred tax benefits that are recognizable because of a business combination either in income from continuing operations in the period of the combination or directly in contributed capital, depending on the circumstances. (Such changes arise through the increase or reduction of the acquirer's valuation allowance on its previously existing deferred tax assets because of the business combination.) Previously, Statement 109 required a reduction of the acquirer's valuation allowance because of a business combination to be recognized through a corresponding reduction to goodwill or certain noncurrent assets or an increase in so-called negative goodwill. This Statement therefore improves the representational faithfulness of the information provided about the effect of a business combination on both the acquirer's deferred tax assets and the related valuation allowance and the goodwill and noncurrent assets acquired in the business combination.

This Statement makes various other amendments to the authoritative literature intended to provide additional guidance or to conform the guidance in that literature to that provided in this Statement. For example, this Statement amends FASB Statement No. 142, *Goodwill and Other Intangible Assets,* to, among other things, provide guidance on the impairment testing of acquired research and development intangible assets and assets that the acquirer intends not to use.

This Statement also eliminates many EITF issues and other interpretative guidance on accounting for business combinations and incorporates the parts of that guidance that remain pertinent. Therefore, in addition to improving the guidance provided about accounting for a business combination in the authoritative literature, this Statement makes that guidance easier to use.

What Is the Effect of This Statement on Convergence with International Reporting Standards?

This Statement, together with the IASB's IFRS 3, *Business Combinations* (as revised in 2007), completes a joint effort by the FASB and the IASB to improve financial reporting about business combinations and to promote the international convergence of accounting standards. Statement 141 and IFRS 3 (as issued in 2004) both required use of the acquisition method rather than the pooling-of-interests method to account for business combinations. In this Statement and the revised IFRS 3, the Boards in large part achieved their goal of reaching the same conclusions on the more significant issues involving application of the acquisition method of accounting for a business combination. Appendix G describes the substantive differences between this Statement and IFRS 3 (as revised in 2007). One significant difference is the measurement requirements for a noncontrolling interest in an acquiree. This Statement requires an acquirer to measure a noncontrolling interest at its acquisition-date fair value. IFRS 3 (as revised in 2007) provides the acquirer a choice for each business combination to measure a noncontrolling interest either at its fair value or on the basis of its proportionate interest in the identifiable net assets of the acquiree. The Boards' requirements for recognizing at the acquisition date assets and liabilities arising from contingencies also differ, in part because the IASB decided to carry forward IFRS 3's requirements for those assets and liabilities on an interim basis, pending completion of its project to revise IAS 37, *Provisions, Contingent Liabilities and Contingent Assets.*

What Is the Effective Date of This Statement?

This Statement applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. An entity may not apply it before that date. The effective date of this Statement is the same as that of the related FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements.*

Statement of Financial Accounting Standards No. 141 (revised 2007)

Business Combinations

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FASB Statement No. 141 (revised 2007), *Business Combinations,* is set out in paragraphs 1–77 and Appendixes A and D–F. All paragraphs have equal authority. Paragraphs in **bold type** state the main principles.

OBJECTIVE

1. The objective of this Statement 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. To accomplish that, this Statement establishes principles and requirements for how the acquirer:

a. Recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree
b. Recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase
c. Determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

SCOPE

2. This Statement applies to a transaction or other event that meets the definition of a *business combination* in paragraph 3(e). This Statement does not apply to:

a. The formation of a joint venture
b. The acquisition of an asset or a group of assets that does not constitute a business (paragraphs D2–D7)
c. A combination between entities or businesses under common control (paragraphs D8–D14)
d. A combination between not-for-profit organizations or the acquisition of a for-profit business by a not-for-profit organization.

KEY TERMS

3. This Statement uses the following terms with the specified definitions:

a. The *acquiree* is the business or businesses that the acquirer obtains control of in a business combination.
b. The *acquirer* is the entity that obtains control of the acquiree. However, in a business combination in which a variable interest entity is acquired, the primary beneficiary of that entity always is the acquirer.
c. The *acquisition date* is the date on which the acquirer obtains control of the acquiree.
d. A *business* is an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs, or other economic benefits directly to investors or other owners, members, or participants.
e. A *business combination* is a transaction or other event in which an acquirer obtains control of one or more businesses. Transactions sometimes referred to as "true mergers" or "mergers of equals" also are business combinations as that term is used in this Statement.
f. *Contingent consideration* usually is an obligation of the acquirer to transfer additional assets or equity interests to the former owners of an acquiree as part of the exchange for control of the acquiree if specified future events occur or conditions are met. However, contingent consideration also may give the acquirer the right to the return of previously transferred consideration if specified conditions are met.
g. *Control* has the meaning of *controlling financial interest* in paragraph 2 of Accounting Research Bulletin No. 51, *Consolidated Financial Statements,* as amended.
h. The term *equity interests* is used broadly to mean ownership interests of investor-owned entities and owner, member, or participant interests of mutual entities.
i. *Fair value* is 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 (FASB Statement No. 157, *Fair Value Measurements,* paragraph 5).
j. *Goodwill* is an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized.
k. An asset is *identifiable* if it either:
   (1) Is separable, that is, capable of being separated or divided from the entity and sold, transferred, licensed, rented, or exchanged, either individually or together with a related contract, identifiable asset, or liability, regardless of whether the entity intends to do so; or
   (2) Arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.
l. An *intangible asset* is an asset (not including a financial asset) that lacks physical substance. As used in this Statement, the term *intangible asset* excludes goodwill.
m. A *mutual entity* is an entity other than an investor-owned entity that provides dividends, lower costs, or other economic benefits directly to its owners, members, or participants. For example, a mutual insurance company, a credit union, and a cooperative entity are all mutual entities.
n. *Noncontrolling interest* is the equity in a subsidiary not attributable, directly or indirectly, to a parent (ARB 51, as amended).
o. The term *owners* is used broadly to include holders of equity interests of investor-owned entities and owners, members of, or participants in, mutual entities.

IDENTIFYING A BUSINESS COMBINATION

4. **An entity shall determine whether a transaction or other event is a *business combination* by applying the definition in this Statement, which requires that the assets acquired and liabilities assumed constitute a *business.* If the assets acquired are not a business, the reporting entity shall account for the transaction or other event as an asset acquisition.**

5. Paragraphs A2–A9 in Appendix A provide guidance on identifying a business combination and the definition of a business. Paragraphs D2–D7 describe the typical accounting for an asset acquisition.

THE ACQUISITION METHOD

6. **An entity shall account for each business combination by applying the acquisition method.**

7. Applying the acquisition method requires:

a. Identifying the acquirer
b. Determining the acquisition date
c. Recognizing and measuring the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree
d. Recognizing and measuring goodwill or a gain from a bargain purchase.

Identifying the Acquirer

8. **For each business combination, one of the combining entities shall be identified as the acquirer.**

9. The guidance in ARB 51, as amended, shall be used to identify the acquirer—the entity that obtains control of the acquiree. If a business combination has occurred but applying the guidance in ARB 51 does not clearly indicate which of the combining entities is the acquirer, the factors in paragraphs A11–A15 shall be considered in making that determination. However, in a business combination in which a variable interest entity is acquired, the primary beneficiary of that entity always is the acquirer. The determination of which party, if any, is the primary beneficiary of a variable interest entity shall be made in accordance with FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities,* as amended, not by applying either the guidance in ARB 51 or that in paragraphs A11–A15.

Determining the Acquisition Date

10. **The acquirer shall identify the acquisition date, which is the date on which it obtains control of the acquiree.**

11. The date on which the acquirer obtains control of the acquiree generally is the date on which the acquirer legally transfers the consideration, acquires the assets, and assumes the liabilities of the acquiree—the closing date. However, the acquirer might obtain control on a date that is either earlier or later than the closing date. For example, the acquisition date precedes the closing date if a written agreement provides that the acquirer obtains control of the acquiree on a date before the closing date. An acquirer shall consider all pertinent facts and circumstances in identifying the acquisition date.

Recognizing and Measuring the Identifiable Assets Acquired, the Liabilities Assumed, and Any Noncontrolling Interest in the Acquiree

Recognition Principle

12. **As of the acquisition date, the acquirer shall recognize, separately from goodwill, the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. Recognition of identifiable assets acquired and liabilities assumed is subject to the conditions specified in paragraphs 13 and 14.**

Recognition conditions

13. To qualify for recognition as part of applying the acquisition method, 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. For example, costs the acquirer expects but is not obligated to incur in the future to effect its plan to exit an activity of an acquiree or to terminate the employment of or relocate an acquiree's employees are not liabilities at the acquisition date. Therefore, the acquirer does not recognize those costs as part of applying the acquisition method. Instead, the acquirer recognizes those costs in its postcombination financial statements in accordance with other applicable generally accepted accounting principles (GAAP).

14. In addition, to qualify for recognition as part of applying the acquisition method, 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. The acquirer shall apply the guidance in paragraphs 57–59 to determine which assets acquired or liabilities assumed are part of the exchange for the acquiree and which, if any, are the result of separate transactions to be accounted for in accordance with their nature and the applicable GAAP.

15. The acquirer's application of the recognition principle and conditions may result in recognizing some assets and liabilities that the acquiree had not previously recognized as assets and liabilities in its financial statements. For example, the acquirer recognizes the acquired identifiable intangible assets, such as a brand name, a patent, or a customer relationship,

that the acquiree did not recognize as assets in its financial statements because it developed them internally and charged the related costs to expense.

16. Paragraphs A16–A56 provide guidance on recognizing operating leases and intangible assets. Paragraphs 23–30 specify the types of identifiable assets and liabilities that include items for which this Statement provides limited exceptions to the recognition principle and conditions in paragraphs 12–14.

Classifying or designating identifiable assets acquired and liabilities assumed in a business combination

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

18. In some situations, GAAP provides for different accounting depending on how an entity classifies or designates a particular asset or liability. Examples of classifications or designations that the acquirer shall make on the basis of the pertinent conditions as they exist at the acquisition date include but are not limited to:

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

19. This Statement provides two exceptions to the principle in paragraph 17:

a. Classification of a lease contract as either an operating lease or a capital lease in accordance with FASB Statement No. 13, *Accounting for Leases,* as interpreted by FASB Interpretation No. 21, *Accounting for Leases in a Business Combination*
b. Classification of a contract written by an entity that is in the scope of FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises,* as amended by this Statement, as an insurance or reinsurance contract or a deposit contract.

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

Measurement Principle

20. **The acquirer shall measure the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at their acquisition-date fair values.**

21. Paragraphs A57–A61 provide guidance on measuring the fair values of particular identifiable assets and a noncontrolling interest in an acquiree.

Exceptions to the Recognition or Measurement Principles

22. This Statement provides limited exceptions to its recognition and measurement principles. Paragraphs 23–33 specify the types of identifiable assets and liabilities that include items for which this Statement provides limited exceptions. The acquirer shall apply the specified GAAP or the specified requirements rather than the recognition and measurement principles in paragraphs 12 and 20 to determine when to recognize or how to measure the assets or liabilities identified in paragraphs 23–33. That will result in some items being either:

a. Recognized either by applying recognition conditions in addition to those in paragraphs 13 and 14 or by applying the requirements of other GAAP, with results that differ from applying the recognition principle and conditions in paragraphs 12–14; or
b. Measured at an amount other than their acquisition-date fair values.

Exceptions to both the recognition and measurement principles

Assets and liabilities arising from contingencies

23. FASB Statement No. 5, *Accounting for Contingencies,* defines a *contingency* as an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an entity that will ultimately be resolved when one or more future events occur or fail to occur.

24. The acquirer shall recognize as of the acquisition date, assets acquired and liabilities assumed that would be within the scope of Statement 5 if not acquired or assumed in a business combination, except for assets or liabilities arising from contingencies that are subject to specific guidance in this Statement as follows:

a. If the acquisition-date fair value of the asset or liability arising from a contingency can be determined during the measurement period, that asset or liability shall be recognized at the acquisition date measured at fair value. For example, the acquisition-date fair value of a warranty obligation often can be determined.
b. If the acquisition-date fair value of the asset or liability arising from a contingency cannot be determined during the measurement period, an asset or a liability shall be recognized at the acquisition date if both of the following criteria are met:
   (1) Information available before the end of the measurement period indicates that it is probable that an asset existed or that a liability had been incurred at the acquisition date. It is implicit in this condition that it must be probable at the acquisition date that one or more future events confirming the existence of the asset or liability will occur.
   (2) The amount of the asset or liability can be reasonably estimated.

   Criteria (1) and (2) shall be applied using the guidance in Statement 5 and in FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss,* for application of similar criteria in paragraph 8 of Statement 5.

If neither criterion (a) nor criterion (b) is met at the acquisition date using information that is available during the measurement period about facts and circumstances that existed as of the acquisition date, the acquirer shall not recognize an asset or liability as of the acquisition date. In periods after the acquisition date, the acquirer shall account for an asset or a liability arising from a contingency that does not meet the recognition criteria at the acquisition date in accordance with other applicable GAAP, including Statement 5, as appropriate.

24A. Contingent consideration arrangements of an acquiree assumed by the acquirer in a business combination shall be recognized initially at fair value in accordance with the guidance for contingent consideration arrangements in paragraph 41.

25. [This paragraph has been deleted. See Status page.]

Income taxes

26. The acquirer shall recognize and measure a deferred tax asset or liability arising from the assets acquired and liabilities assumed in a business combination in accordance with FASB Statement No. 109, *Accounting for Income Taxes*, as amended by this Statement.

27. The acquirer shall account for the potential tax effects of temporary differences, carryforwards, and any income tax uncertainties of an acquiree that exist at the acquisition date or that arise as a result of the acquisition in accordance with Statement 109, as amended, and related interpretative guidance, including FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, once that Interpretation becomes effective.[a] If the acquirer is a nonpublic entity within the scope of FSP FIN 48-3, *Effective Date of FASB Interpretation No. 48 for Certain Nonpublic Enterprises,* and elects to defer the application of that Interpretation, the acquirer shall continue to recognize acquired income tax positions in accordance with literature that was authoritative immediately prior to the effective date of this Statement, such as EITF Issue No. 93-7, "Uncertainties Related to Income Taxes in a Purchase Business Combination," and Question 17 of the FASB Special Report, *A Guide to Implementation of Statement 109 on Accounting for Income Taxes.*

Employee benefits

28. The acquirer shall recognize and measure a liability (or asset, if any) related to the acquiree's employee benefit arrangements in accordance with other

[a]The effective date of Interpretation 48 is deferred for nonpublic entities included within the scope of FSP FIN48-3 to annual financial statements for fiscal years beginning after December 15, 2008.

GAAP, as amended by this Statement. For example, employee benefits in the scope of the following standards would be recognized and measured in accordance with those standards:

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

Indemnification assets

29. The seller in a business combination may contractually indemnify the acquirer for the outcome of a contingency or uncertainty related to all or part of a specific asset or liability. For example, the seller may indemnify the acquirer against losses above a specified amount on a liability arising from a particular contingency; in other words, the seller will guarantee that the acquirer's liability will not exceed a specified amount. As a result, the acquirer obtains an indemnification asset. The acquirer shall recognize an indemnification asset at the same time that it recognizes the indemnified item, measured on the same basis as the indemnified item, subject to the need for a valuation allowance for uncollectible amounts. Therefore, if the indemnification relates to an asset or a liability that is recognized at the acquisition date and measured at its acquisition-date fair value, the acquirer shall recognize the indemnification asset at the acquisition date measured at its acquisition-date fair value. For an indemnification asset measured at fair value, the effects of uncertainty about future cash flows because of collectibility considerations are included in the fair value measure and a separate valuation allowance is not necessary (paragraph A57).

30. In some circumstances, the indemnification may relate to an asset or a liability that is an exception to the recognition or measurement principles. For example, an indemnification may relate to a contingency that is not recognized at the acquisition date because it does not satisfy the criteria for recognition in paragraph 24 at that date. Alternatively, an indemnification may relate to an asset or a liability, for example, one that results from an uncertain tax position that is measured on a basis other than acquisition-date fair value (paragraphs 26 and 27). In those circumstances, the indemnification asset shall be recognized and measured using assumptions consistent with those used to measure the indemnified item, subject to management's assessment of the collectibility of the indemnification asset and any contractual limitations on the indemnified amount. Paragraph 64 provides guidance on the subsequent accounting for an indemnification asset.

Exceptions to the measurement principle

Reacquired rights

31. The acquirer shall measure the value of a reacquired right recognized as an intangible asset in accordance with paragraph A23 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. Paragraphs A23 and A24 provide additional recognition guidance. Paragraph 61 provides guidance on the subsequent accounting for reacquired rights.

Share-based payment awards

32. The acquirer shall measure a liability or an equity instrument related to the replacement of an acquiree's share-based payment awards with share-based payment awards of the acquirer in accordance with the method in FASB Statement No. 123 (revised 2004), *Share-Based Payment.* (This Statement refers to the result of that method as the *fair-value-based measure* of the award.) Paragraphs 43–46 and A91–A106 provide additional guidance.

Assets held for sale

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

Recognizing and Measuring Goodwill or a Gain from a Bargain Purchase

34. **The acquirer shall recognize goodwill as of the acquisition date, measured as the excess of (a) over (b) below:**

a. The aggregate of:
   (1) The consideration transferred measured in accordance with this Statement, which generally requires acquisition-date fair value (paragraph 39)
   (2) The fair value of any noncontrolling interest in the acquiree
   (3) In a business combination achieved in stages, the acquisition-date fair value of the acquirer's previously held equity interest in the acquiree
b. The net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed measured in accordance with this Statement.

35. 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. 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 (paragraph 34(a)(1)). Paragraphs A67–A69 provide additional guidance on applying the acquisition method to combinations of mutual entities, including measuring the acquisition-date fair value of the acquiree's equity interests using a valuation technique.

A Bargain Purchase

36. Occasionally, an acquirer will make a *bargain purchase,* which is a business combination in which the amount in paragraph 34(b) exceeds the aggregate of the amounts specified in paragraph 34(a). If that excess remains after applying the requirements in paragraph 38, the acquirer shall recognize the resulting gain in earnings on the acquisition date. The gain shall be attributed to the acquirer. Paragraphs A71 and A72 provide additional guidance.

37. A bargain purchase might happen, for example, in a business combination that is a forced sale in which the seller is acting under compulsion. However, the recognition or measurement exceptions for particular items discussed in paragraphs 23–33 also may result in recognizing a gain (or change the amount of a recognized gain) on a bargain purchase.

38. Before recognizing a gain on a bargain purchase, the acquirer shall reassess whether it has correctly identified all of the assets acquired and all of the liabilities assumed and shall recognize any additional assets or liabilities that are identified in that review. The acquirer shall then review the procedures used to measure the amounts this Statement requires to be recognized at the acquisition date for all of the following:

a. The identifiable assets acquired and liabilities assumed
b. The noncontrolling interest in the acquiree, if any
c. For a business combination achieved in stages, the acquirer's previously held equity interest in the acquiree
d. The consideration transferred.

The objective of the review is to ensure that the measurements appropriately reflect consideration of all available information as of the acquisition date.

Consideration Transferred

39. The consideration transferred in a business combination shall be measured at fair value, which shall be calculated as the sum of the acquisition-date fair values of the assets transferred by the acquirer, the liabilities incurred by the acquirer to former owners of the acquiree, and the equity interests issued by the acquirer. (However, any portion of the acquirer's share-based payment awards exchanged for awards held by the acquiree's employees that is included in consideration transferred in the business combination shall be measured in accordance with paragraph 32 rather than at fair value.) Examples of potential forms of consideration include cash, other assets, a business or a subsidiary of the acquirer, contingent consideration (paragraphs 41 and 42), common or preferred equity instruments, options, warrants, and member interests of mutual entities.

40. The consideration transferred may include assets or liabilities of the acquirer that have carrying

amounts that differ from their fair values at the acquisition date (for example, nonmonetary assets or a business of the acquirer). If so, the acquirer shall 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. However, sometimes the transferred assets or liabilities remain within the combined entity after the business combination (for example, because the assets or liabilities were transferred to the acquiree rather than to its former owners), and the acquirer therefore retains control of them. In that situation, the acquirer shall measure those assets and liabilities at their carrying amounts immediately before the acquisition date and shall not recognize a gain or loss in earnings on assets or liabilities it controls both before and after the business combination.

Contingent consideration

41. The consideration the acquirer transfers in exchange for the acquiree includes any asset or liability resulting from a contingent consideration arrangement (paragraph 3(f)). The acquirer shall recognize the acquisition-date fair value of contingent consideration as part of the consideration transferred in exchange for the acquiree.

42. The acquirer shall classify an obligation to pay contingent consideration as a liability or as equity in accordance with FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity,* EITF Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock," or other applicable GAAP. For example, Statement 150 provides guidance on whether to classify as a liability a contingent consideration arrangement that is, in substance, a put option written by the acquirer on the market price of the acquirer's shares issued in the business combination. The acquirer shall classify as an asset a right to the return of previously transferred consideration if specified conditions are met. Paragraph 65 provides guidance on the subsequent accounting for contingent consideration.

Acquirer share-based payment awards exchanged for awards held by the acquiree's employees

43. An acquirer may exchange its share-based payment awards (replacement awards) for awards held by employees of the acquiree. Exchanges of share options or other share-based payment awards in conjunction with a business combination are modifications of share-based payment awards in accordance with Statement 123(R). 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:

a. The terms of the acquisition agreement
b. The terms of the acquiree's awards
c. Applicable laws or regulations.

44. In situations in which acquiree awards would expire as a consequence of a business combination and if 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 postcombination financial statements. That is, none of the fair-value-based measure of those awards shall be included in meas-uring the consideration transferred in the business combination.

45. 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 Statement 123(R). 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.

46. 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. Paragraphs A91–A106 provide additional guidance on

distinguishing between the portion of a replacement award that is attributable to precombination service, which the acquirer includes in the consideration transferred in the business combination, and the portion that is attributed to postcombination service, which the acquirer recognizes as compensation cost in its postcombination financial statements.

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

A Business Combination Achieved in Stages

47. An acquirer sometimes obtains control of an acquiree in which it held an equity interest immediately before the acquisition date. For example, on December 31, 20X1, Entity A holds a 35 percent noncontrolling equity interest in Entity B. On that date, Entity A purchases an additional 40 percent interest in Entity B, which gives it control of Entity B. This Statement refers to such a transaction as a *business combination achieved in stages,* sometimes also referred to as a step acquisition.

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

A Business Combination Achieved without the Transfer of Consideration

49. An acquirer sometimes obtains control of an acquiree without transferring consideration. The acquisition method of accounting for a business combination applies to those combinations. Such circumstances include:

a. The acquiree repurchases a sufficient number of its own shares for an existing investor (the acquirer) to obtain control.
b. Minority veto rights lapse that previously kept the acquirer from controlling an acquiree in which the acquirer held the majority voting interest.
c. The acquirer and acquiree agree to combine their businesses by contract alone. The acquirer transfers no consideration in exchange for control of an acquiree and holds no equity interests in the acquiree, either on the acquisition date or previously. Examples of business combinations achieved by contract alone include bringing two businesses together in a stapling arrangement or forming a dual listed corporation.

50. In a business combination achieved by contract alone, the acquirer shall attribute to the equity holders of the acquiree the amount of the acquiree's net assets recognized in accordance with the requirements of this Statement. In other words, the equity interests in the acquiree held by parties other than the acquirer are a noncontrolling interest in the acquirer's postcombination financial statements even if the result is that all of the equity interests in the acquiree are attributed to the noncontrolling interest.

Measurement Period

51. **If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the acquirer shall report in its financial statements provisional amounts for the items for which the accounting is incomplete. During the measurement period, the acquirer shall retrospectively 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. During the measurement period, the acquirer also shall recognize additional assets or liabilities if new information is obtained about facts and circumstances that existed as of the acquisition date that, if known, would have resulted in the recognition of those assets and liabilities as of that date. The measurement period ends as soon as the acquirer receives the information it was seeking about facts and circumstances that existed as of the acquisition date or learns that more information is not obtainable. However, the measurement period shall not exceed one year from the acquisition date.**

52. The measurement period is the period after the acquisition date during which the acquirer may adjust the provisional amounts recognized for a business combination. The measurement period provides the

acquirer with a reasonable time to obtain the information necessary to identify and measure the following as of the acquisition date in accordance with the requirements of this Statement:

a. The identifiable assets acquired, liabilities assumed, and any noncontrolling interest in the acquiree
b. The consideration transferred for the acquiree (or the other amount used in measuring goodwill in accordance with paragraphs 34 and 35)
c. In a business combination achieved in stages, the equity interest in the acquiree previously held by the acquirer
d. The resulting goodwill recognized in accordance with paragraph 34 or the gain on a bargain purchase recognized in accordance with paragraph 36.

53. The acquirer shall consider all pertinent factors in determining whether information obtained after the acquisition date should result in an adjustment to the provisional amounts recognized or whether that information results from events that occurred after the acquisition date. Pertinent factors include the time at which additional information is obtained and whether the acquirer can identify a reason for a change to provisional amounts. Information that is obtained shortly after the acquisition date is more likely to reflect circumstances that existed at the acquisition date than is information obtained several months later. For example, unless an intervening event that changed its fair value can be identified, the sale of an asset to a third party shortly after the acquisition date for an amount that differs significantly from its provisional fair value determined at that date is likely to indicate an error in the provisional amount.

54. The acquirer recognizes an increase (decrease) in the provisional amount recognized for an identifiable asset (liability) by means of a decrease (increase) in goodwill. However, 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, the 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.

55. During the measurement period, the acquirer shall recognize adjustments to the provisional amounts as if the accounting for the business combination had been completed at the acquisition date. Thus, the acquirer shall revise comparative information for prior periods presented in financial statements as needed, including making any change in depreciation, amortization, or other income effects recognized in completing the initial accounting. Paragraphs A73–A76 provide additional guidance.

56. After the measurement period ends, the acquirer shall revise the accounting for a business combination only to correct an error in accordance with FASB Statement No. 154, *Accounting Changes and Error Corrections.*

Determining What Is Part of the Business Combination Transaction

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

58. 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 (or its former owners) before the combination, is likely to be a separate transaction. The following are examples of separate transactions that are not to be included in applying the acquisition method:

a. A transaction that in effect settles preexisting relationships between the acquirer and acquiree (paragraphs A78–A85)

b. A transaction that compensates employees or former owners of the acquiree for future services (paragraphs A86–A90)
c. A transaction that reimburses the acquiree or its former owners for paying the acquirer's acquisition-related costs (paragraph 59).

Paragraphs A77–A106 provide additional guidance for determining whether a transaction is separate from the business combination transaction.

Acquisition-Related Costs

59. Acquisition-related costs are costs the acquirer incurs to effect a business combination. Those costs include finder's fees; advisory, legal, accounting, valuation, and other professional or consulting fees; general administrative costs, including the costs of maintaining an internal acquisitions department; and costs of registering and issuing debt and equity securities. The acquirer shall account for acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received, with one exception. The costs to issue debt or equity securities shall be recognized in accordance with other applicable GAAP.

SUBSEQUENT MEASUREMENT AND ACCOUNTING

60. **In general, an acquirer shall subsequently measure and account for assets acquired, liabilities assumed or incurred, and equity instruments issued in a business combination in accordance with other applicable GAAP for those items, depending on their nature (paragraph 66). However, this Statement provides guidance on subsequently measuring and accounting for the following assets acquired, liabilities assumed or incurred, and equity instruments issued in a business combination:**

a. Reacquired rights
b. Assets and liabilities arising from contingencies recognized as of the acquisition date
c. Indemnification assets
d. Contingent consideration
e. Contingent consideration arrangements of an acquiree assumed by the acquirer.

Reacquired Rights

61. A reacquired right recognized as an intangible asset in accordance with paragraph A23 shall be amortized over the remaining contractual period of the contract in which the right was granted. An acquirer that subsequently sells a reacquired right to a third party shall include the carrying amount of the intangible asset in determining the gain or loss on the sale.

Assets and Liabilities Arising from Contingencies

62. An acquirer shall develop a systematic and rational basis for subsequently measuring and accounting for assets and liabilities arising from contingencies depending on their nature.

63. [This paragraph has been deleted. See Status page.]

Indemnification Assets

64. At each subsequent reporting date, the acquirer shall measure an indemnification asset that was recognized in accordance with paragraphs 29 and 30 at the acquisition date on the same basis as the indemnified liability or asset, subject to any contractual limitations on its amount and, for an indemnification asset that is not subsequently measured at its fair value, management's assessment of the collectibility of the indemnification asset. The acquirer shall derecognize the indemnification asset only when it collects the asset, sells it, or otherwise loses the right to it.

Contingent Consideration

65. 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. Such changes are measurement period adjustments in accordance with paragraphs 51–55. However, changes resulting from events after the acquisition date, such as meeting an earnings target, reaching a specified share price, or reaching a milestone on a research and development project, are not measurement period adjustments. The acquirer shall account for changes in the fair value of contingent consideration that are not measurement period adjustments as follows:

a. Contingent consideration classified as equity shall not be remeasured and its subsequent settlement shall be accounted for within equity.
b. Contingent consideration classified as an asset or a liability is remeasured to fair value at each reporting date until the contingency is resolved.

The changes in fair value are recognized in earnings unless the arrangement is a hedging instrument for which Statement 133, as amended by this Statement, requires the changes to be initially recognized in other comprehensive income.

65A. Contingent consideration arrangements of an acquiree assumed by the acquirer in a business combination shall be measured subsequently in accordance with the guidance for contingent consideration arrangements in paragraph 65.

Other Statements That Provide Guidance on Subsequent Measurement and Accounting

66. Examples of other Statements that provide guidance on subsequently measuring and accounting for assets acquired and liabilities assumed or incurred in a business combination include:

a. FASB Statement No. 142, *Goodwill and Other Intangible Assets,* as amended by this Statement, prescribes the accounting for goodwill and identifiable intangible assets acquired in a business combination, including:
   (1) Recognition of intangible assets used in research and development activities, regardless of whether those assets have an alternative future use
   (2) Classification of research and development intangible assets as indefinite-lived until the completion or abandonment of the associated research and development efforts.
b. The following Statements provide guidance on the subsequent accounting for an insurance or reinsurance contract acquired in a business combination:
   (1) FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises*
   (2) FASB Statement No. 97, *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments*
   (3) FASB Statement No. 113, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts*
   (4) FASB Statement No. 120, *Accounting and Reporting by Mutual Life Insurance Enterprises and by Insurance Enterprises for Certain Long-Duration Participating Contracts.*
c. Statement 109, as amended by this Statement, prescribes the subsequent accounting for deferred tax assets (including valuation allowances) and liabilities acquired in a business combination.
d. Statement 123(R) provides guidance on subsequent measurement and accounting for the portion of replacement share-based payment awards issued by an acquirer that is attributable to employees' future services.
e. ARB 51, as amended, provides guidance on accounting for changes in a parent's ownership interest in a subsidiary after control is obtained.

DISCLOSURES

67. **The acquirer shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of a business combination that occurs either:**

a. During the current reporting period; or
b. After the reporting date but before the financial statements are issued or are available to be issued (appropriate date determined in accordance with FASB Statement No. 165, *Subsequent Events*).

68. To meet the objective in paragraph 67, 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. 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.
f. The acquisition-date fair value of the total consideration transferred and the acquisition-date fair value of each major class of consideration, such as:
   (1) Cash
   (2) Other tangible or intangible assets, including a business or subsidiary of the acquirer
   (3) 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.

g. For contingent consideration arrangements and indemnification assets:
   (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.

h. For acquired receivables not subject to the requirements of AICPA Statement of Position 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer:*
   (1) The fair value of the receivables
   (2) The gross contractual amounts receivable
   (3) The best estimate at the acquisition date of the contractual cash flows not expected to be collected.

   The disclosures shall be provided by major class of receivable, such as loans, direct finance leases in accordance with Statement 13, and any other class of receivables.

i. The amounts recognized as of the acquisition date for each major class of assets acquired and liabilities assumed (paragraph A107).

j. For assets and liabilities arising from contingencies recognized at the acquisition date:
   (1) 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 Statement 5 and Interpretation 14)
   (2) The nature of the contingencies
   (3) [This subparagraph has been deleted. See Status page.]

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

jj. For assets and liabilities arising from contingencies that have not been recognized at the acquisition date, the disclosures required by Statement 5 if the criteria for disclosures in that Statement are met. The disclosures required, if any, by this paragraph and by paragraph 68(j) shall be included in the footnote that describes the business combination.

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

l. If the acquirer is required to disclose segment information in accordance with FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information,* the amount of goodwill by reportable segment. If the assignment of goodwill to reporting units required by Statement 142 has not been completed as of the date the financial statements are issued or are available to be issued (appropriate date determined in accordance with Statement 165), the acquirer shall disclose that fact.

m. For transactions that are recognized separately from the acquisition of assets and assumptions of liabilities in the business combination (paragraph 57):
   (1) A description of each transaction
   (2) How the acquirer accounted for each transaction
   (3) The amounts recognized for each transaction and the line item in the financial statements in which each amount is recognized
   (4) If the transaction is the effective settlement of a preexisting relationship, the method used to determine the settlement amount.

n. The disclosure of separately recognized transactions required by paragraph 68(m) shall include the amount of acquisition-related costs, the amount recognized as an expense and the line item or items in the income statement in which those expenses are recognized. The amount of any issuance costs not recognized as an expense and how they were recognized also shall be disclosed.

o. In a bargain purchase (paragraphs 36–38):
   (1) The amount of any gain recognized in accordance with paragraph 36 and the line item in the income statement in which the gain is recognized
   (2) A description of the reasons why the transaction resulted in a gain.

p. For each business combination in which the acquirer holds less than 100 percent of the equity interests in the acquiree at the acquisition date:
   (1) The fair value of the noncontrolling interest in the acquiree at the acquisition date
   (2) The valuation technique(s) and significant inputs used to measure the fair value of the noncontrolling interest.

q. In a business combination achieved in stages:
   (1) The acquisition-date fair value of the equity interest in the acquiree held by the acquirer immediately before the acquisition date

(2) The amount of any gain or loss recognized as a result of remeasuring to fair value the equity interest in the acquiree held by the acquirer before the business combination (paragraph 48) and the line item in the income statement in which that gain or loss is recognized.

r. If the acquirer is a *public business enterprise,* as described in paragraph 9 of Statement 131:
   (1) The amounts of revenue and earnings of the acquiree since the acquisition date included in the consolidated income statement for the reporting period
   (2) The revenue and earnings of the combined entity for the current reporting period as though the acquisition date for all business combinations that occurred during the year had been as of the beginning of the annual reporting period (*supplemental pro forma information*)
   (3) If comparative financial statements are presented, the revenue and earnings of the combined entity for the comparable prior reporting period as though the acquisition date for all business combinations that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period (*supplemental pro forma information*).

   If disclosure of any of the information required by this subparagraph is impracticable, the acquirer shall disclose that fact and explain why the disclosure is impracticable. This Statement uses the term *impracticable* with the same meaning as *impracticability* in paragraph 11 of Statement 154.

69. For individually immaterial business combinations occurring during the reporting period that are material collectively, the acquirer shall disclose the information required by paragraphs 68(e)–68(r) in the aggregate.

70. If the acquisition date of a business combination is after the reporting date but before the financial statements are issued or are available to be issued (appropriate date determined in accordance with Statement 165), the acquirer shall disclose the information required by paragraph 68 unless the initial accounting for the business combination is incomplete at the time the financial statements are issued or are available to be issued (appropriate date determined in accordance with Statement 165). In that situation, the acquirer shall describe which disclosures could not be made and the reason why they could not be made.

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

72. To meet the objective in paragraph 71, the acquirer shall disclose the following information for each material business combination or in the aggregate for individually immaterial business combinations that are material collectively:

a. If the initial accounting for a business combination is incomplete (paragraph 51) for particular assets, liabilities, noncontrolling interests, or items of consideration and the amounts recognized in the financial statements for the business combination thus have been determined only provisionally:
   (1) The reasons why the initial accounting is incomplete
   (2) The assets, liabilities, equity interests, or items of consideration for which the initial accounting is incomplete
   (3) The nature and amount of any measurement period adjustments recognized during the reporting period in accordance with paragraph 55.

b. For each reporting period after the acquisition date until the entity collects, sells, or otherwise loses the right to a contingent consideration asset, or until the entity settles a contingent consideration liability or the liability is cancelled or expires:
   (1) Any changes in the recognized amounts, including any differences arising upon settlement
   (2) Any changes in the range of outcomes (undiscounted) and the reasons for those changes
   (3) The disclosures required by paragraph 32 of Statement 157.

c. [This subparagraph has been deleted. See Status page.]

d. A reconciliation of the carrying amount of goodwill at the beginning and end of the reporting period as required by Statement 142, as amended.

73. If the specific disclosures required by this Statement and other GAAP do not meet the objectives set out in paragraphs 67 and 71, the acquirer shall disclose whatever additional information is necessary to meet those objectives.

EFFECTIVE DATE AND TRANSITION

74. This Statement shall be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Earlier application is prohibited.

75. Assets and liabilities that arose from business combinations whose acquisition dates preceded the application of this Statement shall not be adjusted upon application of this Statement.

76. An entity, such as a mutual entity, that has not yet applied Statement 141 and FASB Statement No. 147, *Acquisitions of Certain Financial Institutions,* and that had one or more business combinations that were accounted for using the purchase method shall apply the transition provisions in paragraphs A130–A134. An entity that has not yet applied Statement 142 in its entirety shall apply that Statement in its entirety at the same time that it applies this Statement.

Income Taxes

77. For business combinations in which the acquisition date was before the effective date of this Statement, the acquirer shall apply the requirements of Statement 109, as amended by this Statement, prospectively. That is, the acquirer shall not adjust the accounting for prior business combinations for previously recognized changes in acquired tax uncertainties or previously recognized changes in the valuation allowance for acquired deferred tax assets. However, after the effective date of this Statement:

a. The acquirer shall recognize, as an adjustment to income tax expense (or a direct adjustment to contributed capital in accordance with paragraph 26 of Statement 109), changes in the valuation allowance for acquired deferred tax assets.
b. If the acquirer is a nonpublic entity within the scope of FSP FIN48-3 that does not elect to defer the application of Interpretation 48, or the acquirer is a public entity, the acquirer shall recognize changes in the acquired income tax positions in accordance with Interpretation 48, as amended by this Statement.
c. If the acquirer is a nonpublic entity within the scope of FSP FIN48-3 and elects to defer the application of Interpretation 48, the acquirer shall recognize, as an adjustment to income tax expense, changes in the acquired income tax positions that were recognized and measured in accordance with literature that was authoritative immediately before the effective date of this Statement, such as EITF Issue No. 93-7, "Uncertainties Related to Income Taxes in a Purchase Business Combination," and Question 17 of the FASB Special Report, *A Guide to Implementation of Statement 109 on Accounting for Income Taxes,* until the acquirer adopts Interpretation 48. After the acquirer adopts Interpretation 48, the acquirer shall recognize changes in the acquired income tax positions in accordance with that Interpretation, as amended by this Statement.

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

This Statement was adopted by the affirmative vote of five members of the Financial Accounting Standards Board. Ms. Seidman dissented; Mr. Smith abstained.

Ms. Seidman dissents from the issuance of this Statement, primarily because of certain aspects of the accounting for goodwill, bargain purchases, and noncontrolling (minority) interests in a subsidiary.

This Statement requires that goodwill (or a gain on a bargain purchase) be recognized based on the difference between (a) the fair values (or other recorded amounts) ascribed to identifiable net assets of the acquiree and (b) the fair value of any consideration plus the fair value of any noncontrolling interest at the acquisition date. Ms. Seidman disagrees with this decision for two reasons. First, she would have measured the consideration as of the agreement date because she believes that at the agreement date it is reasonable to presume that the fair value of the consideration represents the fair value of the business (or portion of the business) acquired. Ms. Seidman supports the use of a "transaction price presumption" to simplify the accounting for business combinations.

However, after the agreement date, if the value of the consideration changes, goodwill (or a gain on a bargain purchase) attributed to the acquired business could reflect value changes that are related to the acquirer's other activities, not the acquired business. For example, if the acquirer's equity securities are a significant part of the consideration, and the only factor that changes between the agreement date and the acquisition date is that the acquirer's share price declines, the acquirer would record a bargain purchase and recognize a gain, which Ms. Seidman believes is inappropriate.

Ms. Seidman accepts that, regardless of the valuation date selected, goodwill (or a gain on a bargain purchase) is a residual calculation that absorbs the effects of recognition and measurement exceptions made in the standard (such as the accounting for employee benefit plans and deferred taxes). Goodwill (or a gain on a bargain purchase) also absorbs any differences between the entity-specific factors that might have affected the agreed-upon price and the combined exit prices (fair values) of the identifiable assets and liabilities acquired. Because of those practical and necessary decisions, and the issues relating to the use of the acquisition date to value any consideration transferred, Ms. Seidman would not have required that the goodwill calculation include goodwill relating to the noncontrolling interest, that is, the portion that was not acquired. Ms. Seidman believes that the residual amount reported as goodwill will not faithfully represent the fair value of the subsidiary's goodwill; therefore, the incremental informational value of capturing the portion relating to the noncontrolling interest does not outweigh the cost of developing it, especially if the acquired entity is a private company. Ms. Seidman would have preferred an approach that would have:

a. Included a presumption that the agreement-date fair value of the consideration transferred represents the fair value of the transaction as a whole
b. Described goodwill as the residual difference between the fair value of the consideration transferred and the fair value (or other recorded amounts) of the acquirer's interest in the identifiable net assets acquired
c. Not recognized any goodwill relating to the noncontrolling interest.

Ms. Seidman also does not agree with other changes in accounting for transactions involving noncontrolling interests in subsidiaries, which are described in her dissent from FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements.* This Statement on business combinations addresses a narrow aspect of accounting for transactions involving noncontrolling interests—when an entity that has a noncontrolling interest in another entity gains control of that other entity, either in one transaction or in steps. Ms. Seidman disagrees with the requirement in a step acquisition to recognize the effect of remeasuring any previous investment to fair value through earnings because that investment was not part of the exchange. Ms. Seidman agrees that gaining control is a significant economic event that warrants a change from investment accounting to consolidation. However, the previous investment has not been sold. Under current accounting standards, gains and losses on cost method, available-for-sale, and equity method investments are only recognized in earnings when the investment is sold (other than impairment). Ms. Seidman would have recognized the effect of those remeasurements as a separate component of other comprehensive income instead of current-period earnings.

Members of the Financial Accounting Standards Board:

Robert H. Herz,
Chairman
George J. Batavick
G. Michael Crooch
Thomas J. Linsmeier
Leslie F. Seidman
Lawrence W. Smith
Donald M. Young

Appendix A

IMPLEMENTATION GUIDANCE

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Appendix A

IMPLEMENTATION GUIDANCE

This appendix is an integral part of this Statement.

Introduction

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

Identifying a Business Combination (Application of Paragraph 4)

A2. This Statement defines a business combination as a transaction or other event in which an acquirer obtains control of one or more businesses. An acquirer might obtain control of an acquiree in a variety of ways such as:

a. By transferring cash, cash equivalents, or other assets (including net assets that constitute a business)
b. By incurring liabilities
c. By issuing equity interests
d. By providing more than one type of consideration
e. Without transferring consideration, including by contract alone (paragraph 49).

A3. A business combination may be structured in a variety of ways for legal, taxation, or other reasons, which include but are not limited to:

a. One or more businesses become subsidiaries of an acquirer or the net assets of one or more businesses are legally merged into the acquirer.
b. One combining entity transfers its net assets or its owners transfer their equity interests to another combining entity or its owners.
c. All of the combining entities transfer their net assets or the owners of those entities transfer their equity interests to a newly formed entity (sometimes referred to as a roll-up or put-together transaction).
d. A group of former owners of one of the combining entities obtains control of the combined entity.

Definition of a Business (Application of Paragraph 4)

A4. This Statement defines a business as an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs, or other economic benefits directly to investors or other owners, members, or participants. A business consists of inputs and processes applied to those inputs that have the ability to create outputs. Although businesses usually have outputs, outputs are not required for an integrated set to qualify as a business. The three elements of a business are defined as follows:

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

A5. To be capable of being conducted and managed for the purposes defined, an integrated set of activities and assets requires two essential elements—in-

puts and processes applied to those inputs, which together are or will be used to create outputs. However, a business need not include all of the inputs or processes that the seller used in operating that business if market participants are capable of acquiring the business and continuing to produce outputs, for example, by integrating the business with their own inputs and processes. FASB Statement No. 157, *Fair Value Measurements,* describes *market participants* as:

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

A6. The nature of the elements of a business varies by industry and by the structure of an entity's operations (activities), including the entity's stage of development. Established businesses often have many different types of inputs, processes, and outputs, whereas new businesses often have few inputs and processes and sometimes only a single output (product). Nearly all businesses also have liabilities, but a business need not have liabilities.

A7. An integrated set of activities and assets in the development stage might not have outputs. If not, the acquirer should consider other factors to determine whether the set is a business. Those factors include, but are not limited to, whether the set:

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

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

A8. Determining whether a particular set of assets and activities is a business should be based on whether the integrated set is capable of being conducted and managed as a business by a market participant. Thus, in evaluating whether a particular set is a business, it is not relevant whether a seller operated the set as a business or whether the acquirer intends to operate the set as a business.

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

Identifying the Acquirer (Application of Paragraphs 8 and 9)

A10. The guidance in ARB No. 51, *Consolidated Financial Statements,* as amended, shall be used to identify the acquirer—the entity that obtains control of the acquiree. If a business combination has occurred but applying the guidance in ARB 51 does not clearly indicate which of the combining entities is the acquirer, the factors in paragraphs A11–A15 shall be considered in making that determination. However, in a business combination in which a variable interest entity is acquired, the primary beneficiary of that entity always is the acquirer. The determination of which party, if any, is the primary beneficiary of a variable interest entity shall be made in accordance with FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities,* as amended, not by applying either the guidance in ARB 51 or that in paragraphs A11–A15.

A11. In a business combination effected primarily by transferring cash or other assets or by incurring liabilities, the acquirer usually is the entity that transfers the cash or other assets or incurs the liabilities.

A12. In a business combination effected primarily by exchanging equity interests, the acquirer usually is the entity that issues its equity interests. However, in some business combinations, commonly called *reverse acquisitions,* the issuing entity is the acquiree. Paragraphs A108–A129 provide guidance on accounting for reverse acquisitions. Other pertinent facts and circumstances also shall be considered in identifying the acquirer in a business combination effected by exchanging equity interests, including:

a. *The relative voting rights in the combined entity after the business combination*—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.

b. *The existence of a large minority voting interest in the combined entity if no other owner or organized group of owners has a significant voting interest*—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.
c. *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.
d. *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.
e. *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.

A13. The acquirer usually is the combining entity whose relative size (measured in, for example, assets, revenues, or earnings), is significantly larger than that of the other combining entity or entities.

A14. In a business combination involving more than two entities, determining the acquirer shall include a consideration of, among other things, which of the combining entities initiated the combination, as well as the relative size of the combining entities (paragraph A13).

A15. A new entity formed to effect a business combination is not necessarily the acquirer. If a new entity is formed to issue equity interests to effect a business combination, one of the combining entities that existed before the business combination shall be identified as the acquirer by applying the guidance in paragraphs A10–A14. In contrast, a new entity that transfers cash or other assets or incurs liabilities as consideration may be the acquirer.

Recognizing Particular Assets Acquired and Liabilities Assumed (Application of Paragraphs 12–15)

Operating Leases

A16. 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 A17 and A18.

A17. 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.

A18. An identifiable intangible asset may be associated with an operating lease, which may be evidenced by market participants' willingness to pay a price for the lease even if it is at market terms. For example, a lease of gates at an airport or of retail space in a prime shopping area might provide entry into a market or other future economic benefits that qualify as identifiable intangible assets, for example, as a customer relationship. In that situation, the acquirer shall recognize the associated identifiable intangible asset(s) in accordance with paragraph A19.

Recognition of Intangible Assets Separately from Goodwill

A19. The acquirer shall recognize separately from goodwill the identifiable intangible assets acquired in a business combination. An intangible asset is *identifiable* if it meets either the separability criterion or the contractual-legal criterion described in paragraph 3(k).

A20. An intangible asset that meets the contractual-legal criterion is identifiable even if the asset is not transferable or separable from the acquiree or from other rights and obligations. For example:

a. An acquiree leases a manufacturing facility under an operating lease that has terms that are favorable relative to market 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. (See also paragraphs A17 and A18.)

b. An acquiree owns and operates a nuclear power plant. The license to operate that power plant is an intangible asset that meets the contractual-legal criterion for recognition separately from goodwill, even if 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.
c. 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.

A21. The separability criterion means that an acquired intangible asset is capable of being separated or divided from the acquiree and sold, transferred, licensed, rented, or exchanged, either individually or together with a related contract, identifiable asset, or liability. An intangible asset that the acquirer would be able to sell, license, or otherwise exchange for something else of value meets the separability criterion even if the acquirer does not intend to sell, license, or otherwise exchange it. An acquired intangible asset meets the separability criterion if there is evidence of exchange transactions for that type of asset or an asset of a similar type, even if those transactions are infrequent and regardless of whether the acquirer is involved in them. For example, customer and subscriber lists are frequently licensed and thus meet the separability criterion. Even if an acquiree believes its customer lists have characteristics different from other customer lists, the fact that customer lists are frequently licensed generally means that the acquired customer list meets the separability criterion. However, a customer list acquired in a business combination would not meet the separability criterion if the terms of confidentiality or other agreements prohibit an entity from selling, leasing, or otherwise exchanging information about its customers.

A22. An intangible asset that is not individually separable from the acquiree or combined entity meets the separability criterion if it is separable in combination with a related contract, identifiable asset, or liability. For example:

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

Reacquired rights

A23. As part of a business combination, 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. Examples of such rights include 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. A reacquired right is an identifiable intangible asset that the acquirer recognizes separately from goodwill. Paragraph 31 provides guidance on measuring a required right, and paragraph 61 provides guidance on the subsequent accounting for a reacquired right.

A24. If the terms of the contract giving rise to a reacquired right are favorable or unfavorable relative to the terms of current market transactions for the same or similar items, the acquirer shall recognize a settlement gain or loss. Paragraph A79 provides guidance for measuring that settlement gain or loss.

Assembled workforce and other items that are not identifiable

A25. The acquirer subsumes into goodwill the value of an acquired intangible asset that is not identifiable as of the acquisition date. For example, an acquirer may attribute value to the existence of an assembled

workforce, which is an existing collection of employees that permits the acquirer to continue to operate an acquired business from the acquisition date. An assembled workforce does not represent the intellectual capital of the skilled workforce—the (often specialized) knowledge and experience that employees of an acquiree bring to their jobs. Because the assembled workforce is not an identifiable asset to be recognized separately from goodwill, any value attributed to it is subsumed into goodwill.

A26. The acquirer also subsumes into goodwill any value attributed to items that do not qualify as assets at the acquisition date. For example, the acquirer might attribute value to potential contracts the acquiree is negotiating with prospective new customers at the acquisition date. Because those potential contracts are not themselves assets at the acquisition date, the acquirer does not recognize them separately from goodwill. The acquirer should not subsequently reclassify the value of those contracts from goodwill for events that occur after the acquisition date. However, the acquirer should assess the facts and circumstances surrounding events occurring shortly after the acquisition to determine whether a separately recognizable intangible asset existed at the acquisition date.

A27. After initial recognition, an acquirer accounts for intangible assets acquired in a business combination in accordance with the provisions of FASB Statements No. 142, *Goodwill and Other Intangible Assets,* and No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets.* However, as described in paragraph 8 of Statement 142, the accounting for some acquired intangible assets after initial recognition is prescribed by other Statements.

A28. The identifiability criteria determine whether an intangible asset is recognized separately from goodwill. However, the criteria neither provide guidance for measuring the fair value of an intangible asset nor restrict the assumptions used in estimating the fair value of an intangible asset. For example, the acquirer would take into account assumptions that market participants would consider, such as expectations of future contract renewals, in measuring fair value. It is not necessary for the renewals themselves to meet the identifiability criteria. (However, see paragraph 31, which establishes an exception to the fair value measurement principle for reacquired rights recognized in a business combination.) EITF Issue No. 02-7, "Unit of Accounting for Testing Impairment of Indefinite-Lived Intangible Assets," provides guidance for determining whether indefinite-lived intangible assets should be combined into a single unit of account to test for impairment if they are operated as a single asset and essentially are inseparable from one another.

Examples of Intangible Assets That Are Identifiable

A29. The following are examples of identifiable intangible assets acquired in a business combination. Some of the examples may have characteristics of assets other than intangible assets. The acquirer should account for those assets in accordance with their substance. The examples are not intended to be all-inclusive.

A30. Intangible assets designated with the symbol # are those that arise from contractual or other legal rights. Those designated with the symbol * do not arise from contractual or other legal rights but are separable. Intangible assets designated with the symbol # might also be separable, but separability is not a necessary condition for an asset to meet the contractual-legal criterion.

Marketing-related intangible assets

A31. Marketing-related intangible assets are primarily used in the marketing or promotion of products or services. Examples of marketing-related intangible assets are:

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

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

A32. Trademarks are words, names, symbols, or other devices used in trade to indicate the source of a product and to distinguish it from the products of others. A service mark identifies and distinguishes the source of a service rather than a product. Collective marks identify the goods or services of members of a group. Certification marks certify the geographical origin or other characteristics of a good or service.

A33. Trademarks, trade names, service marks, collective marks, and certification marks may be protected legally through registration with governmental agencies, continuous use in commerce, or by other means. If it is protected legally through registration

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

A34. The terms *brand* and *brand name,* often used as synonyms for trademarks and other marks, are general marketing terms that typically refer to a group of complementary assets such as a trademark (or service mark) and its related trade name, formulas, recipes, and technological expertise. This Statement does not preclude an entity from recognizing, as a single asset separately from goodwill, a group of complementary intangible assets commonly referred to as a brand if the assets that make up that group have similar useful lives.

Internet domain names #

A35. An Internet domain name is a unique alphanumeric name that is used to identify a particular numeric Internet address. Registration of a domain name creates an association between that name and a designated computer on the Internet for the period of the registration. Those registrations are renewable. A registered domain name acquired in a business combination meets the contractual-legal criterion.

Customer-related intangible assets

A36. Examples of customer-related intangible assets are:

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

Customer lists *

A37. A customer list consists of information about customers, such as their names and contact information. A customer list also may be in the form of a database that includes other information about the customers, such as their order histories and demographic information. A customer list generally does not arise from contractual or other legal rights. However, customer lists are frequently leased or exchanged. Therefore, a customer list acquired in a business combination normally meets the separability criterion.

Order or production backlog #

A38. An order or production backlog arises from contracts such as purchase or sales orders. An order or production backlog acquired in a business combination meets the contractual-legal criterion even if the purchase or sales orders are cancelable.

Customer contracts and the related customer relationships #

A39. If an entity establishes relationships with its customers through contracts, those customer relationships arise from contractual rights. Therefore, customer contracts and the related customer relationships acquired in a business combination meet the contractual-legal criterion, even if confidentiality or other contractual terms prohibit the sale or transfer of a contract separately from the acquiree.

A40. A customer contract and the related customer relationship may represent two distinct intangible assets. Both the useful lives and the pattern in which the economic benefits of the two assets are consumed may differ.

A41. A customer relationship exists between an entity and its customer if (a) the entity has information about the customer and has regular contact with the customer, and (b) the customer has the ability to make direct contact with the entity. Customer relationships meet the contractual-legal criterion if an entity has a practice of establishing contracts with its customers, regardless of whether a contract exists at the acquisition date. Customer relationships also may arise through means other than contracts, such as through regular contact by sales or service representatives. As noted in paragraph A38, an order or a production backlog arises from contracts such as purchase or sales orders and therefore is considered a contractual right. Consequently, if an entity has relationships with its customers through these types of contracts, the customer relationships also arise from contractual rights and therefore meet the contractual-legal criterion.

Noncontractual customer relationships *

A42. A customer relationship acquired in a business combination that does not arise from a contract may nevertheless be identifiable because the relationship is separable. Exchange transactions for the same asset or a similar asset that indicate that other entities have sold or otherwise transferred a particular type of

noncontractual customer relationship would provide evidence that the noncontractual customer relationship is separable. For example, relationships with depositors are frequently exchanged with the related deposits and therefore meet the criteria for recognition as an intangible asset separately from goodwill.

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

A43. The following examples illustrate the recognition of customer contract and customer relationship intangible assets acquired in a business combination.

a. Acquirer Company (AC) acquires Target Company (TC) in a business combination on December 31, 20X5. TC has a five-year agreement to supply goods to Customer. Both TC and AC believe that Customer will renew the 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 TC establishes its relationship with Customer through a contract, not only the agreement itself but also TC's customer relationship with Customer meet the contractual-legal criterion.
b. AC acquires TC in a business combination on December 31, 20X5. TC manufactures goods in two distinct lines of business: sporting goods and electronics. Customer purchases both sporting goods and electronics from TC. TC has a contract with Customer to be its exclusive provider of sporting goods but has no contract for the supply of electronics to Customer. Both TC and AC believe that only one overall customer relationship exists between TC and Customer. The contract to be Customer's exclusive supplier of sporting goods, whether cancelable or not, meets the contractual-legal criterion. Additionally, because TC establishes its relationship with Customer through a contract, the customer relationship with Customer meets the contractual-legal criterion. Because TC has only one customer relationship with Customer, the fair value of that relationship incorporates assumptions about TC's relationship with Customer related to both sporting goods and electronics. However, if AC determines that the customer relationships with Customer for sporting goods and for electronics are separate from each other, AC would assess whether the customer relationship for electronics meets the separability criterion for identification as an intangible asset.
c. AC acquires TC in a business combination on December 31, 20X5. TC does business with its customers solely through purchase and sales orders. At December 31, 20X5, TC has a backlog of customer purchase orders from 60 percent of its customers, all of whom are recurring customers. The other 40 percent of TC's customers also are recurring customers. However, as of December 31, 20X5, TC 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 TC's customers meet the contractual-legal criterion. Additionally, because TC has established its relationship with 60 percent of its customers through contracts, not only the purchase orders but also TC's customer relationships meet the contractual-legal criterion. Because TC has a practice of establishing contracts with the remaining 40 percent of its customers, its relationship with those customers also arises through contractual rights and therefore meets the contractual-legal criterion even though TC does not have contracts with those customers at December 31, 20X5.
d. AC acquires TC, an insurer, in a business combination on December 31, 20X5. TC has a portfolio of one-year motor insurance contracts that are cancelable by policyholders. Because TC establishes its relationships with policyholders through insurance contracts, the customer relationship with policyholders meets the contractual-legal criterion. Statement 142 applies to the customer relationship intangible asset.

Artistic-related intangible assets

A44. Examples of artistic-related intangible assets are:

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

A45. Artistic-related assets acquired in a business combination are identifiable if they arise from contractual or legal rights such as those provided by copyright. The holder can transfer a copyright, either in whole through an assignment or in part through a

licensing agreement. An acquirer is not precluded from recognizing a copyright intangible asset and any related assignments or license agreements as a single asset, provided they have similar useful lives.

Contract-based intangible assets

A46. Contract-based intangible assets represent the value of rights that arise from contractual arrangements. Customer contracts are one type of contract-based intangible asset. If the terms of a contract give rise to a liability (for example, if the terms of an operating lease or customer contract are unfavorable relative to market terms), the acquirer recognizes it as a liability assumed in the business combination. Examples of contract-based intangible assets are:

a. Licensing, royalty, standstill agreements #
b. Advertising, construction, management, service or supply contracts #
c. Lease agreements (whether the acquiree is the lessee or the lessor) #
d. Construction permits #
e. Franchise agreements #
f. Operating and broadcast rights #
g. Servicing contracts such as mortgage servicing contracts #
h. Employment contracts #
i. Use rights such as drilling, water, air, timber cutting, and route authorities. #

Servicing contracts such as mortgage servicing contracts #

A47. Contracts to service financial assets are one type of contract-based intangible asset. Although servicing is inherent in all financial assets, it becomes a distinct asset (or liability) by one of the following:

a. If the transfer of the servicer's financial assets met the requirements for sale accounting
b. Through the separate acquisition or assumption of a servicing obligation that does not relate to financial assets of the combined entity.

FASB Statement No. 156, *Accounting for Servicing of Financial Assets,* provides guidance on accounting for servicing contracts.

A48. If mortgage loans, credit card receivables, or other financial assets are acquired in a business combination with the servicing obligation, the inherent servicing rights are not a separate intangible asset because the fair value of those servicing rights is included in the measurement of the fair value of the acquired financial asset.

Employment contracts #

A49. Employment contracts that are beneficial contracts from the perspective of the employer because the pricing of those contracts is favorable relative to market terms are one type of contract-based intangible asset.

Use rights #

A50. Use rights such as drilling, water, air, timber cutting, and route authorities are contract-based intangible assets to be accounted for separately from goodwill. Particular use rights may have characteristics of tangible, rather than intangible, assets. For example, mineral rights, defined as the legal right to explore, extract, and retain at least a portion of the benefits from mineral deposits, are tangible assets. An acquirer should account for use rights based on their nature.

Technology-based intangible assets

A51. Examples of technology-based intangible assets are:

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

Computer software and mask works #

A52. Computer software and program formats acquired in a business combination that are protected legally, such as by patent or copyright, meet the contractual-legal criterion for identification as intangible assets.

A53. Mask works are software permanently stored on a read-only memory chip as a series of stencils or integrated circuitry. Mask works may have legal protection. Mask works with legal protection that are acquired in a business combination meet the contractual-legal criterion for identification as intangible assets.

Databases, including title plants *

A54. Databases are collections of information, often stored in electronic form (such as on computer disks or files). A database that includes original works of

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

A55. Title plants constitute a historical record of all matters affecting title to parcels of land in a particular geographical area. Title plant assets are bought and sold, either in whole or in part, in exchange transactions or are licensed. Therefore, title plant assets acquired in a business combination meet the separability criterion.

Trade secrets such as secret formulas, processes, recipes #

A56. A trade secret is "information, including a formula, pattern, recipe, compilation, program, device, method, technique, or process that (1) derives independent economic value, actual or potential, from not being generally known and (2) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy."[1] If the future economic benefits from a trade secret acquired in a business combination are legally protected, that asset meets the contractual-legal criterion. Otherwise, trade secrets acquired in a business combination are identifiable only if the separability criterion is met, which is likely to be the case.

Measuring the Fair Values of Particular Identifiable Assets and a Noncontrolling Interest in an Acquiree (Application of Paragraph 20)

Assets with Uncertain Cash Flows (Valuation Allowances)

A57. The acquirer shall not recognize a separate valuation allowance as of the acquisition date for assets acquired in a business combination that are measured at their acquisition-date fair values because the effects of uncertainty about future cash flows are included in the fair value measure. For example, because this Statement requires the acquirer to measure acquired receivables, including loans, at their acquisition-date fair values, the acquirer does not recognize a separate valuation allowance for the contractual cash flows that are deemed to be uncollectible at that date.

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

A58. The acquirer shall measure the acquisition-date fair value of an asset, such as a building or a patent or other intangible asset, that is subject to an operating lease in which the acquiree is the lessor separately from the lease contract. In other words, the fair value of the asset shall be the same regardless of whether it is subject to an operating lease. In accordance with paragraph A17, the acquirer separately recognizes an asset or a liability if the terms of the lease are favorable or unfavorable relative to market terms.

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

A59. For competitive or other reasons, the acquirer may intend not to use an acquired asset, for example, a research and development intangible asset, or it may intend to use the asset in a way that is not its highest and best use. Nevertheless, the acquirer shall measure the asset at fair value determined in accordance with Statement 157 reflecting its highest and best use in accordance with the appropriate valuation premise, both initially and for purposes of subsequent impairment testing.

Measuring the Fair Value of a Noncontrolling Interest in an Acquiree

A60. This Statement requires the acquirer to measure a noncontrolling interest in the acquiree at its fair value at the acquisition date. An acquirer sometimes will be able to measure the acquisition-date fair value of a noncontrolling interest on the basis of active market prices for the equity shares not held by the acquirer. In other situations, however, an active market price for the equity shares will not be available. In those situations, the acquirer would measure the fair value of the noncontrolling interest using other valuation techniques.

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

A61. The fair values of the acquirer's interest in the acquiree and the noncontrolling interest on a per-share basis might differ. The main difference is likely to be the inclusion of a control premium in the per-share fair value of the acquirer's interest in the acquiree or, conversely, the inclusion of a discount for lack of control (also referred to as a minority interest discount) in the per-share fair value of the noncontrolling interest.

A62–A65. [These paragraphs have been deleted. See Status page.]

Measuring Goodwill or a Gain from a Bargain Purchase

Measuring the Acquisition-Date Fair Value of the Acquirer's Interest in the Acquiree Using Valuation Techniques (Application of Paragraphs 34–38)

A66. In a business combination achieved without the transfer of consideration, the acquirer must substitute the acquisition-date fair value of its interest in the acquiree for the acquisition-date fair value of the consideration transferred to measure goodwill or a gain on a bargain purchase (paragraphs 34–36). The acquirer should measure the acquisition-date fair value of its interest in the acquiree using one or more valuation techniques that are appropriate in the circumstances and for which sufficient data are available. If more than one valuation technique is used, the acquirer should evaluate the results of the techniques, considering the relevance and reliability of the inputs used and the extent of the available data. Statement 157 provides guidance on using valuation techniques to measure fair value.

Special Considerations in Applying the Acquisition Method to Combinations of Mutual Entities (Application of Paragraph 35)

A67. When two mutual entities combine, the fair value of the equity or member interests in the acquiree (or the fair value of the acquiree) may be more reliably measurable than the fair value of the member interests transferred by the acquirer. In that situation, paragraph 35 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. In addition, the acquirer in a combination of mutual entities shall 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.

A68. 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.

A69. 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.

Bargain Purchases (Application of Paragraphs 36–38)

A70. Paragraphs 36–38 set out the required accounting for a bargain purchase. The following example provides additional guidance on bargain purchases and illustrates its application.

Example 2: A business combination in which the consideration transferred for less than 100 percent of the equity interests in the acquiree is less than the fair value received

A71. On January 1, 20X5, AC acquires 80 percent of the equity interests of TC, a private entity, in exchange for cash of $150. Because the former owners of TC needed to dispose of their investments in TC by a specified date, they did not have sufficient time to market TC to multiple potential buyers. The management of AC initially measures the separately recognizable identifiable assets acquired and the liabilities assumed as of the acquisition date in accordance with the requirements of this Statement. The identifiable assets are measured at $250, and the liabilities assumed are measured at $50. AC engages an independent consultant who determines that the fair value

of the 20 percent noncontrolling interest in TC is $42. The amount of TC'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 TC. Therefore, AC 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 TC and the consideration transferred. After that review, AC decides that the procedures and resulting measures were appropriate. AC measures the gain on its purchase of the 80 percent interest as follows:

	$
Identifiable net assets acquired ($250 – $50)	200
Less: Fair value of the consideration transferred for AC's 80 percent interest in TC; plus	150
Fair value of noncontrolling interest in TC	42
	192
Gain on bargain purchase of 80 percent interest	8

A72. AC would record its acquisition of TC in its consolidated financial statements as follows:

Identifiable assets acquired	$250	
Cash		$150
Liabilities assumed		50
Gain on the bargain purchase		8
Equity—noncontrolling interest in TC		42

Measurement Period (Application of Paragraphs 51–56 and 72(a))

A73. If the initial accounting for a business combination is incomplete at the end of the financial reporting period in which the combination occurs, paragraph 51 requires that the acquirer recognize in its financial statements provisional amounts for the items for which the accounting is incomplete. During the measurement period, the acquirer recognizes adjustments to the provisional amounts needed 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. Paragraph 55 requires the acquirer to recognize such adjustments as if the accounting for the business combination had been completed at the acquisition date. Measurement period adjustments are not included in earnings.

Example 3: Appraisal That Is Incomplete at the Reporting Date

A74. AC acquires TC on September 30, 20X7. AC seeks an independent appraisal for an item of property, plant, and equipment acquired in the combination, and the appraisal was not complete by the time AC issued its financial statements for the year ending December 31, 20X7. In its 20X7 annual financial statements, AC recognized a provisional fair value for the asset of $30,000. At the acquisition date, the item of property, plant, and equipment had a remaining useful life of five years. Five months after the acquisition date, AC received the independent appraisal, which estimated the asset's acquisition-date fair value as $40,000.

A75. In its financial statements for the year ending December 31, 20X8, AC retrospectively adjusts the 20X7 prior-year information as follows:

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

A76. In accordance with paragraph 72(a), AC discloses:

a. In its 20X7 financial statements, that the initial accounting for the business combination has not been completed because the appraisal of property, plant, and equipment has not yet been received.
b. In its 20X8 financial statements, the amounts and explanations of the adjustments to the provisional values recognized during the current reporting period. Therefore, AC discloses that the 20X7 comparative information is retrospectively adjusted to increase the fair value of the item of property, plant, and equipment at the acquisition date by $9,500, offset by a decrease to goodwill of $10,000 and an increase in depreciation expense of $500.

Determining What Is Part of the Business Combination Transaction (Application of Paragraphs 57 and 58)

A77. The acquirer should consider the following factors, which are neither mutually exclusive nor individually conclusive, to determine whether a transaction is part of the exchange for the acquiree or whether the transaction is separate from the business combination:

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

Effective Settlement of a Preexisting Relationship between the Acquirer and Acquiree in a Business Combination (Application of Paragraph 58(a))

A78. The acquirer and acquiree may have a relationship that existed before they contemplated the business combination, referred to here as a *preexisting relationship.* A preexisting relationship between the acquirer and acquiree may be contractual (for example, vendor and customer or licensor and licensee) or noncontractual (for example, plaintiff and defendant).

A79. If the business combination in effect settles a preexisting relationship, the acquirer recognizes a gain or loss, measured as follows:

a. For a preexisting noncontractual relationship (such as a lawsuit), fair value
b. For a preexisting contractual relationship, the lesser of:
   (1) The amount by which the contract is favorable or unfavorable from the perspective of the acquirer when compared with pricing for current market transactions for the same or similar items. (An *unfavorable contract* is a contract that is unfavorable in terms of current market terms. It is not necessarily a loss contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.
   (2) The amount of any stated settlement provisions in the contract available to the counterparty to whom the contract is unfavorable.

   If (2) is less than (1), the difference is included as part of the business combination accounting.

A80. Examples 4 and 5 illustrate the accounting for the effective settlement of a preexisting relationship as a result of a business combination. As indicated in Example 5, the amount of gain or loss recognized may depend in part on whether the acquirer had previously recognized a related asset or liability, and the reported gain or loss therefore may differ from the amount calculated by applying paragraph A79.

A81. A preexisting relationship may be a contract that the acquirer recognizes as a reacquired right in accordance with paragraph A23. If the contract includes terms that are favorable or unfavorable when compared with pricing for current market transactions for the same or similar items, the acquirer recognizes, separately from the business combination, a gain or loss for the effective settlement of the contract, measured in accordance with paragraph A79.

Example 4: Effective settlement of a supply contract as a result of a business combination

A82. AC purchases electronic components from TC under a five-year supply contract at fixed rates. Currently, the fixed rates are higher than rates at which AC could purchase similar electronic components from another supplier. The supply contract allows AC to terminate the contract before the end of the initial 5-year term only by paying a $6 million penalty. With 3 years remaining under the supply contract, AC pays $50 million to acquire TC, which is the fair value of TC based on what other market participants would be willing to pay.

A83. Included in the total fair value of TC is $8 million related to the fair value of the supply contract with AC. The $8 million represents a $3 million component that is "at-market" because the pricing is comparable to pricing for current market transactions for the same or similar items (selling effort, customer relationships, and so forth) and a $5 million component for pricing that is unfavorable to AC because it exceeds the price of current market transactions for similar items. TC has no other identifiable assets or liabilities related to the supply contract, and AC has not recognized any assets or liabilities related to the supply contract before the business combination.

A84. In this example, AC recognizes a loss of $5 million (the lesser of the $6 million stated settlement amount and the amount by which the contract is unfavorable to the acquirer) separately from the business combination. The $3 million at-market component of the contract is part of goodwill.

Example 5: Effective settlement of a contract between the acquirer and acquiree in which the acquirer had recognized a liability before the business combination

A85. Whether AC had previously recognized an amount in its financial statements related to a preexisting relationship will affect the amount recognized as a gain or loss for the effective settlement of the relationship. In Example 4, GAAP might have required AC to recognize a $6 million liability for the supply contract before the business combination. In that situation, AC recognizes a $1 million settlement gain on the contract in earnings at the acquisition date (the $5 million measured loss on the contract less the $6 million loss previously recognized). In other words, AC has in effect settled a recognized liability of $6 million for $5 million, resulting in a gain of $1 million.

Arrangements for Contingent Payments to Employees or Selling Shareholders (Application of Paragraph 58(b))

A86. Whether arrangements for contingent payments to employees or selling shareholders are contingent consideration in the business combination or are separate transactions depends on the nature of the arrangements. Understanding the reasons why the acquisition agreement includes a provision for contingent payments, who initiated the arrangement, and when the parties entered into the arrangement may be helpful in assessing the nature of the arrangement.

A87. If it is not clear whether an arrangement for payments to employees or selling shareholders is part of the exchange for the acquiree or is a transaction separate from the business combination, the acquirer should consider the following indicators:

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

b. *Duration of continuing employment*—If the period of required employment coincides with or is longer than the contingent payment period, that fact may indicate that the contingent payments are, in substance, compensation.
c. *Level of compensation*—Situations in which employee compensation other than the contingent payments is at a reasonable level in comparison to that of other key employees in the combined entity may indicate that the contingent payments are additional consideration rather than compensation.
d. *Incremental payments to employees*—If selling shareholders who do not become employees receive lower contingent payments on a per-share basis than the selling shareholders who become employees of the combined entity, that fact may indicate that the incremental amount of contingent payments to the selling shareholders who become employees is compensation.
e. *Number of shares owned*—The relative number of shares owned by the selling shareholders who remain as key employees may be an indicator of the substance of the contingent consideration arrangement. For example, if the selling shareholders who owned substantially all of the shares in the acquiree continue as key employees, that fact may indicate that the arrangement is, in substance, a profit-sharing arrangement intended to provide compensation for postcombination services. Alternatively, if selling shareholders who continue as key employees owned only a small number of shares of the acquiree and all selling shareholders receive the same amount of contingent consideration on a per-share basis, that fact may indicate that the contingent payments are additional consideration. The preacquisition ownership interests held by parties related to selling shareholders who continue as key employees, such as family members, also should be considered.
f. *Linkage to the valuation*—If the initial consideration transferred at the acquisition date is based on the low end of a range established in the valuation of the acquiree and the contingent formula relates to that valuation approach, that fact may suggest that the contingent payments are additional consideration. Alternatively, if the contingent payment formula is consistent with prior profit-sharing arrangements, that fact may suggest that the substance of the arrangement is to provide compensation.
g. *Formula for determining consideration*—The formula used to determine the contingent payment may be helpful in assessing the substance of the arrangement. For example, if a contingent payment is determined on the basis of a multiple of earnings, that might suggest that the obligation is contingent consideration in the business combination and that the formula is intended to establish or verify the fair value of the acquiree. In contrast, a contingent payment that is a specified percentage of earnings might suggest that the obligation to employees is a profit-sharing arrangement to compensate employees for services rendered.
h. *Other agreements and issues*—The terms of other arrangements with selling shareholders (such as noncompete agreements, executory contracts, consulting contracts, and property lease agreements) and the income tax treatment of contingent payments may indicate that contingent payments are attributable to something other than consideration for the acquiree. For example, in connection with the acquisition, the acquirer might enter into a property lease arrangement with a significant selling shareholder. If the lease payments specified in the lease contract are significantly below market, some or all of the contingent payments to the lessor (the selling shareholder) required by a separate arrangement for contingent payments might be, in substance, payments for the use of the leased property that the acquirer should recognize separately in its postcombination financial statements. In contrast, if the lease contract specifies lease payments that are consistent with market terms for the leased property, the arrangement for contingent payments to the selling shareholder may be contingent consideration in the business combination.

Example 6: Arrangement for contingent payment to an employee

A88. TC hired a candidate as its new CEO under a 10-year contract. The contract required TC to pay the candidate $5 million if TC is acquired before the contract expires. AC acquires TC eight years later. The CEO was still employed at the acquisition date and will receive the additional payment under the existing contract.

A89. In this example, TC entered into the employment agreement before the negotiations of the combination began, and the purpose of the agreement was to obtain the services of CEO. Thus, there is no evidence that the agreement was arranged primarily

to provide benefits to AC or the combined entity. Therefore, the liability to pay $5 million is included in the application of the acquisition method.

A90. In other circumstances, TC might enter into a similar agreement with CEO at the suggestion of AC during the negotiations for the business combination. If so, the primary purpose of the agreement might be to provide severance pay to CEO, and the agreement may primarily benefit AC or the combined entity rather than TC or its former owners. In that situation, AC accounts for the liability to pay CEO in its postcombination financial statements separately from application of the acquisition method.

Acquirer Share-Based Payment Awards Exchanged for Awards Held by the Employees of the Acquiree (Application of Paragraphs 43–46)

A91. If the acquirer is obligated to replace the acquiree's share-based payment awards, paragraph 43 of this Statement requires the acquirer to include either all or a portion of the fair-value-based measure of the replacement awards in the consideration transferred in the business combination. Paragraphs A92–A106 provide additional guidance on and illustrate how to determine the portion of an award to include in consideration transferred in a business combination and the portion to recognize as compensation cost in the acquirer's postcombination financial statements.

A92. To determine the portion of a replacement award that is part of the consideration exchanged for the acquiree and the portion that is compensation for postcombination service, the acquirer first measures both the replacement awards and the acquiree awards as of the acquisition date in accordance with the requirements of FASB Statement No. 123 (revised 2004), *Share-Based Payment*. In most situations, those requirements result in use of the fair-value-based measurement method, but Statement 123(R) permits use of the calculated value method or the intrinsic value method in specified circumstances. This discussion focuses on the fair-value-based method, but the guidance in paragraphs 43–46 and A93–A106 also apply in situations in which Statement 123(R) permits use of either the calculated value method or the intrinsic value method for both the acquiree awards and the replacement awards.

A93. The portion of the replacement award attributable to precombination service is the fair-value-based measure of the acquiree award multiplied by the ratio of the precombination service period to the greater of the total service period or the original service period of the acquiree award. (Examples 9 and 10 below illustrate that calculation.) The total service period is the sum of (a) the part of the requisite service period for the acquiree award that was completed before the acquisition date and (b) the postcombination requisite service period, if any, for the replacement award. The requisite service period includes explicit, implicit, and derived service periods during which employees are required to provide service in exchange for the award (consistent with the requirements of Statement 123(R)).

A94. The portion of a nonvested replacement award attributable to postcombination service, and therefore recognized as compensation cost in the postcombination financial statements, equals the total fair-value-based measure of the replacement award less the amount attributed to precombination service. Therefore, the acquirer attributes any excess of the fair-value-based measure of the replacement award over the fair value of the acquiree award to postcombination service and recognizes that excess as compensation cost in the postcombination financial statements.

A95. The portion of a nonvested replacement award attributable to precombination service, as well as the portion attributable to postcombination service, shall reflect the acquirer's estimate of the number of replacement awards for which the requisite service is expected to be rendered. For example, if the fair-value-based measure of the portion of a replacement award attributed to precombination service is $100 and the acquirer expects that the requisite service will be rendered for only 95 percent of the instruments awarded, the amount included in consideration transferred in the business combination is $95. Changes in the number of replacement awards for which the requisite service is expected to be rendered are reflected in compensation cost for the periods in which the changes or forfeitures occur—not as adjustments to the consideration transferred in the business combination. Similarly, the effects of other events, such as modifications or the ultimate outcome of awards with performance conditions, that occur after the acquisition date are accounted for in accordance with Statement 123(R) in determining compensation cost for the period in which an event occurs. If the replacement award has a graded vesting schedule, the acquirer shall recognize the related compensation cost in accordance with its policy election for other awards with graded vesting in accordance with paragraph 42 of Statement 123(R).

A96. The same requirements for determining the portions of a replacement award attributable to precombination and postcombination service apply regardless of whether a replacement award is classified as a liability or an equity instrument in accordance with the provisions of Statement 123(R). All changes in the fair-value-based measure of awards classified as liabilities after the acquisition date and the related income tax effects are recognized in the acquirer's postcombination financial statements in the period(s) in which the changes occur.

Accounting for the income tax effects of replacement awards classified as equity issued in a nontaxable business combination

A97. 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.

A98. After the acquisition date, the deduction reported on a tax return for a replacement award classified as equity may exceed the fair-value-based measure of the award. In that situation, the acquirer shall recognize any resulting realized tax benefit that exceeds the previously recognized deferred tax asset for that award related to pre- and postcombination service (the excess tax benefit) as additional paid-in capital. That accounting treatment is consistent with the accounting required by Statement 123(R) for an excess tax benefit for a share-based payment award classified as equity that is granted outside of a business combination. The accounting if the amount deductible on the acquirer's tax return is less than the fair-value-based measure of the award also is the same as that prescribed by Statement 123(R) for other awards. The write-off of a deferred tax asset related to that deficiency, net of any related valuation allowance, shall first be offset to the extent of any remaining additional paid-in capital from excess tax benefits from previous share-based payment awards. The remaining balance, if any, of the write-off of a deferred tax asset related to a tax deficiency shall be recognized in earnings.

A99. 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. A future event, such as an employee's disqualifying disposition of shares under a tax law, may give rise to a tax deduction for instruments that ordinarily do not result in a tax deduction. The tax effects of such an event shall be recognized only when it occurs.

A100. The following examples illustrate the application of paragraphs A91–A99 to replacement awards that the acquirer was obligated to issue. The examples assume that all awards are classified as equity. The examples also assume that the awards have only an explicit service period. As discussed in paragraph A93, the acquirer also must take any implicit or derived service periods into account in determining the requisite service period for a replacement award.

Example 7: Acquirer replacement awards that require no postcombination services exchanged for acquiree awards for which employees have rendered the required services as of the acquisition date

A101. AC issues replacement awards of $110 (fair-value-based measure) at the acquisition date for TC awards of $100 (fair-value-based measure) at the acquisition date. No postcombination services are required for the replacement awards, and TC's employees had rendered all of the required service for the acquiree awards as of the acquisition date.

A102. The amount attributable to precombination service is the fair-value-based measure of TC'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, AC immediately recognizes $10 as compensation cost in its postcombination financial statements.

Example 8: Acquirer replacement awards that require postcombination services exchanged for acquiree awards for which employees have rendered the requisite service as of the acquisition date

A103. AC exchanges replacement awards that require one year of postcombination service for share-based payment awards of TC 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, TC's awards had a requisite service period of four years. As of the acquisition date, the TC employees holding unexercised awards had rendered a total of seven years of service since the grant date. Even though TC employees had already rendered all of the requisite service, AC attributes a portion of the replacement award to postcombination compensation cost in accordance with paragraph 46 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 AC's postcombination financial statements in accordance with Statement 123(R).

Example 9: Acquirer replacement awards that require postcombination services exchanged for acquiree awards for which employees have not rendered all of the requisite service as of the acquisition date

A104. AC exchanges replacement awards that require one year of postcombination service for share-based payment awards of TC for which employees had not yet rendered all of the required services as of the acquisition date. The fair-value-based measure of both awards is $100 at the acquisition date. When originally granted, the awards of TC had a requisite service period of four years. As of the acquisition date, the TC employees had rendered 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 the TC awards is attributable to precombination service.

A105. 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 TC's award (4 years). Thus, $50 ($100 × 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 AC's postcombination financial statements.

Example 10: Acquirer replacement awards for which no postcombination services are required exchanged for acquiree awards for which employees have not rendered all of the requisite service as of the acquisition date

A106. Assume the same facts as in Example 9 above, except that AC exchanges replacement awards that require no postcombination service for share-based payment awards of TC for which employees had not yet rendered all of the requisite service as of the acquisition date. The terms of the replaced TC awards did not eliminate any remaining requisite service period upon a change in control. (If the TC awards had included a provision that eliminated any remaining requisite service period upon a change in control, the guidance in Example 7 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 TC's award (4 years). Thus, $50 ($100 × 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, AC recognizes the entire $50 immediately as compensation cost in the postcombination financial statements.

Illustration of Disclosure Requirements (Application of Paragraphs 67–73)

A107. The following example illustrates some of the disclosure requirements of this Statement; it is not based on an actual transaction. The example assumes that AC is a public entity and that TC is a private entity. The illustration presents the disclosures in a tabular format that refers to the specific disclosure requirements illustrated. An actual footnote might present many of the disclosures illustrated in a simple narrative format.

Footnote X: Acquisitions

Paragraph Reference	
68(a)–68(d)	On June 30, 20X0, AC acquired 15 percent of the outstanding common shares of TC. On June 30, 20X2, AC acquired 60 percent of the outstanding common shares of TC. TC is a provider of data networking products and services in Canada and Mexico. As a result of the acquisition, AC is expected to be the leading provider of data networking products and services in those markets. It also expects to reduce costs through economies of scale.
68(e), 68(l)	The goodwill of $2,500 arising from the acquisition consists largely of the synergies and economies of scale expected from combining the operations of AC and TC. All of the goodwill was assigned to AC's network segment.
68(k)	None of the goodwill recognized is expected to be deductible for income tax purposes.
	The following table summarizes the consideration paid for TC and the amounts of the assets acquired and liabilities assumed recognized at the acquisition date, as well as the fair value at the acquisition date of the noncontrolling interest in TC.

At June 30, 20X2

		$
68(f)	**Consideration**	
68(f)(1)	Cash	5,000
68(f)(4)	Equity instruments (100,000 common shares of AC)	4,000
68(f)(3), 68(g)(1)	Contingent consideration arrangement	1,000
	Fair value of total consideration transferred	10,000
68(q)(1)	**Fair value of AC's equity interest in TC held before the business combination**	2,000
		12,000
68(m), 68(n)	**Acquisition-related costs** (included in selling, general, and administrative expenses in AC's income statement for the year ending December 31, 20X2)	1,250
68(i)	**Recognized amounts of identifiable assets acquired and liabilities assumed**	
	Financial assets	3,500
	Inventory	1,000
	Property, plant, and equipment	10,000
	Identifiable intangible assets	3,300
	Financial liabilities	(4,000)
	Liability arising from a contingency	(1,000)
	Total identifiable net assets	12,800
68(p)(1)	**Noncontrolling interest in TC**	(3,300)
	Goodwill	2,500
		12,000

68(f)(4) The fair value of the 100,000 common shares issued as part of the consideration paid for TC ($4,000) was determined on the basis of the closing market price of AC's common shares on the acquisition date.

68(f)(3), 68(g), 72(b) The contingent consideration arrangement requires AC to pay the former owners of TC 5 percent of the revenues of XC, an unconsolidated equity investment owned by TC, in excess of $7,500 for 20X3, up to a maximum amount of $2,500 (undiscounted). The potential undiscounted amount of all future payments that AC could be required to make under the contingent consideration arrangement is between $0 and $2,500. The fair value of the contingent consideration arrangement of $1,000 was estimated by applying the income approach. That measure is based on significant inputs that are not observable in the market, which Statement 157 refers to as Level 3 inputs. Key assumptions include (a) a discount rate range of 20 percent to 25 percent and (b) a probability adjusted level of revenues in XC between $10,000 and $20,000. As of December 31, 20X2, the amount recognized for the contingent consideration arrangement, the range of outcomes, and the assumptions used to develop the estimates had not changed.

68(h) The fair value of the financial assets acquired includes receivables under capital leases of data networking equipment with a fair value of $2,000. The gross amount due under the contracts is $3,100, of which $450 is expected to be uncollectible.

72(a) The fair value of the acquired identifiable intangible assets of $3,300 is provisional pending receipt of the final valuations for those assets.

68(j) A liability of $1,000 has been recognized at fair value for expected warranty claims on products sold by TC during the last 3 years. AC expects that the majority of this expenditure will be incurred in 20X3 and that all will be incurred by the end of 20X4.

68(p) The fair value of the noncontrolling interest in TC, a private company, was estimated by applying the income approach and a market approach. This fair value measurement is based on significant inputs that are not observable in the market and thus represents a Level 3 measurement as defined in Statement 157. Key assumptions include (a) a discount rate range of 20 percent to 25 percent, (b) a terminal value based on a range of terminal EBITDA multiples between 3 and 5 (or, if appropriate, based on long-term sustainable growth rates ranging between 3 percent and 6 percent), (c) financial multiples of companies deemed to be similar to TC, and (d) adjustments because of the lack of control or lack of marketability that market participants would consider when estimating the fair value of the noncontrolling interest in TC.

68(q)(2) AC recognized a gain of $500 as a result of remeasuring to fair value its 15 percent equity interest in TC held before the business combination. The gain is included in other income in AC's income statement for the year ending December 31, 20X2.

68(r) The amounts of TC's revenue and earnings included in AC's consolidated income statement for the year ended December 31, 20X2, and the revenue and earnings of the combined entity had the acquisition date been January 1, 20X2, or January 1, 20X1, are:

		Revenue	Earnings
68(r)(1)	Actual from 6/30/20X2–12/31/20X2	$4,090	$1,710
68(r)(2)	Supplemental pro forma from 1/1/20X2–12/31/20X2	$27,670	$12,870
68(r)(3)	Supplemental pro forma for 1/1/20X1–12/31/20X1	$26,985	$12,325

Reverse Acquisitions (Application of Paragraph A12)

A108. A *reverse acquisition* occurs when the entity that issues securities (the legal acquirer) is identified as the acquiree for accounting purposes based on the guidance in paragraphs A10–A15. 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. For example, reverse acquisitions sometimes occur when a private operating entity wants to become a public entity but does not want to register its equity shares. To accomplish that, 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 example, 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 A10–A15 results in identifying:

a. The public entity as the **acquiree** for accounting purposes (the accounting acquiree)
b. The private entity as the **acquirer** for accounting purposes (the accounting acquirer).

The accounting acquiree must meet the definition of a business for the transaction to be accounted for as a reverse acquisition, and all of the recognition and measurement principles in this Statement, including

the requirement to recognize goodwill, apply. Paragraphs A109–A129 provide guidance on and illustrate how to apply the acquisition method to a reverse acquisition.

Measuring the Consideration Transferred

A109. In a reverse acquisition, the accounting acquirer usually issues no consideration for the acquiree. Instead, the accounting acquiree usually issues its equity shares to the owners of the accounting acquirer. Accordingly, the acquisition-date fair value of the consideration transferred by the accounting acquirer for its interest in the accounting acquiree is based on the number of equity interests the legal subsidiary 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. Paragraph A120 illustrates that calculation. The fair value of the number of equity interests calculated in that way can be used as the fair value of consideration transferred in exchange for the acquiree.

Preparation and Presentation of Consolidated Financial Statements

A110. Consolidated financial statements prepared following a reverse acquisition are issued under the name of the legal parent (accounting acquiree) but described in the notes as a continuation of the financial statements of the legal subsidiary (accounting acquirer), with one adjustment, which is to retroactively adjust the accounting acquirer's legal capital to reflect the legal capital of the accounting acquiree. That adjustment is required to reflect the capital of the legal parent (the accounting acquiree). Comparative information presented in those consolidated financial statements also is retroactively adjusted to reflect the legal capital of the legal parent (accounting acquiree).

A111. Because the consolidated financial statements represent the continuation of the financial statements of the legal subsidiary except for its capital structure, the consolidated financial statements reflect:

a. The assets and liabilities of the legal subsidiary (the accounting acquirer) recognized and measured at their precombination carrying amounts.
b. The assets and liabilities of the legal parent (the accounting acquiree) recognized and measured in accordance with this Statement.
c. The retained earnings and other equity balances of the legal subsidiary (accounting acquirer) **before** the business combination.
d. The amount recognized as issued equity interests in the consolidated financial statements determined by adding the issued equity interest of the legal subsidiary (the accounting acquirer) outstanding immediately before the business combination to the fair value of the legal parent (accounting acquiree) determined in accordance with this Statement. However, the equity structure (that is, the number and type of equity interests issued) reflects the equity structure of the legal parent (the accounting acquiree), including the equity interests the legal parent issued to effect the combination. Accordingly, the equity structure of the legal subsidiary (the accounting acquirer) is restated using the exchange ratio established in the acquisition agreement to reflect the number of shares of the legal parent (the accounting acquiree) issued in the reverse acquisition.
e. The noncontrolling interest's proportionate share of the legal subsidiary's (accounting acquirer's) precombination carrying amounts of retained earnings and other equity interests as discussed in paragraphs A112 and A113 and illustrated in paragraphs A126–A129.

Noncontrolling Interest

A112. In a reverse acquisition, some of the owners of the legal acquiree (the accounting acquirer) might not exchange their equity interests for equity interests of the legal parent (the accounting acquiree). Those owners are treated as a noncontrolling interest in the consolidated financial statements after the reverse acquisition. That is because the owners of the legal acquiree that do not exchange their equity interests for equity interests of the legal acquirer have an interest in only the results and net assets of the legal acquiree—not in the results and net assets of the combined entity. Conversely, even though the legal acquirer is the acquiree for accounting purposes, the owners of the legal acquirer have an interest in the results and net assets of the combined entity.

A113. The assets and liabilities of the legal acquiree are measured and recognized in the consolidated financial statements at their precombination carrying amounts (paragraph A111(a)). Therefore, in a reverse acquisition the noncontrolling interest reflects the noncontrolling shareholders' proportionate interest in the precombination carrying amounts of the legal acquiree's net assets even though the noncontrolling interests in other acquisitions are measured at their fair values at the acquisition date.

Earnings per Share

A114. As noted in paragraph A111(d), the equity structure in the consolidated financial statements following a reverse acquisition reflects the equity structure of the legal acquirer (the accounting acquiree), including the equity interests issued by the legal acquirer to effect the business combination.

A115. In calculating the weighted-average number of common shares outstanding (the denominator of the earnings-per-share calculation) during the period in which the reverse acquisition occurs:

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

b. The number of common shares outstanding from the acquisition date to the end of that period shall be the actual number of common shares of the legal acquirer (the accounting acquiree) outstanding during that period.

A116. The basic earnings per share for each comparative period before the acquisition date presented in the consolidated financial statements following a reverse acquisition shall be calculated by dividing:

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

Example 11: Reverse Acquisition

A117. This example illustrates the accounting for a reverse acquisition in which Entity B, the legal subsidiary, acquires Entity A, the entity issuing equity instruments and therefore the legal parent, on September 30, 20X6. This example ignores the accounting for any income tax effects.

A118. The statements of financial position of Entity A and Entity B immediately before the business combination are:

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

A119. This example also uses the following information:

a. 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.
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.
c. The fair values of Entity A's identifiable assets and liabilities at September 30, 20X6, are the same as their carrying amounts, except that the fair value of Entity A's noncurrent assets at September 30, 20X6, is $1,500.

Calculating the fair value of the consideration transferred

A120. 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 example, 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.

Measuring goodwill

A121. Goodwill is measured as the excess of the fair value of the consideration effectively transferred (the group's interest in Entity A) over the net amount of Entity A's recognized identifiable assets and liabilities, as follows:

	$	$
Consideration effectively transferred		1,600
Net recognized values of Entity A's identifiable assets and liabilities		
Current assets	500	
Noncurrent assets	1,500	
Current liabilities	(300)	
Noncurrent liabilities	(400)	(1,300)
Goodwill		300

Consolidated statement of financial position at September 30, 20X6

A122. The consolidated statement of financial position immediately after the business combination is:

	$
Current assets ($700 + $500)	1,200
Noncurrent assets ($3,000 + $1,500)	4,500
Goodwill	300
Total assets	6,000
Current liabilities ($600 + $300)	900
Noncurrent liabilities ($1,100 + $400)	1,500
Total liabilities	2,400
Shareholders' equity	
Retained earnings	1,400
Issued equity	
250 common shares ($600 + $1,600)	2,200
Total shareholders' equity	3,600
Total liabilities and shareholders' equity	6,000

A123. In accordance with paragraphs A111(c) and A111(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 A109 ($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.

Earnings per share

A124. Entity B's earnings for the annual period ending December 31, 20X5, was $600, and the consolidated earnings for the annual period ending December 31, 20X6, is $800. There was no change in the number of common shares issued by Entity B during the annual period ending December 31, 20X5, and during the period from January 1, 20X6, to the date of the reverse acquisition on September 30, 20X6. Earnings per share for the annual period ended December 31, 20X6, is calculated as follows:

Number of shares deemed to be outstanding for the period from January 1, 20X6, to the acquisition date (that is, the number of common shares issued by Entity A (legal parent, accounting acquiree) in the reverse acquisition)	150
Number of shares outstanding from the acquisition date to December 31, 20X6	250
Weighted-average number of common shares outstanding ([150 × 9 ÷ 12] + [250 × 3 ÷ 12])	175
Earnings per share (800 ÷ 175)	$4.57

A125. Restated earnings per share 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).

Noncontrolling interest

A126. Assume the same facts as above, except that only 56 of Entity B's 60 common shares are exchanged. Because Entity A issues 2.5 shares in exchange for each common share of Entity B, Entity A issues only 140 (rather than 150) shares. As a result, Entity B's shareholders own 58.3 percent of the issued shares of the combined entity (140 of 240 issued shares). The fair value of the consideration transferred for Entity A, the accounting acquiree, is calculated by assuming that the combination had been effected by Entity B's issuing additional common shares to the shareholders of Entity A in exchange for their common shares in Entity A. That is because Entity B is the accounting acquirer, and paragraphs 39 and 40 require the acquirer to measure the consideration exchanged for the accounting acquiree. In calculating the number of shares that Entity B would have had to issue, the noncontrolling interest is ignored. The majority shareholders own 56 shares of Entity B. For that to represent a 58.3 percent equity interest, Entity B would have had to issue an additional 40 shares. The majority shareholders would then own 56 of the 96 issued shares of Entity B and, therefore, 58.3 percent of the combined entity. As a result, the fair value of the consideration transferred for Entity A, the accounting acquiree, is $1,600 (that is, 40 shares each with a fair value of $40). That is the same amount as when all 60 of Entity B's shareholders tender all 60 of its common shares for exchange. The recognized amount of the group's interest in Entity A, the accounting acquiree, does not change if some of Entity B's shareholders do not participate in the exchange.

A127. The noncontrolling interest is represented by the 4 shares of the total 60 shares of Entity B that are not exchanged for shares of Entity A. Therefore, the noncontrolling interest is 6.7 percent. The noncontrolling interest reflects the noncontrolling shareholders' proportionate interests in the precombination carrying amounts of the net assets of Entity B, the legal subsidiary. Therefore, the consolidated statement of financial position is adjusted to show a noncontrolling interest of 6.7 percent of the precombination carrying amounts of Entity B's net assets (that is, $134 or 6.7 percent of $2,000).

A128. The consolidated statement of financial position at September 30, 20X6, reflecting the noncontrolling interest is as follows:

	$
Current assets ($700 + $500)	1,200
Noncurrent assets ($3,000 + $1,500)	4,500
Goodwill	300
Total assets	6,000
Current liabilities ($600 + $300)	900
Noncurrent liabilities ($1,100 + $400)	1,500
Total liabilities	2,400
Shareholders' equity	
Retained earnings ($1,400 × 93.3%)	1,306
Issued equity	
240 common shares ($560 + $1,600)	2,160
Noncontrolling interest	134
Total shareholders' equity	3,600
Total liabilities and shareholders' equity	6,000

A129. The noncontrolling interest of $134 has 2 components. The first component is the reclassification of the noncontrolling interest's share of the accounting acquirer's retained earnings immediately before the acquisition ($1,400 × 6.7% or $93.80). The second component represents the reclassification of the noncontrolling interest's share of the accounting acquirer's issued equity ($600 × 6.7% or $40.20).

Transition for Mutual Entities (Application of Paragraph 76)

A130. Mutual entities were not required to adopt FASB Statement No. 141, *Business Combinations,* or FASB Statement No. 147, *Acquisitions of Certain Financial Institutions,* until the Board issued interpretative guidance for applying the purchase method to those transactions. This Statement provides that interpretative guidance. Before the effective date of this Statement, mutual entities accounted for business combinations as follows:

a. Combinations between mutual entities were accounted for using APB Opinion No. 16, *Business Combinations,* using either the purchase method or the pooling- of-interests method.
b. Combinations between mutual entities that are financial institutions were accounted for using FASB Statement No. 72, *Accounting for Certain Acquisitions of Banking or Thrift Institutions,* using the purchase method. Statement 72 used the term *financial institution* to mean all or part of a commercial bank, a savings and loan association, a credit union, or other depository institution having assets and liabilities of the same types as those institutions.

A131. Statements 141 and 147 provided the transition provisions for an entity that had a business combination accounted for using the purchase method in accordance with Opinion 16 or Statement 72. Accordingly, upon adoption of this Statement, a mutual entity that had a business combination accounted for using the purchase method needs to apply transition provisions similar to those that were in Statement 141 or Statement 147. The following paragraphs provide those transition provisions.

Transition for Mutual Entities That Had Purchase Business Combinations Accounted for in Accordance with Opinion 16 or Statement 72

A132. Upon adoption of this Statement, a mutual entity that had a purchase business combination accounted for in accordance with Opinion 16 or Statement 72 shall apply the following transition provisions for goodwill and intangible assets acquired in that business combination:

a. The entity shall reclassify to goodwill (*reclassified goodwill*) amounts that do not meet the criteria in paragraph 3(k) of this Statement for recognition separately from goodwill. Therefore, the entity shall reclassify to goodwill:
   (1) The carrying amount of acquired intangible assets that do not meet the criteria in paragraph 3(k) of this Statement for recognition separately from goodwill.
   (2) The carrying amount of *unidentifiable intangible assets* that do not meet the criteria in paragraph 3(k) of this Statement for recognition separately from goodwill. Statement 72 described *unidentifiable intangible assets* as the amount by which the fair value of the liabilities assumed exceeds the fair value of tangible and identified intangible assets acquired.
   (3) Any deferred tax liabilities related to the intangible assets or unidentifiable intangible assets also shall be reclassified to goodwill if the amortization of the intangible assets or the unidentifiable intangible assets is not deductible for tax purposes.
b. The entity shall reclassify to intangible assets the carrying amount of any intangible asset that:
   (1) Meets the definition of identifiable in paragraph 3(k) of this Statement
   (2) Has been recognized but reported on the face of the statement of financial position in goodwill (or as goodwill and intangible assets) or as unidentifiable intangible assets; and
   (3) Has been separately accounted for (that is, separate accounting records have been maintained). An entity would be deemed to have maintained separate accounting records if there is a separate general ledger account or other subsidiary ledger (such as a spreadsheet or similar ledger account) to which periodic amortization charges, impairment charges, and other accounting entries were posted. An entity shall not "carve out" from goodwill any intangible assets that had not been identified and measured at fair value (as defined or described in Statement 141 or Opinion 16) in the initial recording of the business combination and subsequently accounted for separately from goodwill.
c. The entity shall write off and recognize in earnings the amount of any unamortized deferred credit related to an excess over cost arising from either a business combination accounted for before applying this Statement or an investment accounted for by the equity method before applying this Statement.

A133. A mutual entity must apply Statement 142 in its entirety for goodwill and intangible assets acquired in a business combination as of the beginning of the first annual reporting period beginning on or after December 15, 2008. Therefore, it should follow the transitional goodwill impairment testing guidance in Statement 142 for previously recognized goodwill, as adjusted in accordance with paragraph A132. Additionally, the provisions of Statement 144 apply to long-term customer-relationship intangible assets, except for servicing assets, recognized in the acquisition of a financial institution. Examples of long-term customer-relationship intangible assets include depositor- and borrower-relationship intangible assets, credit cardholder intangible assets, and servicing assets. Servicing assets, however, are accounted for in accordance with FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities,* as amended.

A134. Other than as set forth in paragraphs A132 and A133, the amount of the purchase price assigned to the assets acquired and liabilities assumed in a business combination for which the acquisition date was before this Statement is applied shall not be changed. However, this paragraph does not affect the requirement to change the amounts assigned to the assets acquired in a business combination for which the acquisition date was before this Statement is applied because of (a) the resolution of a consideration contingency based on earnings (paragraph 28 of Statement 141) or (b) changes to the purchase price allocation before the end of the allocation period (paragraph 40 of Statement 141).

Appendix B

BASIS FOR CONCLUSIONS

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Appendix B

BASIS FOR CONCLUSIONS

Introduction

B1. This basis for conclusions summarizes the FASB's and the IASB's (the Boards') considerations in reaching the conclusions in this Statement. It includes the reasons why each Board accepted particular approaches and rejected others. Individual Board members gave greater weight to some factors than to others.

B2. This Statement carries forward without reconsideration the primary conclusions each Board reached in FASB Statement No. 141 and IFRS 3, both of which were titled *Business Combinations.* The conclusions carried forward include, among others, the requirement to apply the *purchase method* (which this Statement refers to as the *acquisition method*) to account for all business combinations and the identifiability criteria for recognizing an intangible asset separately from goodwill. This appendix includes the reasons for those conclusions, as well as the reasons for the conclusions the Boards reached in their joint deliberations that led to this revised version of Statement 141 and IFRS 3. Because the provisions of this Statement on applying the acquisition method represent a more extensive change to Statement 141 than to IFRS 3, this appendix includes more discussion of the FASB's than of the IASB's conclusions in the second phase of their respective business combinations projects.

B3. In discussing the Boards' consideration of comments on Exposure Drafts, this appendix refers to the Exposure Draft that preceded Statement 141 as the *1999 Exposure Draft* and to the one that preceded IFRS 3 as *ED 3;* it refers to the joint Exposure Draft that preceded this revised Statement as the *2005 Exposure Draft.* Other Exposure Drafts issued by each

Board in developing Statement 141 or IFRS 3 are explained in the context of the issues they addressed. As used in this appendix, *this Statement* and *this IFRS* refer to the revised versions of Statement 141 and IFRS 3; references to Statement 141 and to IFRS 3 are to the original versions of those standards.

B4. The FASB and the IASB concurrently deliberated the issues in the second phase of the project and reached the same conclusions on most of them. Appendix G describes the substantive differences that remain; the most significant difference is measurement of a noncontrolling interest in an acquiree (paragraphs B205–B221). In addition, the application of some provisions of this Statement on which the Boards reached the same conclusions may differ because of differences in:

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

Definition of a Business Combination

B5. The FASB's 1999 Exposure Draft proposed that a *business combination* be defined as occurring when one entity acquires net assets that constitute a business or acquires equity interests in one or more other entities and thereby obtains control over that entity or entities. Many respondents who commented on the proposed definition said that it would exclude certain transactions covered by APB Opinion No. 16, *Business Combinations,* in particular, transactions in which none of the former shareholder groups of the combining entities obtained control over the combined entity (such as roll-ups, put-togethers, and so-called mergers of equals). During its redeliberations of the 1999 Exposure Draft, the FASB concluded that those transactions should be included in the definition of a business combination and in the scope of Statement 141. Therefore, paragraph 10 of Statement 141 indicated that it also applied to business combinations in which none of the owners of the combining entities as a group retain or receive a majority of the voting rights of the combined entity. However, the FASB acknowledged at that time that some of those business combinations might not be acquisitions and said that it intended to consider in another project whether business combinations that are not acquisitions should be accounted for using the fresh-start method rather than the purchase method.

B6. IFRS 3, issued in March 2004, defined a business combination as "the bringing together of separate entities or businesses into one reporting entity." In developing IFRS 3, the IASB considered adopting the definition of a business combination in Statement 141. It did not do so because that definition excluded some forms of combinations encompassed in IAS 22, *Business Combinations* (which IFRS 3 replaced), such as those described in paragraph B5 in which none of the former shareholder groups of the combining entities obtained control over the combined entity. Accordingly, IFRS 3 essentially retained the definition of a business combination from IAS 22.

B7. The definition of a business combination was an item of divergence between Statement 141 and IFRS 3. In addition, the definition in Statement 141 excluded combinations in which control is obtained by means other than acquiring net assets or equity interests. An objective of the second phase of the FASB's project leading to this Statement was to reconsider whether the accounting for a change in control resulting in the acquisition of a business should differ because of the way in which control is obtained.

B8. The FASB considered several alternatives for improving the definition of a business combination, including adopting the definition of a business combination in IFRS 3. That definition would encompass all transactions or other events that are in the scope of this Statement. The FASB concluded, however, that the definition of a business combination in IFRS 3 was too broad for its purposes because it would allow for the inclusion in a business combination of one or more businesses that the acquirer does not control.

B9. Because it considers all changes of control in which an entity acquires a business to be economically similar transactions or events, the FASB decided to expand the definition of a business combination to include all transactions or other events in

which an entity obtains control of a business. Application of the expanded definition will improve the consistency of accounting guidance and the relevance, completeness, and comparability of the resulting information about the assets, liabilities, and activities of an acquired business.

B10. The IASB also reconsidered the definition of a business combination. The result was that the IASB and the FASB adopted the same definition. The IASB observed that the IFRS 3 definition could be read to include circumstances in which there may be no triggering economic event or transaction and thus no change in an economic entity, per se. For example, under the IFRS 3 definition, an individual's decision to prepare combined financial statements for all or some of the entities that he or she controls could qualify as a business combination. The IASB concluded that a business combination should be described in terms of an economic event rather than in terms of consolidation accounting and that the definition in this Statement and the revised IFRS 3 satisfies that condition.

B11. The IASB also observed that, although the IFRS 3 definition of a business combination was sufficiently broad to include them, formations of joint ventures were excluded from the scope of IFRS 3. Because joint ventures also are excluded from the scope of the revised IFRS 3, the revised definition of a business combination is intended to include all of the types of transactions and other events initially included in the scope of IFRS 3.

B12. Some respondents to the 2005 Exposure Draft who consider particular combinations of businesses to be "true mergers" said that the definition of a business combination as a transaction or other event in which an acquirer obtains control of one or more businesses seemed to exclude true mergers. The Boards concluded that the most straightforward way of indicating that the scope of this Statement, and the definition of a business combination, is intended to include true mergers, if any occur, is simply to state that fact, which paragraph 3(e) does.

B13. Some respondents to the 2005 Exposure Draft also said that it was not clear that the definition of a business combination, and thus the scope of this Statement, includes reverse acquisitions and perhaps other combinations of businesses. The Boards observed that in a reverse acquisition, one entity—the one whose equity interests are acquired—obtains economic (although not legal) control over the other and therefore is the acquirer, as indicated in paragraph A12. Therefore, the Boards concluded that it is unnecessary to state explicitly that reverse acquisitions are included in the definition of a business combination and thus in the scope of this Statement and the revised IFRS 3.

Change in Terminology

B14. As defined in this Statement, a business combination could occur in the absence of a purchase transaction. Accordingly, the Boards decided to replace the term *purchase method,* which was previously used to describe the method of accounting for business combinations that this Statement requires, with the term *acquisition method.* To avoid confusion, this appendix uses that term throughout, including when referring to Statement 141 and IFRS 3 (and earlier Exposure Drafts or other documents) that used the term *purchase method.*

Definition of a Business

B15. The definition of a business combination in this Statement provides that a transaction or other event is a business combination only if the assets acquired and liabilities assumed constitute a business (an acquiree), and paragraph 3(d) defines a *business.*

B16. Statement 141 did not include a definition of a business. Instead, it referred to EITF Issue No. 98-3, "Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business," for guidance on whether a group of net assets constitutes a business. Some constituents said that particular aspects of the definition and the related guidance in Issue 98-3 were both unnecessarily restrictive and open to misinterpretation. They suggested that the FASB reconsider that definition and guidance as part of this phase of the project, and it agreed to do so. In addition to considering how its definition and guidance might be improved, the FASB, in conjunction with the IASB, decided that the Boards should strive to develop a joint definition of a business.

B17. Before issuing IFRS 3, the IASB did not have a definition of a business or guidance similar to that in Issue 98-3. Consistent with the suggestions of respondents to ED 3, the IASB decided to provide a definition of a business in IFRS 3. In developing that definition, the IASB also considered the guidance in Issue 98-3. However, the definition in IFRS 3 benefited from deliberations in this project to that date,

and it differed from Issue 98-3 in some aspects. For example, the definition in IFRS 3 did not include either of the following factors, both of which were in Issue 98-3:

a. A requirement that a business be self-sustaining
b. A presumption that a transferred set of activities and assets in the development stage that has not commenced planned principal operations cannot be a business.

B18. In the second phase of their business combinations projects, both Boards considered the suitability of their existing definitions of a business in an attempt to develop an improved, common definition. To address the perceived deficiencies and misinterpretations, the Boards modified their respective definitions of a business and clarified the related guidance. The more significant modifications, and the reasons for them, are to:

a. Continue to exclude self-sustaining as the definition in IFRS 3 did, and instead provide that the integrated set of activities and assets must be **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. Focusing on the capability to achieve the purposes of the business helps avoid the overly restrictive interpretations that existed in accordance with the former guidance.
b. Clarify the meanings of the terms *inputs, processes,* and *outputs* that were used in both Issue 98-3 and IFRS 3. Clarifying the meanings of those key terms, together with other modifications, helps eliminate the need for extensive detailed guidance and the misinterpretations that sometimes stem from such guidance.
c. Clarify that inputs and processes applied to those inputs are essential and that although the resulting outputs normally are present, they need not be present. Therefore, an integrated set of assets and activities could qualify as a business if the integrated set is capable of being conducted and managed to produce the resulting outputs. Together with item (a), clarifying that outputs need not be present for an integrated set to be a business helps avoid the overly restrictive interpretations of the guidance in Issue 98-3.
d. Clarify that a business need not include all of the inputs or processes that the seller used in operating that business if a market participant is capable of continuing to produce outputs, for example, by integrating the business with its own inputs and processes. This clarification also helps avoid the need for extensive detailed guidance and assessments about whether a missing input or process is minor.
e. Continue to exclude a presumption that an integrated set in the development stage is not a business merely because it has not yet commenced its planned principal operations, as IFRS 3 did. Eliminating that presumption is consistent with focusing on assessing the capability to achieve the purposes of the business (item (a)) and helps avoid the overly restrictive interpretations that existed with the former guidance.

B19. The Boards also considered whether to include in this Statement a presumption similar to the one in Issue 98-3 that an asset group is a business if goodwill is present. Some members of the FASB's resource group suggested that that presumption results in circular logic that is not especially useful guidance in practice. Although the Boards had some sympathy with those views, they noted that such a presumption could be useful in avoiding interpretations of the definition of a business that would hinder the stated intent of applying this Statement's guidance to economically similar transactions. The presumption also might simplify the assessment of whether a particular set of activities and assets meets the definition of a business. Therefore, this Statement's implementation guidance retains that presumption.

B20. The Boards considered whether to expand the scope of this Statement to all acquisitions of groups of assets. They noted that doing so would avoid the need to distinguish between those groups that are businesses and those that are not. However, both Boards noted that broadening the scope of this Statement beyond acquisitions of businesses would require further research and deliberation of additional issues and delay the implementation of this Statement's improvements to practice. The Boards therefore did not extend the scope of this Statement to acquisitions of all asset groups. Paragraphs D2–D7 describe the typical accounting for an asset acquisition.

B21. This Statement amends FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities,* to clarify that the initial consolidation of a variable interest entity that is a *business* is a business combination. Therefore, the assets, liabilities, and noncontrolling interests of the

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

Method of Accounting for Business Combinations

B22. Both Opinion 16 and IAS 22 permitted use of either the acquisition method or the pooling of interests (pooling) method of accounting for a business combination, although the two methods were not intended as alternatives for the same set of facts and circumstances. The 1999 Exposure Draft and ED 3 proposed, and Statement 141 and IFRS 3 required, use of the acquisition method to account for all business combinations. The Boards did not redeliberate that conclusion during the project that led to this Statement.

B23. In developing Statement 141 and IFRS 3, the FASB and the IASB considered three possible methods of accounting for business combinations—the pooling method, the acquisition method, and the fresh-start method. In assessing those methods, both Boards were mindful of the disadvantages of having more than one method of accounting for business combinations, as evidenced by the experience with Opinion 16 and IAS 22. The Boards concluded that having more than one method could be justified only if the alternative method (or methods) could be demonstrated to produce information that is more decision useful and if unambiguous and nonarbitrary boundaries could be established that unequivocally distinguish when one method is to be applied instead of another. The Boards also concluded that most business combinations are acquisitions and, for the reasons discussed in paragraphs B24–B28, that the acquisition method is the appropriate method for those business combinations. Respondents to the 1999 Exposure Draft and ED 3 generally agreed. Therefore, neither the pooling method nor the fresh-start method could be appropriately used for all business combinations.

Reasons for Adopting the Acquisition Method

B24. Both Boards concluded that the acquisition method is the appropriate method of accounting for all business combinations in which one entity obtains control of one or more other businesses because that method is consistent with how the accounting model generally accounts for transactions in which assets are acquired and liabilities are assumed or incurred. Therefore, it produces information that is comparable to other accounting information.

B25. The acquisition method views a combination from the perspective of the acquirer—the entity that obtains control of the other combining business(es). The acquirer purchases or otherwise obtains control over net assets and recognizes in its financial statements the assets acquired and liabilities assumed, including those not previously recognized by the acquiree. Consequently, users of financial statements are better able to assess the initial investments made and the subsequent performance of those investments and compare them with the performance of other entities. In addition, by initially recognizing almost all of the assets acquired and liabilities assumed at their fair values, the acquisition method includes in the financial statements more information about the market's expectation of the value of the future cash flows associated with those assets and liabilities, which enhances the relevance of that information.

B26. Most of the respondents to ED 3 supported the proposal to eliminate the pooling method and to require all business combinations to be accounted for by applying the acquisition method, pending the IASB's future consideration of whether the fresh-start method might be applied to some combinations. Respondents to the 1999 Exposure Draft generally agreed that most business combinations are acquisitions, and many said that all combinations involving only two entities are acquisitions. Respondents also agreed that the acquisition method is the appropriate

method of accounting for business combinations in which one of the combining entities obtains control over the other combining entities. However, some qualified their support for the acquisition method contingent upon the FASB's decisions about some aspects of applying that method, particularly the accounting for goodwill.

B27. The Boards concluded that most business combinations, both two-party transactions and those involving three or more entities (multiparty combinations) are acquisitions. The Boards acknowledged that some multiparty combinations (in particular, those that are commonly referred to as roll-up or put-together transactions) might not be acquisitions; however, they noted that the acquisition method has generally been used to account for them. The Boards decided not to change that practice at this time. Consequently, this Statement requires the acquisition method to be used to account for all business combinations, including those that some might not consider acquisitions.

B28. Both Boards considered assertions that exceptions to the acquisition method should be provided for circumstances in which identifying the acquirer is difficult. Respondents taking that view generally said that the pooling method would provide better information in those circumstances. Although acknowledging that identifying the acquirer sometimes may be difficult, the Boards concluded that it would be practicable to identify an acquirer in all business combinations. Moreover, the FASB observed that an acquirer must be identified for federal income tax purposes, regardless of how difficult it may be to do so. Both Boards also concluded that in no circumstances does the pooling method provide better information than the acquisition method.

Reasons for Rejecting the Pooling Method

Mergers and acquisitions are similar economically

B29. Some observers, including some respondents to the 1999 Exposure Draft and to ED 3, argued that business combinations in which the predominant form of consideration is equity interests, generally referred to as *mergers,* are different from acquisitions and should be accounted for differently. They said that the pooling method is appropriate for a merger because ownership interests are continued (either completely or substantially), no new capital is invested and no assets are distributed, postcombination ownership interests are proportional to those before the combination, and the intention is to unite commercial strategies. Those respondents said that a merger should be accounted for in terms of the carrying amounts of the assets and liabilities of the combining entities because, unlike acquisitions in which only the acquirer survives the combination, all of the combining entities effectively survive a merger.

B30. Most respondents who favored retaining the pooling method also supported limiting its application. Many of those respondents suggested limiting use of the pooling method to "true mergers" or "mergers of equals," which they described as combinations of entities of approximately equal size or those in which it is difficult to identify an acquirer.

B31. The Boards also considered the assertion that the pooling method properly portrays true mergers as a transaction between the owners of the combining entities rather than between the combining entities. The Boards rejected that assertion, noting that business combinations are initiated by, and take place because of, a transaction between the combining entities themselves. The entities—not their owners—engage in the negotiations necessary to carry out the combination, although the owners must eventually participate in and approve the transaction.

B32. Many respondents agreed with the Boards that although ownership interests are continued in a combination effected by an exchange of equity instruments, those interests **change** as a result of the combination. The former owners of each entity no longer have an exclusive interest in the net assets of the precombination entities. Rather, after the business combination, the owners of the combining entities have a residual interest in the net assets of the combined entity. The information provided by the pooling method fails to reflect that and therefore is not representationally faithful.

B33. Both Boards observed that all business combinations entail some bringing together of commercial strategies. Accordingly, the intention to unite commercial strategies is not unique to mergers and does not support applying a different accounting method to some combinations than that applied to others.

B34. Some respondents said that mergers are virtually identical to acquisitions economically, making them in-substance acquisitions. Some noted that shares could have been issued for cash and that cash then used to effect the combination, with the result being the same economically as if shares had been used to effect the combination.

B35. Both Boards concluded that "true mergers" or "mergers of equals" in which none of the combining entities obtain control of the others are so rare as to be virtually nonexistent, and many respondents agreed. Other respondents stated that even if a true merger or merger of equals did occur, it would be so rare that a separate accounting treatment is not warranted. The Boards also observed that respondents and other constituents were unable to suggest an unambiguous and nonarbitrary boundary for distinguishing true mergers or mergers of equals from other business combinations and concluded that developing such an operational boundary would not be feasible. Moreover, even if those mergers could feasibly be distinguished from other combinations, both Boards noted that it does not follow that mergers should be accounted for on a carry-over basis. If they were to be accounted for using a method other than the acquisition method, the fresh-start method would be better than the pooling method.

Information provided is not decision useful

B36. Some proponents of the pooling method argued that it provides decision-useful information for the business combinations for which they favor its use. They said that the information is more representationally faithful than the information that the acquisition method would provide for those combinations. However, other respondents said that the information provided by the acquisition method is more revealing than that provided by the pooling method. Respondents also noted that the pooling method does not hold management accountable for the investment made and the subsequent performance of that investment. In contrast, the accountability that results from applying the acquisition method forces management to examine business combination deals carefully to see that they make sense economically.

B37. Both Boards observed that an important part of decision-useful information is information about cash-generating abilities and cash flows generated. The IASB's *Framework for the Preparation and Presentation of Financial Statements* (the *Framework*) says that "The economic decisions that are taken by users of financial statements require an evaluation of the ability of an entity to generate cash and cash equivalents and of the timing and certainty of their generation" (paragraph 15). FASB Concepts Statement No. 1, *Objectives of Financial Reporting by Business Enterprises,* indicates that ". . . financial reporting should provide information to help investors, creditors, and others assess the amounts, timing, and uncertainty of prospective net cash inflows to the related enterprise" (paragraph 37; footnote reference omitted). Neither the cash-generating abilities of the combined entity nor its future cash flows generally are affected by the method used to account for the combination. However, fair values reflect the expected cash flows associated with acquired assets and assumed liabilities. Because the pooling method records the net assets acquired at their carrying amounts rather than at their fair values, the information that the pooling method provides about the cash-generating abilities of those net assets is less useful than that provided by the acquisition method.

B38. Both Boards also concluded that the information provided by the pooling method is less relevant because it has less predictive value and feedback value than the information that is provided by other methods. It also is less complete because it does not reflect assets acquired or liabilities assumed that were not included in the precombination financial statements of the combining entities. The pooling method also provides a less faithful representation of the combined entity's performance in periods after the combination. For example, by recording assets and liabilities at the carrying amounts of predecessor entities, postcombination revenues may be overstated (and expenses understated) as the result of embedded gains that were generated by predecessor entities but not recognized by them.

B39. FASB Concepts Statement No. 2, *Qualitative Characteristics of Accounting Information,* and the *Framework* describe comparability as an important characteristic of decision-useful information. Use of different accounting methods for the same set of facts and circumstances makes the resulting information less comparable and thus less useful for making economic decisions. As discussed in paragraphs B29–B35, the Boards concluded that all business combinations are economically similar. Accordingly, use of the same method to account for all combinations enhances the comparability of the resulting financial reporting information. Both Boards observed that the acquisition method, but not the pooling method, could reasonably be applied to all two-party business combinations.

B40. Opponents of the pooling method generally said that eliminating that method would enhance the comparability of financial statements of entities that grow by means of acquisitions. Both Boards agreed.

Inconsistent with historical-cost accounting model

B41. Both Boards observed that the pooling method is an exception to the general concept that exchange transactions are accounted for in terms of the fair values of the items exchanged. Because the pooling method records the combination in terms of the precombination carrying amounts of the parties to the transaction, it fails to record and thus to hold management accountable for the investment made in the combination.

B42. Some respondents to the FASB's 1999 Exposure Draft who advocated use of the pooling method asserted that it is consistent with the historical-cost model and that eliminating the pooling method would be a step toward adopting a fair-value model. They argued that before eliminating the pooling method, the FASB should resolve the broad issue of whether to adopt a fair-value model in place of the historical-cost model. The FASB disagreed, noting that, regardless of the merits of a fair-value model, the pooling method is an aberration that is inconsistent with the historical-cost model.

B43. Although the historical-cost model is frequently described as being "transaction based," the fair-value model also records all transactions. In both models, transactions are recognized on the basis of the fair values exchanged at the transaction date. In contrast, the pooling method does not result in recognizing in the records of the combined entity the values exchanged; instead, only the carrying amounts of the predecessor entities are recognized. Failure to record those values can adversely affect the relevance and reliability of the combined entity's financial statements for years—and even decades—to come. For those reasons, both Boards concluded that the pooling method is inconsistent with the historical-cost model. Requiring use of the acquisition method is not a step toward adopting a fair-value accounting model. Rather, it eliminates an exception to the historical-cost model and requires accounting for assets acquired and liabilities assumed in a business combination consistently with other acquisitions of assets and incurrences of liabilities.

Disclosure not an adequate response

B44. In urging that the pooling method be retained, a few respondents to the 1999 Exposure Draft said that any perceived problems with having two methods of accounting could be addressed by enhanced disclosures in the notes to the financial statements. However, they generally did not specify what those disclosures should be and how they would help overcome the comparability problems that inevitably result from having two methods.

B45. The FASB considered whether enhanced disclosures might compensate for the deficiencies of the pooling method but doubted the usefulness of almost any disclosures short of disclosing what the results would have been had the acquisition method been used to account for the business combination. Providing disclosures that would enable users of financial statements to determine what the results would have been had the transaction been accounted for by the acquisition method would be a costly solution that begs the question of why the acquisition method was not used to account for the transaction in the first place. Thus, the FASB rejected enhanced disclosures as a viable alternative.

Not cost beneficial

B46. Some of the Boards' constituents cited cost-benefit considerations as a reason for retaining the pooling method. They argued that the pooling method is a quicker and less expensive way to account for a business combination because it does not require an entity to hire outside appraisers to value assets for accounting purposes.

B47. Other constituents favored eliminating the pooling method for cost-benefit reasons. Some argued that the pooling method causes preparers of financial statements, auditors, regulators, and others to spend unproductive time dealing with the detailed criteria required by Opinion 16 in attempts to qualify some business combinations for the pooling method. Others noted that using the acquisition method of accounting for all business combinations would eliminate the enormous amount of interpretive guidance necessary to accommodate the pooling method. They also said that the benefits derived from making the acquisition method the only method of accounting for business combinations would significantly outweigh any issues that might arise from accounting for the very rare true merger or merger of equals by the acquisition method.

B48. Both Boards concluded that requiring a single method of accounting is preferable because having more than one method would lead to higher costs associated with applying, auditing, enforcing, and analyzing the information produced by the different methods. The FASB's conclusions on benefits and costs are more fully discussed in paragraphs B437–B444.

Perceived economic consequences not a valid reason for retention

B49. Some of the respondents to the 1999 Exposure Draft and ED 3 who favored retaining the pooling method cited public policy considerations or other perceived economic consequences of eliminating it. Some argued that eliminating the pooling method would require some investors to adjust to different measures of performance, potentially affecting market valuations adversely in some industries during the transition period. Others argued that it would impede desirable consolidation in some industries, reduce the amount of capital flowing into those industries, slow the development of new technology, and adversely affect entrepreneurial culture. Some argued that eliminating the pooling method would reduce the options available to some regulatory agencies and possibly require regulated entities to maintain a second set of accounting records.

B50. Other respondents did not share those views. Some said that because business combinations are (or should be) driven by economic rather than accounting considerations, economically sound deals would be completed regardless of the method used to account for them. Others noted that the financial community values business combinations in terms of their fair values rather than book values; therefore, those transactions should initially be recognized in the financial statements at fair value.

B51. Both Boards have long held that accounting standards should be neutral; they should not be slanted to favor one set of economic interests over another. Neutrality is the absence of bias intended to attain a predetermined result or to induce a particular behavior. Neutrality is an essential aspect of decision-useful financial information because biased financial reporting information cannot faithfully represent economic phenomena. The consequences of a new financial reporting standard may indeed be negative for some interests in either the short or long term. But the dissemination of unreliable and potentially misleading information is, in the long run, harmful for all interests.

B52. Both Boards rejected the view that the pooling method should be retained because eliminating it could have adverse consequences for some economic interests. Accounting requirements for business combinations should seek neither to encourage nor to discourage business combinations. Instead, those standards should produce unbiased information about those combinations that is useful to investors, creditors, and others in making economic decisions about the combined entity.

Acquisition method flaws remedied

B53. Some respondents to the 1999 Exposure Draft or to ED 3 supported retaining the pooling method because of perceived problems associated with the acquisition method. Most of those comments focused on the effects of goodwill amortization.

B54. Both Boards concluded that the pooling method is so fundamentally flawed that it does not warrant retention, regardless of perceived problems with the acquisition method. The Boards also observed that the most frequently cited concern is remedied by the requirement of FASB Statement No. 142, *Goodwill and Other Intangible Assets,* and IAS 36, *Impairment of Assets,* to test goodwill for impairment and recognize a loss if it is impaired rather than to amortize goodwill.

The Fresh-Start Method

B55. In the fresh-start method, none of the combining entities are viewed as having survived the combination as an independent reporting entity. Rather, the combination is viewed as the transfer of the net assets of the combining entities to a new entity that assumes control over them. The history of that new entity, by definition, begins with the combination.

B56. In the first part of their respective business combinations projects, both the FASB and the IASB acknowledged that a case could be made for using the fresh-start method to account for the relatively rare business combination that does not clearly qualify as an acquisition. Such a combination might be defined either as one in which an acquirer cannot be identified or as one in which the acquirer is substantially modified by the transaction. However, the Boards both observed that those transactions have been accounted for by the acquisition method, and they decided not to change that practice.

B57. Neither the FASB nor the IASB currently has on its agenda a project to consider the fresh-start method. However, both Boards have expressed interest in considering whether joint venture formations and some formations of new entities in multiparty business combinations should be accounted for by the fresh-start method. Depending on the relative priorities of that topic and other topics competing for

their agendas when time becomes available, the Boards might undertake a joint project to consider those issues at some future date.

Scope

B58. This Statement excludes from its scope some transactions that also were excluded from the scope of both Statement 141 and IFRS 3. However, this Statement includes in its scope combinations involving only mutual entities and combinations achieved by contract alone, which were excluded from the scope of Statement 141 and IFRS 3. Paragraphs B59–B79 discuss the Boards' reasons for those conclusions.

Joint Ventures and Combinations between Entities under Common Control

B59. Formations of joint ventures and combinations of entities under common control are excluded from the scope of this Statement. Those transactions also were excluded from the scope of both Statement 141 and IFRS 3, and the Boards continue to believe that issues related to such combinations are appropriately excluded from the scope of this project. The Boards are aware of nothing that has happened since Statement 141 and IFRS 3 were issued to suggest that the issuance of this Statement should be delayed to address the accounting for those events.

B60. In developing IFRS 3, the IASB considered whether it should amend the definition of joint control in IAS 31, *Interests in Joint Ventures,* because it was concerned that its decision to eliminate the pooling method would create incentives for business combinations to be structured to meet the definition of a joint venture. After considering comments on the definition proposed in ED 3, the IASB revised the definition of joint control in IAS 31 to clarify that:

a. Unanimous consent on **all** financial and operating decisions is not necessary for an arrangement to satisfy the definition of a joint venture—unanimous consent on only strategic decisions is sufficient.
b. In the absence of a contractual agreement requiring unanimous consent to strategic financial and operating decisions, a transaction in which the owners of multiple businesses agree to combine their businesses into a new entity (sometimes referred to as a roll-up transaction) should be accounted for by the acquisition method. Majority consent on such decisions is not sufficient.

B61. In developing Statement 141, the FASB noted that constituents consider the guidance in paragraph 3(d) of APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock,* in assessing whether an entity is a joint venture, and it decided not to change that practice in its project on business combinations.

Not-for-Profit Organizations

B62. The FASB also decided to exclude from the scope of this Statement business combinations between not-for-profit organizations and acquisitions of for-profit businesses by not-for-profit organizations. Some aspects of combinations involving not-for-profit organizations are different from combinations involving business entities. For example, it cannot be presumed that combinations involving organizations that serve a public interest are necessarily exchange transactions in which willing parties exchange equal values. For that reason, the FASB is addressing the accounting for combinations involving not-for-profit organizations in a separate project. It issued an Exposure Draft in October 2006 that addresses accounting for combinations involving not-for-profit organizations.

B63. IFRSs generally do not have scope limitations for not-for-profit activities in the private or public sector. Although IFRSs are developed for profit-oriented entities, a not-for-profit entity might be required, or choose, to apply IFRSs. A scope exclusion for combinations involving not-for-profit organizations is not necessary.

Combinations of Mutual Entities

B64. During its deliberations leading to Statement 141, the FASB concluded that combinations involving only mutual entities also should be accounted for using the acquisition method but decided not to mandate its use until the FASB considered implementation questions raised about the application of that method. Similarly, IFRS 3 did not require use of the acquisition method for combinations between mutual entities, although the IASB also had concluded that the acquisition method was appropriate for those combinations. Instead, as part of the first phase of its business combinations project, the IASB published an Exposure Draft of Proposed Amendments to IFRS 3, *Combinations by Contract Alone or Involving Mutual Entities,* which proposed an interim approach for accounting for those combinations until the IASB considered related implementation issues

in the second phase of its project. In light of respondents' comments, the IASB decided not to proceed with the proposals in the Exposure Draft, primarily for reasons of timing and impending consideration of those issues in the second phase of this project.

B65. After Statement 141 was issued, the FASB began a joint project with the Canadian Accounting Standards Board (AcSB). The objective of that project was to develop guidance for combinations between two or more mutual entities. In October 2001, the FASB and the AcSB held a roundtable discussion with representatives of mutual banks, credit unions, cooperatives, and other mutual entities. In January 2004, the FASB met with representatives of organizations of cooperative and other mutual entities to discuss its tentative conclusions and specific concerns raised by constituents. In addition, the FASB conducted field visits with three mutual entities in 2004.

B66. A few participants in those meetings indicated a preference for the fresh-start method as an alternative to the acquisition method for particular mergers, especially for those in which it is difficult to identify the acquirer. On both occasions, however, those participants acknowledged the costs and practical difficulties that a fresh-start alternative would impose, especially on entities with recurring combinations. After considering those views, the FASB concluded that any potential advantages of using the fresh-start method for some combinations between mutual entities would be outweighed by the disadvantages of having two methods of accounting.

B67. During the deliberations leading to the 2005 Exposure Draft, some representatives of mutual entities reiterated concerns expressed during the development of Statement 141 about requiring all combinations of mutual entities to be accounted for using the acquisition method. Many of those constituents reiterated public policy concerns similar to those discussed in paragraphs B49–B52. For example, some said that eliminating the pooling method could impede desirable combinations and reduce the amount of capital flowing into their industries. They suggested, for example, that the requirement to identify an acquirer could impede mergers of neighboring mutual entities when both the fact and appearance of a merger of equals are of paramount importance to their directors, members, and communities. The Boards did not find those arguments persuasive for the same reasons discussed in paragraphs B49–B52.

B68. Although mutual entities have particular characteristics that distinguish them from other business entities, the Boards noted that the two types of entities also have many common characteristics. The Boards also observed that the economic motivations for combinations between mutual entities, such as to provide their constituents with a broader range of, or access to, services and cost savings through economies of scale, are similar to those for combinations between other business entities. For example:

a. Although mutual entities generally do not have shareholders in the traditional sense of investor-owners, they are in effect "owned" by their members and are in business to serve their members or other stakeholders. Like other businesses, mutual entities strive to provide their members with a financial return or benefits. A mutual entity generally does that by focusing on providing its members with its products and services at lower prices. For example, the benefit provided by a credit union may be a lower interest rate on a borrowing than might be obtainable through an investor-owned financial institution. In a wholesale buying co-operative, the benefit might be lower net costs, after reflecting patronage dividends.
b. Members' interests in a mutual entity generally are not transferable like other ownership interests. However, they usually include a right to share in the net assets of the mutual entity in the event of its liquidation or conversion to another form of entity.
c. A higher percentage of combinations among mutual entities than of combinations among other business entities occur without an exchange of cash or other readily measurable consideration, but such combinations are not unique to mutual entities. Business combinations without an exchange of cash or other readily measurable consideration also take place between other entities, particularly combinations of private entities.

B69. Thus, the Boards concluded that the attributes of mutual entities are not sufficiently different from those of other entities to justify different accounting for business combinations. The Boards also concluded that the benefits of requiring combinations of mutual entities to be accounted for by the acquisition method would justify the related costs. Therefore, combinations between mutual entities were included within the scope of the 2005 Exposure Draft.

B70. Many of the respondents to the 2005 Exposure Draft who commented on combinations of mutual entities objected to including them in the scope of

this Statement and thus requiring them to be accounted for by the acquisition method. Respondents objected to the use of the acquisition method for conceptual, practical, and cost-benefit reasons. For example, some said that a combination involving only mutual entities is a "true pooling of interests" and that the acquisition method thus would not reflect the economics of the transactions. Some also said that it often would be difficult to identify an acquirer. Some also noted the absence of readily measurable consideration transferred in many combinations of mutual entities, which would make it necessary to use other valuation techniques to develop the fair values needed to apply the acquisition method. For those reasons, respondents also said that using the acquisition method for combinations of mutual entities would not be cost-beneficial. Respondents proposed other methods of accounting for mutual entities, including the pooling method, the fresh-start method, and a net asset method that was the same as the modified version of the acquisition method proposed by the IASB in its Exposure Draft mentioned in paragraph B64.

B71. In considering those comments, the Boards noted that respondents' reasons for their objections to the acquisition method generally were the same as the factors discussed in paragraphs B67 and B68. For the same reasons discussed in those paragraphs, the Boards affirmed their conclusion that the attributes of mutual entities are not sufficiently different from those of investor-owned entities to justify a different method of accounting for combinations of mutual entities. The Boards also noted that, regardless of the intent of the combining entities, the general result of a combination involving only mutual entities is that one entity obtains control of the other entity (or entities). Thus, combinations involving only mutual entities are included in the scope of this Statement.

B72. Some representatives of mutual entities suggested that this Statement should permit an acquisition of a mutual entity to be reported as an increase in the retained earnings of the acquirer (combined entity) as had been the practice in accordance with the pooling method of accounting. The Boards observed that in a combination between two investor-owned entities in which the acquirer issues its equity shares as consideration for all of the acquiree's equity shares, the fair value of the acquiree's equity is recognized as an addition to the acquirer's equity—generally as an increase to the acquirer's common stock and paid-in capital. Thus, the equity (net assets) of the combined entity is increased from the acquisition of the acquiree (and the fair value of its net assets), but retained earnings of the acquirer are unaffected. The Boards concluded that business combinations between two investor-owned entities are economically similar to those between two mutual entities in which the acquirer issues member interests for all the member interests of the acquiree. Thus, the Boards concluded that those similar transactions should be similarly reported. Therefore, this Statement clarifies that if the only consideration exchanged is the member interests of the acquiree for the member interests of the acquirer (or the member interests of the combined entity), the amount of the acquiree's net assets is recognized as a direct addition to capital or equity, not retained earnings (paragraph A67).

B73. During the Boards' redeliberations of the 2005 Exposure Draft, some representatives of mutual entities also proposed that the entire amount of the acquiree's net assets recognized in accordance with this Statement should be considered a gain on a bargain purchase. They contended that the exchange of member interests in at least some forms of mutual entities does not constitute consideration because the interests the acquirer transfers have no economic value. The Boards disagreed, noting that one mutual entity—the acquiree—presumably would not be willing to transfer its net assets to the control of another—the acquirer—in exchange for nothing of value.

B74. The FASB also considered more specific concerns of representatives of credit unions about adverse economic consequences for those entities. Those representatives argued that requiring the application of the acquisition method would impede consolidation within that industry and might misrepresent the financial soundness and regulatory capital of two credit unions that combine their operations. They noted that in the United States, applicable federal law defines net worth for credit unions as the "retained earnings balance of the credit union, as determined under generally accepted accounting principles." Because the regulatory definition of net worth is narrower than equity under GAAP, they expressed concern that the exclusion of the equity of an acquired credit union from retained earnings of the combined entity could make a financially sound combined entity appear to be financially unsound. Thus, they suggested that credit unions be permitted to continue to report the equity of an acquired mutual entity as an addition to retained earnings of the combined entity. The FASB was not persuaded by those arguments; it

believes that this Statement will not affect the ability of credit unions to restructure and combine with other credit unions.

B75. Additionally, constituents told the FASB that the number of combinations between credit unions in which the regulatory net worth calculation could be significantly affected is relatively small in any given year. The FASB also noted that the regulatory filings of credit unions and other entities and the needs of their regulators are separate matters beyond the purpose of financial statements. Concepts Statement 2 states that a necessary and important characteristic of accounting information is neutrality. In the context of business combinations, neutrality means that accounting standards should neither encourage nor discourage business combinations but, rather, provide information about those combinations that is fair and evenhanded. The FASB observed that its public policy goal is to issue accounting standards that result in neutral and representationally faithful financial information. Eliminating use of the pooling method for all entities and requiring that all entities, including mutual entities, report the resulting increase directly in equity other than retained earnings is consistent with that public policy goal.

B76. Some respondents to the 2005 Exposure Draft said that cooperatives do not fit within the definition of a mutual entity and that cooperatives are sufficiently different from other entities to justify a different method of accounting for combinations involving only cooperatives. To support their view, they cited factors such as differences in legal characteristics and different purposes of cooperatives in addition to providing economic benefits to members.

B77. The Boards considered the differences between, for example, a cooperative that provides electricity to its members in a rural area and other types of mutual entities, such as a mutual insurance company. The Boards acknowledged particular differences between the two types of entities, for example, the cooperative issues member shares and the mutual insurance company does not. In addition, the objective of the cooperative may include providing more social and cultural benefits to its community in addition to the economic benefits provided to its members than does another type of mutual entity. However, the Boards concluded that cooperatives generally provide direct and indirect economic benefits such as dividends and lower costs of services, including credit, or other products directly to its members. The Boards concluded that differences in the amount of social and cultural benefits an entity seeks to provide do not justify a conclusion that cooperatives are sufficiently different from other mutual entities that they do not fit within the definition of a mutual entity. Thus, cooperatives are included in the definition of a mutual entity in this Statement.

Combinations Achieved by Contract Alone

B78. Both Boards also concluded that business combinations achieved by contract alone should be included in the scope of this Statement. Those combinations were not included in the scope of either Statement 141 or IFRS 3, although the Boards understand that practice in the United States generally was to account for them in accordance with Statement 141. For example, in EITF Issue No. 97-2, "Application of FASB Statement No. 94 and APB Opinion No. 16 to Physician Practice Management Entities and Certain Other Entities with Contractual Management Arrangements," the Task Force reached a consensus that a transaction in which a physician practice management entity executes a management agreement with a physician practice should be accounted for as a business combination. Technically, that transaction would not meet the definition of a business combination in Opinion 16 or Statement 141 because the physician practice management entity does not acquire either equity interests in or the net assets of the physician practice.

B79. The Boards understand that difficulties may arise in applying the acquisition method to combinations achieved by contract alone. In particular, such business combinations normally do not involve the payment of readily measurable consideration, and in rare circumstances it might be difficult to identify the acquirer. However, as for combinations between mutual entities and for the reasons discussed above, the Boards concluded that the acquisition method can and should be applied in accounting for such business combinations. In reaching that conclusion, the Boards also concluded that in a business combination achieved by contract alone:

a. Difficulties in identifying the acquirer are not a sufficient reason to justify a different accounting treatment, and no further guidance is necessary for identifying the acquirer for combinations by contract alone.
b. In the United States, these transactions are already being accounted for by the acquisition method and insurmountable issues have not been encountered.

c. Determining the fair value of the identifiable assets acquired and liabilities assumed and calculating the related goodwill should be consistent with decisions reached in the second phase of the project.

Applying the Acquisition Method

B80. The 2005 Exposure Draft identified four steps in applying the acquisition method, and it discussed the requirements for applying the acquisition method in terms of those steps:

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

In contrast, paragraph 7 of this Statement indicates that applying the acquisition method requires:

a. Identifying the acquirer
b. Determining the acquisition date
c. Recognizing and measuring the identifiable assets acquired, liabilities assumed, and any noncontrolling interest in the acquiree
d. Recognizing and measuring goodwill or a gain from a bargain purchase.

B81. The main changes to the list of steps in applying the acquisition method are to eliminate measuring the fair value of the acquiree as a whole and to add recognizing and measuring goodwill as a separate step. The primary reason for those changes is the Boards' decision to focus on measuring the components of the business combination, including any noncontrolling interest in the acquiree, rather than measuring the fair value of the acquiree as a whole. The Boards observed that neither the requirements of the 2005 Exposure Draft nor those of this Statement for applying the acquisition method result in a fair value measure of either the acquiree as a whole or the acquirer's interest in the acquiree. For example, this Statement does not provide for recognizing a loss if the acquirer overpays for the acquiree, that is, if the acquisition-date fair value of the consideration transferred exceeds the acquisition-date fair value of the acquirer's interest in the acquiree. The IASB's decision to allow an acquirer to choose to measure any noncontrolling interest in the acquiree at fair value or on the basis of its proportionate interest in the acquiree's identifiable net assets adds another potential difference between the results of applying the requirements of the revised IFRS 3 and measuring the acquisition-date fair value of the acquiree as a whole. (See paragraphs B209–B221 for discussion of the reasons why the IASB provided that choice.) Paragraphs B330 and B331 discuss the reasons why this Statement also eliminates the related presumption in the 2005 Exposure Draft that the consideration transferred in exchange for the acquiree measures the fair value of the acquirer's interest in the acquiree.

Identifying the Acquirer

B82. The Boards' decision that all business combinations in the scope of this Statement should be accounted for by the acquisition method means that the acquirer must be identified in every business combination.

B83. The FASB and the IASB separately developed the guidance on identifying the acquirer that appeared in Statement 141 and IFRS 3, respectively. Paragraphs B84–B92 discuss the FASB's development of the guidance in Statement 141, and paragraphs B93–B101 discuss the IASB's development of the guidance in IFRS 3. Paragraphs B102–B105 discuss the Boards' joint consideration of how to identify the acquirer in a business combination in the second phase of their projects on business combinations.

Developing the Guidance in Statement 141

B84. Statement 141's guidance on identifying the acquirer focused on the types of business combinations included in its scope, which excluded transactions in which one entity obtains control over one or more other entities by means other than transferring assets, incurring liabilities, or issuing equity securities. Thus, Statement 141 did not include the general guidance that the entity that obtains control is the acquirer, although that was the effect of the guidance for the combinations within its scope.

B85. In developing its 1999 Exposure Draft, the FASB affirmed the guidance in Opinion 16 that in a business combination effected primarily through the distribution of cash or other assets or by incurring liabilities, the acquirer generally is the entity that distributes cash or other assets or assumes or incurs liabilities. The FASB considered a variety of suggestions on factors that should be considered in identifying the acquirer in a business combination effected through an exchange of equity interests. The guidance proposed in the 1999 Exposure Draft reflected the FASB's conclusion that all pertinent facts

and circumstances should be considered in identifying the acquirer, particularly the relative voting rights in the combined entity after the combination. That proposed guidance said that the existence of unusual or special voting arrangements and options, warrants, or convertible securities should be considered in determining which shareholder group retained or received the larger portion of the voting rights in the combined entity. In addition, factors related to the composition of the board of directors and senior management of the combined entity should be considered and should be weighted equally with the factors related to voting rights.

B86. Respondents to the 1999 Exposure Draft who commented on the proposed criteria for identifying the acquirer generally agreed that they were appropriate. Some respondents said that the proposed guidance was an improvement over Opinion 16 because it provided additional factors to consider in determining which shareholder group retained or received the larger share of the voting rights in the combined entity. However, many respondents suggested improvements to the proposed criteria, and some suggested that the FASB consider other criteria.

B87. Several respondents suggested that the FASB retain the presumptive approach in Opinion 16 for identifying the acquirer in transactions effected through an exchange of equity interests. That approach presumes that, in the absence of evidence to the contrary, the acquirer is the combining entity whose owners as a group retain or receive the larger share of the voting rights in the combined entity. Other respondents suggested that the factors to be considered in identifying the acquirer should be provided in the form of a hierarchy. Some of those respondents also suggested that the FASB provide additional guidance explaining how factors relating to voting rights (unusual special voting arrangements and options, warrants, or convertible securities) would affect the determination of the acquirer.

B88. In considering those suggestions, the FASB observed, as it did in developing the 1999 Exposure Draft, that because each business combination is unique, the facts and circumstances relevant to identifying the acquirer in one combination may be less relevant in another. Therefore, Statement 141 did not retain the presumptive approach in Opinion 16 nor did it provide hierarchical guidance because to do so would have implied that some factors always are more important than others in identifying the acquirer. However, as suggested by respondents, the FASB modified the proposed guidance to explain how some of the factors influence the identification of the acquirer.

B89. The 1999 Exposure Draft did not propose requiring consideration of the payment of a premium over the market value of the equity securities acquired as evidence of the identity of the acquirer. Some respondents to the 1999 Exposure Draft said that the payment of a premium is a strong indicator of the identity of the acquirer. Upon reconsideration, the FASB decided to include in Statement 141 the payment of a premium as a criterion to be considered in identifying the acquirer.

B90. In developing Statement 141, the FASB observed that identifying the acquirer might be difficult in some multiparty business combinations, particularly those that might not be acquisitions but that are required to be accounted for as such. The FASB noted that in those circumstances it might be helpful to consider additional factors such as which of the entities initiated the combination and whether the reported amounts of assets, revenues, and earnings of one of the combining entities significantly exceed those of the others. Respondents to the 1999 Exposure Draft generally agreed, and Statement 141 included that guidance.

B91. In addition, as suggested by respondents, the FASB decided that Statement 141 should explicitly state that in some business combinations, such as reverse acquisitions, the entity that issues the equity interests may not be the acquirer. In a reverse acquisition, one entity (Entity A) obtains ownership of the equity instruments of another entity (Entity B), but Entity A issues enough of its own voting equity instruments as consideration in the exchange transaction that control of the combined entity passes to the owners of Entity B.

B92. If a new entity is formed to issue equity instruments to effect a business combination, Statement 141 required that one of the combining entities that existed before the combination must be identified as the acquirer for essentially the same reasons as those discussed in paragraphs B98–B101 in the context of IFRS 3's similar requirement.

Developing the Guidance in IFRS 3

B93. As proposed in ED 3, IFRS 3 carried forward from IAS 22 the principle that in a business combination accounted for using the acquisition method the

acquirer is the combining entity that obtains control of the other combining entities or businesses. The IASB observed that using the control concept as the basis for identifying the acquirer is consistent with using the control concept in IAS 27, *Consolidated and Separate Financial Statements,* to define the boundaries of the reporting entity and to provide the basis for establishing the existence of a parent-subsidiary relationship. IFRS 3 also carried forward the guidance in IAS 22 that control is the power to govern the financial and operating policies of the other entity so as to obtain benefits from its activities. IFRS 3 also provided the same guidance as IAS 22 for identifying the acquirer if one of the combining entities might have obtained control even if it does not acquire more than one-half of the voting rights of another combining entity.

Identifying an acquirer in a business combination effected through an exchange of equity interests

B94. In developing ED 3 and IFRS 3, the IASB decided not to carry forward the guidance in IAS 22 on identifying which of the combining entities is the acquirer in a reverse acquisition. IAS 22 required the entity whose owners control the combined entity to be treated as the acquirer. That approach presumed that in a business combination effected through an exchange of equity interests, the entity whose owners control the combined entity is always the entity with the power to govern the financial and operating policies of the other entity so as to obtain benefits from its activities. The IASB observed that because the presumption is not always accurate, carrying it forward would in effect override the control concept for identifying the acquirer.

B95. The IASB observed that the control concept focuses on the relationship between two entities, in particular, whether one entity has the power to govern the financial and operating policies of another so as to obtain benefits from its activities. Therefore, determining which of the combining entities has, as a consequence of the combination, the power to govern the financial and operating policies of the other so as to obtain benefits from its activities is fundamental to identifying the acquirer, regardless of the form of the consideration.

B96. The IASB also observed that in some reverse acquisitions, the acquirer may be the entity whose equity interests have been acquired and the acquiree is the issuing entity. For example, a private entity might arrange to have itself "acquired" by a smaller public entity through an exchange of equity interests as a means of obtaining a stock exchange listing. As part of the agreement, the directors of the public entity resign and are replaced with directors appointed by the private entity and its former owners. The IASB observed that in such circumstances, the private entity, which is the legal subsidiary, has the power to govern the financial and operating policies of the combined entity so as to obtain benefits from its activities. Treating the legal subsidiary as the acquirer in such circumstances thus is consistent with applying the control concept for identifying the acquirer. Treating the legal parent as the acquirer in such circumstances would place the form of the transaction over its substance, thereby providing less useful information than would be provided using the control concept to identify the acquirer.

B97. Therefore, the IASB proposed in ED 3 that the acquirer in a business combination effected through an issue of equity interests should be identified by considering all pertinent facts and circumstances to determine which of the combining entities has the power to govern the financial and operating policies of the other so as to obtain benefits from its activities. Pertinent facts and circumstances include, but are not limited to, the relative ownership interests of the owners of the combining entities. Respondents to ED 3 generally supported that requirement, which was consistent with the requirement of Statement 141.

Identifying an acquirer if a new entity is formed to effect a business combination

B98. If a new entity is formed to issue equity instruments to effect a business combination, ED 3 proposed, and IFRS 3 required, one of the combining entities that existed before the combination to be identified as the acquirer on the basis of the evidence available. In considering that requirement, the IASB identified two approaches to applying the acquisition method that had been applied in various jurisdictions. The first approach viewed business combinations from the perspective of one of the combining entities that existed before the combination. Under that approach, the acquirer must be one of the combining entities that existed before the combination and therefore cannot be a new entity formed to issue equity instruments to effect a combination. The second approach viewed business combinations from the perspective of the entity providing the consideration, which could be a newly formed entity. Under that approach, the acquirer must be the entity providing the

consideration. Some jurisdictions interpreted IAS 22 as requiring the first approach; other jurisdictions interpreted IAS 22 as requiring the second approach.

B99. If a new entity is formed to issue equity instruments to effect a business combination between two or more other entities, viewing the combination from the perspective of the entity providing the consideration would result in the newly formed entity applying the acquisition method to each of the other combining entities. The IASB noted that the result would be the same as applying the fresh-start method to account for the business combination, which would potentially provide users of the financial statements with more relevant information than requiring one of the preexisting entities to be treated as the acquirer.

B100. The IASB also considered whether treating a new entity formed to issue equity instruments to effect a business combination as the acquirer would place the form of the transaction over its substance, because the new entity may have no economic substance. The formation of such entities is often related to legal, tax, or other business considerations that do not affect the identification of the acquirer. For example, a combination between two entities that is structured so that one entity directs the formation of a new entity to issue equity instruments to the owners of both of the combining entities is, in substance, no different from a transaction in which one of the combining entities directly acquires the other. Therefore, the transaction should be accounted for in the same way as a transaction in which one of the combining entities directly acquires the other. To do otherwise would impair both the comparability and the reliability of the information.

B101. The IASB concluded that the users of an entity's financial statements are provided with more useful information about a business combination when that information faithfully represents the transaction it purports to represent. Therefore, IFRS 3 required the acquirer to be one of the combining entities that existed before the combination.

Convergence and Clarification of Statement 141's and IFRS 3's Guidance for Identifying the Acquirer

B102. The deliberations of the FASB and the IASB described in paragraphs B84–B101 resulted in similar but not identical guidance for identifying the acquirer in Statement 141 and IFRS 3. But the guidance was worded differently, and the Boards were concerned that differences in identifying the acquirer could arise. Therefore, as part of the effort to develop a common standard on accounting for business combinations, the Boards decided to develop common guidance for identifying the acquirer that could be applied internationally. For example, the FASB adopted the IASB's definition of an acquirer as the entity that obtains control of the other combining entities, and both Boards decided to include in their respective guidance an explicit reference to their other standards that provide guidance for identifying the acquirer. That guidance, although previously implicit, was not in Statement 141. The intention of the Boards is to conform and clarify their guidance but not to change the substance of the provisions for identifying an acquirer previously provided in Statement 141 and IFRS 3.

B103. Some respondents to the 2005 Exposure Draft noted that the existing FASB and IASB definitions of control in their respective consolidations standards are somewhat different and, in rare instances, may lead to identifications of different acquirers. The Boards agreed with that observation, but they affirmed their conclusion in developing the 2005 Exposure Draft that developing a common definition of control is outside the scope of the business combinations project.

Identifying the Acquirer in Business Combinations Involving Only Mutual Entities

B104. The Boards considered whether differences between mutual entities and investor-owned entities or differences between combinations of mutual entities and combinations of investor-owned entities result in a need for different or additional guidance for identifying the acquirer in combinations of mutual entities. The Boards did not note any such differences. As a result, the Boards concluded that an acquirer must be identified for all business combinations, including those involving only mutual entities.

B105. The Boards also concluded that the indicators for identifying the acquirer in a business combination are applicable to mutual entities and that no additional indicators are needed to identify the acquirer in those combinations. Both Boards acknowledged that difficulties may arise in identifying the acquirer in combinations of two virtually equal mutual entities but observed that those difficulties also arise in combinations of two virtually equal investor-owned entities. The Boards concluded that those difficulties, which are not unique to mutual entities, could be resolved in practice.

Determining the Acquisition Date

B106. Statement 141 and IFRS 3 carried forward without reconsideration the provisions of Opinion 16 and IAS 22, respectively, on determining the acquisition date. With one exception that applies only to Statement 141 (paragraphs B108–B110), that guidance resulted in the same acquisition date as the guidance in this Statement.

B107. In both Statement 141 and IFRS 3, the guidance on the acquisition date, which IFRS 3 also referred to as the *exchange date,* was incorporated within the guidance on determining the cost of the acquisition rather than being stated separately. This Statement clarifies the acquisition-date guidance to make explicit that the acquisition date is the date that the acquirer obtains control of the acquiree. Paragraphs B338–B342 discuss the related issue of the measurement date for equity securities transferred as consideration in a business combination and the changes this Statement makes to the previous requirements on that issue.

B108. The FASB also eliminated the "convenience" exception that Statement 141 carried forward from Opinion 16 and the reporting alternative permitted by ARB No. 51, *Consolidated Financial Statements.* Statement 141, paragraph 48, permitted an acquirer to designate an effective date other than the date that assets or equity interests are transferred or liabilities are assumed or incurred (the acquisition date) if it also reduced the cost of the acquiree and net income as required by that paragraph to compensate for recognizing income before consideration was transferred. Paragraph 11 of ARB 51 permitted an acquirer to include a subsidiary that was purchased during the year in the consolidation as though it had been acquired at the beginning of the year and to deduct the preacquisition earnings at the bottom of the consolidated income statement.

B109. The FASB concluded that to faithfully represent an acquirer's financial position and results of operations, the acquirer should account for all business combinations at the acquisition date. In other words, its financial position should reflect the assets acquired and liabilities assumed at the acquisition date—not before or after they are obtained or assumed. Moreover, the acquirer's financial statements for the period should include only the cash inflows and outflows, revenues and expenses, and other effects of the acquiree's operations after the acquisition date.

B110. Very few respondents to the 2005 Exposure Draft commented on the proposed guidance on determining the acquisition date. Those who did generally raised practicability issues related to eliminating the ability to designate an effective date other than the acquisition date. The Boards concluded that the financial statement effects of eliminating that exception were rarely likely to be material. For example, for convenience an entity might wish to designate an acquisition date of the end (or the beginning) of a month, the date on which it closes its books, rather than the actual acquisition date during the month. Unless events between the "convenience" date and the actual acquisition date result in material changes in the amounts recognized, that entity's practice would comply with the requirements of this Statement. Therefore, the Boards decided to retain the guidance in the 2005 Exposure Draft about determining the acquisition date.

Recognition

B111. This Statement's recognition principle is stated in paragraph 12. Paragraphs B112–B130 discuss the recognition conditions the acquirer is to use in applying the recognition principle. This Statement also provides guidance for recognizing particular assets and liabilities, which is discussed in paragraphs B131–B184. This Statement's guidance on classifying and designating assets acquired and liabilities assumed is discussed in paragraphs B185–B188, and the limited exceptions to the recognition principle provided in this Statement are discussed in paragraphs B263–B303.

Conditions for Recognition

B112. The Boards decided that to achieve a reasonably high degree of consistency in practice and to resolve existing inconsistencies, this Statement should provide guidance for applying its recognition principle. That guidance emphasizes two fundamental conditions. To measure and recognize an item as part of applying the acquisition method, the item acquired or assumed must be:

a. An asset or liability at the acquisition date
b. Part of the business combination rather than the result of a separate transaction.

An asset or a liability at the acquisition date

B113. In determining whether an item should be recognized at the acquisition date as part of the business combination, the Boards decided that the appropriate first step is to apply the definitions of assets and

liabilities in FASB Concepts Statement No. 6, *Elements of Financial Statements,* or the IASB's *Framework,* respectively.

B114. The Boards observed that in accordance with both Statement 141 and IFRS 3, and their predecessors and the related interpretative guidance, particular items were recognized **as if** they were assets acquired or liabilities assumed at the acquisition date even though they did not meet the definition of an asset or a liability. That practice was related to the previous emphasis on measuring the cost of (or investment in) the acquiree rather than the acquisition-date fair values of the assets acquired and liabilities assumed. For example, as discussed in paragraphs B365–B370, some expenses for services received in connection with a business combination were capitalized as part of the cost of the acquiree (and recognized as part of goodwill) **as if** they were an asset at the acquisition date. In addition, some future costs that an acquirer expected to incur often were viewed as a cost of the acquiree and recognized **as if** they were a liability at the acquisition date—expected restructuring costs were an example. The Boards concluded that the representational faithfulness, consistency, and understandability of financial reporting would be improved by eliminating such practices.

Part of the business combination

B115. The second condition for recognizing an asset acquired or a liability assumed or incurred in a business combination is that the asset or liability must be part of the business combination transaction rather than an asset or a liability resulting from a separate transaction. Making that distinction requires an acquirer to identify the components of a transaction in which it obtains control over an acquiree. The objective of the condition and the guidance on identifying the components of a business combination is to ensure that each component is accounted for in accordance with its economic substance.

B116. The Boards decided to provide application guidance to help address concerns about the difficulty of determining whether a part of the consideration transferred is for the acquiree or is for another purpose. The Boards observed that parties directly involved in the negotiations of an impending business combination may take on the characteristics of related parties. Therefore, they may be willing to enter into other agreements or include as part of the business combination agreement some arrangements that are designed primarily for the benefit of the acquirer or the combined entity, for example, to achieve more favorable financial reporting outcomes after the business combination. Because of those concerns the Boards decided to develop a principle for determining whether a particular transaction or arrangement entered into by the parties to the combination is part of what the acquirer and acquiree exchange in the business combination or is a separate transaction.

B117. The Boards concluded that a transaction that is designed primarily for the economic benefit of the acquirer or the combined entity (rather than the acquiree or its former owners before the business combination) is not part of the exchange for the acquiree. Those transactions should be accounted for separately from the business combination. The Boards acknowledge that judgment may be required to determine whether part of the consideration paid or the assets acquired and liabilities assumed stems from a separate transaction. Accordingly, the 2005 Exposure Draft included both a general principle and implementation guidance for applying that principle, including several examples.

B118. Respondents' comments on the proposed guidance on identifying the components of a business combination transaction were mixed. For example, some respondents said that the general principle was clear and provided adequate guidance; others said that the proposed principle was not clear. Several respondents said that the focus on determining whether a transaction benefits the acquiree or the acquirer was not clear because a transaction or event that benefits the acquiree also would benefit the combined entity because the acquiree is part of the combined entity.

B119. The Boards agreed with respondents that the proposed principle for distinguishing between components of a business combination needed improvement. Accordingly, they revised the principle to focus on whether a transaction is 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 or its former owners **before the combination** (paragraph 58).

B120. The Boards also concluded that the focus of the principle should be on identifying whether a business combination includes separate transactions that should be accounted for separately in accordance with their economic substance rather than solely on assessing whether a transaction is part of the exchange for the acquiree (paragraph 57). Focusing

solely on whether assets or liabilities are part of the exchange for the acquiree might not result in all transactions being accounted for in accordance with their economic substance. For example, if an acquirer asks the acquiree to pay some or all of the acquisition-related costs on its behalf and the acquiree has paid those costs before the acquisition date, at the acquisition date the acquiree will show no liability for those costs. Therefore, some might think that the principle as stated in the 2005 Exposure Draft does not apply to the transactions giving rise to the acquisition-related costs. The Boards concluded that focusing instead on whether a transaction is separate from the business combination will more clearly convey the intention of the principle and thus will provide users with more relevant information about the financial effects of transactions and events entered into by the acquirer. The acquirer's financial statements will reflect the financial effects of all transactions for which the acquirer is responsible in accordance with their economic substance.

B121. To help in applying the principle, paragraph 58 of this Statement includes three examples of transactions that are separate from the transaction in which an acquirer obtains control over an acquiree, and Appendix A provides additional implementation guidance.

B122. The first example in paragraph 58 is directed at ensuring that a transaction that in effect settles a preexisting relationship between the acquirer and the acquiree is excluded from the accounting for the business combination. Assume, for example, that a potential acquiree has an asset (receivable) for an unresolved claim against the potential acquirer. The acquirer and the acquiree's owners agree to settle that claim as part of an agreement to sell the acquiree to the acquirer. The Boards concluded that if the acquirer makes a lump-sum payment to the seller-owner, part of that payment is to settle the claim and is not part of the consideration transferred to acquire the business. Thus, the portion of the payment that relates to the claim settlement should be excluded from the accounting for the business combination and accounted for separately. In effect, the acquiree relinquished its claim (receivable) against the acquirer by transferring it (as a dividend) to the acquiree's owner. Thus, at the acquisition date the acquiree has no receivable (asset) to be acquired as part of the combination, and the acquirer would account for its settlement payment separately. The FASB observed that the conclusion that a transaction that settles a preexisting relationship is not part of applying the acquisition method is consistent with the conclusion in EITF Issue No. 04-1, "Accounting for Preexisting Relationships between the Parties to a Business Combination," which is incorporated into this Statement and therefore nullified.

B123. The second and third examples also are directed at ensuring that payments that are not part of the consideration transferred for the acquiree are excluded from the business combination accounting. The Boards concluded that the payments for such transactions or arrangements should be accounted for separately in accordance with the applicable requirements for those transactions. Paragraph B370 also discusses potential abuses related to the third example—payments to reimburse the acquiree or its former owners for paying the acquirer's costs incurred in connection with the business combination.

B124. To provide additional help in identifying the components of a business combination, paragraph A77 includes three factors to be considered in assessing a business combination transaction: (a) the reason for the transaction, (b) who initiated the transaction, and (c) the timing of the transaction. Although those factors are neither mutually exclusive nor individually conclusive, the Boards decided that the factors could help in considering whether a transaction or event is arranged primarily for the economic benefit of the acquirer or the combined entity or primarily for the benefit of the acquiree and its former owners before the business combination.

IFRS 3's criterion on reliability of measurement

B125. IFRS 3 included another recognition criterion for assets acquired or liabilities assumed in a business combination. That criterion required an asset or liability to be recognized separately from goodwill only if it could be reliably measured. In its deliberations leading to the revised IFRS 3, the IASB decided to eliminate reliability of measurement as an overall criterion, which it observed is unnecessary because reliability of measurement is a part of the overall recognition criteria in the *Framework*.

IFRS 3's criterion on probability of an inflow or outflow of benefits

B126. IFRS 3 provided that an acquirer should recognize the acquiree's identifiable assets (other than intangible assets) and liabilities (other than contingent liabilities) only if it is probable that the asset or liability will result in an inflow or outflow of economic benefits. The revised IFRS 3 does not contain

that probability recognition criterion, and thus it requires the acquirer to recognize identifiable assets acquired and liabilities assumed regardless of the degree of probability of an inflow or outflow of economic benefits.

B127. The recognition criteria in the *Framework* include the concept of probability to refer to the degree of uncertainty that the future economic benefits associated with an asset or liability will flow to or from the entity.

B128. During the development of the revised IFRS 3, the IASB reconsidered items described in IAS 37, *Provisions, Contingent Liabilities and Contingent Assets,* as contingent assets and contingent liabilities. Analyzing the rights or obligations in such items to determine which are conditional and which are unconditional clarifies the question of whether the entity has an asset or a liability at the acquisition date.[2] As a result, the IASB concluded that many items previously described as contingent assets or contingent liabilities meet the definition of an asset or a liability in the *Framework* because they contain unconditional rights or obligations as well as conditional rights or obligations. Once the unconditional right in an asset (the unconditional obligation in a liability) is identified, the question to be addressed becomes what is the inflow (outflow) of economic benefits relating to that unconditional right (unconditional obligation).

B129. The IASB noted that the *Framework* articulates the probability recognition criterion in terms of a flow of economic benefits rather than just direct cash flows. If an entity has an unconditional obligation, it is certain that an outflow of economic benefits from the entity is required, even if there is uncertainty about the timing and the amount of the outflow of benefits associated with a related conditional obligation. Hence, the IASB concluded that the liability (the unconditional obligation) satisfies the *Framework*'s probability recognition criterion. That conclusion applies equally to unconditional rights. Thus, if an entity has an unconditional right, it is certain that it has the right to an inflow of economic benefits, and the probability recognition criterion is satisfied.

B130. Therefore, the IASB decided that inclusion of the probability criterion in the revised IFRS 3 is unnecessary because an unconditional right or obligation always will satisfy the criterion. In addition, the IASB made consequential amendments to paragraphs 25 and 33 of IAS 38, *Intangible Assets,* to clarify the reason for its conclusion that the probability recognition criterion is always considered to be satisfied for intangible assets that are acquired separately or in a business combination. Specifically, the amendment indicates that an entity expects there to be an inflow of economic benefits embodied in an intangible asset acquired separately or in a business combination, even if there is uncertainty about the timing and the amount of the inflow.

Recognizing Particular Identifiable Assets Acquired and Liabilities Assumed

B131. To help ensure the consistent application of the requirements of this Statement, the Boards decided to provide specific recognition guidance for particular types of identifiable assets acquired and liabilities assumed in a business combination. That guidance and the reasons for it are discussed in the following paragraphs.

Liabilities associated with restructuring or exit activities of the acquiree

B132. Paragraph 13 of this Statement explains that an acquirer recognizes liabilities for restructuring or exit activities acquired in a business combination only if they meet the definition of a liability at the acquisition date. Costs associated with restructuring or exiting an acquiree's activities that are not liabilities at that date are recognized as postcombination activities or transactions of the combined entity when the costs are incurred. In considering acquired restructuring or exit activities, the FASB and the IASB began at different points because the requirements of Statement 141 and IFRS 3 on the issue differed.

B133. In applying Statement 141, acquirers looked to EITF Issue No. 95-3, "Recognition of Liabilities in Connection with a Purchase Business Combination," for guidance on recognizing liabilities associated with restructuring or exit activities of an acquirer. Issue 95-3 provided that the costs of an acquirer's plan to (a) exit an activity of an acquired company, (b) involuntarily terminate employees of an acquired company, or (c) relocate employees of an acquired company should be recognized as liabilities assumed in a

[2]Paragraphs BC11–BC17 and BC22–BC26 of the basis for conclusions for the draft amendments to IAS 37, issued for comment in June 2005, discuss this issue in more detail.

purchase business combination if specified conditions were met. Those conditions did not require the existence of a present obligation to another party. In developing the 2005 Exposure Draft, the FASB concluded, as it did in FASB Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities,* that only present obligations to others are liabilities under the definition in Concepts Statement 6. An exit or disposal plan, by itself, does not create a present obligation to others for costs an entity expects to incur under the plan. Thus, an entity's commitment to an exit or disposal plan, by itself, is not a sufficient condition for recognition of a liability. Consistent with that conclusion, this Statement nullifies the guidance in Issue 95-3, which was not consistent with Statement 146.

B134. Before the IASB issued IFRS 3, IAS 22, like Issue 95-3, required the acquirer to recognize as part of allocating the cost of a combination a provision for terminating or reducing the activities of the acquiree (a *restructuring provision*) that was not a liability of the acquiree at the acquisition date, provided that the acquirer had satisfied specified criteria. The criteria in IAS 22 were similar to those in Issue 95-3. In developing ED 3 and IFRS 3, the IASB considered the view that a restructuring provision that was not a liability of the acquiree at the acquisition date should nonetheless be recognized by the acquirer as part of allocating the cost of the combination if the specified conditions were met. Those supporting this view, including some respondents to ED 3, argued that:

a. The estimated cost of terminating or reducing the activities of the acquiree would have influenced the price paid by the acquirer for the acquiree and therefore should be taken into account in measuring goodwill.
b. The acquirer is committed to the costs of terminating or reducing the activities of the acquiree because of the business combination. In other words, the combination is the past event that gives rise to a present obligation to terminate or reduce the activities of the acquiree.

B135. In developing IFRS 3, the IASB rejected those arguments, noting that the price paid by the acquirer would also be influenced by future losses and other "unavoidable" costs that relate to the future conduct of the business, such as costs of investing in new systems. IFRS 3 did not provide for recognizing those costs as liabilities because they do not represent liabilities of the acquiree at the acquisition date, although the expected future outflows may affect the value of existing recognized assets. The IASB concluded that it would be inconsistent to recognize "unavoidable" restructuring costs that arise in a business combination but to prohibit recognition of a liability for other "unavoidable" costs to be incurred as a result of the combination.

B136. The IASB's general criteria for identifying and recognizing restructuring provisions appear in IAS 37. IAS 37 states that a constructive obligation to restructure (and therefore a liability) arises only when the entity has developed a detailed formal plan for the restructuring and either raised a valid expectation in those affected that it will carry out the restructuring by publicly announcing details of the plan or begun implementing the plan. IAS 37 requires such a liability to be recognized when it becomes probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and the amount of the obligation can be reliably estimated.

B137. IFRS 3 reflected the IASB's conclusion that if the criteria in paragraph 31 of IAS 22 for the recognition of a restructuring provision were carried forward, similar items would be accounted for differently. The timing of the recognition of restructuring provisions would differ, depending on whether a plan to restructure arises in connection with, or in the absence of, a business combination. The IASB decided that such a difference would impair the usefulness of the information provided to users about an entity's plans to restructure because both comparability and reliability would be diminished. Accordingly, IFRS 3 contained the same requirements as the revised IFRS 3 for recognizing liabilities associated with restructuring or exit activities.

B138. Few of the comments on the 2005 Exposure Draft from respondents who apply IFRSs in preparing their financial statements addressed its proposal

on accounting for costs to restructure or exit activities of an acquiree (restructuring costs). Those who did so generally agreed with its proposal to carry forward the requirement of IFRS 3 for recognizing liabilities associated with restructuring or exit activities of an acquiree. But the provisions of the 2005 Exposure Draft on that issue represented a change to GAAP in the United States, and the FASB received several responses objecting to the proposed change. It also received some responses that agreed with them, generally for the same reasons that the Boards proposed the provisions in the 2005 Exposure Draft.

B139. Respondents who disagreed with the proposed accounting for liabilities associated with restructuring or exit activities of an acquiree generally cited one or more of the following reasons in support of their view:

a. Acquirers factor restructuring costs into the amount they are willing to pay for the acquiree. Therefore, those costs should be included in accounting for the business combination.
b. It is not clear why the Boards decided that restructuring costs should not be recognized as liabilities assumed in the business combination when those costs are more likely to be incurred than some of the liabilities related to contingencies that the Boards proposed to recognize as liabilities assumed in a combination.
c. Capitalizing restructuring costs as part of a business combination would be consistent with the accounting for other asset acquisitions in which the amount capitalized is equal to the amount paid to acquire and place the asset in service.

B140. The Boards were not persuaded by those views. They observed that the view described in paragraph B139(a) is essentially the same as the view of some respondents to ED 3 discussed in paragraph B134(a). In addition, the Boards noted that the acquirer does not pay the acquiree or its owners for the anticipated costs to restructure or exit activities, and the acquirer's plans to do so do not give rise to an obligation and associated liability at the acquisition date. The acquirer ordinarily incurs a liability associated with such costs after it gains control of the acquiree's business.

B141. The Boards also disagreed with the view that the accounting for costs to restructure or exit some of an acquiree's activities is inconsistent with the requirements of this Statement on contingencies. To the contrary, the two requirements are consistent with each other because both require recognition of a liability only if an obligation that meets the definition of a liability exists at the acquisition date.

B142. The Boards also observed that the requirements of this Statement on restructuring costs are consistent with current practice in accounting for many similar costs expected to be incurred in conjunction with other acquisitions of assets. For example, one airline might acquire an aircraft from another airline. The acquirer likely would consider the costs of changing the logo on the aircraft and making any other intended changes to its configuration in deciding what it is willing to pay for the aircraft. Other airlines bidding for the aircraft might also have plans to change the aircraft if they are the successful bidders. The nature and extent of the changes each airline anticipates making and the costs each would incur are likely to differ.

B143. In accordance with both GAAP and IFRSs, the airline recognizes none of those anticipated, post-acquisition costs at the date the aircraft is acquired. Instead, those costs are accounted for after control of the aircraft is obtained. If the costs add to the value of the aircraft and meet the related requirements of GAAP or IFRSs, they will be recognized as assets (probably as an addition to the carrying amount of the aircraft). Otherwise, those additional costs are likely to be charged to expense when incurred.

Operating leases

B144. In accordance with both FASB Statement No. 13, *Accounting for Leases,* and IAS 17, *Leases,* an acquiree that is the lessee in an operating lease does not recognize separately the rights and obligations embodied in operating leases. The Boards considered whether to require, for example, the separate recognition of an asset acquired for an acquiree's rights to use property for the specified period and related renewal options or other rights and a liability assumed for an acquiree's obligations to make required lease payments for an operating lease acquired in a business combination. However, at the time they considered how to account for operating leases in a business combination, they were considering adding to their agendas a joint project on accounting for leases. That project was added in 2006. Accordingly, the Boards concluded that this Statement should be consistent with the existing accounting requirements on accounting for leases. Therefore, this Statement

provides that the acquirer recognizes no assets or liabilities related to an operating lease in which the acquiree is the lessee other than those referred to in paragraphs A17 and A18, which are discussed in the following paragraphs.

B145. The 2005 Exposure Draft proposed that the amount by which the terms of an operating lease are favorable or unfavorable in relation to market terms be recognized as a separate intangible asset, regardless of whether the acquiree is the lessee or the lessor. For the FASB, that proposal would have carried forward the related guidance in Statement 141 for leases in which the acquiree is the lessee. Some respondents suggested that, instead, the measure of the fair value of an asset subject to an operating lease in which the acquiree is the lessor should take into account the favorable or unfavorable aspect of the lease terms.

B146. The Boards considered this issue in the context of their respective guidance in other standards on how to determine the fair value of an asset. As noted above, the proposal in the 2005 Exposure Draft was generally consistent with GAAP for business combinations. However, FASB Statement No. 157, *Fair Value Measurements,* on fair value measurements does not provide guidance on the *unit of valuation*—the level at which an asset or liability is aggregated or disaggregated to determine what is being measured. The IASB also does not have general guidance on determining the unit of valuation. However, IAS 40, *Investment Property,* provides that the fair value of investment property takes into account rental income from current leases, and the IASB understands that practice in measuring the fair value of investment property is to take into account the contractual terms of the leases and other contracts in place relating to the asset.

B147. The FASB concluded that this Statement should retain the guidance in the 2005 Exposure Draft that the favorable or unfavorable aspect of an operating lease in which the acquiree is the lessor should be separately recognized as an intangible asset or liability. It concluded that separately reporting that amount rather than embedding an aspect of a lease contract in the fair value of the leased asset would provide more complete information to users of the postcombination financial statements. In addition, the FASB noted that reporting the favorable or unfavorable aspect of the lease contract separately would facilitate appropriate amortization of that amount over the term of the lease rather than over the remaining life of the leased asset. Unlike IAS 16, *Property, Plant and Equipment,* GAAP does not require separating an item of property, plant, or equipment into components, with the components depreciated or amortized over different useful lives.

B148. The IASB decided to require the acquirer in a business combination to follow the guidance in IAS 40 for assets subject to operating leases in which the acquiree is the lessor. The IASB observed that, for lessors who choose the cost option in IAS 40, IAS 16 and IAS 38 both require use of a depreciation or amortization method that reflects the pattern in which the entity expects to consume the asset's future economic benefits. In addition, IAS 16 requires each part of an item of property, plant, and equipment that has a cost that is significant in relation to the total cost of the item to be depreciated separately. Thus, an entity would be required to adjust the depreciation or amortization method for the leased asset to reflect the timing of cash flows attributable to the underlying leases. Therefore, although the presentation of operating leases and the underlying leased assets in the statement of financial position will differ depending on whether an entity applies IFRSs or GAAP, the IASB observed that the identifiable net assets and the depreciation or amortization recognized in the postcombination financial statements will be the same.

Research and development assets

B149. This Statement requires an acquirer to recognize all tangible and intangible research and development assets acquired in a business combination, as was proposed in the 2005 Exposure Draft. Previously, FASB Interpretation No. 4, *Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method,* required an acquirer to measure and immediately expense tangible and intangible assets to be used in research and development that had no alternative future use. A research and development asset was recognized as such only if it had an alternative future use. In contrast, IFRS 3 did not require a research and development asset to have an alternative future use for it to be recognized. This Statement and the revised IFRS 3 therefore do not change the provisions of IFRS 3 on that issue. Accordingly, most of the discussion in paragraphs B150–B156 pertains to the FASB's consideration of this issue.

B150. The FASB concluded that the requirement to immediately write off assets to be used in research and development activities if they have no alternative

future use resulted in information that was not representationally faithful. In addition, eliminating that requirement furthers the goal of international convergence of accounting standards. Therefore, this Statement supersedes Interpretation 4 and requires research and development assets acquired in a business combination to be recognized regardless of whether they have an alternative future use.

B151. Relatively few respondents to the 2005 Exposure Draft commented on the proposed accounting for research and development assets. Those who did generally disagreed with those proposals (they also generally applied GAAP rather than IFRSs), citing either or both of the following concerns as support for their view:

a. In-process research and development may not meet the definition of an asset in Concepts Statement 6 because its low likelihood of success does not represent **probable** future economic benefits.
b. The fair value of in-process research and development may not be measurable with sufficient reliability for recognition in financial statements.

The Boards rejected both of those views for the reasons explained in the following paragraphs.

B152. The Boards agreed with respondents that the likelihood that an individual research and development project will result in a profitable product often is low. However, the Boards also noted that the use of the word *probable* in the FASB's Concepts Statement 6 refers only to something that is not certain. The definition does not use that term as a recognition criterion that specifies the degree of probability of the inflow or outflow of future economic benefits that must be present for an item to qualify for recognition. (See also paragraph A63.) Therefore, the Boards concluded that in-process research and development acquired in a business combination generally will satisfy the definition of an asset because the observable exchange at the acquisition date provides evidence that the parties to the exchange expect future economic benefits to result from that research and development. Uncertainty about the outcome of an individual project is reflected in measuring its fair value.

B153. The Boards also agreed that determining the fair value of in-process research and development requires the use of estimates and judgment, and the resulting amount generally will not be as reliable as the fair values of other assets for which quoted prices in active markets are available. However, the Boards observed that use of estimates and judgment, by itself, does not mean that information is unreliable; reliability does not require precision or certainty. For example, paragraph 86 of the IASB's *Framework* says that "in many cases, cost or value must be estimated; the use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability." The Boards also noted that the requirement to measure the fair value of in-process research and development assets acquired in a business combination is not new—not even in GAAP. In accordance with Interpretation 4, that amount was measured but immediately written off. Moreover, respondents to the 2005 Exposure Draft that apply IFRSs generally did not mention any problems with complying with the provisions of IFRS 3 on research and development assets, which are the same as those in this Statement.

B154. In developing the 2005 Exposure Draft, the FASB also considered whether it could make further improvements by extending the recognition provisions of this Statement for research and development assets to purchases of in-process research and development assets outside a business combination. At that time, the FASB decided not to do so because the additional time needed to deliberate the related issues would have unduly delayed the issuance of this Statement.

B155. Some respondents to the 2005 Exposure Draft objected to the resulting inconsistent GAAP requirements for research and development assets acquired in a business combination and those acquired in another type of transaction. The FASB agreed with respondents that inconsistent accounting for research and development assets depending on how they are acquired is undesirable. Therefore, the FASB expects to reconsider the accounting for research and development assets acquired by means other than in a business combination separately from its project on business combinations.

B156. The FASB also decided to provide guidance on the impairment testing of in-process research and development projects that are temporarily idled or abandoned. It did that by means of an amendment to Statement 142 (see Appendix E).

Distinguishing identifiable intangible assets from goodwill

B157. Early in their respective projects on accounting for business combinations, the FASB and the IASB both observed that intangible assets make up

an increasing proportion of the assets of many (if not most) entities. The Boards also observed that intangible assets acquired in a business combination often were included in the amount recognized as goodwill.

B158. Both the FASB and the IASB decided that they needed to provide explicit criteria for determining whether an acquired intangible asset should be recognized separately from goodwill. The FASB provided such criteria in Statement 141, and the IASB provided similar, although not identical, criteria in IAS 38.[3] One reason for providing such criteria was the Boards' conclusion that the decision usefulness of financial statements would be enhanced if intangible assets acquired in a business combination were distinguished from goodwill. For example, the FASB's Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises,* says that classification in financial statements facilitates analysis by grouping items with essentially similar characteristics and separating items with essentially different characteristics. Analysis aimed at objectives such as predicting amounts, timing, and uncertainty of future cash flows requires financial information segregated into reasonably homogenous groups.

B159. In developing its 1999 Exposure Draft, the FASB considered various characteristics that might distinguish other intangible assets from goodwill. Because the FASB concluded that identifiability is the characteristic that conceptually distinguishes other intangible assets from goodwill, the 1999 Exposure Draft proposed that intangible assets that are identifiable and reliably measurable should be recognized as assets separately from goodwill. Most respondents to the 1999 Exposure Draft agreed that many intangible assets are identifiable and that various intangible assets are reliably measurable. However, respondents' views on the proposed recognition criteria varied. Many of those respondents suggested alternative recognition criteria, and many urged the FASB to clarify the term *reliably measurable.*

B160. The FASB considered those suggestions and decided to modify the proposed recognition criteria to provide a clearer distinction between intangible assets that should be recognized separately from goodwill and those that should be subsumed into goodwill. The FASB then issued a revised Exposure Draft, *Business Combinations and Intangible Assets—Accounting for Goodwill* (2001 Exposure Draft),[4] which proposed that an intangible asset should be recognized separately from goodwill if either:

a. Control over the future economic benefits of the asset results from contractual or other legal rights (the contractual-legal criterion); or
b. The intangible asset is capable of being separated or divided and sold, transferred, licensed, rented, or exchanged (either separately or as part of a group of assets) (the separability criterion).

The FASB concluded that sufficient information should exist to reliably measure the fair value of an asset that satisfies either of those criteria. Thus, the change in the recognition criteria eliminated the need to explicitly include *reliably measurable* as a recognition criterion or to clarify the meaning of that term.

B161. IAS 38 (as issued by the IASB's predecessor body in 1998) clarified that the definition of an intangible asset required an intangible asset to be identifiable to distinguish it from goodwill. However, it did not define the term *identifiable.* Instead, IAS 38 stated that an intangible asset could be distinguished from goodwill if the asset was separable, though separability was not a necessary condition for identifiability.

B162. In developing IFRS 3, the IASB affirmed its conclusion in IAS 38 that identifiability is the characteristic that conceptually distinguishes other intangible assets from goodwill. In addition, the IASB concluded that to provide a definitive basis for identifying and recognizing intangible assets separately from goodwill, the concept of identifiability needed to be articulated more clearly. As a result of that consideration, which is discussed in paragraphs B163–B165, the IASB developed more definitive criteria for distinguishing between identifiable intangible assets and goodwill and included those criteria in both IFRS 3 and IAS 38 (as revised in 2004).

Reasons for the contractual-legal criterion

B163. In developing Statement 141 and IFRS 3, the FASB and the IASB observed that many intangible assets arise from rights conveyed legally by contract, statute, or similar means. For example, franchises are

[3]More detailed information about the IASB's reasoning in developing the criteria in IAS 38 is available in its basis for conclusions.

[4]The 2001 Exposure Draft proposed changes to the proposals in the 1999 Exposure Draft on accounting for goodwill and the initial recognition of intangible assets other than goodwill. See Appendix C of this Statement for further discussion of those Exposure Drafts.

granted to automobile dealers, fast food outlets, and professional sports teams. Trademarks and service marks may be registered with the government. Contracts are often negotiated with customers or suppliers. Technological innovations are often protected by patents. In contrast, goodwill arises from the collection of assembled assets that make up an acquiree or the value created by assembling a collection of assets through a business combination, such as the synergies that are expected to result from combining two or more businesses. Therefore, both Boards concluded that the fact that an intangible asset arises from contractual or other legal rights is an important characteristic that distinguishes many intangible assets from goodwill, and an acquired intangible asset with that characteristic should be recognized separately from goodwill.

Reasons for the separability criterion

B164. As already noted (paragraph B161), the original version of IAS 38 included separability as a characteristic that helps to distinguish intangible assets from goodwill. In developing IFRS 3, the IASB affirmed that conclusion for the reasons discussed in the following paragraphs.

B165. In developing Statement 141 and IFRS 3, the FASB and the IASB observed that some intangible assets that do not arise from rights conveyed by contract or other legal means are nonetheless capable of being separated from the acquiree and exchanged for something else of value. Others, like goodwill, cannot be separated from an entity and sold or otherwise transferred. Both Boards thus concluded that separability is another important characteristic that distinguishes many intangible assets from goodwill. An acquired intangible asset with that characteristic should be recognized separately from goodwill.

B166. The FASB's 2001 Exposure Draft proposed that an intangible asset that was not separable individually would meet the separability criterion if it could be sold, transferred, licensed, rented, or exchanged along with a group of related assets or liabilities. Some respondents suggested that the FASB eliminate that requirement, arguing that unless the asset is separable individually it should be included in the amount recognized as goodwill. Others asked the FASB to clarify the meaning of the term *group of related assets,* noting that even goodwill can be separated from the acquiree if the asset group sold constitutes a business.

B167. The FASB noted that some intangible assets are so closely related to another asset or liability that they are usually sold as a "package" (for example, deposit liabilities and the related depositor relationship intangible asset). If those intangible assets were subsumed into goodwill, gains might be inappropriately recognized if the intangible asset was later sold along with the related asset or obligation. However, the FASB agreed that the proposed requirement to recognize an intangible asset separately from goodwill if it could be sold or transferred as part of an asset group was a broader criterion than it had intended. For those reasons, Statement 141 provided, as does this Statement, that an intangible asset that is not separable individually meets the separability criterion if it can be separated from the entity and sold, transferred, licensed, rented, or exchanged in combination with a related contract, other identifiable asset, or other liability.

B168. Some respondents to the 2001 Exposure Draft suggested limiting the separability criterion to intangible assets that are separable **and** that trade in observable exchange transactions. Although the FASB agreed that exchange transactions provide evidence of an asset's separability, it concluded that those transactions were not necessarily the only evidence of separability and it did not adopt that suggestion.

B169. Other respondents suggested that the separability criterion be modified to require recognition of an intangible asset separately from goodwill only if management of the entity **intends** to sell, lease, or otherwise exchange the asset. The FASB rejected that suggestion because it concluded that the asset's **capability** of being separated from the entity and exchanged for something else of value is the pertinent characteristic of an intangible asset that distinguishes it from goodwill. In contrast, management's intent is not a characteristic of an asset.

The FASB's reasons for rejecting other recognition criteria suggested for Statement 141

B170. Some respondents suggested that the FASB eliminate the requirement to recognize intangible assets separately from goodwill. Others suggested that all intangible assets with characteristics similar to goodwill should be included in the amount recorded as goodwill. The FASB rejected those suggestions because they would diminish rather than improve the decision usefulness of reported financial information.

B171. Some respondents doubted their ability to reliably measure the fair values of many intangible assets. They suggested that the only intangible assets

that should be recognized separately from goodwill are those that have direct cash flows and those that are bought and sold in observable exchange transactions. The FASB rejected that suggestion. Although the fair value measures of some identifiable intangible assets might lack the precision of the measures for other assets, the FASB concluded that the information that will be provided by recognizing intangible assets at their estimated fair values is a more faithful representation than that which would be provided if those intangible assets were subsumed into goodwill. Moreover, including finite-lived intangible assets in goodwill that is not being amortized would further diminish the representational faithfulness of financial statements.

Convergence of criteria in Statement 141 and IFRS 3

B172. The criteria in IFRS 3 for determining if an intangible asset is identifiable and thus should be recognized separately from goodwill included the same contractual or legal and separability conditions as Statement 141. However, IFRS 3 also included a requirement that the fair value of an identifiable intangible asset be reliably measurable to be recognized separately. In developing the 2005 Exposure Draft, the Boards considered how best to converge their respective recognition criteria for intangible assets.

B173. In developing IFRS 3, the IASB noted that the fair value of identifiable intangible assets acquired in a business combination normally is measurable with sufficient reliability to be recognized separately from goodwill. The effects of uncertainty because of a range of possible outcomes with different probabilities are reflected in measuring the asset's fair value; the existence of such a range does not demonstrate an inability to measure fair value reliably. IAS 38 (before amendment by the revised IFRS 3) included a rebuttable presumption that the fair value of an intangible asset with a finite useful life acquired in a business combination can be measured reliably. The IASB had concluded that it might not always be possible to measure reliably the fair value of an asset that has an underlying contractual or legal basis. However, IAS 38 provided that the only circumstances in which it might not be possible to measure reliably the fair value of an intangible asset that arises from legal or other contractual rights acquired in a business combination were if it either:

a. Is not separable; or

b. Is separable, but there is no history or evidence of exchange transactions for the same or similar assets, and otherwise estimating fair value would depend on immeasurable variables.

B174. In developing the 2005 Exposure Draft, the IASB concluded that separate recognition of intangible assets, on the basis of an estimate of fair value, rather than subsuming them in goodwill, provides better information to the users of financial statements even if a significant degree of judgment is required to estimate fair value. For that reason, the IASB decided to propose consequential amendments to IAS 38 to remove the reliability of measurement criterion for intangible assets acquired in a business combination. In redeliberating the proposals in the 2005 Exposure Draft, the IASB affirmed those amendments to IAS 38.

Illustrative list of intangible assets

B175. Paragraphs A29–A56 list examples of identifiable intangible assets that might be acquired in a business combination. That list reflects various changes to similar lists in the Exposure Drafts that the Boards issued earlier in their respective projects on business combinations. The Boards observed that the list is not exhaustive, and a particular type of intangible asset that was included on an earlier list might not be mentioned in Appendix A. That does not necessarily mean that the intangible asset does not qualify as identifiable in accordance with the criteria in this Statement. An acquirer must consider the nature of each acquired intangible asset in determining whether those criteria are met.

Assembled workforce

B176. In developing Statement 141, the FASB did not consider whether an assembled workforce met either the contractual-legal or the separability criterion for recognition as an identifiable intangible asset. Instead, Statement 141 precluded separate recognition of an assembled workforce because of the FASB's conclusion that techniques to measure the value of an assembled workforce with sufficient reliability were not currently available. IFRS 3 and IAS 38, on the other hand, did not explicitly preclude separate recognition of an assembled workforce. However, paragraph 15 of IAS 38 noted that an entity usually would not have sufficient control over the expected future economic benefits arising from an assembled workforce for it to meet the definition of a separate intangible asset.

B177. In developing the 2005 Exposure Draft, the Boards concluded that an acquirer should not recognize an assembled workforce as a separate intangible asset because it meets neither the contractual-legal nor the separability criterion. The views of respondents who commented on recognition of an assembled workforce were mixed. Some agreed with its proposed recognition prohibition. Others suggested that the Boards reconsider that prohibition; they generally said that an assembled workforce is already valued in many situations for purposes of calculating a "contributory asset charge" in determining the fair value of some intangible assets. (In using an "excess earnings" income valuation technique, a contributory asset charge is required to isolate the cash flows generated by the intangible asset being valued from the contribution to those cash flows made by other assets, including other intangible assets. Contributory asset charges are hypothetical "rental" charges for the use of those other contributing assets.) Those respondents opposed a prohibition on recognizing an assembled workforce as a separate intangible asset; they favored permitting acquirers to assess whether an assembled workforce is separable in each situation and to recognize those that are separable.

B178. In reconsidering the proposal in the 2005 Exposure Draft, the Boards concluded that the prohibition of recognizing an assembled workforce should be retained. Because an assembled workforce is a collection of employees rather than an individual employee, it does not arise from contractual or legal rights. Although individual employees might have employment contracts with the employer, the collection of employees, as a whole, does not have such a contract. In addition, an assembled workforce is not separable, either as individual employees or together with a related contract, identifiable asset, or liability. An assembled workforce cannot be sold, transferred, licensed, rented, or otherwise exchanged without causing disruption to the acquirer's business. In contrast, an entity could continue to operate after transferring an identifiable asset. Therefore, an assembled workforce is not an identifiable intangible asset to be recognized separately from goodwill.

B179. The Boards observed that neither Statement 141 nor IAS 38 defined an assembled workforce and that inconsistencies have resulted in practice. In addition, some who objected to the recognition prohibition in the 2005 Exposure Draft apparently consider an assembled workforce to represent the intellectual capital of the skilled workforce—the (often specialized) knowledge and experience that employees of an acquiree bring to their jobs. However, the Boards view an assembled workforce as an existing collection of employees that permits an acquirer to continue to operate an acquired business from the acquisition date, and they decided to include that definition in this Statement (paragraph A25).

B180. The Boards observed that the value of intellectual capital, in effect, is recognized because it is part of the fair value of the entity's other intangible assets, such as proprietary technologies and processes and customer contracts and relationships. In that situation, a process or methodology can be documented and followed to the extent that the business would not be materially affected if a particular employee left the entity. In most jurisdictions, the employer usually "owns" the intellectual capital of an employee. Most employment contracts stipulate that the employer retains the rights to and ownership of any intellectual property created by the employee. For example, a software program created by a particular employee (or group of employees) would be documented and generally would be the property of the entity. The particular programmer who created the program could be replaced by another software programmer with equivalent expertise without significantly affecting the ability of the entity to continue to operate. But the intellectual property created in the form of a software program is part of the fair value of that program and is an identifiable intangible asset if it is separable from the entity. In other words, the prohibition of recognizing an assembled workforce as an intangible asset does not apply to intellectual property; it only applies to the value of having a workforce in place on the acquisition date so that the acquirer can continue the acquiree's operations without having to hire and train a workforce.

Reacquired rights

B181. As part of a business combination, an acquirer may reacquire a right that it had previously granted to the acquiree to use the acquirer's recognized or unrecognized intangible assets. Examples of such rights include 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. The 2005 Exposure Draft proposed, and this Statement requires, an acquirer to recognize such a reacquired right as an identifiable intangible asset (paragraph A23). The fair value of a reacquired right is to be amortized over the remaining term of the contract that gave rise to the right. For entities

applying GAAP, that guidance is not new; it is the same as the related guidance in Issue 04-1. (Paragraphs B308–B310 discuss the measurement of reacquired rights.)

B182. A few respondents to the 2005 Exposure Draft disagreed with recognizing a reacquired right as an identifiable intangible asset because they considered doing so to be the same as recognizing an internally generated intangible asset. Some suggested recognizing a reacquired right as the settlement of a preexisting relationship; others said that a reacquired right should be recognized as part of goodwill.

B183. The Boards rejected the alternative of treating a reacquired right as the termination of a preexisting relationship because reacquisition of, for example, a franchise right does not terminate the right. After a business combination, the right to operate a franchised outlet in a particular region continues to exist. The difference is that the acquirer, rather than the acquiree by itself, now controls the franchise right.

B184. The Boards also rejected recognizing a reacquired right as part of goodwill. Supporters of that alternative consider that such a right differs from other identifiable intangible assets recognized in a business combination because, from the perspective of the combined entity, a franchising relationship with an outside party no longer exists. As already noted, however, the reacquired right and the related cash flows continue to exist. The Boards concluded that recognizing that right separately from goodwill provides users of the financial statements of the combined entity with more decision-useful information than subsuming the right into goodwill. The Boards also observed that a reacquired right meets the contractual-legal and the separability criteria and therefore qualifies as an identifiable intangible asset.

Classifying and Designating Assets Acquired and Liabilities Assumed

B185. In some situations, GAAP or IFRSs provide for different accounting depending on how a particular asset or liability is classified or designated. For example, in accordance with both FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities,* and IAS 39, *Financial Instruments: Recognition and Measurement,* the accounting for particular financial instruments differs depending on how the instrument is classified, for example, as trading, available for sale, or held to maturity. Another example is the accounting for a derivative instrument in accordance with either FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities,* or IAS 39, which depends on whether the derivative is designated as a hedge, and if so, the type of hedge designated.

B186. The 2005 Exposure Draft proposed that the classification of an acquired lease would not change from the acquiree's classification at lease inception unless the terms of the lease were modified as a result of the business combination in a way that would require a different classification in accordance with Statement 13 or IAS 17. But that Exposure Draft did not address classification or designation issues pertaining to other types of contracts. Some respondents and others asked the Boards to provide additional guidance on when the acquirer in a business combination should reconsider and perhaps change the classification or designation of a contract for purposes of applying other accounting requirements.

B187. The Boards decided that providing a general principle for classifying or designating contracts acquired in a business combination would facilitate consistent implementation of this Statement. They observed that application of the acquisition method results in the initial recognition in the acquirer's financial statements of the assets acquired and liabilities assumed in a business combination. Therefore, in concept, the acquirer should classify and designate all items acquired in a business combination at the acquisition date in the context of the contractual terms, economic conditions, and other pertinent factors at that date. That concept underlies the classification and designation principle in paragraph 17.

B188. In the two situations described in paragraph 19, classification of a lease contract as an operating lease or a capital lease and classification of a contract as an insurance or reinsurance contract or a deposit contract, other GAAP or IFRSs require an entity to classify a contract only at its inception, based on the contractual terms and other factors at that date. Because those requirements apply to specific types of contracts regardless of the identity of the parties to the contract, the Boards concluded that such requirements also should apply in accounting for a business combination. Thus, this Statement provides an exception to its principle for classifying and designating assets acquired and liabilities assumed in a business combination for the two types of contracts identified in paragraph 19.

Recognition, Classification, and Measurement Guidance for Insurance and Reinsurance Contracts

B189. This Statement provides guidance specific to insurance and reinsurance contracts acquired or assumed in a business combination, primarily by means of amendments to other insurance-related Statements (see Appendix E). Paragraphs B190–B195 discuss that guidance. Paragraph B196 discusses the IASB's guidance on recognition and measurement of insurance contracts in a business combination, which is provided in IFRS 4, *Insurance Contracts.*

B190. The FASB decided that insurance and reinsurance contracts acquired in a business combination should be accounted for on a fresh-start (new contract) basis. Accordingly, all assets and liabilities arising from the rights and obligations of insurance and reinsurance contracts acquired in a business combination are recognized at the acquisition date, measured at their acquisition-date fair values. That recognition and measurement might include a reinsurance recoverable, a liability to pay future contract claims and claims expenses on the unexpired portion of the acquired contracts, and a liability to pay incurred contract claims and claims expenses. However, those assets acquired and liabilities assumed would not include the acquiree's insurance and reinsurance contract accounts such as deferred acquisition costs and unearned premiums that do not represent future cash flows. The FASB considers that model the most consistent with the acquisition method and with the accounting for other types of contracts acquired in a business combination.

B191. The FASB also decided to require the acquirer to carry forward the acquiree's classification of a contract as an insurance or reinsurance contract (rather than a deposit) on the basis of the terms of the acquired contract and any related contracts or agreements at the inception of the contract. If the terms of those contracts or agreements have been modified in a manner that would change the classification, the acquirer determines the classification of the contract based on its terms and other pertinent factors as of the modification date, which may be the acquisition date. Consideration of related contracts and arrangements is important in assessing whether a contract qualifies as insurance or reinsurance because they can significantly affect the amount of risk transferred.

B192. This Statement also requires that the fair value of the insurance and reinsurance contracts acquired in a business combination be separated into (a) insurance and reinsurance GAAP accounting balances using the acquirer's accounting policies and (b) an intangible asset (or, at times that are expected to be rare, another liability). That guidance permits the acquirer to subsequently report the acquired business on the same basis as its written business (with the exception of the amortization of the intangible asset). Other contracts providing for third-party contingent commissions would be accounted for in the same way as other contingencies, and contracts that provide guarantees of the adequacy of claims liabilities would be accounted for as indemnifications.

B193. The FASB concluded that the intangible asset should be amortized on a basis consistent with the measurement of the liability. For example, for most short-duration contracts such as property and liability insurance contracts, GAAP claims liabilities are not discounted, so amortizing the intangible asset like a discount using an interest method could be an appropriate method. For particular long-duration contracts such as most traditional life insurance contracts, using a basis consistent with the measurement of the liability would be similar to the guidance provided in paragraph 31 of FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises.*

B194. The FASB considered several implementation issues identified by respondents to the 2005 Exposure Draft but decided that specifying the fresh-start model for acquired insurance and reinsurance contracts and providing limited guidance on subsequent accounting, including requiring the intangible asset to be amortized on a basis consistent with the liability, should be sufficient to resolve most practice issues. That level of guidance is also consistent with the limited guidance provided by IFRS 4.

B195. The FASB decided to provide the guidance on recognition and measurement, including subsequent measurement, of insurance and reinsurance contracts acquired in a business combination by means of an amendment to Statement 60. That parallels the location of the IASB's business combination guidance for insurance contracts in IFRS 4 and will make it easier to address any changes in that guidance that might result if the FASB and the IASB eventually undertake a joint project to comprehensively reconsider the accounting for insurance contracts.

B196. Paragraphs 31–33 of IFRS 4 deal with limited aspects of insurance contracts acquired in a business combination. That guidance was developed in

phase I of the IASB's project on insurance contracts. The IASB decided not to amend those paragraphs in phase II of the business combinations project, so as not to preempt phase II of the IASB's project on insurance contracts. In May 2007, the IASB published its initial thoughts for phase II of that project in a discussion paper, *Preliminary Views on Insurance Contracts.*

Measurement

B197. Paragraph 20 of this Statement establishes the principle that the identifiable assets acquired, liabilities assumed, and any noncontrolling interest in an acquiree should be measured at their acquisition-date fair values. The reasons for that principle and its application to contingencies and noncontrolling interests are discussed in paragraphs B198–B245, and the definition of fair value is discussed in paragraphs B246–B251. This Statement provides guidance on determining the acquisition-date fair values of particular types of assets acquired, which is discussed in paragraphs B252–B262. The exceptions to the measurement principle are discussed in paragraphs B279–B311.

Why Establish Fair Value as the Measurement Principle?

Identifiable assets acquired and liabilities assumed

B198. In developing the measurement principle in this Statement, the Boards concluded that fair value is the most relevant attribute for assets acquired and liabilities assumed in a business combination. Measurement at fair value also provides information that is more comparable and understandable than measurement at cost or on the basis of allocating the total cost of an acquisition. Both Statement 141 and IFRS 3 required allocation of that cost on the basis of the fair values of the assets acquired and the liabilities assumed. However, other guidance in those standards required measurements that were other than fair value. Moreover, Statement 141's requirements for measuring identifiable assets acquired and liabilities assumed in an acquisition achieved in stages (a step acquisition) and in acquisitions of less than all of the equity interests in the acquiree resulted in another difference between measuring the fair values of identifiable assets and liabilities and the process of accumulating and allocating costs. Those requirements were the same as the benchmark treatment in IAS 22, which IFRS 3 replaced. The following paragraphs discuss both the IASB's reasons for that change to IAS 22 and the FASB's reasons for the change to Statement 141's requirements for step acquisitions, as well as providing additional discussion of the reasons for the fair value measurement principle in this Statement.

B199. In developing this Statement and IFRS 3, the FASB and the IASB, respectively, examined the inconsistencies that resulted from applying the provisions of Statement 141 and the benchmark treatment in IAS 22, and the related implementation guidance, to acquisitions of businesses. For a step acquisition, that process involved accumulating the costs or carrying amounts of earlier purchases of interests in an entity, which may have occurred years or decades ago. Those amounts were added to the current costs to purchase incremental interests in the acquiree on the acquisition date. The accumulated amounts of those purchases were then allocated to the assets acquired and liabilities assumed. Allocating the accumulated amounts generally resulted in recognizing the identifiable assets and liabilities of the acquiree at a mixture of current exchange prices and carryforward book values for each earlier purchase rather than at their acquisition-date fair values. Users of financial statements have long criticized those practices as resulting in information that lacks consistency, understandability, and usefulness. For example, in response to a September 1991 FASB Discussion Memorandum, *Consolidation Policy and Procedures,* an organization representing lending officers said:

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

B200. The Boards concluded that no useful purpose is served by reporting the assets or liabilities of a newly acquired business using a mixture of their fair values at the date acquired and the acquirer's historical costs or carrying amounts. Amounts that relate to transactions and events occurring before the business is included in the acquirer's financial statements are not relevant to users of those financial statements.

B201. The Boards also observed the criticisms of the information resulting from application of the cost accumulation and allocation process to acquisitions of

businesses that resulted in ownership of less than all of the equity interests in the acquiree. In those circumstances, application of the cost accumulation and allocation process also resulted in identifiable assets and liabilities being assigned amounts that generally were not their acquisition-date fair values. For example, in its 1993 Position Paper, *Financial Reporting in the 1990s and Beyond,* the Association for Investment Management and Research (AIMR)[5] said:

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

B202. In contrast, if all of the interests in the business were acquired in a single purchase, the process of assigning that current purchase price generally resulted in the assets and liabilities being measured and recognized at their acquisition-date fair values. Thus, the reported amounts of assets and liabilities differed depending on whether an acquirer purchased all of the equity interests in an acquiree in one transaction or in multiple transactions.

B203. The Boards concluded that measuring assets acquired or liabilities assumed at amounts other than their fair values at the acquisition date does not faithfully represent their economic values or the acquirer's economic circumstances resulting from the business combination. As discussed in paragraph B37, an important purpose of financial statements is to provide users with relevant and reliable information about the performance of the entity and the resources under its control. That applies regardless of the extent of the ownership interest a parent holds in a particular subsidiary. The Boards concluded that measurement at fair value enables users to better assess the cash-generating abilities of the identifiable net assets acquired in the business combination and the accountability of management for the resources entrusted to it. Thus, the fair value measurement principle in this Statement will improve the completeness, representational faithfulness, and relevance of the information reported in an acquirer's financial statements. The Boards also concluded that application of that measurement principle should not impose undue incremental costs on entities because it also was necessary to measure the fair values of assets acquired and liabilities assumed under the provisions of Statement 141 and IFRS 3, even though those fair values were not always the amounts at which assets and liabilities were recognized.

B204. Thus, this Statement and the revised IFRS 3 reflect the Boards' decisions to develop a standard (and related application guidance) for measuring assets acquired and liabilities assumed in a business combination that:

a. Is consistent with the general principle of initially measuring assets acquired and liabilities assumed at their fair values, thereby improving the relevance and comparability of the resulting information about the assets acquired and liabilities assumed
b. Eliminates inconsistencies and other deficiencies of the purchase price allocation process, including those in acquisitions of businesses that occur in stages and those in which the acquirer obtains a business without purchasing all, or perhaps any, of the acquiree's equity interests on the acquisition date
c. Can be applied in practice with a reasonably high degree of consistency and without imposing undue costs.

Noncontrolling interests

B205. The 2005 Exposure Draft proposed that a noncontrolling interest in an acquiree be determined as the sum of the noncontrolling interest's proportional interest in the identifiable assets acquired and liabilities assumed plus the noncontrolling interest's share of goodwill. Thus, because goodwill is measured as a residual, the amount recognized for a noncontrolling interest in an acquiree also would have been a residual. Also, an important issue in deciding how to measure a noncontrolling interest was whether its share of goodwill should be recognized (often referred to as the "full goodwill versus partial

[5]Subsequently, the AIMR changed its name to the CFA Institute. References to the organization in this appendix use its name at the date it issued a particular paper.

goodwill issue"). In developing the 2005 Exposure Draft, the Boards concluded that it should. (In other words, they selected the "full goodwill" alternative.)

B206. In redeliberating the 2005 Exposure Draft, the Boards observed that they had specified the mechanics of determining the reported amount of a noncontrolling interest but had not identified its measurement attribute. The result of those mechanics would have been that the noncontrolling interest was effectively measured as the "final residual" in a business combination. That is to say, the reported amount of the noncontrolling interest depended on the amount of goodwill attributed to it, and goodwill is measured as a residual. Thus, in a sense, a noncontrolling interest would have been the residual after allocating the residual, or the residual of a residual.

B207. The Boards concluded that, in principle, it is undesirable to have two residual amounts in accounting for a business combination. They also observed that goodwill cannot be measured other than as a residual; measuring the fair value of goodwill directly would not be possible. In contrast, an acquirer can measure the fair value of a noncontrolling interest, for example, on the basis of market prices for the shares held by noncontrolling shareholders or by applying another valuation technique. The noncontrolling interest in the acquiree is a component of a business combination in which less than 100 percent of the equity interests are acquired, and the Boards concluded that, in concept, the noncontrolling interest, like other components of the combination, should be measured at fair value. The Boards concluded that the decision usefulness of information about a noncontrolling interest would be improved if this Statement specified a measurement attribute for a noncontrolling interest rather than merely mechanics for determining that amount. They also concluded that, in principle, the measurement attribute should be fair value. The Boards also understand from consultation with some constituents who use financial statements for making (or making recommendations about) investment decisions that information about the acquisition-date fair value of a noncontrolling interest would be helpful in estimating the value of shares of the parent company, not only at the acquisition date but also at future dates.

B208. The Boards also observed that a noncontrolling interest is a component of equity in the acquirer's consolidated financial statements and that measuring a noncontrolling interest at its acquisition-date fair value is consistent with the way in which other components of equity are measured. For example, outstanding equity shares of the parent company, including shares issued to former owners of an acquiree to effect a business combination, are measured in the financial statements at their fair values (market prices) on the date they were issued. Accordingly, the fair value measurement principle in this Statement applies to a noncontrolling interest in an acquiree, and the revised IFRS 3 permits an acquirer to measure a noncontrolling interest in an acquiree at its acquisition-date fair value.

IFRS 3's choice of measurement basis for a noncontrolling interest

B209. The IASB concluded that, in principle, an acquirer should measure all components of a business combination, including any noncontrolling interest in an acquiree, at their acquisition-date fair values. However, the revised IFRS 3 permits an acquirer to choose whether to measure any noncontrolling interest in an acquiree at its fair value or as the noncontrolling interest's proportionate share of the acquiree's identifiable net assets.

B210. Introducing a choice of measurement basis for noncontrolling interests was not the IASB's first preference. In general, the IASB believes that alternative accounting methods reduce the comparability of financial statements. However, the IASB was not able to agree on a single measurement basis for noncontrolling interests because neither of the alternatives considered (fair value and proportionate share of the acquiree's identifiable net assets) received sufficient Board support to enable a revised business combinations standard to be issued. The IASB decided to permit a choice of measurement basis for noncontrolling interests because it concluded that the benefits of the other improvements to, and the convergence of, the accounting for business combinations developed in this project outweigh the disadvantages of allowing this particular option.

B211. The following sections (a) provide additional information about the measurement alternatives considered by the IASB, (b) summarize the key effects of permitting a choice in measurement basis, and (c) discuss the effect on convergence.

Measurement alternatives

B212. Although the IASB supports the principle of measuring all components of a business combination at fair value, support for that principle was not unanimous. Some IASB members did not support that

principle because it would require measuring noncontrolling interests at fair value. For that reason, those IASB members supported making an exception to the measurement principle for the noncontrolling interest in an acquiree.

B213. Some other IASB members supported an exception for the noncontrolling interest for different reasons. Some advocated an exception on the basis that they did not have sufficient evidence to assess the marginal benefits of reporting the acquisition-date fair value of noncontrolling interests. Those members concluded that, generally, the fair value of the noncontrolling interest could be measured reliably, but they noted that it would be more costly to do so than measuring it at its proportionate share of the acquiree's identifiable net assets. Those members observed that many respondents had indicated that they saw little information of value in the reported noncontrolling interest, no matter how it is measured.

B214. Those IASB members who did not support making an exception concluded that the marginal benefits of reporting the acquisition-date fair value of noncontrolling interests exceed the marginal costs of measuring it.

B215. The IASB considered making it a requirement to measure noncontrolling interests at fair value unless doing so would impose undue cost or effort on the acquirer. However, feedback from constituents and staff research indicated that it was unlikely that the term *undue cost or effort* would be applied consistently. Therefore, such a requirement would be unlikely to appreciably increase the consistency with which different entities measured noncontrolling interests.

B216. The IASB reluctantly concluded that the only way the IFRS would receive sufficient votes to be issued was if it permitted an acquirer to measure a noncontrolling interest either at fair value or at its proportionate share of the acquiree's identifiable net assets, on a transaction-by-transaction basis.

Effects of the optional measurement of noncontrolling interests

B217. The IASB noted that there are likely to be three main differences in outcome that occur when the noncontrolling interest is measured as its proportionate share of the acquiree's identifiable net assets, rather than at fair value. First, the amounts recognized in a business combination for noncontrolling interests and goodwill are likely to be lower (and these should be the only two items affected on initial recognition). Second, if a cash-generating unit is subsequently impaired, any resulting impairment of goodwill recognized through income is likely to be lower than it would have been if the noncontrolling interest had been measured at fair value (although it does not affect the impairment loss attributable to the controlling interest).

B218. The third difference arises if the acquirer subsequently purchases some (or all) of the shares held by the noncontrolling shareholders. By acquiring the noncontrolling interest, presumably at fair value, the equity of the group is reduced by the noncontrolling interest's share of any unrecognized changes in the fair value of the net assets of the business, including goodwill. By measuring the noncontrolling interest initially as a proportionate share of the acquiree's identifiable net assets, rather than at fair value, that reduction in the reported equity attributable to the acquirer is likely to be larger. This matter was considered further in the IASB's deliberations on the proposed amendments to IAS 27.

Convergence

B219. Both Boards decided that, although they would have preferred to have a common measurement attribute for noncontrolling interests, they had considered and removed as many differences between this Statement and the revised IFRS 3 as was practicable.

B220. The Boards were unable to achieve convergence of their respective requirements in several areas because of existing differences in the GAAP and IFRS requirements outside a business combination. The Boards observed that the accounting for impairments in IFRSs is different from that in GAAP. This means that even if the Boards were converged on the initial measurement of noncontrolling interests, and therefore goodwill, the subsequent accounting for goodwill would not be converged. Although this is not a good reason for allowing divergence in the initial measurement of noncontrolling interests, it was a mitigating factor.

B221. Because most business combinations do not involve a noncontrolling interest, the Boards also observed that this Statement and the revised IFRS 3 will align most of the accounting for most business combinations regardless of the different accounting for noncontrolling interests in this Statement and the revised IFRS 3.

Measuring assets and liabilities arising from contingencies, including subsequent measurement

B222. FASB Statement No. 5, *Accounting for Contingencies,* defines a *contingency* as an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an entity that will ultimately be resolved when one or more future events occur or fail to occur. This Statement refers to the assets and liabilities to which contingencies relate as *assets and liabilities arising from contingencies.* For ease of discussion, this Statement also uses that term to refer broadly to the issues related to contingencies, including the issues that the IASB considered in developing its requirements on recognizing and measuring contingent liabilities in a business combination (paragraphs B272–B278 and B242–B245).

B223. This Statement requires the assets and liabilities arising from contingencies that are recognized as of the acquisition date to be measured at their acquisition-date fair values. That requirement is generally consistent with the measurement requirements of IFRS 3, but it represents a change in the way entities generally applied Statement 141. In addition, the IASB's measurement guidance on contingent liabilities carries forward the related guidance in IFRS 3, pending completion of the project to revise IAS 37 (paragraphs B272–B276). Accordingly, the FASB's and the IASB's conclusions on measuring assets and liabilities arising from contingencies are discussed separately.

The FASB's conclusions on measuring assets and liabilities arising from contingencies

B224. The amount of an asset or a liability arising from a contingency recognized in accordance with Statement 141 seldom was the acquisition-date fair value. Rather, it often was the settlement amount or a best estimate of the expected settlement amount based on circumstances existing at a date after the acquisition date.

B225. In developing the 2005 Exposure Draft, the FASB considered whether to require a strict Statement 5 approach for the initial measurement and recognition of all contingencies in a business combination. That would mean that contingencies that did not meet the Statement 5 "probability" criterion would be measured at zero (or at a minimum amount that qualifies as probable) rather than at fair value. They said that applying Statement 5 in accounting for a business combination might be a practical way to reduce the costs and measurement difficulties involved in obtaining the information and legal counsel needed to measure the fair value of numerous contingencies that the acquiree had not recognized in accordance with Statement 5.

B226. The FASB observed that paragraph 17(a) of Statement 5 states that "contingencies that might result in gains usually are not reflected in the accounts since to do so might be to recognize revenue prior to its realization." Thus, to apply Statement 5 in accounting for a business combination in the same way it is applied in other situations likely would result in nonrecognition of gain contingencies, including those for which all of the needed information is available at the acquisition date. The FASB concluded that that would be a step backwards; Statement 141 already required the recognition of gain contingencies at the acquisition date and for which fair value is determinable (paragraphs 39 and 40(a) of Statement 141). Also, in accordance with Statement 5's requirements, contingent losses that arise outside a business combination are not recognized unless there is a high likelihood of a future outflow of resources. In addition, because goodwill is calculated as a residual, omitting an asset for an identifiable contingent gain also would result in overstating goodwill. Similarly, omitting a liability for a contingent loss would result in understating goodwill. Thus, the FASB rejected the Statement 5 approach in accounting for a business combination.

B227. The FASB also considered but rejected retaining existing practice based on FASB Statement No. 38, *Accounting for Preacquisition Contingencies of Purchased Enterprises,* which Statement 141 carried forward without reconsideration. For the reasons described in the preceding paragraph, the FASB concluded that continuing to permit the delayed recognition of most assets and liabilities arising from contingencies that occurred in applying Statement 141 and the related guidance would fail to bring about needed improvements in the accounting for business combinations. The Board decided that requiring an acquirer to measure at fair value and recognize any assets and liabilities arising from contingencies that meet the conceptual elements definitions would help bring about those needed improvements, particularly improvements in the completeness of reported financial information.

B228. Some respondents to the 2005 Exposure Draft were concerned about the ability to reliably measure the fair value of assets and liabilities arising

from contingencies at the acquisition date. The FASB concluded that measuring the fair value of an asset or a liability arising from a contractual contingency with sufficient reliability as of the acquisition date should not be more difficult than measuring the fair value of many other assets and liabilities that this Statement requires to be measured at fair value as of that date. The terms of the contract, together with information developed during the acquisition process, for example, to determine the price to be paid, should provide the needed information. Sufficient information also is likely to be available to measure the acquisition-date fair value of assets and liabilities arising from noncontractual contingencies that satisfy the more-likely-than-not criterion (paragraphs B270 and B271). The Board acknowledges that noncontractual assets and liabilities that do not meet that criterion at the acquisition date are most likely to raise difficult measurement issues and concerns about the reliability of those measures. To address those reliability concerns, the Board decided an acquirer should not measure and recognize such assets and liabilities. Rather, assets and liabilities arising from noncontractual contingencies that do not satisfy the more-likely-than-not criterion at the acquisition date are accounted for in accordance with other GAAP, including Statement 5.

B229. The FASB also observed that respondents who are concerned about the reliability with which the fair values of assets and liabilities arising from contingencies can be measured may be interpreting *reliable measurement* differently than the FASB. To determine a reliable measure of the fair value of a contingency, the acquirer need not be able to determine, predict, or otherwise know the ultimate settlement amount of that contingency at the acquisition date (or within the measurement period) with certainty or precision.

B230. In 2006, the FASB and the IASB issued for comment the first discussion paper in their joint project to improve their respective conceptual frameworks. Paragraph QC21 of that Preliminary Views, *Conceptual Framework for Financial Reporting: Objective of Financial Reporting and Qualitative Characteristics of Decision-Useful Financial Reporting Information,* discusses the relationship between faithful representation, the quality of decision-useful financial reporting information that pertains to the reliability of information, and precision. It says that accuracy of estimates is desirable and some minimum level of accuracy is necessary for an estimate to be a faithful representation of an economic phenomenon. However, faithful representation implies neither absolute precision in the estimate nor certainty about the outcome.

B231. The FASB concluded that the fair values of assets and liabilities arising from contingencies meeting this Statement's recognition criteria are measurable with sufficient reliability as of the acquisition date for recognition in accounting for a business combination if the estimates are based on the appropriate inputs and each input reflects the best available information about that factor. The FASB acknowledges that the fair values measured at the acquisition date will not be the amount for which the asset or the liability is ultimately settled, but it provides information about the current value of an asset or a liability by incorporating uncertainty into the measure.

Subsequent measurement of assets and liabilities arising from contingencies

B232. The FASB observed that applying Statement 5 in the postcombination period to a recognized liability or asset arising from a contingency that did not meet the Statement 5 probability threshold at the acquisition date would result in derecognizing that liability or asset and reporting a gain or loss in earnings of the postcombination period. That result would not faithfully represent the economic events occurring in that period. The Board noted that similar concerns about the potential for misleading reporting consequences do not exist for many financial instruments arising from contingencies, such as options, forward contracts, and other derivatives. Such assets and liabilities generally would continue to be measured at fair value in accordance with other applicable GAAP, which also provides guidance on how to report subsequent changes in the fair values of financial instruments in earnings or comprehensive income. Thus, the FASB decided that it must address the subsequent measurement of assets and liabilities arising from contingencies recognized in a business combination; however, it limited the scope of that effort to assets and liabilities that would subsequently be subject to Statement 5.

B233. The FASB considered five alternatives for subsequent measurement of assets and liabilities arising from contingencies that would be subject to Statement 5 if not acquired or assumed in a business combination:

- Alternative 1—Subsequently measuring at fair value
- Alternative 2—Subsequently reporting amounts initially recognized in a business combination at

their acquisition-date fair values until the acquirer obtains new information about the possible outcome of the contingency. When new information is obtained, the acquirer evaluates that new information and measures a liability at the **higher** of its acquisition-date fair value or the amount that would be recognized if applying Statement 5 and an asset at the **lower** of its acquisition-date fair value or the best estimate of its future settlement amount

- Alternative 3—"Freezing" amounts initially recognized in a business combination
- Alternative 4—Applying an interest allocation method (similar to the model in FASB Statement No. 143, *Accounting for Asset Retirement Obligations*)
- Alternative 5—Applying a deferred revenue method, but only to those items that relate to revenue-generating activities.

B234. Paragraphs B224–B231 discuss the reasons for the FASB's decision to require fair value measurement for initial recognition of assets and liabilities arising from contingencies. For many of those same reasons, the FASB considered requiring Alternative 1—subsequent measurement at fair value. For a variety of reasons, the Board ultimately rejected that alternative. Adopting this alternative would mean that for some entities (maybe many entities) assets and liabilities arising from contingencies acquired in a business combination would be reported at fair value, while other similar assets and liabilities would be reported at Statement 5 amounts. Different measurement of similar assets and liabilities would make financial reports more difficult to understand. The Board noted that a project on business combinations would not be the appropriate place to broadly address perceived deficiencies in Statement 5. Moreover, at the same time this Statement was being finalized, the Board was considering adding a project to its technical agenda to comprehensively reconsider the accounting for contingencies in Statement 5. (The FASB added a project to reconsider the accounting for contingencies to its agenda in September 2007.) The Board concluded that requiring assets and liabilities arising from contingencies to subsequently be measured at fair value was premature and might prejudge the outcome of its deliberations in that project.

B235. The FASB decided, as a practical alternative, to require Alternative 2. In accordance with that approach, the acquirer continues to report an asset or a liability arising from a contingency recognized as of the acquisition date at its acquisition-date fair value absent new information about the possible outcome of the contingency. When such new information is obtained, the acquirer evaluates that new information and measures the asset or liability as follows:

a. A liability is measured at the **higher** of:
   (1) Its acquisition-date fair value; or
   (2) The amount that would be recognized if applying Statement 5.
b. An asset is measured at the **lower** of:
   (1) Its acquisition-date fair value; or
   (2) The best estimate of its future settlement amount.

B236. The FASB concluded that this alternative was a practical bridge between improved reporting at the acquisition date and subsequent accounting under the existing requirements of Statement 5. It would not prejudge the outcome of deliberations that the Board will have in a project to reconsider Statement 5. It also addressed the concerns of some constituents that requiring contingencies to subsequently be measured at fair value would result in contingencies acquired or assumed in a business combination being measured differently than contingencies that arise outside a business combination.

B237. The FASB observed that this alternative provides slightly different guidance for liabilities than it does for assets. Unlike liabilities, it could not require assets to be measured at the lower of their acquisition-date fair values or **the amounts that would be recognized if applying Statement 5.** Because Statement 5 does not allow recognition of gain contingencies, the amount that would be recognized by applying Statement 5 to an asset would be zero. Thus, the Board decided that an asset arising from a contingency should be measured at the lower of its acquisition-date fair value or **the best estimate of its future settlement amount.** The Board believes that that measure is similar to the measure required by Statement 5 for liabilities (loss contingencies). The FASB also observed that the approach for assets allows for the recognition of impairments to the asset; it requires an asset to be decreased to the current estimate of the amount the acquirer expects to collect.

B238. The FASB rejected Alternative 3—freezing the amounts initially recognized. The FASB observed that this alternative results in less relevant information than Alternative 2. Because the Board views Alternative 2 as a practical and operational solution, it saw no compelling reason to adopt a less

optimal alternative. The FASB also rejected Alternative 4—the interest allocation method. In accordance with that method, the contingency would be remeasured using a convention similar to Statement 143 whereby interest rates are held constant for initial cash flow assumptions. The Board noted that the reasons for selecting the interest allocation method in Statement 143 for long-term asset retirement obligations, including concerns about income statement volatility, are not compelling for contingencies such as warranties and pending litigation that generally have shorter lives.

B239. In accordance with Alternative 5—the deferred revenue method—the acquisition-date fair value of a deferred revenue liability (performance obligation) would be amortized after the acquisition date, similar to the approach for separately priced extended warranties and product maintenance contracts acquired outside a business combination. Accruals would be added to the contingency for subsequent direct costs. The FASB acknowledged that the costs to apply that measurement approach would be lower than other measurement approaches. However, the Board concluded that the potential reduction in costs does not justify (a) creating inconsistencies in the subsequent accounting for particular classes of contingencies acquired or assumed in a business combination and (b) the diminished relevance of the resulting information. Thus, the FASB also rejected Alternative 5. Some respondents to the 2005 Exposure Draft supported recognition of subsequent changes in the amounts recognized for assets and liabilities arising from contingencies either as adjustments to goodwill or in comprehensive income rather than in earnings. Some who favored reporting such changes as adjustments to goodwill did so at least in part because of the difficulties they see in distinguishing between changes that result from changes in circumstances after the acquisition date and changes that pertain more to obtaining better information about circumstances that existed at that date. They noted that the latter are measurement period adjustments, many of which result in adjustments to goodwill.

B240. The FASB understands that distinguishing between measurement period adjustments and other changes in the amounts of assets and liabilities arising from contingencies sometimes will be difficult. It observed, however, that similar difficulties exist for other assets acquired and liabilities assumed in a business combination; changes in the amounts of those assets and liabilities after the acquisition date are included in earnings. The FASB saw no compelling reason to treat items arising from contingencies differently.

B241. Those who favored reporting subsequent changes in the amounts recognized for assets and liabilities arising from contingencies in other comprehensive income rather than in earnings generally analogized to the present accounting for available-for-sale securities. They said that items arising from contingencies were not "realized" until the contingency is resolved. The FASB rejected that alternative because it saw no compelling reason to add to the category of items that are initially recognized as other comprehensive income and later "recycled" to earnings. The Board considers reporting subsequent changes in the amounts of items arising from contingencies in earnings to be not only conceptually superior to reporting those changes in comprehensive income but also to be consistent with the way in which other changes in amounts acquired or assumed in a business combination are recognized.

The IASB's conclusions on initial and subsequent measurement of contingent liabilities

B242. As noted in paragraph B223, the IASB's measurement guidance on contingencies carries forward the related guidance in IFRS 3 (except for clarifying that an acquirer cannot recognize a contingency that is not a liability), pending completion of the project to revise IAS 37. Accordingly, contingent liabilities recognized in a business combination are initially measured at their acquisition-date fair values.

B243. In developing IFRS 3, the IASB observed that not specifying the subsequent accounting for contingent liabilities recognized in a business combination might result in inappropriately derecognizing some or all of those contingent liabilities immediately after the combination.

B244. In ED 3 the IASB proposed that a contingent liability recognized in a business combination should be excluded from the scope of IAS 37 and subsequently measured at fair value with changes in fair value recognized in profit or loss until the liability is settled or the uncertain future event described in the definition of a contingent liability is resolved. In considering respondents' comments on this issue, the IASB noted that subsequently measuring such contingent liabilities at fair value would be inconsistent

with the conclusions it reached on the accounting for financial guarantees and commitments to provide loans at below-market interest rates when it revised IAS 39.

B245. The IASB decided to revise the proposal in ED 3 for consistency with IAS 39. Therefore, IFRS 3 and the revised IFRS 3 require contingent liabilities recognized in a business combination to be measured after their initial recognition at the higher of:

a. The amount that would be recognized in accordance with IAS 37; or
b. The amount initially recognized less, when appropriate, cumulative amortization recognized in accordance with IAS 18, *Revenue.*

Definition of Fair Value

B246. This Statement and the revised IFRS 3 each use the same definition of fair value that the FASB and the IASB, respectively, use in their other standards. Specifically, Statement 157 defines *fair value* as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date," and that definition is used in this Statement. IAS 39 and other IFRSs, on the other hand, define fair value as "the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction," and the revised IFRS 3 uses that definition.

B247. The IASB considered also using the definition of fair value from Statement 157 but decided that to do so would prejudge the outcome of its project on fair value measurements. Similarly, the FASB considered using the definition of fair value from IFRS 3 but decided that to do so would be inappropriate in light of Statement 157, which it intends for use in all situations in which a new standard requires measurement at fair value.

B248. The Boards acknowledge that the differing definitions of fair value might result in measuring the fair values of assets acquired and liabilities assumed in a business combination differently depending on whether the combination is accounted for in accordance with this Statement or the revised IFRS 3. However, the Boards consulted with valuation experts on the likely effects of the differing definitions of fair value. As a result of that consultation, the Boards understand that such differences are unlikely to occur often. The Boards also observed that the definitions use different words to articulate essentially the same concepts in two general areas—the nonperformance risk and credit standing of financial liabilities and the market-based measurement objective.

B249. Statement 157 defines nonperformance risk as the risk that an obligation will not be fulfilled and indicates that it affects the fair value of a liability. Nonperformance risk includes but may not be limited to the reporting entity's own credit risk. In comparison, IFRSs do not use the term nonperformance risk in discussing the fair value of a liability. However, IAS 39 requires that the fair value of a financial liability reflect its credit risk. Although the words are different, the Boards believe the underlying concepts are essentially the same.

B250. The definition of fair value from Statement 157 indicates that it is a price in an orderly transaction between market participants. In comparison, IFRSs indicate that fair value reflects an arm's-length transaction between knowledgeable, willing parties. Paragraphs 42–44 of IAS 40 discuss what a *transaction between knowledgeable, willing parties* means:

> . . . In this context, 'knowledgeable' means that both the willing buyer and the willing seller are reasonably informed about the nature and characteristics of the investment property, its actual and potential uses, and market conditions at the balance sheet date . . .
>
> . . . The willing seller is motivated to sell the investment property at market terms for the best price obtainable. The factual circumstances of the actual investment property owner are not a part of this consideration because the willing seller is a hypothetical owner (e.g. a willing seller would not take into account the particular tax circumstances of the investment property owner).
>
> The definition of fair value refers to an arm's length transaction. An arm's length transaction is one between parties that do not have a particular or special relationship that makes prices of transactions uncharacteristic of market conditions. The transaction is presumed to be between unrelated parties, each acting independently.

Thus, although the two definitions use different words, the concept is the same—fair value is a market-based measure in a transaction between unrelated parties.

B251. However, differences in the results of applying the different definitions of fair value may occur in particular areas. For example, Statement 157 defines fair value as an exit price between market participants, and IFRSs define fair value as an exchange price in an arm's-length transaction. Most valuation experts the Boards consulted said that, because transaction costs are not a component of fair value in either definition, an exit price for an asset or liability acquired or assumed in a business combination would differ from an exchange price (entry or exit) only (a) if the asset is acquired for its defensive value or (b) if a liability is measured on the basis of settling it with the creditor rather than transferring it to a third party. However, the Boards understand that ways of measuring assets based on their defensive values in accordance with paragraph A12 of Statement 157 are developing, and it is too early to tell the significance of any differences that might result. It also is not clear that entities will use different methods of measuring the fair value of liabilities assumed in a business combination.

Measuring the Acquisition-Date Fair Values of Particular Assets Acquired

Assets with uncertain cash flows (valuation allowances)

B252. Both Statement 141 and IFRS 3 required receivables to be measured at the present values of amounts to be received determined at appropriate current interest rates, less allowances for uncollectibility and collection costs, if necessary. The Boards considered whether an exception to the fair value measurement principle is necessary for assets such as trade receivables and other short-term and long-term receivables acquired in a business combination. Several of the Boards' constituents suggested that an exception be permitted for practical and other reasons, including concerns about comparing credit losses on loans acquired in a business combination with those on originated loans. In developing the 2005 Exposure Draft, however, the Boards saw no compelling reason for such an exception. The Boards observed that using an acquiree's carrying basis and including collection costs is inconsistent with this Statement's fair value measurement requirement and the underlying notion that the acquirer's initial measurement, recognition, and classification of the assets acquired and liabilities assumed begins on the acquisition date. Because uncertainty about collections and future cash flows is included in the fair value measure of a receivable, the 2005 Exposure Draft proposed that the acquirer not recognize a separate valuation allowance for acquired assets measured at fair value.

B253. In developing the 2005 Exposure Draft, the FASB acknowledged that including uncertainties about future cash flows in a fair value measure, with no separate allowance for uncollectible amounts, differed from the current practice for SEC registrants. That practice was established in SEC Staff Accounting Bulletin Topic 2.A.5, *Adjustments to Allowances for Loan Losses in Connection With Business Combinations*, which states that generally the acquirer's estimation of the uncollectible portion of the acquiree's loans should not change from the acquiree's estimation before the acquisition. However, the FASB also observed that fair value measurement is consistent with guidance in AICPA Statement of Position 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer.* SOP 03-3 prohibits "carrying over" or creating valuation allowances in the initial accounting of all loans acquired in transfers that are within its scope, including business combinations accounted for as an acquisition.

B254. In developing the 2005 Exposure Draft, the Boards also acknowledged that the fair value measurement approach has implications for the capital requirements for financial institutions, particularly banks. The Boards noted, however, that regulatory reporting requirements are a separate matter that is beyond the scope of general purpose financial reporting.

B255. Some respondents to the 2005 Exposure Draft who commented on this issue agreed with the proposal, but many who commented on it disagreed with not recognizing a separate valuation allowance for receivables and similar assets. Some of those respondents favored retaining the guidance in Statement 141 and IFRS 3. They said that the costs of measuring the fair value of trade receivables, loans, receivables under financing leases, and the like would be high; they did not think the related benefits would justify those costs. Some also said that software systems currently available for loans and other receivables do not provide for separate accounting for acquired and originated loans; they have to manually account for loans to which SOP 03-3 applies, incurring significant costs to do so.

B256. As they did in developing the 2005 Exposure Draft, the Boards acknowledged that the requirement to measure receivables and similar assets at fair value

with no separate valuation allowance may lead to additional costs for some entities. However, the Boards observed that entities that apply IAS 39 are required to measure financial assets acquired outside a business combination, as well as those originated, at fair value on initial recognition. The Boards do not think financial or other assets should be measured differently because of the nature of the transaction in which they are acquired. Because the Boards saw no compelling reason to provide an exception to the measurement principle for receivables or other assets with credit risk, they affirmed their conclusion that the benefits of measuring receivables and similar assets at fair value justify the related costs.

B257. Some respondents to the 2005 Exposure Draft said that separate recognition of valuation allowances for loans and similar assets was important to users in evaluating the credit assumptions built into loan valuations. They suggested that the fair value of receivables be split into three components: (a) the gross contractual amounts, (b) a separate discount or premium for changes in interest rates, and (c) a valuation allowance for the credit risk, which would be based on the contractual cash flows expected to be uncollectible. In evaluating that alternative presentation, the Boards noted that the valuation allowance presented would differ from the valuation allowance for receivables under Statement 5 and IAS 39, each of which is determined on the basis of incurred, rather than expected, losses. Thus, how to determine the valuation allowance on an ongoing basis would be problematic. For example, if requirements for other receivables were applied, an immediate gain would be recognized for the difference between incurred losses and expected losses. In contrast, if the valuation allowance for receivables acquired by transfer, including in a business combination, rather than by origination was determined subsequently on an expected loss basis, the result would be a new accounting model for those receivables. The Boards concluded that this project is not the place to consider the broader issues of how best to determine the valuation allowances for receivables, regardless of the manner in which the receivables are acquired.

Disclosure of information about receivables acquired

B258. Some constituents asked the Boards to consider requiring additional disclosures about receivables measured at fair value to help in assessing considerations of credit quality included in the fair value measures, including expectations about receivables that will be uncollectible. Those constituents were concerned that without additional disclosure, it would be impossible to determine the contractual cash flows and the amount of the contractual cash flows not expected to be collected if receivables were recognized at fair value. In response to those comments, the Boards decided to require disclosure of the fair value of receivables acquired, the gross contractual amounts receivable, and the best estimate at the acquisition date of the contractual cash flows not expected to be collected. The disclosures are required for each major class of receivable.

B259. In January 2007, the FASB added a project to its technical agenda to improve disclosures relating to the allowance for credit losses associated with financing receivables. As part of that project, the FASB is considering potential new disclosures and enhanced current disclosures about the credit quality of an entity's portfolio, the entity's credit risk exposures, its accounting policies on valuation allowances, and possibly other areas.

B260. The Boards observed that the work involved in developing a complete set of credit quality disclosures to be made for receivables acquired in a business combination would be similar to that required in the FASB's disclosure project related to valuation allowances. Combining those efforts would be a more efficient use of resources. Accordingly, the FASB decided to include disclosures that should be made in a business combination in the scope of its project on disclosures related to valuation allowances and credit quality, and the IASB will monitor that project. In the interim, the disclosures required by paragraph 68(h) will provide at least some, although perhaps not all, of the information users need to evaluate the credit quality of receivables acquired.

Assets that the acquirer intends not to use or to use in a way other than their highest and best use

B261. While this Statement was being developed, the FASB received inquires about inconsistencies in practice in accordance with Statement 141 related to measuring particular intangible assets that an acquirer intends not to use or intends to use in a way other than their highest and best use. For example, if the acquirer did not intend to use a brand name acquired in a business combination, some entities assigned no value to the asset, and other entities measured it at the amount at which market participants could be expected to exchange the asset, that is, at its fair value.

B262. To avoid such inconsistencies in practice, the Boards decided to clarify the measurement of assets that an acquirer intends not to use (paragraph A59). The intention of both Statement 141 and IFRS 3 was that assets, both tangible and intangible, be measured at their fair values regardless of how or whether the acquirer intends to use them. The FASB observed that measuring such assets in accordance with their highest and best use is consistent with Statement 157. Paragraph A12 of Statement 157 illustrates determining the fair value of an in-process research and development project acquired in a business combination that the acquirer does not intend to complete. The IASB understands from its consultation with preparers, valuation experts, and auditors that IFRS 3 was applied in the way this Statement and the revised IFRS 3 require.

Exceptions to the Recognition or Measurement Principles

B263. As indicated in paragraph 22, this Statement includes limited exceptions to its recognition and measurement principles. Paragraphs B265–B311 discuss the types of identifiable assets and liabilities for which exceptions are provided and the reasons for those exceptions.

B264. It is important to note that not every item that falls into a particular type of asset or liability is an exception to either the recognition or the measurement principle (or both). For example, assets and liabilities arising from contingencies are identified as an exception to the recognition principle because this Statement includes a recognition condition for them in addition to the recognition conditions in paragraphs 13 and 14. Although applying that additional condition will result in not recognizing some assets and liabilities arising from contingencies, those that meet the additional condition will be recognized in accordance with the recognition principle. Another example is employee benefits, which are identified as a type of asset or liability for which exceptions to both the recognition and the measurement principles are provided. As discussed further in paragraphs B296–B300, the acquirer is required to recognize and measure liabilities and any related assets resulting from the acquiree's employee benefit arrangements in accordance with applicable GAAP, as amended by this Statement, rather than by applying the recognition and measurement principles in this Statement. Applying the requirements of other applicable GAAP will result in recognizing many, if not most, types of employee benefit liabilities in the same way that would result from applying the recognition principle (paragraph B297). However, others, for example, withdrawal liabilities from multiemployer plans for entities applying GAAP, are not necessarily consistent with the recognition principle. In addition, applying the requirements of other GAAP generally will result in measuring liabilities for employee benefits (and any related assets) on a basis other than their acquisition-date fair values. However, applying the requirements of Statement 146 to one-time termination benefits results in measuring liabilities for those benefits at their acquisition-date fair values.

Exception to the recognition principle

Assets and liabilities arising from contingencies

B265. Both the FASB's conclusions on recognizing assets and liabilities arising from contingencies and the IASB's conclusions on recognizing contingent liabilities resulted in exceptions to the recognition principle in this Statement and the revised IFRS 3 because both will result in some items being unrecognized at the acquisition date. However, the details of the exceptions differ. The reasons for those exceptions and the differences between them are discussed in paragraphs B266–B278.

The FASB's conclusions on assets and liabilities arising from contingencies

B266. Statement 141 carried forward without reconsideration the requirements of Statement 38 which required an acquirer to include in the purchase price allocation the fair value of an acquiree's contingencies if their fair values could be determined during the allocation period. For those contingencies whose fair values could not be determined during the allocation period, Statement 141 required the acquirer to recognize the contingency in earnings when the occurrence of the contingency became probable and its amount could be reasonably estimated.

B267. Members of its resource group and others told the FASB that in practice acquirers often did not recognize an acquiree's assets and liabilities arising from contingencies at the acquisition date. Instead, a contingency was recognized after the acquisition date at an amount determined at that later date either because its amount was judged not to be "reasonably estimable" or because the contingency was determined not to meet the Statement 5 "probability" criterion for recognition.

B268. The 2005 Exposure Draft proposed that an acquirer recognize all assets and liabilities arising

from an acquiree's contingencies if they meet the definition of an asset or a liability in Concepts Statement 6 regardless of whether a contingency meets the recognition criteria in Statement 5. The FASB, like the IASB, concluded that to faithfully represent the economic circumstances at the acquisition date, in principle, all identifiable assets acquired and liabilities assumed should be recognized separately from goodwill, including assets and liabilities arising from contingencies at the acquisition date.

B269. Respondents to the 2005 Exposure Draft that apply GAAP expressed concern about how to deal with uncertainty about whether and when a contingency gives rise to an asset or a liability that meets the definition in Concepts Statement 6, referred to as *element uncertainty*. An example cited by some respondents involved an acquiree's negotiations with another party at the acquisition date for reimbursement of costs incurred on the other party's behalf. How should the acquirer determine whether that contingency gave rise to an asset that should be recognized as part of the accounting for the business combination? Respondents suggested several means of dealing with element uncertainty, which generally involved placing a threshold either on all contingencies or on the noncontractual contingencies an acquirer is required to recognize at the acquisition date. Other respondents suggested requiring recognition of only those assets and liabilities arising from contingencies whose fair values can be reliably determined, which would be similar to the requirements of Statement 141.

B270. The FASB understands the potential difficulty of resolving element uncertainty, especially for assets or liabilities arising from noncontractual contingencies. It considered whether to deal with element uncertainty by requiring assets and liabilities arising from contingencies to be recognized only if their fair values are reliably measurable. The Board concluded that applying the guidance in Statement 157 on measuring fair value should result in an estimate of the fair value of assets and liabilities arising from contingencies that is sufficiently reliable for recognition. The FASB also observed that adding a measurement condition is an indirect way of dealing with uncertainty involving recognition; it would be better to deal with such uncertainty more directly.

B271. The FASB concluded that most cases of significant uncertainty about whether a potential asset or liability arising from a contingency meets the pertinent definition (element uncertainty) are likely to involve noncontractual contingencies. To help preparers and their auditors deal with element uncertainty, the FASB decided to add a requirement for the acquirer to assess whether it is **more likely than not** that the contingency gives rise to an asset or a liability as defined in Concepts Statement 6. For an asset arising from a contingency, applying that criterion focuses on whether it is more likely than not that the acquirer has obtained control of a future economic benefit as a result of a past transaction or other event. For a liability, the more-likely-than-not criterion focuses on whether the acquirer has a present obligation to sacrifice future economic benefits as a result of a past transaction or other event. If that criterion is met at the acquisition date, the acquirer recognizes the asset or liability, measured at its acquisition-date fair value, as part of the accounting for the business combination. If that criterion is not met at the acquisition date, the acquirer accounts for the noncontractual contingency in accordance with other GAAP, including Statement 5, as appropriate. The FASB concluded that adding the more-likely-than-not criterion would permit acquirers to focus their efforts on the more readily identifiable contingencies of acquirees, thereby avoiding spending disproportionate amounts of time searching for contingencies that, even if identified, would have less significant effects.

The IASB's conclusions on contingent liabilities

B272. In developing the 2005 Exposure Draft, the IASB concluded that an asset or a liability should be recognized separately from goodwill if it satisfied the definitions in the *Framework*. In some cases, the amount of the future economic benefits embodied in the asset or required to settle the liability is contingent (or conditional) on the occurrence or nonoccurrence of one or more uncertain future events. That uncertainty is reflected in measurement. The FASB reached a consistent conclusion.

B273. At the same time that it issued the 2005 Exposure Draft, the IASB also issued for comment a separate Exposure Draft containing similar proposals on the accounting for contingent assets and contingent liabilities within the scope of IAS 37. At that time, the IASB expected that the effective date of the revised IAS 37 would be the same as the effective date of the revised IFRS 3. However, the IASB now expects to issue a revised IAS 37 at a later date. Accordingly, except for clarifying that an acquirer should not recognize a so-called contingent liability that is not an obligation at the acquisition date, the IASB decided to carry forward the related requirements in the

original IFRS 3. The IASB expects to reconsider and, if necessary, amend the requirements in the revised IFRS 3 when it issues the revised IAS 37.

B274. The IASB concluded that an acquirer should recognize a contingent liability assumed in a business combination only if it satisfies the definition of a liability in the *Framework.* This is consistent with the overall objective of the second phase of the project on business combinations in which an acquirer recognizes the assets acquired and liabilities assumed at the date control is obtained.

B275. However, the IASB observed that the definition of a contingent liability in IAS 37 includes both (a) "possible obligations" and (b) present obligations for which either it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation or the amount of the obligation cannot be measured reliably. The IASB concluded that a contingent liability assumed in a business combination should be recognized only if it is a present obligation. Therefore, unlike IFRS 3, the revised IFRS 3 does not permit the recognition of "possible obligations."

B276. Like its decision on the recognition of contingent liabilities assumed in a business combination, the IASB concluded that an acquirer should recognize a contingent asset acquired in a business combination only if it satisfies the definition of an asset in the *Framework.* However, the IASB observed that the definition of a contingent asset in IAS 37 includes only "possible assets." A contingent asset arises when it is uncertain whether an entity has an asset at the balance sheet date, but it is expected that some future event will confirm whether the entity has an asset. Accordingly, the IASB concluded that contingent assets should not be recognized, even if it is virtually certain that they will become unconditional or noncontingent. If an entity determines that an asset exists at the acquisition date (that is, that it has an unconditional right at the acquisition date), that asset is not a contingent asset and should be accounted for in accordance with the appropriate IFRS.

Convergence

B277. The result of the FASB's and the IASB's conclusions on recognizing assets and liabilities arising from contingencies is that the criteria for determining which items to recognize at the acquisition date differ, at least for the short term. That lack of convergence is inevitable at this time, given the status of the IASB's redeliberations on its revision of IAS 37 and the fact that the FASB had no project on its agenda to reconsider the requirements of Statement 5 while the Boards were developing this Statement and the revised IFRS 3. (The FASB added a project to reconsider the accounting for contingencies to its agenda in September 2007.) To attempt to converge on guidance for recognizing assets and liabilities arising from contingencies in a business combination now would run the risk of establishing requirements for a business combination that would be inconsistent with the eventual requirements for assets and liabilities arising from contingencies acquired or incurred by means other than a business combination.

B278. However, the Boards observed that the assets or liabilities arising from contingencies that are recognized in accordance with the FASB's recognition guidance and the contingent liabilities recognized in accordance with the IASB's recognition guidance will be measured consistently. In other words, the initial measurement requirements for assets and liabilities arising from contingencies recognized at the acquisition date have converged. However, the Boards acknowledge that the subsequent measurement requirements differ because Statement 5's measurement guidance differs from that in IAS 37. The reasons for the Boards' conclusions on measuring those assets and liabilities are discussed in paragraphs B224–B245.

Exceptions to both the recognition and measurement principles

Income taxes

B279. The 2005 Exposure Draft proposed, and this Statement requires, that a deferred tax asset or liability be recognized and measured in accordance with either FASB Statement No. 109, *Accounting for Income Taxes,* or IAS 12, *Income Taxes,* respectively. Statement 109 and IAS 12 establish requirements for recognizing and measuring deferred tax assets and liabilities—requirements that are not necessarily consistent with the recognition and measurement principles in this Statement.

B280. The Boards considered identifying deferred tax assets and liabilities as an exception to only the measurement principle because most, if not all, of the requirements of Statement 109 and IAS 12 are arguably consistent with this Statement's recognition principle. The recognition principle requires the acquirer to recognize at the acquisition date the assets

acquired and liabilities assumed that meet the conceptual definition of an asset or a liability at that date. However, the Boards concluded that exempting deferred tax assets and liabilities from both the recognition and the measurement principles would more clearly indicate that the acquirer should apply the recognition and measurement provisions of Statement 109 and IAS 12 and their related interpretations or amendments.

B281. Deferred tax assets or liabilities generally are measured at undiscounted amounts in accordance with Statement 109 and IAS 12. The Boards decided not to require deferred tax assets or liabilities acquired in a business combination to be measured at fair value because they observed that:

a. If those assets and liabilities were measured at their acquisition-date fair values, their subsequent measurement in accordance with Statement 109 or IAS 12 would result in reported postcombination gains or losses in the period immediately following the acquisition even though the underlying economic circumstances did not change. That would not faithfully represent the results of the postcombination period and would be inconsistent with the notion that a business combination that is a fair value exchange should not give rise to the recognition of immediate postcombination gains or losses.
b. To measure those assets and liabilities at their acquisition-date fair values and overcome the reporting problem noted in (a) would require a comprehensive consideration of whether and how to modify the requirements of Statement 109 and IAS 12 for the subsequent measurement of deferred tax assets or liabilities acquired in a business combination. Because of the complexities of Statement 109 and IAS 12 and the added complexities that would be involved in tracking deferred tax assets acquired and liabilities assumed in a business combination, the Boards concluded that the benefits of applying this Statement's fair value measurement principle would not warrant the costs or complexities that would cause.

Respondents to the 2005 Exposure Draft generally supported that exception to the fair value measurement requirements.

B282. To align Statement 109 and IAS 12 more closely and to make the accounting more consistent with the principles in this Statement, the Boards decided to address four specific issues pertaining to the acquirer's income tax accounting in connection with a business combination:

a. Accounting for a change in the acquirer's valuation allowance for its deferred tax asset that results from a business combination
b. Accounting for a change after the acquisition date in the deferred tax benefits for the acquiree's deductible temporary differences or operating loss or tax credit carryforwards acquired in a business combination
c. Accounting for tax benefits arising from tax deductible goodwill in excess of goodwill for financial reporting
d. Accounting for changes after the acquisition date in the uncertainties pertaining to acquired tax positions.

B283. The Boards addressed the first issue because the existing requirements of Statement 109 and IAS 12 differed, with Statement 109 including a change in the acquirer's valuation allowance for its deferred tax asset in the business combination accounting and IAS 12 accounting for a change in recognized deferred tax assets separately from the business combination. The FASB decided to converge with the IAS 12 requirement on the first issue, which the IASB decided to retain. Thus, the acquirer would recognize the change in its valuation allowance as income or expense (or a change in equity), as required by Statement 109, in the period of the business combination.

B284. Because the Boards considered the first issue primarily in an attempt to achieve convergence, they limited their consideration to the requirements of Statement 109 and IAS 12. The FASB acknowledged that both alternatives are defensible on conceptual grounds. However, it concluded that on balance the benefits of converging with the IAS 12 method outweigh the costs related to a change in the accounting in accordance with Statement 109. This Statement therefore amends Statement 109 accordingly.

B285. Most of the respondents to the 2005 Exposure Draft supported its proposal on accounting for changes to the acquirer's own deferred taxes in conjunction with a business combination. But some disagreed; they said that an acquirer factors its expected tax synergies into the price it is willing to pay for the acquiree, and therefore those tax synergies constitute goodwill. Those respondents were concerned about

the potential for double counting the synergies—once in the consideration and a second time by separately recognizing the changes in the acquirer's income taxes.

B286. The Boards acknowledged that in some situations a portion of the tax synergies might be factored into the price paid in the business combination. However, they concluded that it would be difficult, if not impossible, to identify that portion. In addition, an acquirer would not pay more for an acquiree because of tax synergies unless another bidder would also pay more; an acquirer would not knowingly pay more than necessary for the acquiree. Therefore, in some situations none (or only a very small portion) of the tax synergies are likely to be factored into the price paid. The Boards also observed that paragraph 57 requires that only the portion of the consideration transferred for the acquiree and the assets acquired and liabilities assumed in the exchange for the acquiree be included in applying the acquisition method. Excluding effects on the acquirer's ability to utilize its deferred tax asset is consistent with that requirement. Therefore, the Boards decided to retain the treatment of changes in an acquirer's tax assets and liabilities proposed in the 2005 Exposure Draft.

B287. This Statement also amends Statement 109 to require disclosure of the amount of the deferred tax benefit (or expense) recognized in income in the period of the acquisition for the reduction (or increase) of the acquirer's valuation allowance for its deferred tax asset that results from a business combination. The Boards decided that disclosure of that amount is necessary to enable users of the acquirer's financial statements to evaluate the nature and financial effect of a business combination.

B288. The second issue listed in paragraph B282 relates to changes after the acquisition date in the amounts recognized for deferred tax benefits acquired in a business combination. Statement 109 and IAS 12 both required that subsequent recognition of acquired tax benefits reduces goodwill. However, Statement 109 and IAS 12 differed in that:

a. IAS 12 did not permit the reduction of other noncurrent intangible assets, which Statement 109 required.
b. IAS 12 required the recognition of offsetting income and expense in the acquirer's profit or loss when subsequent changes are recognized.

B289. In developing the 2005 Exposure Draft, the FASB concluded that the fair value of other long-lived assets acquired in a business combination should no longer be reduced for changes in a valuation allowance after the acquisition date. That decision is consistent with the Boards' decision not to adjust other acquired assets or assumed liabilities, with a corresponding adjustment to goodwill, for the effects of other events occurring after the acquisition date.

B290. Few respondents to the 2005 Exposure Draft addressed this issue, and the views of those who commented differed. Some favored providing for reduction of goodwill indefinitely because they view the measurement exception for deferred tax assets as resulting in a measure that is drastically different from fair value. Those who supported not permitting the indefinite reduction of goodwill said that, conceptually, changes in estimates pertaining to deferred taxes recognized in a business combination should be treated the same as other revisions to the amounts recorded at acquisition. The Boards agreed with those respondents that a measurement exception should not result in potentially indefinite adjustments to goodwill. This Statement provides other limited exceptions to the recognition and measurement principles, for example, for employee benefits—none of which result in indefinite adjustments to goodwill for subsequent changes.

B291. The 2005 Exposure Draft proposed a rebuttable presumption that the subsequent recognition of acquired tax benefits within one year of the acquisition date be accounted for by reducing goodwill. The rebuttable presumption could have been overcome if the subsequent recognition of the tax benefits resulted from a discrete event or circumstance occurring after the acquisition date. Recognition of acquired tax benefits after the one-year period would be accounted for as a reduction of income tax expense or credited directly to contributed capital depending on the circumstances. Respondents suggested particular modifications to that proposal, including removing the rebuttable presumption about subsequent recognition of acquired tax benefits within one year of the acquisition date and treating increases and decreases in the valuation allowance consistently.

(Statement 109 provided guidance on accounting for decreases.) The Boards agreed with those suggestions and revised the requirements of this Statement accordingly.

B292. As described in paragraph B282(c), the Boards considered whether a deferred tax asset should be recognized in a business combination for any excess amount of tax-deductible goodwill over the goodwill for financial reporting purposes (excess tax goodwill). From a conceptual standpoint, the excess tax goodwill meets the definition of a temporary difference. Not recognizing the tax benefit of that temporary difference at the date of the business combination would be inappropriate and inconsistent with Statement 109 and IAS 12; it also would be inconsistent with the recognition principle in this Statement. Thus, this Statement amends Statement 109 accordingly.

B293. On the issue in paragraph B282(d), respondents to the 2005 Exposure Draft suggested that this Statement should address how to account for subsequent adjustments to amounts recognized for acquired income tax uncertainties. Respondents supported accounting for subsequent adjustments to amounts recognized for tax uncertainties using the same approach as the accounting for subsequent adjustments to acquired deferred tax benefits.

B294. The FASB agreed with respondents' suggestion that an acquirer should recognize changes to acquired income tax uncertainties after the acquisition in the same way as changes in acquired deferred tax benefits. Therefore, this Statement amends FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes,* to require a change to an acquired income tax uncertainty within the measurement period that results from new information about facts and circumstances that existed at the acquisition date to be recognized through a corresponding adjustment to goodwill. If that reduces goodwill to zero, an acquirer would recognize any additional increases of the recognized income tax uncertainty as a reduction of income tax expense. All other changes in the acquired income tax uncertainties would be accounted for in accordance with Interpretation 48.

B295. The IASB also considered whether to address the accounting for changes in acquired income tax uncertainties in a business combination. IAS 12 is silent on income tax uncertainties. The IASB is considering tax uncertainties as part of the convergence income tax project. Therefore, the IASB decided not to modify IAS 12 as part of this project to specifically address the accounting for changes in acquired income tax uncertainties in a business combination.

Employee benefits

B296. This Statement provides exceptions to both the recognition and measurement principles for liabilities and any related assets resulting from the employee benefit arrangements of an acquiree. The acquirer is required to recognize and measure those assets and liabilities in accordance with applicable GAAP, as amended by this Statement. Paragraph 28 lists the applicable requirements for employee benefit arrangements.

B297. As with deferred tax assets and liabilities, the Boards considered identifying employee benefits as an exception only to the measurement principle. The Boards concluded that essentially the same considerations discussed in paragraph B280 for deferred tax assets and liabilities also apply to employee benefits. In addition, the FASB observed that FASB Statements No. 43, *Accounting for Compensated Absences,* and No. 112, *Employers' Accounting for Postemployment Benefits,* require recognition of a liability for compensated absences or postemployment benefits, respectively, only if payment is probable. Arguably, a liability for those benefits exists, at least in some circumstances, regardless of whether payment is probable. Accordingly, to make it clear that the acquirer should apply the recognition and measurement requirements of applicable GAAP or IAS 19 without separately considering the extent to which those requirements are consistent with the principles in this Statement, the Boards exempted employee benefits obligations from both the recognition and the measurement principles.

B298. The FASB decided to amend FASB Statements No. 87, *Employers' Accounting for Pensions,* and No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions,* to require the acquirer to exclude from the liability it recognizes for a single-employer pension or other postretirement benefit plan the effects of expected plan amendments, terminations, or curtailments that it has no obligation to make at the acquisition date. However, those amendments also require the acquirer to include in the liability it recognizes at the acquisition date the expected withdrawal liability for a multiemployer plan if it is probable at that date that the acquirer will withdraw from the plan. For a pension or other postretirement benefit plan, the latter requirement brings

into the authoritative literature a provision that previously appeared only in the basis for conclusions of Statements 87 and 106. The FASB acknowledges that the provisions for single-employer and multiemployer plans are not necessarily consistent, and it considered amending Statements 87 and 106 to require recognition of withdrawal liabilities not yet incurred in postcombination financial statements of the periods in which withdrawals occur. However, it observed that the liability recognized upon withdrawal from a multiemployer plan represents the previously unrecognized portion of the accumulated benefits obligation, which is recognized as it arises for a single-employer plan. In addition, the FASB observed that some might consider the employer's contractual obligation upon withdrawal from a multiemployer plan to be an unconditional obligation to "stand-ready" to pay if withdrawal occurs and therefore to represent a present obligation. Therefore, the FASB decided not to require the same accounting for expected withdrawals from a multiemployer plan that it requires for expected terminations or curtailments of a single-employer plan.

B299. The effect of this Statement's measurement exception for liabilities and any related assets resulting from the acquiree's employee benefit plans is more significant than the related recognition exception. The Boards concluded that it was not feasible to require all employee benefit obligations assumed in a business combination to be measured at their acquisition-date fair values. To do so would effectively require the Boards to comprehensively reconsider the relevant standards for those employee benefits as a part of their business combinations projects. Given the complexities in accounting for employee benefit obligations in accordance with existing requirements, the Boards decided that the only practicable alternative is to require those obligations, and any related assets, to be measured in accordance with their applicable standards.

B300. The 2005 Exposure Draft proposed exempting only employee benefits subject to Statements 87 and 106 from its fair value measurement requirement. Some respondents observed that existing GAAP for other types of employee benefits is not consistent with fair value and said that those benefits also should be exempted. The FASB agreed and modified the measurement exception for employee benefits accordingly.

Indemnification assets

B301. A few constituents asked about the potential inconsistency if an asset for an indemnification is measured at fair value at the acquisition date and the related liability is measured using a different measurement attribute. Members of the FASB's resource group raised the issue primarily in the context of Interpretation 48, which requires an entity to measure a tax position that meets the more-likely-than-not recognition threshold at the largest amount of tax benefit that is more than 50 percent likely to be realized upon ultimate settlement with a taxing authority.

B302. The Boards understand that a business combination sometimes includes an indemnification agreement under which the former owners of the acquiree are required to reimburse the acquirer for any payments the acquirer eventually makes upon settlement of a particular liability. If the indemnification pertains to uncertainty about a position taken in the acquiree's tax returns for prior years or to another item for which this Statement provides a recognition or measurement exception, not providing a related exception for the indemnification asset would result in recognition or measurement anomalies. For example, for an indemnification pertaining to a deferred tax liability, the acquirer would recognize at the acquisition date a liability to the taxing authority for the deferred taxes and an asset for the indemnification due from the former owners of the acquiree. In the absence of an exception, the asset would be measured at fair value, and the liability would be measured in accordance with the pertinent income tax accounting requirements, such as Interpretation 48 for an entity that applies GAAP, because income taxes are an exception to the fair value measurement principle. Those two amounts would differ. The Boards agreed with constituents that an asset representing an indemnification related to a specific liability should be recognized and measured on the same basis as that liability.

B303. The Boards also provided an exception to the recognition principle for indemnification assets. The reasons for that exception are much the same as the reasons the Boards exempted deferred tax assets and liabilities and employee benefits from that principle. Providing an exception to the recognition principle for indemnification assets clarifies that the acquirer does not apply that principle in determining whether or when to recognize such an asset. Rather, the acquirer recognizes the asset when it recognizes the related liability. Therefore, this Statement provides an exception to the recognition and measurement principles for indemnification assets.

Exceptions to the measurement principle

B304. In addition to the exceptions to both the recognition and measurement principles discussed above, this Statement provides exceptions to the measurement principle for particular types of assets acquired or liabilities assumed in a business combination. Those exceptions are discussed in paragraphs B305–B311.

Temporary exception for assets held for sale

B305. The 2005 Exposure Draft proposed that long-lived assets qualifying as held for sale at the acquisition date under FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,* or IFRS 5, *Non-current Assets Held for Sale and Discountinued Operations,* be measured as those standards require—at fair value less costs to sell. The purpose of that proposed exception was to avoid the need to recognize a loss for the selling costs immediately after a business combination (referred to as a *Day 2 loss* because in theory it would be recognized on the day after the acquisition date). That Day 2 loss would result if the assets were initially measured at fair value but the acquirer then applied either Statement 144 or IFRS 5, requiring measurement at fair value less costs to sell, for subsequent accounting. Because that loss would stem entirely from different measurement requirements for assets held for sale acquired in a business combination and for assets already held that are classified as held for sale, the reported loss would not faithfully represent the activities of the acquirer.

B306. After considering responses to the 2005 Exposure Draft, the Boards decided that the exception to the measurement principle for assets held for sale should be eliminated. The definition of fair value in this Statement, and its application in other areas focuses on market data. Costs a buyer (acquirer) incurs to purchase or expects to incur to sell an asset are excluded from the amount at which an asset is measured. The Boards concluded that disposal costs also should be excluded from the measure of assets held for sale.

B307. However, avoiding the Day 2 loss described in paragraph B305 will require the Boards to amend Statement 144 and IFRS 5 to require assets classified as held for sale to be measured at fair value rather than at fair value less costs to sell. The Boards decided to do that, but their respective due process procedures require those amendments to be made in separate projects to give constituents the opportunity to comment on the proposed changes. Although the Boards intend for the amendments of Statement 144 and IFRS 5 to be effective at the same time as this Statement and the revised IFRS 3, they decided as an interim step to include a measurement exception until completion of the amendments.

Reacquired rights

B308. This Statement requires the fair value of a reacquired right recognized as an intangible asset to be measured on the basis of the remaining contractual term of the contract that gave rise to the right, without taking into account potential renewals of that contract (paragraph 31). In developing the 2005 Exposure Draft, the Boards observed that a reacquired right is no longer a contract with a third party. An acquirer who controls a reacquired right could assume indefinite renewals of its contractual term, effectively making the reacquired right an indefinite-lived intangible asset. (The Boards understood that some entities had been classifying reacquired rights in that way.) The Boards concluded that a right reacquired from an acquiree in substance has a finite life; a renewal of the contractual term after the business combination is not part of what was acquired in the business combination. Accordingly, the 2005 Exposure Draft proposed, and this Statement requires, limiting the period over which the intangible asset is amortized (its useful life) to the remaining contractual term of the contract from which the reacquired right stems.

B309. The 2005 Exposure Draft did not include guidance on determining the fair value of a reacquired right. Some constituents indicated that determining that value is a problem in practice, and the Boards agreed that this Statement should include guidance on that point. To be consistent with the requirement for determining the useful life of a reacquired right, the Boards concluded that the fair value of the right should be based on the remaining term of the contract giving rise to the right. The Boards acknowledge that market participants generally would reflect expected renewals of the term of a contractual right in the fair value of a right traded in the market. The Boards decided, however, that determining the fair value of a reacquired right in that manner would be inconsistent with amortizing its value over the remaining contractual term. The Boards also observed that a contractual right transferred to a third party (traded in the market) is not a **reacquired** right.

Accordingly, the Boards decided that departing from the assumptions that market participants would use in measuring the fair value of a reacquired right is appropriate.

B310. A few constituents asked for guidance on accounting for the sale of a reacquired right after the business combination. The Boards concluded that the sale of a reacquired right is in substance the sale of an intangible asset, and paragraph 61 of this Statement requires the sale of a reacquired right to be accounted for in the same way as sales of other assets. Thus, the carrying amount of the right is to be included in determining the gain or loss on the sale.

Share-based payment awards

B311. FASB Statement No. 123 (revised 2004), *Share-Based Payment,* requires measurement of share-based payment awards using what it describes as the *fair-value-based method.* IFRS 2, *Share-based Payment,* requires essentially the same measurement method. The revised IFRS 3 refers to its result as the *market-based measure.* For reasons identified in those standards, application of the measurement methods they require generally does not result in the amount at which market participants would exchange an award at a particular date—its fair value at that date. Therefore, this Statement provides an exception to its measurement principle for share-based payment awards. The reasons for that exception are essentially the same as the reasons already discussed for other exceptions to its recognition and measurement principles that this Statement provides. For example, as with both deferred tax assets and liabilities and assets and liabilities related to employee benefit arrangements, initial measurement of share-based payment awards at their acquisition-date fair values would cause difficulties with the subsequent accounting for those awards in accordance with Statement 123(R) or IFRS 2.

Recognizing and Measuring Goodwill or a Gain from a Bargain Purchase

B312. Consistent with Statement 141 and IFRS 3, this Statement requires the acquirer to recognize goodwill as an asset and to measure it as a residual.

Goodwill Qualifies as an Asset

B313. The FASB's 1999 and 2001 Exposure Drafts listed six components of the amount that in practice under authoritative guidance in effect at that time had been recognized as goodwill. The IASB's ED 3 included a similar, but not identical, discussion. The components and their descriptions, taken from the FASB's Exposure Drafts were:

- Component 1—The excess of the fair values over the book values of the acquiree's net assets at the date of acquisition.
- Component 2—The fair values of other net assets that the acquiree had not previously recognized. They may not have been recognized because they failed to meet the recognition criteria (perhaps because of measurement difficulties), because of a requirement that prohibited their recognition, or because the acquiree concluded that the costs of recognizing them separately were not justified by the benefits.
- Component 3—The fair value of the *going-concern* element of the acquiree's existing business. The going-concern element represents the ability of the established business to earn a higher rate of return on an assembled collection of net assets than would be expected if those net assets had to be acquired separately. That value stems from the synergies of the net assets of the business, as well as from other benefits (such as factors related to market imperfections, including the ability to earn monopoly profits and barriers to market entry—either legal or because of transaction costs—by potential competitors).
- Component 4—The fair value of the expected synergies and other benefits from combining the acquirer's and acquiree's net assets and businesses. Those synergies and other benefits are unique to each combination, and different combinations would produce different synergies and, hence, different values.
- Component 5—Overvaluation of the consideration paid by the acquirer stemming from errors in valuing the consideration tendered. Although the purchase price in an all-cash transaction would not be subject to measurement error, the same may not necessarily be said of a transaction involving the acquirer's equity interests. For example, the number of common shares being traded daily may be small relative to the number of shares issued in the combination. If so, imputing the current market price to all of the shares issued to effect the combination may produce a higher value than those shares would command if they were sold for cash and the cash then used to effect the combination.
- Component 6—Overpayment or underpayment by the acquirer. Overpayment might occur, for

example, if the price is driven up in the course of bidding for the acquiree; underpayment may occur in a distress sale (sometimes termed a fire sale).

B314. The Boards observed that the first two components, both of which relate to the acquiree, conceptually are not part of goodwill. The first component is not itself an asset; instead, it reflects gains that the acquiree had not recognized on its net assets. As such, that component is part of those assets rather than part of goodwill. The second component also is not part of goodwill conceptually; it primarily reflects intangible assets that might be recognized as individual assets.

B315. The fifth and sixth components, both of which relate to the acquirer, also are not conceptually part of goodwill. The fifth component is not an asset in and of itself or even part of an asset but, rather, is a measurement error. The sixth component also is not an asset; conceptually it represents a loss (in the case of overpayment) or a gain (in the case of underpayment) to the acquirer. Thus, neither of those components is conceptually part of goodwill.

B316. The Boards also observed that the third and fourth components are part of goodwill. The third component relates to the acquiree and reflects the excess assembled value of the acquiree's net assets. It represents the preexisting goodwill that was either internally generated by the acquiree or acquired by it in prior business combinations. The fourth component relates to the acquiree and the acquirer jointly and reflects the excess assembled value that is created by the combination—the synergies that are expected from combining those businesses. The Boards described the third and fourth components collectively as "core goodwill."

B317. This Statement tries to avoid subsuming the first, second, and fifth components of goodwill into the amount initially recognized as goodwill. Specifically, an acquirer is required to make every effort to:

a. Measure the consideration accurately (eliminating or reducing component 5)
b. Recognize the identifiable net assets acquired at their fair values rather than their carrying amounts (eliminating or reducing component 1)
c. Recognize all acquired intangible assets meeting the criteria in paragraph 3(k) of this Statement so that they are not subsumed into the amount initially recognized as goodwill (reducing component 2).

B318. In developing Statement 141 and IFRS 3, the FASB and the IASB both considered whether "core goodwill" (the third and fourth components) qualifies as an asset under the definition in their respective conceptual frameworks. (That consideration was based on the existing conceptual frameworks. In 2004, the FASB and the IASB began work on a joint project to develop an improved conceptual framework that, among other things, would eliminate both substantive and wording differences in their existing frameworks. Although the asset definition is likely to change as a result of that project, the Boards observed that nothing in their deliberations to date indicates that any such changes are likely to call into question whether goodwill continues to qualify as an asset.)

Asset definition in Concepts Statement 6

B319. Paragraph 172 of Concepts Statement 6 says that an item that has future economic benefits has the capacity to serve the entity by being exchanged for something else of value to the entity, by being used to produce something of value to the entity, or by being used to settle its liabilities.

B320. 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).

B321. 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.

Asset definition in the IASB's Framework

B322. Paragraph 53 of the IASB's *Framework* explains that "the future economic benefit embodied in an asset is the potential to contribute, directly or indirectly, to the flow of cash and cash equivalents to the entity."

B323. The IASB concluded that core goodwill represents resources from which future economic benefits are expected to flow to the entity. In considering whether core goodwill represents a resource **controlled** by the entity, the IASB considered the assertion that core goodwill arises, at least in part, through factors such as a well-trained workforce, loyal customers, and so on, and that these factors cannot be regarded as controlled by the entity because the workforce could leave and the customers could go elsewhere. However, the IASB, like the FASB, concluded that control of core goodwill is provided by means of the acquirer's power to direct the policies and management of the acquiree. Therefore, both the FASB and the IASB concluded that core goodwill meets the conceptual definition of an asset.

Relevance of information about goodwill

B324. In developing Statement 141, the FASB also considered the relevance of information about goodwill. Although IFRS 3's basis for conclusions did not explicitly discuss the relevance of information about goodwill, the FASB's analysis of that issue was available to the IASB members as they developed IFRS 3, and they saw no reason not to accept that analysis.

B325. More specifically, in developing Statement 141, the FASB considered the views of users as reported by the AICPA Special Committee[6] and as expressed by the Financial Accounting Policy Committee (FAPC) of the Association for Investment Management and Research (AIMR) in its 1993 position paper, *Financial Reporting in the 1990s and Beyond.* The FASB observed that users have mixed views about whether goodwill should be recognized as an asset. Some are troubled by the lack of comparability between internally generated goodwill and acquired goodwill that results under present standards, but others do not appear to be particularly bothered by it. However, users appear to be reluctant to give up information about goodwill acquired in a business combination. In the view of the AICPA Special Committee, users want to retain the option of being able to use that information. Similarly, the FAPC said that goodwill should be recognized in financial statements.

B326. The FASB also considered the growing use of "economic value added" (EVA)[7] and similar measures, which increasingly are being employed as means of assessing performance. The Board observed that such measures commonly incorporate goodwill, and in business combinations accounted for by the pooling method, an adjustment was commonly made to incorporate a measure of the goodwill that was not recognized under that method. As a result, the aggregate amount of goodwill is included in the base that is subject to a capital charge that is part of the EVA measure, and management is held accountable for the total investment in the acquiree.

B327. The FASB also considered evidence about the relevance of goodwill provided by a number of research studies that empirically examined the relationship between goodwill and the market value of business entities.[8] Those studies generally found a positive relationship between the reported goodwill of entities and their market values, thereby indicating that investors in the markets behave as if they view goodwill as an asset.

Measuring Goodwill as a Residual

B328. Paragraph 34 of this Statement requires the acquirer to measure goodwill as the excess of one amount (described in paragraph 34(a)) over another (described in paragraph 34(b)). Therefore, goodwill is measured as a residual, which is consistent with Statement 141 and IFRS 3, in which the FASB and

[6]AICPA Special Committee on Financial Reporting, *Improving Business Reporting—A Customer Focus* (New York: AICPA, 1994).

[7]EVA was developed by the consulting firm of Stern Stewart & Company (and is a registered trademark of Stern Stewart) as a financial performance measure that improves management's ability to make decisions that enhance shareholder value.

[8]Refer to, for example, Eli Amir, Trevor S. Harris, and Elizabeth K. Venuti, "A Comparison of the Value-Relevance of U.S. versus Non-U.S. GAAP Accounting Measures Using Form 20-F Reconciliations," *Journal of Accounting Research,* Supplement (1993): 230–264; Mary Barth and Greg Clinch, "International Accounting Differences and Their Relation to Share Prices: Evidence from U.K., Australian and Canadian Firms," *Contemporary Accounting Research* (spring 1996): 135–170; Keith W. Chauvin and Mark Hirschey, "Goodwill, Profitability, and the Market Value of the Firm," *Journal of Accounting and Public Policy* (summer 1994): 159–180; Ross Jennings, John Robinson, Robert B. Thompson, and Linda Duvall, "The Relation between Accounting Goodwill Numbers and Equity Values," *Journal of Business Finance and Accounting* (June 1996): 513–533; and Mark G. McCarthy and Douglas K. Schneider, "Market Perception of Goodwill: Some Empirical Evidence," *Accounting and Business Research* (winter 1995): 69–81.

the IASB, respectively, concluded that direct measurement of goodwill is not possible. The Boards did not reconsider measuring goodwill as a residual in the second phase of the business combinations project. However, the Boards simplified the measurement of goodwill acquired in a business combination achieved in stages (a step acquisition). In accordance with Statement 141 and IFRS 3, an entity that acquired another entity in a step acquisition measured goodwill by reference to the cost of each step and the related fair value of the underlying identifiable net assets acquired. This process was costly because it required the acquirer in a step acquisition to determine the amounts allocated to the identifiable net assets acquired at the date of each acquisition, even if those steps occurred years or decades earlier. In contrast, this Statement requires goodwill to be measured once—at the acquisition date. Thus, this Statement reduces the complexity and costs of accounting for step acquisitions.

B329. Both Boards decided that all assets acquired and liabilities assumed, including those of an acquiree (subsidiary) that is not wholly owned, as well as, in principle, any noncontrolling interest in the acquiree, should be measured at their acquisition-date fair values (or in limited situations, their amounts determined in accordance with other GAAP). Thus, this Statement eliminates the past practice of not recognizing the portion of goodwill related to the noncontrolling interests in subsidiaries that are not wholly owned. However, as discussed in paragraphs B209–B211, the IASB concluded that the revised IFRS 3 should permit entities to measure any noncontrolling interest in an acquiree as its proportionate share of the acquiree's identifiable net assets. If an entity chooses that alternative, only the goodwill related to the acquirer is recognized.

Using the acquisition-date fair value of consideration to measure goodwill

B330. As discussed in paragraph B81, this Statement does not focus on measuring the acquisition-date fair value of either the acquiree as a whole or the acquirer's interest in the acquiree as the 2005 Exposure Draft did. Consistent with that change, the Boards also eliminated the presumption in the 2005 Exposure Draft that, in the absence of evidence to the contrary, the acquisition-date fair value of the consideration transferred is the best evidence of the fair value of the acquirer's interest in the acquiree at that date. Therefore, paragraph 34 describes the measurement of goodwill in terms of the recognized amount of consideration transferred, generally its acquisition-date fair value, and paragraph 35 specifies how to measure goodwill if the fair value of the acquiree is more reliably measurable than the fair value of the consideration transferred or if no consideration is transferred.

B331. Because business combinations generally are exchange transactions in which knowledgeable, unrelated willing parties exchange equal values, the Boards continue to believe that the acquisition-date fair value of the consideration transferred provides the best evidence of the acquisition-date fair value of the acquirer's interest in the acquiree in many, if not most, situations. However, that is not the case if the acquirer either makes a bargain purchase or pays more than the acquiree is worth at the acquisition date—if the acquirer underpays or overpays. This Statement provides for recognizing a gain in the event of a bargain purchase, but it does not provide for recognizing a loss in the event of an overpayment (paragraph B382). Therefore, the Boards concluded that focusing directly on the fair value of the consideration transferred rather than on the fair value of the acquirer's interest in the acquiree, with a presumption that the two amounts usually are equal, would be a more straightforward way of describing how to measure goodwill. (The same conclusion applies to measuring the gain on a bargain purchase, which is discussed in paragraphs B371–B381). That change in focus also will avoid unproductive disputes in practice about whether the consideration transferred or another valuation technique provides the best evidence for measuring the acquirer's interest in the acquiree in a particular situation.

Using the acquirer's interest in the acquiree to measure goodwill

B332. The Boards acknowledge that in the absence of readily measurable consideration, the acquirer is likely to incur costs to measure the acquisition-date fair value of its interest in the acquiree and incremental costs to have that measure independently verified. The Boards observed that in many of those circumstances companies already incur such costs as part of their due diligence procedures. For example, an acquisition of a privately held entity by another privately held entity often is accomplished by an exchange of equity shares that do not have observable market prices. To determine the exchange ratio, those entities generally engage advisors and valuation experts to assist them in valuing the acquiree as well as the equity transferred by the acquirer in exchange for

the acquiree. Similarly, a combination of two mutual entities often is accomplished by an exchange of member interests of the acquirer for all of the member interests of the acquiree. In many, but not necessarily all, of those cases the directors and managers of the entities also assess the relative fair values of the combining entities to ensure that the exchange of member interests is equitable to the members of both entities.

B333. The Boards concluded that the benefits in terms of improved financial information resulting from this Statement outweigh the incremental measurement costs that this Statement may require. Those improvements include the increased relevance and understandability of information resulting from applying this Statement's measurement principle and guidance on recognizing and measuring goodwill, which are consistent with reflecting the change in economic circumstances that occurs at that date.

B334. The 2005 Exposure Draft included illustrative guidance for applying the fair value measurement requirement if no consideration is transferred or the consideration transferred is not the best evidence of the acquisition-date fair value of the acquiree. That illustrative guidance drew on related guidance in the FASB's Exposure Draft that preceded Statement 157. Because Statement 157 provides guidance on using valuation techniques such as the market approach and the income approach for measuring fair value, the FASB decided that it is unnecessary for this Statement to provide the same guidance.

B335. The IASB decided not to include in the revised IFRS 3 guidance on using valuation techniques to measure the acquisition-date fair value of the acquirer's interest in the acquiree. The IASB has on its agenda a project to develop guidance on measuring fair value. While deliberations on that project are in process, the IASB considers it inappropriate to include fair value measurement guidance in IFRSs.

B336. The FASB, on the other hand, completed its project on fair value measurement when it issued Statement 157. This Statement, together with Statement 157, provides broadly applicable measurement guidance that is relevant and useful in measuring the acquirer's interest in the acquiree. However, both Boards were concerned that without some discussion of special considerations for measuring the fair value of mutual entities, some acquirers might neglect to consider relevant assumptions that market participants would make about future member benefits when using a valuation technique. For example, the acquirer of a cooperative entity should consider the value of the member discounts in its determination of the fair value of its interest in the acquiree. Therefore, the Boards decided to include a discussion of special considerations in measuring the fair value of mutual entities (paragraphs A67–A69).

Measuring Consideration and Determining Whether Particular Items Are Part of the Consideration Transferred for the Acquiree

B337. Paragraphs B338–B360 discuss the Boards' conclusions on measuring specific items of consideration that often are transferred by acquirers. Paragraphs B361–B370 then discuss whether particular replacement awards of share-based compensation and acquisition-related costs incurred by acquirers are part of the consideration transferred for the acquiree.

Measurement date for equity securities transferred

B338. The guidance in Statement 141 and IFRS 3 on the measurement date for equity securities transferred as consideration in a business combination differed, and Statement 141's guidance on that issue was contradictory. Paragraph 22 of Statement 141, which was carried forward from Opinion 16, said that the market price for a reasonable period before and after the date that the terms of the acquisition are agreed to and announced should be considered in determining the fair value of the securities issued. That effectively established the agreement date as the measurement date for equity securities issued as consideration. However, paragraph 49 of Statement 141, which also was carried forward from Opinion 16, said that the cost of an acquiree should be determined as of the acquisition date. IFRS 3, on the other hand, required measuring the consideration transferred in a business combination at its fair value on the exchange date, which was the acquisition date for a combination in which control is achieved in a single transaction. (IFRS 3, like Statement 141, included special guidance on determining the cost of a business combination in which control is achieved in stages.) In their deliberations leading to the 2005 Exposure Draft, the Boards decided that the fair value of equity securities issued as consideration in a business combination should be measured at the acquisition date.

B339. In reaching their conclusions on this issue, the Boards considered the reasons for the consensus reached in EITF Issue No. 99-12, "Determination of

the Measurement Date for the Market Price of Acquirer Securities Issued in a Purchase Business Combination." That consensus states that the value of the acquirer's marketable equity securities issued to effect a business combination should be determined on the basis of the market price of the securities over a reasonable period before and after the terms of the acquisition are agreed to and announced. The arguments for that consensus are based on the view that the announcement of a transaction, and the related agreements, normally bind the parties to the transaction so that the acquirer is obligated at that point to issue the equity securities at the closing date. If the parties are bound to the transaction at the agreement (announcement) date, the value of the underlying securities on that date best reflects the value of the bargained exchange. The Boards did not find those arguments compelling. The Boards observed that to make the announcement of a recommended transaction binding generally requires shareholders' authorization or another binding event, which also gives rise to the change in control of the acquiree.

B340. Additionally, the Boards noted that measuring the fair value of equity securities issued on the agreement date (or on the basis of the market price of the securities for a short period before and after that date) did not result in a consistent measure of the consideration transferred. The fair values of all other forms of consideration transferred are measured at the acquisition date. The Boards decided that all forms of consideration transferred should be valued on the same date, which also should be the same date that the assets acquired and liabilities assumed are measured. The Boards also observed that negotiations between an acquirer and an acquiree typically provide for share adjustments in the event of material events and circumstances between the agreement date and acquisition date. In addition, ongoing negotiations after announcement of agreements, which are not unusual, provide evidence that agreements generally are not binding at the date they are announced. Lastly, the Boards also observed that the parties typically provide for cancellation options if the number of shares to be issued at the acquisition date would not reflect an exchange of approximately equal fair values at that date.

B341. Respondents to the 2005 Exposure Draft expressed mixed views on the measurement date for equity securities. Some supported the proposal to measure equity securities at their fair values on the acquisition date, generally for the same reasons given in that Exposure Draft. Others, however, favored use of the agreement date. They generally cited one or more of the following as support for their view:

a. An acquirer and a target entity both consider the fair value of a target entity on the agreement date in negotiating the amount of consideration to be paid. Measuring equity securities issued as consideration at fair value on the agreement date reflects the values taken into account in negotiations.
b. Changes in the fair value of the acquirer's equity securities between the agreement date and the acquisition date may be caused by factors unrelated to the business combination.
c. Changes in the fair value of the acquirer's equity securities between the agreement date and the acquisition date may result in inappropriate recognition of either a bargain purchase or artificially inflated goodwill if the fair value of those securities is measured at the acquisition date.

B342. In considering those comments, the Boards observed, as they did in the 2005 Exposure Draft, that valid conceptual arguments can be made for both the agreement date and the acquisition date. However, they also observed that the parties to a business combination are likely to take into account expected changes between the agreement date and the acquisition date in the fair value of the acquirer and the market price of the acquirer's securities issued as consideration. The argument against acquisition date measurement of equity securities noted in paragraph B341(a) is mitigated if acquirers and targets generally consider their best estimates at the agreement date of the fair values of the amounts to be exchanged on the acquisition dates. The Boards also noted that measuring the equity securities on the acquisition date avoids the complexities of dealing with situations in which the number of shares or other consideration transferred can change between the agreement date and the acquisition date. The Boards therefore concluded that equity instruments issued as consideration in a business combination should be measured at their fair values on the acquisition date.

Contingent consideration, including subsequent measurement

B343. In accordance with the guidance in Statement 141, which was carried forward from Opinion 16 without reconsideration, an acquirer's obligations to make payments conditioned on the outcome of future events (often called *contingent consideration*) usually were not recognized at the acquisition

date. Rather, acquirers usually recognized those obligations when the contingency was resolved and consideration was issued or became issuable. In general, issuing additional securities or distributing additional cash or other assets upon resolving contingencies based on reaching particular earnings levels resulted in delayed recognition of an additional element of cost of an acquiree. In contrast, issuing additional securities or distributing additional assets upon resolving contingencies based on security prices did not change the recognized cost of an acquiree.

B344. The IASB carried forward in IFRS 3 the requirements for contingent consideration from IAS 22 without reconsideration. In accordance with IFRS 3, an acquirer recognized consideration that is contingent on future events at the acquisition date only if it is probable and can be measured reliably. If the required level of probability or reliability for recognition was reached only after the acquisition date, the additional consideration was treated as an adjustment to the accounting for the business combination and to goodwill at that later date.

B345. Therefore, in accordance with both Statement 141 and IFRS 3, unlike other forms of consideration, an obligation for contingent consideration was not always measured at its acquisition-date fair value, and its remeasurement either sometimes (Statement 141) or always (IFRS 3) resulted in an adjustment to the business combination accounting.

B346. In developing the 2005 Exposure Draft, both Boards concluded that the delayed recognition of contingent consideration in their previous standards on business combinations was unacceptable because it ignored the fact that the acquirer's agreement to make contingent payments is the obligating event in a business combination transaction. Although the amount of the future payments the acquirer will make is conditional on future events, the obligation to make them if the specified future events occur is unconditional. The same is true for a right to the return of previously transferred consideration if specified conditions are met. Failure to recognize that obligation or right at the acquisition date would not faithfully represent the economic consideration exchanged at that date. Thus, both Boards concluded that obligations and rights associated with contingent consideration arrangements should be measured and recognized at their acquisition-date fair values.

B347. The Boards considered arguments that it might be difficult to measure the fair value of contingent consideration at the acquisition date. The Boards acknowledged that measuring the fair value of some contingent payments may be difficult, but they concluded that to delay recognition of, or otherwise ignore, assets or liabilities that are difficult to measure would cause financial reporting to be incomplete and thus diminish its usefulness in making economic decisions.

B348. Moreover, a contingent consideration arrangement is inherently part of the economic considerations in the negotiations between the buyer and seller. Such arrangements commonly are used by buyers and sellers to reach an agreement by sharing particular specified economic risks related to uncertainties about future outcomes. Differences in the views of the buyer and seller about those uncertainties often are reconciled by their agreeing to share the risks in such ways that favorable future outcomes generally result in additional payments to the seller and unfavorable outcomes result in no or lower payments. The Boards observed that information used in those negotiations often will be helpful in estimating the fair value of the contingent obligation assumed by the acquirer.

B349. The Boards noted that most contingent consideration obligations are financial instruments and many are derivative instruments. Reporting entities that use such instruments extensively, auditors, and valuation professionals are familiar with the use of valuation techniques for estimating the fair values of financial instruments. The Boards concluded that acquirers should be able to use valuation techniques to develop estimates of the fair values of contingent consideration obligations that are sufficiently reliable for recognition. The Boards also observed that an effective estimate of zero for the acquisition-date fair value of contingent consideration, which often was the result under Statement 141 and IFRS 3, was unreliable.

B350. Some respondents to the 2005 Exposure Draft were especially concerned about the reliability with which the fair value of performance-based contingent consideration can be measured. The FASB and the IASB considered those concerns in the context of related requirements in their standards on share-based payments (Statement 123(R) and IFRS 2, respectively), neither of which requires performance conditions to be included in the fair-value-based measure of an award of share-based payment at the grant date. For example, compensation cost is recognized for a share option with vesting requirements that depend on achievement of an earnings target only when achievement of the target is probable,

and any such cost recognized during the vesting period is reversed if the target is not achieved. Both Statement 123(R) and IFRS 2 cite constituents' concerns about the measurability at the grant date of the expected outcomes associated with performance conditions as part of the reason for that treatment.

B351. The Boards concluded that the requirements for awards of share-based payment subject to performance conditions should not determine the requirements for contingent (or conditional) consideration in a business combination. In addition, the Boards concluded that the negotiations between buyer and seller inherent in a contingent consideration arrangement in a business combination provide better evidence of its fair value than is likely to be available for most share-based payment arrangements with performance conditions.

B352. The Boards also noted that some contingent consideration arrangements obligate the acquirer to deliver its equity securities if specified future events occur. The Boards concluded that the classification of such instruments as either equity or a liability should be based on existing GAAP or IFRSs, as indicated in paragraph 42.

Subsequent measurement of contingent consideration

B353. For reasons similar to those discussed in the context of assets and liabilities arising from contingencies (paragraphs B232 and B243), the Boards concluded that this Statement must address subsequent accounting for contingent consideration. Consistent with the accounting for other obligations that require an entity to deliver its equity shares, the Boards concluded that obligations for contingent payments that are classified as equity should not be remeasured after the acquisition date.

B354. The Boards observed that many obligations for contingent consideration that qualify for classification as liabilities meet the definition of derivative instruments in Statement 133 or IAS 39. To improve transparency in reporting particular instruments, the Boards concluded that all contracts that otherwise would be in the scope of those standards (if not issued in a business combination) should be subject to their requirements if issued in a business combination. Therefore, the Boards decided to eliminate their respective provisions (paragraph 11(c) of Statement 133 and paragraph 3(f) of IAS 39) that excluded contingent consideration in a business combination from the scope of those standards. Accordingly, liabilities for payments of contingent consideration that are subject to the requirements of Statement 133 or IAS 39 would subsequently be measured at fair value at each reporting date, with changes in fair value recognized in accordance with whichever of those standards an entity applies in its financial statements.

B355. In considering the subsequent accounting for contingent payments that are liabilities but are not derivatives, the Boards concluded that, in concept, all liabilities for contingent payments should be accounted for similarly. Therefore, liabilities for contingent payments that are not derivative instruments also should be remeasured at fair value after the acquisition date. The Boards concluded that applying those provisions would faithfully represent the fair value of the liability for the contingent payment of consideration that remains a liability until settled.

B356. The Boards also considered whether subsequent changes in the fair values of liabilities for contingent consideration should be reflected as adjustments to the consideration transferred in the business combination (usually in goodwill). Some respondents to the 2005 Exposure Draft favored that alternative because they think that changes in the fair value of contingent consideration effectively resolve differing views of the acquirer and the former owners of the acquiree about the acquisition-date fair value of the acquiree. The Boards acknowledged that a conclusive determination at the acquisition date of the fair value of a liability for contingent consideration might not be practicable in the limited circumstances in which particular information is not available at that date. As discussed in more detail in paragraphs B390–B400, the Boards decided that this Statement should provide for provisional measurement of the fair value of assets acquired or liabilities assumed or incurred, including liabilities for contingent payments, in those circumstances.

B357. Except for adjustments during the measurement period to provisional estimates of fair values at the acquisition date, the Boards concluded that subsequent changes in the fair value of a liability for contingent consideration do not affect the acquisition-date fair value of the consideration transferred. Rather, those subsequent changes in value generally are directly related to postcombination events and changes in circumstances related to the combined entity. Thus, subsequent changes in value for postcombination events and circumstances should not affect

the measurement of the consideration transferred or goodwill on the acquisition date. (The Boards acknowledge that some changes in fair value might result from events and circumstances related in part to a precombination period. But that part of the change usually is indistinguishable from the part related to the postcombination period, and the Boards concluded that the benefits in those limited circumstances that might result from making such fine distinctions would not justify the costs that such a requirement would impose.)

B358. The Boards also considered arguments that the results of the requirements of this Statement for recognition of changes in the fair value of contingent consideration after the acquisition date are counterintuitive because they will result in:

a. Recognizing gains if the specified milestone or event requiring the contingent payment is not met. For example, the acquirer would recognize a gain on the reversal of the liability if an earnings target in an earnout arrangement is not achieved.
b. Recognizing losses if the combined entity is successful and the amount paid exceeds the estimated fair value of the liability at the acquisition date.

B359. The Boards accept the consequence that recognizing the fair value of a liability for payment of contingent consideration is likely to subsequently result in a gain if smaller or no payments are required or result in a loss if greater payments are required. That is a consequence of entering into contingent consideration arrangements related to future changes in the value of a specified asset or liability or earnings of the acquiree after the acquisition date. For example, if a contingent consideration arrangement relates to the level of future earnings of the combined entity, higher earnings in the specified periods may be partially offset by increases in the liability to make contingent payments based on earnings because the acquirer has agreed to share those increases with former owners of the acquiree.

B360. The Boards also observed that liabilities for contingent payments may be related to contingencies surrounding an outcome for a particular asset or another liability. In those cases, the effect on income of the period of a change in the fair value of the liability for the contingent payment may be offset by a change in the value of the asset or other liability. For example, after an acquisition the combined entity might reach a favorable settlement of pending litigation of the acquiree for which it had a contingent consideration arrangement. If the combined entity is thus required to make a contingent payment to the seller of the acquiree that exceeds the initially estimated fair value of the liability for contingent consideration, the effect of the increase in that liability may be offset in part by the reduction in the liability to the litigation claimant. Similarly, if the acquirer is not required to make a contingent payment to the seller because an acquired research and development project failed to result in a viable product, the gain from the elimination of the liability may be offset, in whole or in part, by an impairment charge to the asset acquired.

Acquirer share-based payment awards exchanged for acquiree awards

B361. An acquirer sometimes issues replacement awards to benefit the employees of the acquiree for past services, for future services, or for both. Accordingly, the 2005 Exposure Draft included guidance for determining the extent to which replacement awards are for past services (and thus part of the consideration transferred in the business combination) or future services (and thus not part of the consideration transferred). In developing that guidance, the Boards' objective was, insofar as possible, to be consistent with the guidance in their respective standards on share-based payments.

B362. Few respondents to the 2005 Exposure Draft commented on this issue, and those who did generally agreed with the proposals, at least as they related to entities that apply IFRS 2 in accounting for share-based payments awards granted other than in a business combination. However, in redeliberating the 2005 Exposure Draft, the FASB observed that some of its proposals on share-based payment awards were not consistent with Statement 123(R), which was issued after the related deliberations in the second phase of its business combinations project. For example, the 2005 Exposure Draft proposed that the excess, if any, of the fair value of replacement awards over the fair value of the replaced acquiree awards be immediately recognized as compensation cost in the postcombination financial statements even if employees were required to render future service to earn the rights to the replacement awards. Statement 123(R), on the other hand, requires recognition of additional compensation cost arising in a modification of the terms of an award (which is the same as the replacement of one award with another) over the requisite service period. The FASB concluded that, in general, the requirements of this Statement on

accounting for replacements of share-based payment awards should be consistent with the requirements for other share-based payment awards in Statement 123(R). The FASB modified the guidance in this Statement on accounting for any excess of the fair value of replacement awards over the fair value of the replaced awards to achieve that goal.

B363. In addition, the FASB's constituents raised questions about other aspects of the guidance on accounting for the replacement of share-based payment awards. Those questions generally related to interpretative guidance that Statement 123(R) superseded or nullified without providing comparable guidance—specifically, FASB Interpretation No. 44, *Accounting for Certain Transactions involving Stock Compensation,* and EITF Issue No. 00-23, "Issues Related to the Accounting for Stock Compensation under APB Opinion No. 25 and FASB Interpretation No. 44." Paragraphs A91–A106 provide guidance to help in resolving those implementation questions. In developing that guidance, the FASB sought to apply the same principles to the replacement of share-based payment awards in a business combination that are applied to share-based payment awards in other situations. The IASB agreed with that goal, and it decided that the guidance on accounting for replacement awards of share-based payment is consistent with the guidance in IFRS 2 on accounting for modification of share-based payment awards.

B364. The Boards concluded that the guidance in this Statement is consistent with the objective that the consideration transferred for an acquired business includes those payments that are for the business and excludes those payments that are for other purposes. Compensation for future services to be rendered to the acquirer by former owners or other employees of the acquiree is not, in substance, consideration for the business acquired.

Acquisition-related costs

B365. The Boards considered whether acquisition-related costs are part of the consideration transferred in exchange for the acquiree. Those costs include an acquirer's costs incurred in connection with a business combination (a) for the services of lawyers, investment bankers, accountants, and other third parties and (b) for issuing debt or equity instruments used to effect the business combination (issue costs). Generally, acquisition-related costs are charged to expense as incurred, but the costs to issue debt or equity securities are an exception. Currently, the accounting for issue costs is mixed and conflicting practices have developed in the absence of clear accounting guidance. The FASB is addressing issue costs in its project on liabilities and equity and has tentatively decided that those costs should be expensed as incurred. Some FASB members would have preferred to require that issue costs to effect a business combination be expensed, but they did not think that the business combinations project was the place to make that decision. Therefore, the FASB decided to allow mixed practices for accounting for issue costs to continue until the project on liabilities and equity resolves the issue broadly.

B366. The Boards concluded that acquisition-related costs are not part of the fair value exchange between the buyer and seller for the business. Rather, they are separate transactions in which the buyer pays for the fair value of services received. The Boards also observed that those costs, whether for services performed by external parties or internal staff of the acquirer, generally do not represent assets of the acquirer at the acquisition date because the benefits obtained are consumed as the services are received.

B367. Thus, the 2005 Exposure Draft proposed, and this Statement requires, the acquirer to exclude acquisition-related costs from the measure of the fair value of both the consideration transferred and the assets acquired or liabilities assumed as part of the business combination. Those costs are to be accounted for separately from the business combination, generally recognized as expenses when incurred. This Statement therefore resolves inconsistencies in accounting for acquisition-related costs in accordance with the cost-accumulation approach in Statement 141 and IFRS 3, which provided that the cost of an acquiree included *direct* costs incurred for an acquisition of a business but excluded *indirect* costs. Direct costs included out-of-pocket or incremental costs, for example, finder's fees and fees paid to outside consultants for accounting, legal, or valuation services for a successful acquisition, but direct costs incurred in unsuccessful negotiations were expensed as incurred. Indirect costs included recurring internal costs, such as maintaining an acquisition department. Although those costs also could be directly related to a successful acquisition, they were expensed as incurred.

B368. Some respondents to the 2005 Exposure Draft said that acquisition-related costs, including costs of due diligence, are unavoidable costs of the

investment in a business. They suggested that because the acquirer intends to recover its due diligence cost through the postacquisition operations of the business, that transaction cost should be capitalized as part of the total investment in the business. Some also argued that the buyer specifically considers those costs in determining the amount that it is willing to pay for the acquiree. The Boards rejected those arguments. They found no persuasive evidence indicating that the seller of a particular business is willing to accept less than fair value as consideration for its business merely because a particular buyer may incur more (or less) acquisition-related costs than other potential buyers for that business. Further, the Boards concluded that the intentions of a particular buyer, including its plans to recover such costs, are a separate matter that is distinct from the fair value measurement objective in this Statement.

B369. The Boards acknowledge that the cost-accumulation models in Statement 141 and IFRS 3 included some acquisition-related costs as part of the carrying amount of assets acquired. The Boards also acknowledge that all asset acquisitions are similar transactions that, in concept, should be accounted for similarly, regardless of whether assets are acquired separately or as part of a group of assets that may meet the definition of a business. However, as noted in paragraph B20, the Boards decided not to extend the scope of this Statement to all acquisitions of groups of assets. Therefore, the Boards accept that, at this time, accounting for most acquisition-related costs separately from the business combination, generally as an expense as incurred for services received in connection with a combination, differs from some standards or accepted practices that require or permit particular acquisition-related costs to be included in the cost of an asset acquisition. The Boards concluded, however, that this Statement improves financial reporting by eliminating inconsistencies in accounting for acquisition-related costs in connection with a business combination and by applying the fair value measurement principle to all business combinations. The Boards also observed that in practice under Statement 141 and IFRS 3, most acquisition-related costs were subsumed in goodwill, which also was not consistent with accounting for asset acquisitions.

B370. The Boards also considered concerns about the potential for abuse. Some constituents, including some respondents to the 2005 Exposure Draft, said that if acquirers could no longer capitalize acquisition-related costs as part of the cost of the business acquired, they might modify transactions to avoid recognizing those costs as expenses. For example, some said that a buyer might ask a seller to make payments to the buyer's vendors on its behalf. To facilitate the negotiations and sale of the business, the seller might agree to make those payments if the total amount to be paid to it upon closing of the business combination is sufficient to reimburse the seller for payments it made on the buyer's behalf. If the disguised reimbursements were treated as part of the consideration transferred for the business, the acquirer might not recognize those expenses. Rather, the measure of the fair value of the business and the amount of goodwill recognized for that business might be overstated. To mitigate such concerns, this Statement requires any payments to an acquiree (or its former owners) in connection with a business combination that are payments for goods or services that are not part of the acquired business to be assigned to those goods or services and accounted for as a separate transaction. This Statement specifically requires an acquirer to determine whether any portion of the amounts transferred by the acquirer are separate from the consideration exchanged for the acquiree and the assets acquired and liabilities assumed in the business combination. Paragraphs 57–59 and A77 provide guidance for making that determination.

Bargain Purchases

B371. Paragraphs 36–38 of this Statement set out the accounting requirements for a bargain purchase. 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 prices below their fair values. However, bargain purchases have occurred and are likely to continue to occur. Circumstances in which they occur include a forced liquidation or distress sale (for example, after the death of a founder or key manager) in which owners need to sell a business quickly, which may result in a price that is less than fair value.

B372. The Boards observed that an economic gain is inherent in a bargain purchase. 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 (paid) for it. The Boards concluded that, in concept, the acquirer should recognize that gain at the acquisition date. However, the Boards acknowledged that although the reasons for a forced liquidation or distress sale often are apparent, sometimes clear evidence might not exist; for example, if a seller uses a closed

(private) process for the sale and to maintain its negotiating position is unwilling to reveal the main reason for the sale. The appearance of a bargain purchase without evidence of the underlying reasons would raise concerns in practice about the existence of measurement errors.

B373. Constituents, including some respondents to the 2005 Exposure Draft, expressed concerns about recognizing gains upon the acquisition of a business, particularly if it is difficult to determine whether a particular acquisition is in fact a bargain purchase. They also suggested that an initial determination of an excess of the acquisition-date fair value (or other recognized amounts) of the identifiable net assets acquired over the fair value of the consideration paid by the acquirer plus the recognized amount of any noncontrolling interest in the acquiree might arise from other factors, including:

a. Errors in measuring the fair values of the (1) consideration paid for the business, (2) assets acquired, or (3) liabilities assumed
b. Using measures in accordance with GAAP or IFRSs that are not fair values.

Distinguishing a bargain purchase from measurement errors

B374. The Boards acknowledged concerns raised by constituents that a requirement to recognize gains on a bargain purchase might provide an opportunity for inappropriate gain recognition from intentional errors resulting from the acquirer's:

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

B375. The Boards think that problems surrounding intentional measurement errors by acquirers generally are best addressed by means other than setting standards specifically intended to avoid abuse. Strong internal control systems and the use of independent valuation experts and external auditors are among the means by which both intentional and unintentional measurement errors are minimized. Standards specifically designed to avoid abuse would inevitably lack neutrality. (See paragraph B51 for a discussion of the need for neutrality in accounting and accounting standards.) However, the Boards share constituents' concerns about the potential for inappropriate gain recognition resulting from measurement bias or undetected measurement errors. Thus, the Boards decided, as specified in paragraph 38, to require the acquirer to reassess whether it has correctly identified all of the assets acquired and all of the liabilities assumed before recognizing a gain on a bargain purchase. The acquirer then must review the procedures used to measure the amounts this Statement requires to be recognized at the acquisition date for all of the following:

a. The identifiable assets acquired and liabilities assumed
b. The noncontrolling interest in the acquiree, if any
c. For a business combination achieved in stages, the acquirer's previously held equity interest in the acquiree
d. The consideration transferred.

The objective of that review is to ensure that appropriate consideration has been given to all available information in identifying the items to be measured and recognized and in determining their fair values. The Boards believe that the required review will mitigate, if not eliminate, undetected errors that might have existed in the initial measurements.

B376. The Boards acknowledged, however, that the required review might be insufficient to eliminate concerns about unintentional measurement bias. They decided to address that concern by limiting the extent of gain that can be recognized. Thus, this Statement provides that a gain on a bargain purchase is measured as the excess of:

a. The net of the acquisition-date amounts of the identifiable assets acquired and liabilities assumed; over
b. The acquisition-date fair value of the consideration transferred plus the recognized amount of any noncontrolling interest in the acquiree and, if the transaction is an acquisition achieved in stages, the acquisition-date fair value of the acquirer's previously held equity interest in the acquiree.

That means that both a gain on a bargain purchase and goodwill cannot be recognized for the same business combination. The 2005 Exposure Draft defined a bargain purchase as a transaction in which the fair value of the acquirer's interest in the acquiree exceeds the consideration transferred for it, but it would have required that any resulting goodwill be written

off before a gain was recognized. The result of this Statement's requirement is the same, but there will be no goodwill to write off if the gain is measured with reference to the identifiable net assets acquired rather than the fair value of the acquirer's interest in the acquiree. In addition, paragraph 68(o) requires the acquirer to disclose information about a gain recognized on a bargain purchase.

B377. The main purpose of the limitation on gain recognition is to mitigate the potential for inappropriate gain recognition through measurement errors, particularly those that might result from unintended measurement bias. The main purpose of the disclosure requirement is to provide information that enables users of an acquirer's financial statements to evaluate the nature and financial effect of business combinations that occur during the period. The Boards acknowledged, however, that the limitation and disclosure requirements also may help to mitigate constituents' concerns about potential abuse, although that is not their primary objective.

B378. Moreover, the Boards believe that concerns about abuse resulting from the opportunity for gain recognition may be overstated. Financial analysts and other users have often told the Boards that they give little weight to one-time or unusual gains, such as those resulting from a bargain purchase transaction. In addition, the Boards noted that managers of entities generally have no incentive to overstate assets acquired or understate liabilities assumed in a business combination because that generally would result in higher postcombination expenses when the assets are used or become impaired or liabilities are remeasured or settled.

Distinguishing a bargain purchase from a "negative goodwill result"

B379. The Boards acknowledged that a so-called negative goodwill result remains a possibility (although in most situations, a remote possibility), because this Statement continues to require particular assets acquired and liabilities assumed to be measured at amounts other than their acquisition-date fair values. The Boards observed, however, that this Statement addresses most deficiencies in past requirements on accounting for business combinations that previously led to negative goodwill results—that is, a result that had the appearance but not the economic substance of a bargain purchase. For example, no liability often was recognized for some contingent payment arrangements (for example, earnouts) at the acquisition date, which could result in the appearance of a bargain purchase by understating the consideration paid. This Statement, in contrast, requires the measurement and recognition of substantially all liabilities at their fair values on the acquisition date.

B380. The Boards also considered concerns raised by some constituents that a buyer's expectations of future losses and its need to incur future costs to make a business viable might give rise to a negative goodwill result. That is, a buyer would only be willing to pay a seller an amount that is, according to that view, less than the fair value of the acquiree (or its identifiable net assets) because to make a fair return on the business the buyer would need to make further investments in that business to bring its condition to fair value. The Boards disagreed with that view for the reasons noted in paragraphs B134–B143 in the context of liabilities associated with restructuring or exit activities of the acquiree, as well as those that follow.

B381. Fair values are measured by reference to unrelated buyers and sellers that are knowledgeable and have a common understanding about factors relevant to the business and the transaction and that also are willing and able to transact in the same market(s) and have the legal and financial ability to do so. The Boards are aware of no compelling reason to believe that, in the absence of duress, a seller would willingly and knowingly sell a business for an amount less than its fair value. Thus, the Boards concluded that careful application of this Statement's fair value measurement requirements will mitigate concerns that negative goodwill might result and be misinterpreted as a bargain purchase transaction.

Overpayments

B382. The Boards considered whether this Statement should include special provisions to account for a business combination in which a buyer overpays for its interest in the acquiree. The Boards acknowledged that overpayments are possible and, in concept, an overpayment should lead to the acquirer's recognition of an expense (or loss) in the period of the acquisition. However, the Boards believe that in practice any overpayment is unlikely to be detectable or known at the acquisition date. That is, the Boards are not aware of instances in which a buyer knowingly overpays or is compelled to overpay a seller to acquire a business. Even if an acquirer thinks it might have overpaid in some sense, the amount of overpayment would be difficult, if not impossible, to quantify. Thus, the Boards concluded that in practice it is

not possible to identify and reliably measure an overpayment at the acquisition date. Accounting for overpayments is best addressed through subsequent impairment testing when evidence of a potential overpayment first arises.

Additional Guidance for Particular Types of Business Combinations

B383. To help entities apply the acquisition method as required by this Statement, the Boards decided to provide additional guidance for business combinations achieved in stages and those achieved without the transfer of consideration. Paragraphs B384–B389 discuss the guidance provided on business combinations achieved in stages. The guidance on combinations achieved without the transfer of consideration merely responds to a question about how to report the acquiree's net assets in the equity section of the acquirer's postcombination statement of financial position, and this appendix does not discuss that guidance further.

Business Combinations Achieved in Stages

B384. 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 for a controlling financial interest in all of the underlying assets and liabilities of that entity (acquiree) and the right to direct how the acquiree and its management use those assets in its operations.

B385. In August 2003, the FASB held a roundtable meeting with members of its resource group on business combinations and other constituents to discuss, among other things, the decision to require an acquirer to remeasure any previously held equity interest in an acquiree at its acquisition-date fair value and to recognize in earnings any gain or loss. The users of financial statements indicated they did not have significant concerns with that change to present practice, as long as the amount of the gain or loss is clearly disclosed in the financial statements or in the notes. Paragraph 68(q) of this Statement requires that disclosure.

B386. The Boards rejected the view expressed by some constituents that the carrying amount of any preacquisition investment should be retained in the initial accounting for the cost of the business acquired. The Boards concluded that cost-accumulation practices led to many of the inconsistencies and deficiencies in financial reporting as required by Statement 141 and, to a lesser extent, IFRS 3 (paragraphs B198–B202).

B387. Some constituents also expressed concern about what they described as allowing an opportunity for gain recognition on a purchase transaction. The Boards noted that the required remeasurement also could result in loss recognition. Moreover, the Boards rejected the characterization that the result is to recognize a gain or loss on a purchase. Rather, under today's mixed attribute accounting model, economic gains and losses are recognized as they occur for some, but not all, financial instruments. If an equity interest in an entity is not required to be measured at its fair value, the recognition of a gain or loss at the acquisition date is merely a consequence of the delayed recognition of the economic gain or loss that is present in that financial instrument. If the investment asset had been measured at fair value at each reporting date, the gain or loss would have been recognized as it occurred, and measurement of the asset at its acquisition-date fair value would result in no further gain or loss.

B388. Some respondents who agreed that an acquirer should remeasure its previously held equity interest at fair value would recognize any resulting gain or loss in other comprehensive income rather than in net income. Those respondents said that the accounting for previously held equity interests is similar to the accounting for available-for-sale securities. Changes in the value of available-for-sale securities are recognized in other comprehensive income. They view each step in a step acquisition as a transaction in which the acquirer only obtains more shares in the acquiree. Because the shares that the acquirer previously held have not been exchanged or sold, they think that the recognition of net income is not appropriate.

B389. 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.

Measurement Period

B390. This Statement provides an acquirer with a reasonable period after the acquisition date, a *measurement period,* during which to obtain the information necessary to identify and measure the items specified in paragraph 52 as of the acquisition date in accordance with the requirements of this Statement. If sufficient information is not available at the acquisition date to measure those amounts, the acquirer determines and recognizes provisional amounts until the necessary information becomes available.

B391. The Boards concluded that providing for retrospective adjustments during the measurement period should help to resolve concerns about the quality and availability of information at the acquisition date for measuring the fair values of particular items at that date. Constituents especially indicated such concerns about assets and liabilities arising from contingencies and contingent consideration arrangements, which also affect the amount of goodwill or the gain recognized on a bargain purchase.

B392. The Boards decided to place constraints on the period for which it is deemed reasonable to be seeking information necessary to complete the accounting for a business combination. The measurement period ends as soon as the acquirer receives the necessary information about facts and circumstances that existed as of the acquisition date or learns that the information is not obtainable. However, in no circumstances may the measurement period exceed one year from the acquisition date. The Boards concluded that providing a measurement period longer than one year would not be especially helpful; obtaining reliable information about circumstances and conditions that existed more than a year ago is likely to become more difficult as time passes. Of course, the outcome of some contingencies and similar matters may not be known within a year. But the objective of the measurement period is to provide time to obtain the information necessary to measure the fair value of the item as of the acquisition date. Determining the ultimate settlement amount of a contingency or other item is not necessary. Uncertainties about the timing and amount of future cash flows are part of the measure of the fair value of an asset or liability.

B393. The Boards also concluded that acquirers should provide users of their financial statements with relevant information about the status of items that have been measured only provisionally. Thus, paragraph 72(a) specifies particular disclosures about those items.

B394. Both Statement 141 and IFRS 3 included a period during which an acquirer might measure particular amounts provisionally if the necessary information was not available at the acquisition date. Neither of those provisions was identical to the measurement period guidance in this Statement, although IFRS 3's was quite similar. However, the measurement period provisions in this Statement differ in important ways from the allocation period guidance of Statement 141 and its cost-allocation method. This Statement emphasizes the principle that assets acquired, liabilities assumed, and any noncontrolling interest in the acquiree should be measured at their acquisition-date fair values. Statement 141's allocation period and its postcombination adjustments delayed the recognition of assets and liabilities, and those assets and liabilities were not measured at their acquisition-date fair values when they were recognized. Therefore, the FASB decided to replace the Statement 141 term *allocation period* and its guidance with the measurement period guidance in this Statement.

B395. The FASB also decided that to improve the quality of comparative information reported in financial statements and to converge with the requirements of IFRS 3, this Statement should require the acquirer to:

a. Recognize adjustments made during the measurement period to the provisional values of the assets acquired and liabilities assumed as if the accounting for the business combination had been completed at the acquisition date
b. Adjust comparative information in previously issued financial statements, including any change in depreciation, amortization, or other income effect recognized as a result of completing the initial accounting.

B396. Statement 141 was silent about whether adjustments during its allocation period were to be reported retrospectively, but the FASB noted that in practice the effects of those adjustments typically were reported in the postcombination period, not retrospectively. The FASB acknowledged concerns that retrospective adjustments and adjusting previously issued comparative information are more costly. The FASB observed, however, that applying measurement period adjustments retrospectively would result in at least two significant benefits: (a) improvements in comparative period information and (b) avoidance of divergent accounting between U.S. entities and others and the reduction of reconciling items and their attendant costs. The FASB concluded, as had the IASB in developing IFRS 3, that those overall benefits outweigh the potential costs of retrospective application.

B397. Some respondents to the 2005 Exposure Draft (generally those who apply GAAP rather than IFRSs) disagreed with retrospective application of measurement period adjustments. They consider measurement period adjustments to be similar to changes in estimates, which are accounted for prospectively. They noted that FASB Statement No. 154, *Accounting Changes and Error Corrections,* and IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors,* both require retrospective adjustment only for changes in accounting policy or restatement for errors.

B398. In considering those responses, the Boards observed that measurement period adjustments in a business combination differ from the changes in estimates dealt with by Statement 154 and IAS 8. Measurement period adjustments result from information about assets, liabilities, and noncontrolling interests **as of** the acquisition date that becomes available only after that date. In contrast, adjustments for changes in estimates generally result from changes in facts and circumstances that affect an estimate, for example, a change in technology that affects the useful life of an asset.

B399. The Boards concluded that adjustments during the measurement period following a business combination are more analogous to Type I subsequent events (AU Section 560, *Subsequent Events*) than to changes in estimates. The effects of events that occur after the end of an accounting period but before the financial statements for that period are issued that provide evidence of a condition that existed at the date of the financial statements are reflected in financial statements as of that date. Similarly, the effects of information that first becomes available during the measurement period that provides evidence of conditions or circumstances that existed at the acquisition date should be reflected in the accounting as of that date.

B400. To recognize measurement period adjustments only prospectively would be inconsistent with the recognition and measurement principles in this Statement. Thus, although the Boards understand the practical and other difficulties with retrospective adjustments, on balance, they concluded that requiring such adjustments in this situation is appropriate.

Disclosures

B401. 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, as part of their respective projects that led to Statement 141 and IFRS 3, the FASB and the IASB both considered the usefulness of the disclosure requirements required by Opinion 16 and IAS 22, respectively, for the acquisition method. Statement 141 and IFRS 3 carried forward disclosures from the earlier requirements for business combinations that remained relevant, eliminated those that did not, and modified those that were affected by changes in the recognition or measurement requirements. In the second phase of their projects on business combinations, the Boards undertook essentially the same sort of reconsideration of the disclosure requirements in Statement 141 and IFRS 3, and they also considered particular disclosures requested by respondents to the 2005 Exposure Draft.

B402. The remainder of this section first reviews the changes that Statement 141 and IFRS 3 made to the disclosure requirements of Opinion 16 and IAS 22, respectively (paragraphs B403–B418). Paragraphs B419–B428 then discuss the changes this Statement makes to the disclosure requirements of Statement 141 and IFRS 3.

Disclosure Requirements of Statement 141

Disclosure of information about the purchase price allocation and pro forma sales and earnings

B403. The 1999 Exposure Draft would have required tabular disclosure of the fair values allocated to each of the major classes of assets and liabilities

presented in the statement of financial position and the acquiree's related carrying amounts immediately before its acquisition. That Exposure Draft also proposed eliminating the pro forma sales and earnings disclosures required by Opinion 16.

B404. Approximately half of the respondents who commented on the proposed requirement to disclose information about the purchase price allocation agreed that the information would be useful in assessing postacquisition earnings and cash flows of the acquirer. However, some respondents questioned the usefulness of the proposed disclosure of information about the acquiree's carrying amounts of assets acquired and liabilities assumed, particularly if the financial statements of the acquiree were not audited or were prepared on a basis other than GAAP. After considering those views, the FASB affirmed its conclusion that information about the allocation of the purchase price to major classes of assets and liabilities in the statement of financial position would be useful in assessing the amount and timing of future cash flows. However, it agreed that information about the related carrying amounts might be of limited usefulness. Thus, Statement 141 required disclosure of information about the allocation of the purchase price to each major class of asset and liability in the acquiree's statement of financial position but not their previous carrying amounts.

B405. After considering respondents' views, the FASB included in Statement 141 the pro forma disclosure requirements from Opinion 16. However, the FASB also continued the exemption of nonpublic entities from the pro forma disclosure requirements. Preparers and auditors of financial statements of nonpublic entities urged the FASB to continue that exemption, which was initially provided by FASB Statement No. 79, *Elimination of Certain Disclosures for Business Combinations by Nonpublic Enterprises.*

Disclosures related to goodwill

B406. The FASB's 2001 Exposure Draft (see paragraph B160 for a discussion of that Exposure Draft) would have required the acquirer to disclose (a) the reasons for the acquisition, including a description of the factors that led to a purchase price that resulted in goodwill, and (b) the amount of goodwill assigned to each reportable segment. The requirement to disclose goodwill by reportable segment was limited to entities that are within the scope of FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information.* That Exposure Draft also proposed requiring disclosure of the amount of goodwill expected to be deductible for tax purposes if the goodwill initially recognized in a material business combination was significant in relation to the total cost of the acquiree. After considering the comments of respondents, the FASB affirmed its conclusion that the information would be useful in estimating the amount and timing of future impairment losses, and Statement 141 required that disclosure.

Disclosure of information about intangible assets other than goodwill

B407. If the amount assigned to intangible assets was significant in relation to the total cost of an acquiree, Statement 141 required disclosure of the following information to help users of financial statements assess the amount and timing of future cash flows:

a. The total amount assigned to intangible assets subject to amortization and the total amount assigned to those that are not subject to amortization
b. The amount assigned to each major intangible asset class
c. For intangible assets subject to amortization, the weighted-average amortization period in total and for each major intangible asset class
d. The amount of any significant residual value assumed, both in total and for each major class of intangible asset.

Other disclosure requirements

B408. The 1999 Exposure Draft proposed, and Statement 141 required, disclosure of specified information for a series of immaterial business combinations that are material in the aggregate completed in a reporting period:

a. The number of entities acquired and a brief description of them
b. The aggregate cost of the acquired entities, the number of equity interests issued or issuable, and the value assigned to them
c. The aggregate amount of any contingent payments, options, or commitments and the accounting treatment that will be followed should any such contingency occur (if potentially significant in relation to the aggregate cost of the acquired entities)
d. The information about goodwill required for a material acquisition if the aggregate amount as-

signed to goodwill or to other intangible assets acquired was significant in relation to the aggregate cost of the acquired entities.

B409. In addition, the 1999 Exposure Draft proposed, and Statement 141 required, that the information required to be disclosed for a completed business combination also would be disclosed for a material business combination completed after the balance sheet date but before the financial statements are issued (unless disclosure of such information was not practicable). That requirement was consistent with auditing standards on subsequent events.

Disclosures in interim financial information

B410. Several analysts and other users recommended that the FASB require disclosure of supplemental pro forma revenues and earnings in interim financial information because that information would be more useful if it was available earlier. Statement 141 amended APB Opinion No. 28, *Interim Financial Reporting,* to require disclosure of that information.

Disclosure Requirements of IFRS 3

B411. IFRS 3 identified three objectives that its disclosure requirements were intended to meet, specifically, to provide the users of an acquirer's financial statements with information that enables them to evaluate:

a. The nature and financial effect of business combinations that were effected during the reporting period or after the balance sheet date but before the financial statements were authorized for issue.
b. The financial effects of gains, losses, error corrections, and other adjustments recognized in the current period that relate to business combinations that were effected in the current period or in previous periods.
c. Changes in the carrying amount of goodwill during the period.

B412. The IASB began its discussion of the disclosure requirements necessary to meet the objectives by assessing the disclosure requirements in SIC-28, *Business Combinations—"Date of Exchange" and Fair Value of Equity Instruments,* and IAS 22. The IASB concluded that information disclosed in accordance with SIC-28 about equity instruments issued as part of the cost of a business combination helped to meet the first of the three objectives outlined above. Therefore, IFRS 3 carried forward the disclosure requirements in SIC-28.

B413. The IASB also concluded that information previously disclosed in accordance with IAS 22 about business combinations classified as acquisitions and goodwill helped to meet the objectives in paragraph B411. Therefore, IFRS 3 carried forward the related disclosure requirements in IAS 22, amended as necessary to reflect changes IFRS 3 made to the provisions of IAS 22. For example, IAS 22 required disclosure of the amount of any adjustment during the period to goodwill or "negative goodwill" resulting from subsequent identification or changes in value of the acquiree's identifiable assets and liabilities. IFRS 3 required that an acquirer, with specified exceptions, adjust the initial accounting for a combination after that accounting was complete only to correct an error. Thus, IFRS 3 revised the IAS 22 disclosure requirement to require disclosure of information about error corrections required to be disclosed by IAS 8.

B414. The IASB then assessed whether any additional disclosure requirements should be included in IFRS 3 to ensure that the three disclosure objectives were met and considered the disclosure requirements in the corresponding standards of its partner standard setters. As a result, and after considering respondents' comments on ED 3, the IASB identified, and IFRS 3 required, the following additional disclosures to help meet the first of the three disclosure objectives in paragraph B411:

a. For each business combination effected during the period:
   (1) The amounts recognized at the acquisition date for each class of the acquiree's assets, liabilities, and contingent liabilities, and, if practicable, the carrying amounts of each of those classes, determined in accordance with IFRSs, immediately before the combination. If such disclosure was impracticable, an entity disclosed that fact, together with an explanation of why disclosure was impracticable.
   (2) A description of the factors that contributed to the recognition of goodwill—including a description of each intangible asset that was not recognized separately from goodwill and an explanation of why the intangible asset's fair value could not be measured reliably. If

the acquirer's interest in the acquiree's identifiable net assets exceeded the cost, the acquirer was required to describe the nature of that excess.

(3) The amount of the acquiree's profit or loss since the acquisition date included in the acquirer's profit or loss for the period, unless disclosure was impracticable. If such disclosure was impracticable, the acquirer disclosed that fact, together with an explanation of why disclosure was impracticable.

b. The information required to be disclosed for each business combination that was effected during the period in aggregate for business combinations that are individually immaterial.

c. The revenue and profit or loss of the combined entity for the period as though the acquisition date for all business combinations that were effected during the period had been the beginning of that period, unless such disclosure was impracticable.

B415. To aid in meeting the second disclosure objective in paragraph B411, IFRS 3 also required disclosure of the amount and an explanation of any gain or loss recognized in the current period that both:

a. Related to the identifiable assets acquired or liabilities or contingent liabilities assumed in a business combination that was effected in the current or a previous period; and

b. Was of such size, nature, or incidence that disclosure was relevant to an understanding of the combined entity's financial performance.

B416. To help achieve the third disclosure objective in paragraph B411, the IASB concluded that the previous requirement to disclose a reconciliation of the carrying amount of goodwill at the beginning and end of the period should be amended to require separate disclosure of net exchange rate differences arising during the period in accordance with IAS 21, *The Effects of Changes in Foreign Exchange Rates.*

B417. The IASB observed that there might be situations in which the information disclosed under the specific requirements would not completely satisfy IFRS 3's three disclosure objectives. In that situation, IFRS 3 required disclosure of any additional information necessary to meet those objectives.

B418. IFRS 3 also required the acquirer to disclose the number of equity instruments issued or issuable as part of the cost of a business combination, the fair value of those instruments, and the basis for determining that fair value. Although IAS 22 did not explicitly require disclosure of that information, the IASB concluded that the acquirer should have provided it as part of disclosing the cost of acquisition and a description of the purchase consideration paid or contingently payable in accordance with paragraph 87(b) of IAS 22. The IASB decided that to avoid inconsistent application, IFRS 3 should explicitly require disclosure of that information.

Disclosure Requirements of This Statement

B419. The Boards decided that this Statement and the revised IFRS 3 should include overall objectives for the disclosure of information that would be useful to investors, creditors, and others in evaluating the financial effects of a business combination. The objectives, which are stated in paragraphs 67 and 71, are, in substance, the same as those in IFRS 3 and the 2005 Exposure Draft. Respondents to the 2005 Exposure Draft who discussed the proposed disclosures generally agreed with the disclosure objectives. In reconsidering that Exposure Draft, however, the Boards noted that the third objective in IFRS 3, to provide information that enables users of an entity's financial statements to evaluate changes in the carrying amount of goodwill during the period, is effectively included in the objective in paragraph 71. Thus, the Boards combined those two objectives.

B420. In addition, both Boards concluded, as the IASB did in developing IFRS 3, that it is not necessary (or possible) to identify all of the specific information that may be necessary to meet those objectives for all business combinations. Rather, this Statement and the revised IFRS 3 specify particular disclosures that generally are required to meet those objectives and require acquirers to disclose any additional information about the circumstances surrounding a particular business combination that they consider necessary to meet those objectives (paragraph 73).

B421. Changes to the disclosure requirements of Statement 141 and IFRS 3 include the elimination of disclosures of amounts or information that was based on applying the cost-allocation (purchase price) method for assigning amounts to assets and liabilities that is replaced by this Statement's fair value measurement principle. Some of those disclosures are modified to retain the information but conform the amounts to be disclosed with the fair value measurement principle.

B422. The Boards added some disclosure requirements to those in Statement 141, IFRS 3, or both and modified or eliminated others. Those changes are described below, together with an indication of how the changes relate to each Board's previous requirements and references to related discussions in other parts of this basis for conclusions where pertinent.

a. In response to requests from some commentators on the 2005 Exposure Draft, the Boards added to both Statement 141 and IFRS 3 disclosure of information about receivables acquired (paragraphs B258–B260).
b. The Boards modified both Statement 141's and IFRS 3's disclosures about contingent consideration in a business combination to make them consistent with this Statement's and the revised IFRS 3's requirements for contingent consideration. Paragraph 68(g) describes the specific disclosures now required.
c. The FASB added to Statement 141 disclosure of the revenue and earnings of the acquiree, if practicable, for a minimum of the period from the acquisition date through the end of the current year. The disclosure is required only by public business entities for the current year, the current interim period, and cumulative interim periods from the acquisition date through the end of the current year. IFRS 3 already required disclosure of the amount of the acquiree's profit or loss included in the acquirer's profit or loss for the period, unless that was impracticable; the IASB added revenues to that disclosure (paragraphs B423–B428).
d. The FASB modified Statement 141's disclosure of supplemental pro forma information about results of operations for the comparable prior period presented to focus on revenue and earnings of the combined entity for the comparable prior reporting period as though the acquisition date for all business combinations during the current year had been the beginning of the comparable prior annual reporting period. The disclosure is required only for public entities and only if practicable. The IASB decided not to add that disclosure (paragraph B428).
e. The FASB replaced Statement 141's disclosure of the period for which the results of operations of the acquiree are included in the income statement of the combined entity with disclosure of the acquisition date—a disclosure that IFRS 3 already required. This Statement no longer permits the alternative practice of reporting revenues and expenses of the acquiree as if the acquisition occurred as of the beginning of the year (or a designated date) with a reduction to eliminate the acquiree's preacquisition period earnings (paragraphs B108–B110).
f. The Boards revised both Statement 141's and IFRS 3's disclosures about contingencies, at the acquisition date and subsequently, to make them consistent with the requirements of this Statement and the revised IFRS 3 on assets and liabilities arising from contingencies. The FASB's and the IASB's disclosures on contingencies differ because the recognition requirements to which they relate differ (paragraphs B265–B278).
g. The FASB added to Statement 141 disclosure of the amount of acquisition-related costs, which IFRS 3 already required, and the Boards added to both Statement 141 and IFRS 3 disclosure of the amount of acquisition-related costs expensed and the income statement line item in which that expense is reported.
h. The FASB eliminated Statement 141's requirement to disclose the amount of in-process research and development acquired that had been measured and immediately written off to expense in accordance with Interpretation 4. This Statement no longer permits that practice (paragraphs B149–B155).
i. The Boards added to both Statement 141 and IFRS 3 disclosure of the acquisition-date fair value or other recognized amount of the noncontrolling interest in the acquiree and the valuation techniques and key model inputs used for determining that value. An entity that prepares its financial statements in accordance with IFRSs also discloses the measurement basis selected for the noncontrolling interest.
j. For a business combination achieved in stages, the Boards added to both Statement 141 and IFRS 3 disclosure of the fair value of the acquirer's previously held equity interest in the acquiree, the amount of gain or loss recognized in accordance with paragraph 48, and the line item in the income statement in which that gain or loss is recognized.
k. The FASB replaced Statement 141's disclosure of extraordinary gains recognized for "negative goodwill" with disclosure of the amount of any gain recognized in the period for a bargain purchase, the line item in the income statement in which it is recognized, and a description of the reasons why the transaction resulted in a gain

(paragraphs B371–B381). IFRS 3 already required disclosure of that amount (although it was not called a gain on a bargain purchase).

l. The Boards added to both Statement 141 and IFRS 3 the disclosures described in paragraph 68(m) about transactions that are separate from the acquisition of assets and assumption of liabilities in the exchange for the acquiree. The 2005 Exposure Draft proposed requiring disclosures about only preexisting relationships between the acquirer and acquiree. The Boards broadened the disclosure to all separate transactions in response to comments on the Exposure Draft.

m. The Boards revised the disclosures in Statement 141 and IFRS 3 about aspects of the purchase price allocation not yet completed to make them consistent with the requirements of this Statement and the revised IFRS 3 about the measurement period. The specific disclosures required appear in paragraph 72(a).

n. The IASB eliminated IFRS 3's required disclosure of the acquiree's carrying amounts in accordance with IFRSs for each class of its assets and liabilities immediately before the combination. The IASB concluded that providing that disclosure could often involve significant costs because the acquiree might not be applying IFRSs and that those costs might exceed the benefits of the information to users.

Disclosure of Information about Postcombination Revenue and Earnings of the Acquiree

B423. Paragraph 68(r) of this Statement requires an entity to disclose, for each business combination (and for individually immaterial business combinations that are material collectively), the amounts of revenue and earnings of the acquiree since the acquisition date included in the consolidated income statement for the period. At its August 2003 roundtable discussion with users of financial statements, the FASB discussed the potential usefulness of information about increases or decreases in postcombination revenues and earnings from acquired businesses versus revenues and earnings from the operations already owned by the acquirer (organic growth). The FASB also asked whether that information would be preferable to the pro forma supplemental disclosure of revenue and results of operations of the combined entity for the current period as though the acquisition date for all business combinations during the year had been as of the beginning of the annual reporting period. Statement 141 carried that disclosure forward from Opinion 16, and IFRS 3 required a similar disclosure.

B424. The FASB also questioned whether those disclosures are directed at similar objectives and, if so, whether one may be preferable. The FASB observed that making postcombination distinctions might be too costly or impossible if the operations of the acquiree are integrated with those of the acquirer. Although users acknowledged that point, they indicated that information about actual postcombination revenues and earnings is preferable to the pro forma disclosures and should be required whenever possible. Some also said that distinguishing acquired revenues from organic revenues is most important and suggested that acquirers be required to provide that information for a 12-month period following an acquisition rather than only through the end of the annual period.

B425. The Boards agreed with users that the information about postcombination revenues and earnings of the acquiree is useful. However, for practical reasons, the Boards concluded that this Statement should provide an exception to that requirement if distinguishing the postcombination earnings of the acquiree from earnings of the combined entity is impracticable. The Boards also decided that in those circumstances the acquirer should disclose that fact and the reasons why it is impracticable to provide the postcombination information. The period for that disclosure is limited to the end of the current annual period because the Boards concluded that the information needed to provide the disclosure during that period generally will be available. A short period often is required to fully integrate an acquiree's operations with those of the acquirer. The Boards also observed that the usefulness of the separate information diminishes as the operations of the acquiree are integrated with the combined entity.

B426. The FASB proposed in its version of the 2005 Exposure Draft that the postcombination disclosures focus on *results of operations* rather than on revenues and earnings. *Results of operations* was defined as revenue, income before extraordinary items and the cumulative effect of accounting changes, earnings, and earnings per share. In considering the responses to the Exposure Draft and opportunities for further convergence, the FASB decided to revise its disclosures to focus on revenues and earnings, which is consistent with the related requirements of the revised IFRS 3. The Boards observed that the term

results of operations is not used or defined in IFRSs; it thus would have been more difficult for the IASB to converge with the disclosures initially proposed by the FASB.

B427. The FASB considered expanding the disclosure of postcombination revenues and earnings of an acquiree to all entities because the information would be valuable to any investor, not merely investors in public business entities. To do so also would converge with the requirements of the IASB. However, the FASB was concerned about imposing the additional costs on nonpublic entities because it believes that the benefits to users of those entities would not be sufficient to warrant imposing those costs. The FASB also observed that the IASB has not completed its separate deliberations on its small- and medium-sized entities project and thus does not have an established practice of differential disclosure for circumstances in which it is clear that the benefits would be sufficient for some entities but not so clear for all entities. Because of those cost-benefit concerns, the FASB decided not to expand this disclosure requirement to all entities.

B428. If comparative financial statements are presented, the FASB decided to require disclosure of supplemental pro forma information about the revenue and earnings of the combined entity for the comparable prior reporting period as though the acquisition date for all business combinations during the current year had been the beginning of the comparable prior annual reporting period. The disclosure is required only for public entities and only if practicable. The IASB considered also requiring that disclosure, but it observed that the needed information would be particularly difficult and costly to obtain in the international environment. An entity that prepares its financial statements in accordance with IFRSs might in a given year acquire other entities that had previously applied the domestic reporting requirements of several different countries. Because the IASB did not consider it feasible to require the disclosure in the international environment, the revised IFRS 3 requires only disclosure of revenues and profit or loss for the current reporting period determined as though the acquisition date for all combinations during the period had been as of the beginning of the annual reporting period.

Effective Date and Transition

B429. This Statement is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008, that is, for 2009 financial statements. The IASB decided to provide a slightly later effective date. The revised IFRS 3 is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after July 1, 2009. The IASB assured its constituents that there would be a transition period of approximately 18 months between the publication date and the effective date of the revised IFRS 3 as part of its commitment to have a period of stability following the initial transition to IFRSs. The FASB decided to make this Statement effective as soon as practicable, that is, for 2009 financial statements. The FASB believes that that effective date provides sufficient time for entities and their auditors to analyze, interpret, and prepare for implementation of the provisions of this Statement.

B430. The Boards also concluded that the effective date of this Statement and the revised IFRS 3 should be the same as that of the amendments to their respective consolidation standards (Statement 160, amending ARB 51, and the IASB's amendment to IAS 27). Particular provisions in those amendments, which address the subsequent accounting for an acquiree in consolidated financial statements, are related to provisions in this Statement and the revised IFRS 3 that address the initial accounting for an acquiree at the acquisition date. The Boards concluded that linking the timing of the changes in accounting required by those amendments to those required by this Statement and the revised IFRS 3 would minimize disruptions to practice, which benefits both preparers and users of financial statements.

B431. This Statement prohibits early application, and the revised IFRS 3 permits early application. The FASB's Investors Technical Advisory Committee and other users of financial statements told the FASB that providing alternatives for when entities adopt a new standard impairs comparability. The IASB observed, however, that the changes to IFRS 3 are less extensive than the changes to Statement 141. In addition, the IASB observed that IAS 27 is silent on the accounting for changes in controlling ownership interests in a subsidiary, and it wanted entities to be able to adopt the guidance in the amended IAS 27 as soon as it is issued. Accordingly, the IASB retained the proposal in the 2005 Exposure Draft to permit entities to adopt the revised IFRS 3 early if they so choose.

B432. The FASB and the IASB also concluded that this Statement and the revised IFRS 3 should be applied prospectively. As with most other requirements that relate to particular types of transactions, applying this Statement and the revised IFRS 3 retrospectively would not be feasible.

Effective Date and Transition for Combinations Involving Only Mutual Entities

B433. Paragraph 60 of Statement 141 indicated that the provisions of that Statement were not effective for combinations involving only mutual entities until the Board issued interpretative guidance for the application of the purchase method to those transactions. This Statement provides that interpretative guidance. Thus, in the absence of special effective date provisions provided by this Statement, the delayed application for combinations between mutual entities would end upon the application of this Statement. The Board observed that taken literally that could result in mutual entities making a two-step transition—transitioning to Statement 141 when the guidance in this Statement is issued and then transitioning to the provisions of this Statement when it becomes effective.

B434. The Board decided that it should include in this Statement provisions to avoid the complexities and difficulties that a two-step transition might impose on both issuers of financial statements and the users of those financial statements. The Board concluded that it would be best to effect the Statement 141 change that precludes the use of the pooling method at the same time that this Statement's changes to the procedures for applying the acquisition method become effective. Therefore, the effective date for combinations between mutual entities is the same as the effective date for all other entities applying this Statement.

B435. The Board also decided that this Statement should carry forward the transition provisions of Statement 141 that are relevant for entities that had purchase business combinations accounted for in accordance with Opinion 16. Therefore, the transition provisions that applied to entities that adopted Statement 141 will now also apply to combinations between mutual entities upon the effective date of this Statement. Those provisions are provided in paragraphs A132–A134 of this Statement.

B436. Additionally, in October 2002, the FASB issued FASB Statement No. 147, *Acquisitions of Certain Financial Institutions.* That Statement provided interpretative guidance on the application of the purchase (acquisition) method to acquisitions of financial institutions. It also provided transitional guidance for financial institutions that accounted for acquisitions in accordance with FASB Statement No. 72, *Accounting for Certain Acquisitions of Banking or Thrift Institutions.* However, Statement 147 did not apply to transactions between two or more mutual entities that are financial institutions. The Board decided that this Statement should provide transition provisions that are relevant for mutual entities that are financial institutions and that had purchase business combinations accounted for in accordance with Statement 72. Therefore, the transition provisions that applied to financial institutions that adopted Statement 147 will now also apply to combinations between mutual entities that are financial institutions upon the effective date of this Statement.

Benefits and Costs

B437. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement a new standard are borne primarily by the preparer. The Board's assessment of the costs and benefits of issuing an accounting standard is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement an accounting standard or to quantify the value of improved information in financial statements.

B438. The Board concluded that Statement 141 remedied significant deficiencies and filled significant voids in financial reporting. The requirement to account for all business combinations by the acquisition method provided users of financial statements with information about the cost of those transactions that the pooling method did not provide because that method did not reflect the values exchanged in the business combination transaction. Therefore, users of financial statements are better able to assess both the initial costs and the subsequent performance of those investments.

B439. The Board concluded that the requirements of this Statement will result in improved financial reporting in several ways. Foremost, by focusing on

fundamental principles for recognizing and measuring all business combinations, this Statement will assist the Board in establishing principles-based standards that simplify GAAP whenever possible while improving the comparability and understanding of the resulting information. This Statement furthers that effort by requiring that all acquirers recognize the assets acquired and liabilities assumed as part of a business combination measured at their fair values, with limited exceptions, regardless of the ownership percentage acquired or the means used to acquire the business.

B440. The Board concluded that this Statement improves the completeness, relevance, and comparability of information provided to investors, creditors, and other users of financial statements by requiring more assets and liabilities to be separately recognized and initially measured at fair value. For example, in accordance with this Statement:

a. Assets and liabilities arising from contingencies that meet the more-likely-than-not criterion but not the previous criteria for recognition will be separately recognized at fair value rather than subsumed in goodwill.
b. Research and development assets acquired in a business combination will be measured and recognized at their fair values rather than expensed at the acquisition date as previously required.
c. Assets and liabilities of acquired businesses that are not wholly owned generally would be recognized at the full amount of their fair values rather than measured in part at fair value, based on the percentage of ownership interest acquired in the business combination, and in part on another basis.

B441. This Statement benefits both issuers and users of financial statements by converging to a common set of high-quality financial accounting standards on an international basis. That improves the comparability of financial information around the world, and it also simplifies and reduces the costs of accounting for entities that issue financial statements in accordance with both GAAP and international accounting standards.

B442. The Board concluded that the guidance in this Statement is not overly complex. Indeed, it eliminates guidance that many have found to be complex, costly, and arbitrary and that has been the source of considerable uncertainties and costs in the marketplace. Moreover, this Statement does not introduce a new method of accounting but rather expands the use of the acquisition method of accounting that is familiar, has been widely used, and for which there is a substantial base of experience.

B443. This Statement also improves the comparability and usefulness of information provided by mutual entities by eliminating the permitted use of the pooling method by those entities in their accounting for acquisitions of other mutual entities. Statement 141 allowed a delayed effective date for applying its provisions to business combinations between mutual entities. The use of two methods that produced such dramatically different financial statement outcomes made it difficult or impossible for users to compare the financial statements of entities that have accounted for their business combinations by different methods.

B444. The Board sought to reduce the costs of applying this Statement by:

a. Providing a more-likely-than-not criterion to help acquirers identify assets and liabilities arising from noncontractual contingencies to recognize at the acquisition date
b. Not requiring subsequent fair value measurements for assets and liabilities arising from contingencies
c. Requiring that particular assets and liabilities (for example, those related to deferred taxes, pensions, and other postemployment benefits) continue to be measured in accordance with existing accounting standards rather than at fair value
d. Applying its provisions prospectively rather than retrospectively.

The Board acknowledges that those steps may result in some sacrifice of the benefits of improved financial reporting in accordance with this Statement. However, the Board believes that the complexities and related costs that result from applying the fair value measurement requirement to all assets and liabilities, at this time, and requiring retrospective application are not justified.

Appendix C

BACKGROUND INFORMATION

C1. Before the issuance of FASB Statement No. 141, *Business Combinations,* the guidance on accounting for business combinations was provided by APB

Opinion No. 16, *Business Combinations,* which the Accounting Principles Board of the American Institute of Certified Public Accountants issued in 1970. Opinion 16 provided for two methods of accounting for business combinations—the pooling-of-interests method (pooling) and the purchase method. Those methods were not alternatives or substitutes for one another. Opinion 16 required that the pooling method be used if a business combination met 12 specified conditions; otherwise, the purchase method was to be used.

C2. During the 1970s, the FASB had an active project on its agenda to reconsider the accounting for business combinations and purchased intangible assets. However, the Board later decided to defer consideration of the issues in that project until after it had completed development of its conceptual framework for accounting and reporting. In 1981, the Board removed the inactive business combinations project from its agenda to focus on higher priority projects.

C3. In August 1996, the Board added the current project on accounting for business combinations to its agenda. The objective of that project was to improve the transparency of accounting for and reporting of business combinations, including the accounting for goodwill and other intangible assets. In 1999, the Board decided that that objective would best be achieved through several phases focused on specific issues.

C4. In the first of those phases, which ended in June 2001 with the concurrent issuance of Statement 141 and FASB Statement No. 142, *Goodwill and Other Intangible Assets,* the Board reconsidered the methods of accounting for business combinations and the accounting for goodwill and other intangible assets required in Opinion 16 and APB Opinion No. 17, *Intangible Assets* (which also was issued in 1970). The second phase commenced immediately after the issuance of Statements 141 and 142.

C5. In the second phase of the project, the Board considered issues related to the application of the acquisition method, including how that method should be applied to combinations involving only mutual entities and business combinations achieved in stages (step acquisitions). This Statement is a result of the Board's deliberations on those issues and revises Statement 141 to incorporate the decisions reached on those issues.

C6. In a separate phase of the project, the Board is considering the accounting for combinations involving not-for-profit organizations, which resulted in the issuance of FASB October 2006 Exposure Drafts, *Not-for-Profit Organizations: Mergers and Acquisitions,* and *Not-for-Profit Organizations: Goodwill and Other Intangible Assets Acquired in a Merger or Acquisition.* The comment period ended in January 2007. At the time this Statement was issued, the Board was redeliberating those Exposure Drafts.

C7. The mergers and acquisitions Exposure Draft would provide guidance for the accounting for mergers and acquisitions by not-for-profit organizations and the accounting for noncontrolling interests in subsidiaries. The goodwill Exposure Draft would provide guidance for the subsequent accounting for and reporting of goodwill and other intangible assets acquired in a merger or acquisition.

C8. This Statement does not address the accounting for the formation of joint ventures, push-down accounting (including spinoffs), and common control transactions. The Board may reconsider those issues in another project in the future.

Reasons the FASB Took on the Business Combinations Project

C9. A principal reason for taking on this project in 1996 was the increase in merger and acquisition activity that brought greater attention to the fact that two transactions that are economically similar may be accounted for by different methods (either the pooling method or the purchase method) that produce dramatically different financial statement results. Consequently, both the representational faithfulness and the comparability of those financial statements suffered.

C10. Another reason the Board decided to undertake this project was that many constituents perceived the differences in the pooling and purchase methods to have affected competition in markets for mergers and acquisitions. Entities that could not meet all of the conditions for applying the pooling method believed that they faced an unlevel playing field in competing for targets with entities that could apply that method. That perception and the resulting attempts to expand the application of the pooling method placed considerable tension on the interpretation and application of the provisions of Opinion 16. The volume of inquiries fielded by the staffs of the FASB and the Securities and Exchange Commission and the auditing profession was evidence of that tension.

C11. The unlevel playing field that was perceived to stem from the application of the pooling and purchase methods extended internationally as well. Cross-border differences in accounting standards for business combinations and the rapidly accelerating movement of capital flows globally heightened the need for accounting standards to be comparable internationally. Promoting international comparability in accounting standards is part of the Board's mission, and many members of the Financial Accounting Standards Advisory Council (FASAC) cited the opportunity to promote greater international comparability in the standards for business combinations as a reason for adding this project to the Board's agenda. FASAC had consistently ranked a possible project on business combinations as a high priority for a number of years.

Conduct of the Business Combinations Project

First Phase—Statements 141 and 142

C12. Paragraphs C13–C21 discuss the objectives and significant steps during the Board's conduct of the first phase of its project that led to Statements 141 and 142.

C13. Largely because of concerns about the perception of an unlevel cross-border playing field with the United States in the accounting standards for business combinations, the Canadian Accounting Standards Board (AcSB) conducted a business combinations project concurrently with the first phase of the FASB's project. The goal of that concurrent effort was to establish common standards on business combinations and intangible assets. In 2001, the AcSB concurrently adopted their standards and issued new Handbook Sections 1581, *Business Combinations,* and 3062, *Goodwill and Other Intangible Assets,* which are consistent with Statements 141 and 142.

C14. The Board also worked with other members of an international organization of standard-setting bodies with the aim of achieving convergence internationally with respect to the methods of accounting for business combinations. That organization, known as the "Group of 4 plus 1" (G4+1), consisted of the Australian Accounting Standards Board (AASB), the New Zealand Financial Reporting Standards Board (FRSB), the United Kingdom Accounting Standards Board (UK ASB), the AcSB, the FASB, and an observer, the International Accounting Standards Committee (IASC).

C15. The Board formed a business combinations task force comprising individuals from a number of organizations representing a wide range of the Board's constituents. The first meeting of that task force was held in February 1997. Relevant academic research was reviewed, and the meeting discussion centered on a background paper that addressed the project's scope, the direction the project should take, and how the project should be conducted.

C16. The June 1997 FASB Special Report, *Issues Associated with the FASB Project on Business Combinations,* was based on that background paper and indicated some of the Board's initial decisions about the project's scope, direction, and conduct. The 54 comment letters received in response to that Special Report generally expressed agreement with those decisions.

C17. In 1998, the FASB participated in the development of a G4+1 Position Paper, *Recommendations for Achieving Convergence on the Methods of Accounting for Business Combinations.* That Position Paper considered the pooling method, the purchase method, and the fresh-start method,[9] and concluded that only the purchase method should be used to account for business combinations.

C18. The Board issued the Position Paper as an FASB Invitation to Comment, *Methods of Accounting for Business Combinations: Recommendations of the G4+1 for Achieving Convergence,* in December 1998, the same date on which other G4+1 member organizations issued similar documents for comment. The FASB received 148 comment letters, the AcSB received 40 letters, the UK ASB received 35 letters, the IASC received 35 letters, the AASB received 5 letters, and the FRSB received 4 letters.

C19. After considering the recommendations of the G4+1 and the responses to the Invitation to Comment, the Board decided that only the purchase

[9]Under the fresh-start method, the assets and liabilities of the combining entities (regardless of whether they had been recognized in the statements of financial position of those entities) are recognized in the statement of financial position of the combined entity at fair value. The combined entity is treated as a new entity as of the date of the combination and its history commences on that date. The fresh-start method is currently used in practice to account for certain corporate reorganization transactions. As with the purchase method, the fresh-start method can be applied to business combinations that are effected by cash, other assets, debt, equity shares, or a combination thereof.

method should be used to account for business combinations. The Board also decided that certain changes should be made in how the purchase method should be applied, particularly in the accounting for and financial statement presentation of goodwill and other intangible assets. Those changes were proposed in the September 1999 FASB Exposure Draft, *Business Combinations and Intangible Assets* (1999 Exposure Draft). The Board received 210 comment letters in response to the 1999 Exposure Draft. In February 2000, the Board held 4 days of public hearings, 2 days in San Francisco and 2 days in New York City, at which 43 individuals or organizations presented their views on the 1999 Exposure Draft.

C20. In redeliberating the proposals in the 1999 Exposure Draft, the Board considered changes suggested by various constituents, in particular, changes related to the accounting for goodwill. During October and November 2000, Board and staff members explored the suggested changes to the accounting for goodwill in field visits with 14 companies. The Board's deliberations resulted in significant changes to the proposed requirements related to goodwill but not to other issues addressed in the 1999 Exposure Draft. In particular, the Board decided that goodwill should no longer be amortized and should be tested for impairment in a manner different from how other assets are tested for impairment. The Board also affirmed the proposal that only the purchase method should be used to account for business combinations. In February 2001, the Board issued a revised Exposure Draft, *Business Combinations and Intangible Assets—Accounting for Goodwill* (2001 Exposure Draft), that proposed changes to the 1999 Exposure Draft with regard to the accounting for goodwill and the initial recognition of intangible assets other than goodwill. The Board received 211 comment letters on the 2001 Exposure Draft.

C21. The Board decided to separate the guidance for business combinations from that for goodwill and other intangible assets and issue that guidance in two concurrently issued final documents, Statements 141 and 142. Those two Statements parallel and supersede Opinions 16 and 17, respectively. The Board also decided that Statement 141 should supersede both Opinion 16 and FASB Statement No. 38, *Accounting for Preacquisition Contingencies of Purchased Enterprises,* and carry forward without reconsideration portions of the guidance in that Opinion and that Statement related to the application of the purchase method.

Second and Third Phases—Statement 141(R)

C22. Paragraphs C23–C36 discuss the objectives and significant steps during the Board's conduct of the second and third phases of its project that led to this Statement.

Second phase—guidance for applying the acquisition method

C23. At its outset, the objective of the second phase of the project was to consider the existing guidance on the application of the purchase method (now called the acquisition method) of accounting with the objective of improving the completeness, relevance, and comparability of financial information about business combinations provided in financial statements. Shortly after commencing this phase, the FASB and the IASB agreed to jointly reconsider their guidance for applying the acquisition method of accounting for business combinations. Thus, the Board conducted this phase of the project jointly with the IASB with the goal of developing a single, high-quality accounting standard that could be used for both international and domestic financial reporting.

C24. In the second phase of the project, the Board considered the purchase method procedures that Statement 141 carried forward, without reconsideration, from Opinion 16 and Statement 38. The Board also addressed other related issues that it did not consider during its deliberations in the first phase. Those issues include accounting for business combinations through means other than a purchase of its net assets or equity interests and business combinations achieved in stages (step acquisitions). The Board's deliberations related to business combinations achieved in stages led to comprehensively reconsidering the accounting for and reporting of noncontrolling interests and the issuance of FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements* (an amendment to ARB No. 51, *Consolidated Financial Statements*), which was issued concurrently with this Statement. The Board also considered disclosure requirements consistent with its objective of improving the relevance of information reported to investors, creditors, and other users of financial statements.

C25. The IASB also has been conducting its project on business combinations in multiple phases. The first phase of its project resulted in the issuance of IFRS 3, *Business Combinations,* in March 2004 and revisions to IAS 36, *Impairment of Assets,* and

IAS 38, *Intangible Assets.* The scope of the IASB's first phase was similar to that of Statements 141 and 142 and similar conclusions were reached on the major issues. The second phase of the IASB's project addresses issues not addressed in their first phase. Those include issues related to the:

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

In April 2002, the IASB commenced part (a) of its second phase and, as discussed in paragraph C23, agreed to conduct that part as a joint project with the FASB. (In 2004, the IASB also decided to include part (b) in the scope of the joint project and, thus, further align its scope with that of this Statement.)

C26. The two Boards shared staff and other resources and coordinated their deliberations of issues; however, for the most part, the Boards separately deliberated the issues within this joint project. In addition, throughout the project, the Boards and their staff received technical support from members of the FASB's business combinations resource group comprising individuals with accounting, auditing, valuation, and related financial reporting expertise in business combinations. In 2003, the FASB expanded the resource group to gain additional counsel from financial analysts and other users of financial statements. The Board and some IASB members held educational meetings with resource group members in April and August 2003. In addition, throughout the project, the Board held educational meetings with FASAC and other constituents and industry groups to benefit from their insight and expertise on specific project- and industry-related issues. To gain additional information about the benefits and costs of this Statement, in September and October 2004, the Board also conducted field visits with five companies that recently completed a business combination.

C27. The FASB deliberated the issues at 43 public decision-making meetings. In addition, the Board met jointly with the IASB at public meetings held in September 2002, October 2003, and April 2004. As a result of those deliberations, in June 2005, the Boards issued a joint Exposure Draft, *Business Combinations* (2005 Exposure Draft), to replace Statement 141 and IFRS 3. The comment period for the 2005 Exposure Draft was 120 days.

C28. The FASB and the IASB received more than 280 comment letters on the 2005 Exposure Draft. On October 27, 2005 (in Norwalk, Connecticut), and November 9, 2005 (in London, England), the Boards held public roundtable meetings with more than 45 constituents to discuss issues raised in the comment letters. At the roundtable meetings, constituents discussed several aspects of the 2005 Exposure Draft, including the definition of a business and a business combination; applicability of the acquisition method to mutual entities; step and partial acquisitions; measuring consideration, including the measurement date of equity securities issued as consideration, contingent consideration, and acquisition-related costs; measuring the fair value of assets acquired and liabilities assumed, including contingencies, restructuring costs, in-process research and development, and valuation allowances; bargain purchases and overpayments; measurement period adjustments; and noncontrolling interests issues, including the economic unit concept versus the parent company concept, classification of noncontrolling interests as equity, and transactions with noncontrolling owners.

C29. Throughout 2006 and early 2007, the Board redeliberated the issues raised by respondents to the 2005 Exposure Draft and by participants in the roundtable meetings at 13 public decision-making meetings. In addition, the Board met jointly with the IASB at three public meetings held in April 2006, October 2006, and April 2007.

C30. In developing this Statement, the Board considered the comments from respondents to the 2005 Exposure Draft, as well as input from the roundtable participants, the FASAC, the Small Business Advisory Council, the User Advisory Council, and members of the Investor Task Force. In response, the Board reconsidered and clarified particular aspects of the proposals in the 2005 Exposure Draft.

Third phase—combinations involving only mutual entities

C31. Another objective of the FASB's project was to consider and develop guidance on the application of the acquisition method for combinations involving only mutual entities. During its deliberations leading to Statement 141, the Board concluded that those combinations should be accounted for using the acquisition method. However, the Board decided to defer the effective date of those Statements for combinations involving only mutual entities until it issued interpretative guidance about how mutual entities should apply the acquisition method. At its outset, the

Board conducted this third phase of the project jointly with the AcSB. The Board (and the AcSB) decided to use a "differences-based" approach for addressing the issues in this phase and for identifying circumstances particular to mutual entities that may require additional guidance. That approach presumed that the provisions and guidance of Statements 141 and 142 would apply to combinations involving only mutual entities, unless the economic conditions or other circumstances of the combination were found to be so different as to warrant a different accounting treatment or further guidance.

C32. In October 2001, the Board held a roundtable discussion meeting with representatives of different types of mutual entities to discuss the characteristics of mutual entities and how they differ from other business entities and the present accounting for business combinations. The Board learned that mutual entities have many common characteristics to other business entities and some distinguishing characteristics. The Board also learned that the economic motivations driving combinations involving only mutual entities, such as providing constituents with a broader range of or access to services and cost savings through economies of scale, are similar to those driving combinations between other business entities.

C33. Following that October 2001 roundtable meeting, the Board deliberated the related issues about combinations involving only mutual entities at eight of its public decision-making meetings. A couple of the more significant of the identified differences considered and deliberated included:

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

C34. After considering those differences and the related issues, the Board concluded that combinations between mutual entities are economically similar to combinations between other business entities and that there is no need to issue separate application guidance for those business combinations. As a result, in December 2003, the Board:

a. Affirmed its decision that the accounting for the acquisition of a mutual entity and the calculation of the related goodwill should be consistent with decisions reached in the second phase of the project
b. Decided to provide some specific guidance for applying the acquisition method to acquisitions of mutual entities
c. Decided to include in this Statement the results of its deliberations and conclusions on both the second and third phases of the project on business combinations. Thus, this Statement provides accounting standards and guidance that is applicable for business combinations between investor-owned entities and mutual entities.

C35. In January 2004, the Board held a meeting with representatives of organizations of cooperative and other mutual entities to discuss its tentative conclusions and specific concerns raised about the benefits and costs of implementing this Statement, including regulatory and other public policy concerns. To gain additional information about the benefits and costs of this Statement, in September and October 2004, the Board also conducted field visits with three mutual entities (a credit union, a mutual bank, and a cooperative) that recently merged with a similar entity. Each of those combinations was accomplished without an exchange of cash or other readily measurable consideration.

C36. During redeliberations of the 2005 Exposure Draft, the Board affirmed that a business combination between mutual entities should be included in the scope of this Statement and, therefore, accounted for using the acquisition method.

Appendix D

CONTINUING AUTHORITATIVE GUIDANCE

Introduction

D1. This appendix provides continuing authoritative guidance for asset acquisitions and for transactions between entities under common control. The guidance in this appendix has been quoted, paraphrased, or modified as necessary so that it can be understood in the context of this Statement. The original source of the guidance is noted parenthetically or otherwise.

Accounting for Asset Acquisitions—General Concepts

D2. Paragraph 4 of this Statement clarifies that if the assets acquired and liabilities assumed do not constitute a *business,* as defined in paragraph 3(d), then the transaction should be accounted for as an asset acquisition. The typical accounting for an asset acquisition is described in paragraphs D3–D7.[10]

D3. *Initial recognition.* Assets commonly are acquired in exchange transactions that trigger the initial recognition of the assets acquired and any liabilities assumed. If the consideration given in exchange for the assets (or net assets) acquired is in the form of assets surrendered (such as cash), the assets surrendered are derecognized at the date of acquisition. If the consideration given is in the form of liabilities incurred or equity interests issued, the liabilities incurred and equity interests issued are initially recognized at the date of acquisition. (FAS 141, ¶4)

D4. *Initial measurement.* Assets are recognized based on their *cost* to the acquiring entity, which generally includes the transaction costs of the asset acquisition, and no gain or loss is recognized unless the fair value of noncash assets given as consideration differs from the assets' carrying amounts on the acquiring entity's books. For transactions involving nonmonetary consideration within the scope of APB Opinion No. 29, *Accounting for Nonmonetary Transactions*, an acquirer must first determine if any of the conditions in paragraph 20 of Opinion 29 apply. (FAS 141, ¶5)

D5. Asset acquisitions in which the consideration given is cash are measured by the amount of cash paid, which generally includes the transaction costs of the asset acquisition. However, if the consideration given is not in the form of cash (that is, in the form of noncash assets, liabilities incurred, or equity interests issued), measurement is based on either the cost, which shall be measured based on the fair value of the consideration given or the fair value of the assets (or net assets) acquired, whichever is more clearly evident and, thus, more reliably measurable. For transactions involving nonmonetary consideration within the scope of Opinion 29, an acquirer must first determine if any of the conditions in paragraph 20 of Opinion 29 apply. (FAS 141, ¶6)

D6. *Allocating cost.* Acquiring assets in groups requires not only ascertaining the cost of the asset (or net asset) group but also allocating that cost to the individual assets (or individual assets and liabilities) that make up the group. The cost of such a group is determined using the concepts described in paragraphs D4 and D5. The cost of a group of assets acquired in an asset acquisition shall be allocated to the individual assets acquired or liabilities assumed based on their relative fair values and shall not give rise to goodwill. The allocated cost of an asset that the entity does not intend to use or intends to use in a way that is not its highest and best use, such as a brand name, shall be determined based on its relative fair value. (FAS 141, ¶7; FAS 142, ¶9)

D7. *Accounting after acquisition.* After the acquisition, the acquiring entity accounts for the asset or liability in accordance with the appropriate generally accepted accounting principles. The basis for measuring the asset acquired or liability assumed has no effect on the subsequent accounting for the asset or liability. (Opinion 16, paragraph 69; FAS 141, ¶8)

Transactions between Entities under Common Control

D8. Paragraph 2(c) states that this Statement does not apply to combinations between entities or businesses under common control. The following are examples of those types of transactions:

a. An entity charters a newly formed entity and then transfers some or all of its net assets to that newly chartered entity.
b. A parent transfers the net assets of a wholly owned subsidiary into the parent and liquidates the subsidiary. That transaction is a change in legal organization but not a change in the reporting entity.
c. A parent transfers its controlling interest in several partially owned subsidiaries to a new wholly owned subsidiary. That also is a change in legal organization but not in the reporting entity.
d. A parent exchanges its ownership interests or the net assets of a wholly owned subsidiary for additional shares issued by the parent's less-than-wholly-owned subsidiary, thereby increasing the parent's percentage of ownership in the less-than-wholly-owned subsidiary but leaving all of the

[10]Paragraph E34(b) of this Statement amends FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities,* to require that the primary beneficiary of a variable interest entity that does not constitute a business initially measure and recognize the assets (except goodwill) and liabilities of the variable interest entity in accordance with paragraphs 12–33 of this Statement.

existing noncontrolling interest outstanding. (FAS 141, ¶D11)

e. A parent's less-than-wholly-owned subsidiary issues its shares in exchange for shares of another subsidiary previously owned by the same parent, and the noncontrolling shareholders are not party to the exchange. That is not a business combination from the perspective of the parent. (FTB 85-5, ¶7)
f. A limited liability company is formed by combining entities under common control. (Practice Bulletin 14, ¶.05)

D9. When accounting for a transfer of assets or exchange of shares between entities under common control, the entity that receives the net assets or the equity interests should initially recognize the assets and liabilities transferred at their carrying amounts in the accounts of the transferring entity at the date of transfer. (FAS 141, ¶D12) If the carrying amounts of the assets and liabilities transferred differ from the historical cost of the parent of the entities under common control, for example, because push-down accounting had not been applied, then the financial statements of the receiving entity should reflect the transferred assets and liabilities at the historical cost of the parent of the entities under common control. (EITF Issue 90-5)

Procedural Guidance

D10. Some transfers of net assets or exchanges of shares between entities under common control result in a change in the reporting entity. In practice, the method that many entities have used to account for those transactions is similar to the pooling-of-interests method. Paragraphs D11–D14 provide procedural guidance that should be considered when preparing financial statements and related disclosures for the entity that receives the net assets. (FAS 141, ¶D14)

D11. In some instances, the entity that receives the net assets or equity interests (the receiving entity) and the entity that transferred the net assets or equity interests (the transferring entity) may account for similar assets and liabilities using different accounting methods. In such circumstances, the carrying amounts of the assets and liabilities transferred may be adjusted to the basis of accounting used by the receiving entity if the change would be preferable. Any such change in accounting method should be applied retrospectively, and financial statements presented for prior periods should be adjusted unless it is impracticable to do so. FASB Statement No. 154, *Accounting Changes and Error Corrections,* provides guidance if retrospective application is impracticable. (FAS 141, ¶D15)

D12. The financial statements of the receiving entity should report results of operations for the period in which the transfer occurs as though the transfer of net assets or exchange of equity interests had occurred at the beginning of the period. Results of operations for that period will thus comprise those of the previously separate entities combined from the beginning of the period to the date the transfer is completed and those of the combined operations from that date to the end of the period. By eliminating the effects of intercompany transactions in determining the results of operations for the period before the combination, those results will be on substantially the same basis as the results of operations for the period after the date of combination. The effects of intercompany transactions on current assets, current liabilities, revenue, and cost of sales for periods presented and on retained earnings at the beginning of the periods presented should be eliminated to the extent possible. The nature of and effects on earnings per share of nonrecurring intercompany transactions involving long-term assets and liabilities need not be eliminated but should be disclosed. (Opinion 16, paragraph 56; FAS 141, ¶D16)

D13. Similarly, the receiving entity should present the statement of financial position and other financial information as of the beginning of the period as though the assets and liabilities had been transferred at that date. Financial statements and financial information presented for prior years also should be retrospectively adjusted to furnish comparative information. All adjusted financial statements and financial summaries should indicate clearly that financial data of previously separate entities are combined. However, the comparative information in prior years should only be adjusted for periods during which the entities were under common control. (Opinion 16, paragraph 57; FAS 141, ¶D17)

D14. The notes to the financial statements of the receiving entity should disclose the following for the period in which the transfer of assets and liabilities or exchange of equity interests occurred:

a. The name and brief description of the entity included in the reporting entity as a result of the net asset transfer or exchange of equity interests
b. The method of accounting for the transfer of net assets or exchange of equity interests. (FAS 141, ¶D18)

The receiving entity also should consider whether additional disclosures are required in accordance with FASB Statement No. 57, *Related Party Disclosures.*

Appendix E

AMENDMENTS TO EXISTING PRONOUNCEMENTS

E1. [This paragraph has been deleted. See Status page.]

E2. This Statement replaces FASB Statement No. 141, *Business Combinations.*

E3. This Statement nullifies the following pronouncements:

a. FASB Statement No. 72, *Accounting for Certain Acquisitions of Banking or Thrift Institutions*
b. FASB Statement No. 147, *Acquisitions of Certain Financial Institutions*
c. FASB Interpretation No. 4, *Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method*
d. FASB Interpretation No. 9, *Applying APB Opinions No. 16 and 17 When a Savings and Loan Association or a Similar Institution Is Acquired in a Business Combination Accounted for by the Purchase Method*
e. FASB Technical Bulletin No. 85-5, *Issues Relating to Accounting for Business Combinations*
f. FASB Staff Position FAS 141-1 and FAS 142-1, "Interaction of FASB Statements No. 141 and No. 142 and EITF Issue No. 04-2."

E4. The following references are replaced by this Statement:

a. All references to *FASB Statement No. 141, Business Combinations,* are replaced by *FASB Statement No. 141 (revised 2007), Business Combinations.*
b. All references to *Statement 141* are replaced by *Statement 141(R).*
c. All references to *purchase method* are replaced by *acquisition method.*

E5. ARB No. 43, Chapter 1A, "Prior Opinions—Rules Adopted by Membership," is amended as follows: [Added text is underlined and deleted text is ~~struck out~~.]

a. Paragraph 3:

~~Earned surplus of a subsidiary company created prior to acquisition does not form a part of the consolidated earned surplus of the parent company and subsidiaries; nor can any dividend declared out of such surplus properly be credited to the income account of the parent company.~~

E6. APB Opinion No. 14, *Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants,* is amended as follows:

a. Paragraph 9:

The contrary view is that convertible debt possesses characteristics of both debt and equity and that separate accounting recognition should be given to the debt characteristics and to the conversion option at time of issuance. This view is based on the premise that there is an economic value inherent in the conversion feature or call on the stock and that the nature and value of this feature should be recognized for accounting purposes by the issuer. The conversion feature is not significantly different in nature from the call represented by an option or warrant, and sale of the call is a type of capital transaction. The fact that the conversion feature coexists with certain debt characteristics in a hybrid security and cannot be sold or transferred separately from these senior elements or from the debt instrument itself does not constitute a logical or compelling reason why the values of the two elements should not receive separate accounting recognition. Similar separate accounting recognition for disparate features of single instruments is reflected in, for example, the capitalization of long-term leases—involving the separation of the principal and interest elements~~—and in the allocation of the purchase cost in a bulk acquisition between goodwill and other assets~~.

E7. [This paragraph has been deleted. See Status page.]

E8. APB Opinion No. 28, *Interim Financial Reporting,* is amended as follows:

a. Footnote 3a to paragraph 21, as added previously:

Disclosures required in interim financial information related to a business combination are set

forth in paragraphs 67–73 of FASB Statement No. 141 (revised 2007), *Business Combinations* ~~paragraph 58 of FASB Statement No. 141, *Business Combinations*~~.

E9. APB Opinion No. 29, *Accounting for Nonmonetary Transactions,* is amended as follows:

a. Footnote 3a to paragraph 4(a), as added previously:

Paragraph A2(a) of Statement 141(R)~~Paragraph 10 of Statement 141~~ states that an exchange of a business for a business is a business combination.

E10. APB Opinion No. 30, *Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions,* is amended as follows:

a. Paragraph 20, as amended:

Extraordinary items are events and transactions that are distinguished by their unusual nature *and* by the infrequency of their occurrence. Thus, *both* of the following criteria should be met to classify an event or transaction as an extraordinary item:

a. *Unusual nature*—the underlying event or transaction should possess a high degree of abnormality and be of a type clearly unrelated to, or only incidentally related to, the ordinary and typical activities of the entity, taking into account the environment in which the entity operates. (See discussion in paragraph 21.)
b. *Infrequency of occurrence*—the underlying event or transaction should be of a type that would not reasonably be expected to recur in the foreseeable future, taking into account the environment in which the entity operates. (See discussion in paragraph 22.)

However, the following items shall be recognized as an extraordinary items regardless of whether those criteria are met:

(1) [This subparagraph has been deleted. See Status page.]
(2) The net effect of discontinuing the application of FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation,* pursuant to paragraph 6 of FASB Statement No. 101, *Regulated Enterprises—Accounting for the Discontinuation of Application of FASB Statement No. 71.*
~~(3) The remaining excess of fair value of acquired net assets over cost pursuant to paragraphs 45 and 46 of FASB Statement No. 141, *Business Combinations.*~~

E11. FASB Statement No. 2, *Accounting for Research and Development Costs,* is amended as follows:

a. Paragraph 3A is added as follows:

This Statement does not apply to research and development assets acquired in a business combination. Tangible and intangible assets acquired in a business combination that are used in research and development activities are recognized and measured at fair value in accordance with FASB Statement No. 141 (revised 2007), *Business Combinations,* regardless of whether they have an alternative future use. After initial recognition, tangible assets acquired in a business combination that are used in research and development activities are accounted for in accordance with their nature. After initial recognition, intangible assets acquired in a business combination that are used in research and development activities are accounted for in accordance with FASB Statement No. 142, *Goodwill and Other Intangible Assets,* as amended.

b. Paragraph 12:

~~All r~~Research and development costs encompassed by this Statement shall be charged to expense when incurred. As noted in paragraph 3A, this Statement does not apply to tangible and intangible assets acquired in a business combination that are used in research and development activities.

E12. FASB Statement No. 5, *Accounting for Contingencies,* is amended as follows:

a. Paragraph 7A is added as follows:

This Statement does not apply to contingent gains or losses that are recognized at the acquisition date in a business combination. FASB Statement No. 141 (revised 2007), *Business Combinations,* provides the subsequent accounting and disclosure requirements for contingent

gains or losses recognized as part of a business combination. This Statement does, however, apply to contingent gains or losses that were acquired or assumed in a business combination but that were not recognized at the acquisition date because they did not meet the recognition threshold in Statement 141(R) at that date.

E13. FASB Statement No. 15, *Accounting by Debtors and Creditors for Troubled Debt Restructurings,* is amended as follows:

a. Footnote 5 to paragraph 13, as amended:

Paragraphs 13, 15, and 19 indicate that the fair value of assets transferred or the fair value of an equity interest granted shall be used in accounting for a settlement of a payable in a troubled debt restructuring. That guidance is not intended to preclude using the fair value of the payable settled if more clearly evident than the fair value of the assets transferred or of the equity interest granted in a full settlement of a payable (paragraphs 13 and 15). ~~(See paragraph 6 of FASB Statement No. 141, *Business Combinations.*)~~ However, in a partial settlement of a payable (paragraph 19), the fair value of the assets transferred or of the equity interest granted shall be used in all cases to avoid the need to allocate the fair value of the payable between the part settled and the part still outstanding.

b. Footnote 16 to paragraph 28, as amended:

Paragraphs 28 and 33 indicate that the fair value of assets received shall be used in accounting for satisfaction of a receivable in a troubled debt restructuring. That guidance is not intended to preclude using the fair value of the receivable satisfied if more clearly evident than the fair value of the assets received in full satisfaction of a receivable (paragraph 28). ~~(See paragraph 6 of Statement 141.)~~ However, in a partial satisfaction of a receivable (paragraph 33), the fair value of the assets received shall be used in all cases to avoid the need to allocate the fair value of the receivable between the part satisfied and the part still outstanding.

E14. FASB Statement No. 45, *Accounting for Franchise Fee Revenue,* is amended as follows:

a. Paragraph 19:

~~A transaction in which a franchisor acquires the business of an operating franchisee ordinarily shall be accounted for as a business combination in accordance with FASB Statement No. 141, *Business Combinations,* assuming no relationship existed at the time of the franchise sale to preclude revenue recognition (paragraphs 10 and 11). If such a transaction is, in substance, a cancellation of an original franchise sale, the transaction shall be accounted for in accordance with paragraph 18.~~

E15. FASB Statement No. 52, *Foreign Currency Translation,* is amended as follows:

a. Paragraph 101, as effectively amended:

The functional currency approach applies equally to translation of financial statements of foreign investees whether accounted for by the equity method or consolidated. It also applies to translation after a business combination. Therefore, the foreign statements and the foreign currency transactions of an investee that are accounted for by the equity method should be translated in conformity with the requirements of this Statement in applying the equity method. Likewise, after a business combination ~~accounted for by the purchase method~~, the amount assigned~~allocated~~ at the acquisition date ~~of acquisition~~ to the assets acquired and the liabilities assumed (including goodwill or the gain recognized for a bargain purchase~~*goodwill* or [*excess over cost,*] as those terms are used in FASB Statement No. 141, *Business Combinations*~~) should be translated in conformity with the requirements of this Statement. Accumulated translation adjustments attributable to noncontrolling~~minority~~ interests should be allocated to and reported as part of the noncontrolling~~minority~~ interest in the consolidated enterprise.

E16. FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises,* is amended as follows:

a. Paragraphs 59A–59E and the related heading are added as follows:

Insurance and Reinsurance Contracts Acquired in a Business Combination

59A. The acquirer shall consider insurance and reinsurance contracts acquired in a business combination to be new contracts for measurement and accounting purposes.

59B. The acquirer shall carry forward the acquiree's classification of an acquired contract as an insurance or reinsurance contract or a deposit contract based on an understanding of the contractual terms of the acquired contract and any related contracts or agreements at the inception of the contract or, if the terms of those contracts or agreements were later modified in a manner that would change the classification, at the date of that modification (which may be the acquisition date).

59C. The acquirer shall recognize and measure at fair value the assets and liabilities arising from the rights and obligations of the insurance and reinsurance contracts acquired in the business combination. However, the acquirer shall recognize that fair value in components as follows:

a. Assets and liabilities measured in accordance with the acquirer's accounting policies for insurance and reinsurance contracts that it issues or holds. For example, the contractual assets acquired could include a reinsurance recoverable and the liabilities assumed could include a liability to pay future contract claims and claims expenses on the unexpired portion of the acquired contracts and a liability to pay incurred contract claims and claims expenses. However, those assets acquired and liabilities assumed would not include the acquiree's deferred acquisition costs and unearned premiums that do not represent future cash flows.
b. An intangible asset (or occasionally another liability), representing the difference between (1) the fair value of the contractual insurance and reinsurance assets acquired and liabilities assumed and (2) the amount described in (a).

After the business combination, the acquirer shall measure the intangible asset (or other liability) on a basis consistent with the related insurance or reinsurance liability. For example, for most short-duration contracts such as many property and liability insurance contracts, GAAP claim liabilities are not discounted, so amortizing the intangible asset like a discount using an interest method could be an appropriate method. For certain long-duration contracts such as most traditional life insurance contracts, using a basis consistent with the measurement of the liability would be similar to the guidance provided in paragraph 31 of Statement 60, which requires that deferred acquisition costs be amortized using methods that include the same assumptions used in estimating the liability for future policy benefits.

59D. Other related contracts that are not insurance or reinsurance contracts shall be recognized and measured at the date of acquisition in accordance with FASB Statement No. 141 (revised 2007), *Business Combinations.* For example, a contingent commission arrangement is a contractual contingency that the acquirer shall account for in accordance with paragraph 24 of Statement 141(R). An example of an indemnification agreement that may be in the form of a reinsurance contract is a guarantee by the seller of the adequacy of acquired claims and claims expense liabilities at the date of acquisition. The acquirer shall recognize any indemnification asset resulting from such an agreement in accordance with paragraphs 29 and 30 of Statement 141(R).

59E. The disclosures in paragraphs 44, 45, and 46 of Statement 142 shall apply to the intangible assets recognized pursuant to paragraph 59C of this Statement.

E17. FASB Statement No. 68, *Research and Development Arrangements,* is amended as follows:

a. Paragraph 11 and its related footnote 3, as amended:

If the enterprise's obligation is to perform research and development for others and the enterprise subsequently decides to exercise an option to purchase the other parties' interests in the research and development arrangement or to obtain the exclusive rights to the results of the research and development, the nature of those results and their future use shall determine the accounting for the purchase transaction or business combination.[3]

[3] ~~Paragraph 5 of FASB Interpretation No. 4, *Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method,* states: ". . . the accounting for the cost of an item to be used in research and development activities is the same under paragraphs 11 and 12 of Statement 2 whether the item is purchased singly, or as part of a group of assets, or as part of an entire enterprise in a business combination accounted for by the purchase method."~~ The accounting for ~~other~~ recognized intangible assets acquired by the enterprise is specified in FASB Statement No. 142, *Goodwill and Other Intangible Assets.*

E18. FASB Statement No. 86, *Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed,* is amended as follows:

a. Paragraph 2:

> This Statement establishes standards of financial accounting and reporting for the costs of computer software to be sold, leased, or otherwise marketed as a separate product or as part of a product or process, whether internally developed and produced or purchased. It identifies the costs incurred in the process of creating a software product that are research and development costs and those that are production costs to be capitalized, and it specifies amortization, disclosure, and other requirements. As used in this Statement, the terms *computer software product, software product,* and *product* encompass a computer software program, a group of programs, and a **product enhancement.**[1] This Statement does not address the accounting and reporting of costs incurred for computer software created for internal use or for others under a contractual arrangement. This Statement does not apply to research and development assets acquired in a business combination. Tangible and intangible assets acquired in a business combination that are used in research and development activities are recognized and measured at fair value in accordance with FASB Statement No. 141 (revised 2007), *Business Combinations.* However, this Statement applies to any costs incurred after the date of a business combination for computer software to be sold, leased, or otherwise marketed as a separate product or as part of a product or process, whether internally developed and produced or purchased.

E19. FASB Statement No. 87, *Employers' Accounting for Pensions,* is amended as follows:

a. Paragraph 74, as amended:

> If an acquiree sponsors a single-employer defined benefit pension plan, the acquirer shall recognize as part of the business combination an asset or a liability representing the funded status of the plan (paragraph 35). 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. If an acquiree participates in a multiemployer plan, and it is probable as of the acquisition date that the acquirer will withdraw from that plan, the acquirer shall recognize as part of the business combination a withdrawal liability in accordance with Statement 5. ~~When an employer is acquired in a business combination and that employer sponsors a single-employer defined benefit pension plan, the assignment of the purchase price to individual assets acquired and liabilities assumed shall include a liability for the projected benefit obligation in excess of plan assets or an asset for plan assets in excess of the projected benefit obligation, thereby eliminating any previously existing net gain or loss, prior service cost or credit, or transition asset or obligation recognized in accumulated other comprehensive income. If it is expected that the plan will be terminated or curtailed, the effects of those actions shall be considered in measuring the projected benefit obligation.~~

b. Paragraph E15, as amended:

> ~~*Q*—If the acquiring employer in a business combination accounted for in accordance with FASB Statement No. 141, *Business Combinations,* includes the employees of the acquired employer in its pension plan and grants them credit for prior service (the acquired employer did not have a pension plan), should the credit granted for prior service be treated as prior service cost and recognized in other comprehensive income or treated as part of the cost of the acquisition? [24–27, 74]~~
>
> ~~*A*—The answer to this question depends on an analysis of all the facts and circumstances surrounding the acquisition. If the acquiring employer's granting of credit for prior service to the employees is required by the seller as part of the consummation of the acquisition, then it should be considered as part of the cost of the acquisition. Otherwise, the credit granted for prior service should be accounted for as a retroactive plan amendment.~~
>
> ~~If the credit granted for prior service is considered part of the cost of the acquisition, the debit offsetting the increase in the projected benefit obligation should be an adjustment of the goodwill otherwise determined for the acquisition. If~~

~~the credit granted for prior service is accounted for as a retroactive plan amendment, the prior service cost is recognized in other comprehensive income and subject to amortization as specified in paragraphs 24–27. The effects of the alternatives on the balance sheet, income statement, and other comprehensive income could differ.~~

c. Paragraph E88, as amended:

~~*Q*—If the acquired enterprise sponsors a single-employer defined benefit pension plan at the date of the acquisition, should the pension asset or pension liability recognized by the acquiring employer be separately amortized to income in periods subsequent to the acquisition? [74]~~

~~*A*—No. The pension asset or pension liability should not be separately amortized. Rather, it is affected by the accounting for the pension plan in future periods.~~

E20. FASB Statement No. 97, *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments,* is amended as follows:

a. The following footnote a is added at the end of paragraph 6, as amended:

This Statement applies to all insurance enterprises to which Statement 60 applies. The Statement establishes standards of financial accounting and reporting for three classes of long-duration contracts issued by those insurance enterprises and for reporting realized investment gains and losses. Those contracts are referred to in this Statement as *investment contracts, limited-payment contracts,* and *universal life-type contracts.* The accounting for long-duration contracts not otherwise addressed by this Statement is prescribed in Statement 60 and FASB Statement No. 120, *Accounting and Reporting by Mutual Life Insurance Enterprises and by Insurance Enterprises for Certain Long-Duration Participating Contracts.*[a]

[a]Paragraphs 59A–59E of Statement 60 include guidance on the initial recognition and measurement for insurance and reinsurance contracts acquired in a business combination.

E21. FASB Statement No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions,* is amended as follows:

a. Paragraph 86, as amended:

If an acquiree sponsors a single-employer defined benefit postretirement plan, the acquirer shall recognize as part of the business combination an asset or a liability representing the funded status of the plan (paragraph 44A). 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 accumulated postretirement benefit obligation assumed shall reflect any other necessary changes in assumptions based on the acquirer's assessment of relevant future events. If an acquiree participates in a multiemployer plan and it is probable as of the acquisition date that the acquirer will withdraw from that plan, the acquirer shall recognize as part of the business combination a withdrawal liability in accordance with Statement 5.~~When an employer is acquired in a business combination and that employer sponsors a single-employer defined benefit postretirement plan, the assignment of the purchase price to individual assets acquired and liabilities assumed shall include a liability for the accumulated postretirement benefit obligation in excess of the fair value of the plan assets or an asset for the fair value of the plan assets in excess of the accumulated postretirement benefit obligation. The accumulated postretirement benefit obligation assumed shall be measured based on the benefits attributed by the acquired entity to employee service prior to the date the business combination is consummated, adjusted to reflect (a) any changes in assumptions based on the purchaser's assessment of relevant future events (as discussed in paragraphs 23–42) and (b) the terms of the substantive plan (as discussed in paragraphs 23–28) to be provided by the purchaser to the extent they differ from the terms of the acquired entity's substantive plan.~~

b. Paragraph 87:

~~If the postretirement benefit plan of the acquired entity is amended as a condition of the business combination (for example, if the change is required by the seller as part of the consummation of the acquisition), the effects of any improvements attributed to services rendered by the participants of the acquired entity's plan prior to the~~

~~date of the business combination shall be accounted for as part of the accumulated postretirement benefit obligation of the acquired entity. Otherwise, if improvements to the postretirement benefit plan of the acquired entity are not a condition of the business combination, credit granted for prior service shall be recognized as a plan amendment as discussed in paragraphs 50–55. If it is expected that the plan will be terminated or curtailed, the effects of those actions shall be considered in measuring the accumulated postretirement benefit obligation. Otherwise, no future changes to the plan shall be anticipated.~~

c. Paragraph 88, as amended:

~~As a result of applying the provisions of paragraphs 86 and 87, any previously existing net gain or loss, prior service cost or credit, or transition obligation or transition asset remaining in accumulated other comprehensive income is eliminated for the acquired employer's plan.~~

E22. FASB Statement No. 109, *Accounting for Income Taxes,* is amended as follows:

a. Paragraph 9(d):

Prohibits recognition of a deferred tax liability ~~or asset~~ related to goodwill (or the portion thereof) for which amortization is not deductible for tax purposes (paragraph 30)

b. Paragraph 11(h), as amended:

Business combinations. There may be differences between the tax bases and the recognized values of assets acquired and liabilities assumed in a business combination ~~assigned values and the tax bases of the assets and liabilities recognized in a business combination~~. Those differences will result in taxable or deductible amounts when the reported amounts of the assets or ~~and~~ liabilities are recovered or ~~and~~ settled, respectively.

c. Paragraph 16:

An enterprise shall recognize a deferred tax liability or asset for all temporary differences[6] and operating loss and tax credit carryforwards in accordance with the provisions of paragraph 17. **Deferred tax expense or benefit** is the change during the year in an enterprise's deferred tax liabilities and assets.[7] For deferred tax liabilities and assets ~~acquired~~ recognized in a ~~purchase~~ business combination during the year, it is the change since the acquisition ~~combination~~ date. Total income tax expense or benefit for the year is the sum of deferred tax expense or benefit and income taxes currently payable or refundable.

d. Paragraph 26:

The effect of a change in the beginning-of-the-year balance of a valuation allowance that results from a change in circumstances that causes a change in judgment about the realizability of the related deferred tax asset in future years ordinarily shall be included in income from continuing operations. The only exceptions are changes to valuation allowances ~~the initial recognition (that is, by elimination of the valuation allowance)~~ of certain tax benefits that are ~~allocated~~ adjusted within the measurement period as required by paragraph 30A and the initial recognition (that is, by elimination of the valuation allowances) of tax benefits of items covered by paragraph 36 (items (c) and (e)–(g)). The effect of other changes in the balance of a valuation allowance are allocated among continuing operations and items other than continuing operations as required by paragraph 35.

e. Paragraph 30, as amended:

As of the acquisition date, a~~A~~ deferred tax liability or asset shall be recognized in accordance with the requirements of this Statement for an acquired entity's taxable or deductible temporary differences (except the portion of goodwill for which amortization is not deductible for tax purposes, leveraged leases, and acquired Opinion 23 differences[8]) or operating loss or tax credit carryforwards. For example, taxable or deductible temporary differences arise from differences between the tax bases and the recognized values of assets acquired and liabilities assumed in a business combination.~~differences between the assigned values and the tax bases of the assets and liabilities (except the portion of goodwill for which amortization is not deductible for tax purposes, unallocated excess over cost (also referred to as negative goodwill), leveraged leases, and acquired Opinion 23 differences[8]) recognized in a purchase business combination (r~~Refer to paragraphs 259–272 for

additional guidance~~)~~. An acquirer shall assess the need for a valuation allowance as of the acquisition date for an acquired entity's deferred tax asset in accordance with this Statement.~~If a valuation allowance is recognized for the deferred tax asset for an acquired entity's deductible temporary differences or operating loss or tax credit carryforwards at the acquisition date, the tax benefits for those items that are first recognized (that is, by elimination of that valuation allowance) in financial statements after the acquisition date shall be applied (a) first to reduce to zero any goodwill related to the acquisition, (b) second to reduce to zero other noncurrent intangible assets related to the acquisition, and (c) third to reduce income tax expense.~~

f. Paragraph 30A and its related footnote 8a are added as follows:

The effect of a change in a valuation allowance for an acquired entity's deferred tax asset shall be recognized as follows:

a. Changes within the measurement period[8a] that result from new information about facts and circumstances that existed at the acquisition date shall be recognized through a corresponding adjustment to goodwill. However, once goodwill is reduced to zero, an acquirer shall recognize any additional decrease in the valuation allowance as a bargain purchase in accordance with paragraphs 36–38 of Statement 141(R).
b. All other changes shall be reported as a reduction or increase to income tax expense (or a direct adjustment to contributed capital as required by paragraph 26).

[8a]The measurement period in the context of a business combination is described in paragraphs 51–56 of Statement 141(R).

g. Footnote 9a to paragraph 36(d), as added previously:

FASB Statement No. 141, *Business Combinations,* prohibited~~s~~ the use of the pooling-of-interests method for all business combinations initiated after June 30, 2001. FASB Statement No. 141 (revised 2007), *Business Combinations,* which replaces Statement 141, continues to prohibit the use of the pooling-of-interests method.

h. Paragraph 37:

The tax benefit of an operating loss carryforward or carryback (other than those carryforwards referred to at the end of this paragraph) shall be reported in the same manner as the source of the income or loss in the current year and not in the same manner as (a) the source of the operating loss carryforward or taxes paid in a prior year or (b) the source of expected future income that will result in realization of a deferred tax asset for an operating loss carryforward from the current year. The only exception~~s are as follows:~~ is the tax effects of deductible temporary differences and carryforwards that are allocated to shareholders' equity in accordance with the provisions of paragraph 36 (items (c) and (e)–(g)).

~~a. Tax effects of deductible temporary differences and carryforwards that existed at the date of a purchase business combination and for which a tax benefit is initially recognized in subsequent years in accordance with the provisions of paragraph 30~~
~~b. Tax effects of deductible temporary differences and carryforwards that are allocated to shareholders' equity in accordance with the provisions of paragraph 36 (items (c) and (e)–(g)).~~

i. Paragraph 45(f):

Tax expense that results from allocating certain tax benefits ~~either~~ directly to contributed capital ~~or to reduce goodwill or other noncurrent intangible assets of an acquired entity~~

j. Paragraph 45(h):

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. For example, any acquisition-date income tax benefits or expenses recognized from changes in the acquirer's valuation allowance for its previously existing deferred tax assets as a result of a business combination (paragraph 266).

k. Paragraph 48:

An enterprise shall disclose (a) the amounts and expiration dates of operating loss and tax credit carryforwards for tax purposes and (b) any portion of the valuation allowance for deferred tax assets for which subsequently recognized tax

benefits will be ~~allocated to reduce goodwill or other noncurrent intangible assets of an acquired entity or~~ credited directly to contributed capital (paragraph~~s 30 and~~ 36).

l. Paragraph 259, as amended:

This Statement requires recognition of deferred tax liabilities and deferred tax assets (and related valuation allowances, if necessary) for the deferred tax consequences of differences between the tax bases and the recognized values of assets acquired and liabilities assumed in a business combination~~assigned values and the tax bases of the assets and liabilities recognized in a business combination~~. A deferred tax liability ~~or asset~~ is not recognized when~~for a difference between~~ the reported amount of goodwill exceeds ~~and~~ the tax basis of goodwill or the portion thereof for which amortization is not deductible for tax purposes (paragraph~~s~~ 262) ~~and 263), unallocated "negative" goodwill,~~ and leveraged leases (paragraphs 256–258). Acquired Opinion 23 differences are accounted for in accordance with the requirements of Opinion 23, as amended by this Statement (paragraphs 31–34).

m. Paragraph 260:

The following example illustrates recognition and measurement of a deferred tax liability and asset in a nontaxable business combination. The assumptions are as follows:

a. The enacted tax rate is 40 percent for all future years, and amortization of goodwill is not deductible for tax purposes.
b. A~~n~~ wholly owned enterprise is acquired for $20,000, and the enterprise has no leveraged leases.
c. The tax basis of the net assets acquired (other than goodwill) is $5,000, and the recognized value ~~assigned value (other than goodwill)~~ is $12,000. Future recovery of the assets and settlement of the liabilities at their assigned values will result in $20,000 of taxable amounts and $13,000 of deductible amounts that can be offset against each other. Therefore, no valuation allowance is necessary.

The amounts recorded to account for the ~~purchase~~business combination transaction are as follows:

~~Assigned~~Recognized value of the net assets (other than goodwill) acquired	$12,000
Deferred tax liability for $20,000 of taxable temporary differences	(8,000)
Deferred tax asset for $13,000 of deductible temporary differences	5,200
Goodwill	10,800
Consideration paid for the acquiree~~Purchase price of the acquired enterprise~~	$20,000

n. Paragraph 261:

In a taxable business combination, the consideration paid ~~purchase price~~ is assigned to the assets acquired and liabilities assumed ~~recognized~~ for financial reporting and tax purposes ~~as well as for financial reporting~~. However, the amounts ~~assigned to~~recognized for particular assets and liabilities may differ for financial reporting and tax purposes. A deferred tax liability and asset are recognized for the deferred tax consequences of those temporary differences in accordance with the recognition and measurement requirements of this Statement. For 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. If a valuation allowance is recognized for that deferred tax asset at the acquisition date, recognized benefits for those tax deductions after the acquisition date should be applied in accordance with paragraph 26.~~(a) first to reduce to zero any goodwill related to that acquisition, (b) second to reduce to zero other noncurrent intangible assets related to that acquisition, and (c) third to reduce income tax expense.~~

o. Paragraph 262:

Amortization of goodwill is deductible for tax purposes in some tax jurisdictions. In those tax

jurisdictions, the reported amount of goodwill and the tax basis of goodwill are each separated into two components as of the ~~combination~~acquisition date for purposes of deferred tax calculations. The first component of each equals the lesser of (a) goodwill for financial reporting or (b) tax-deductible goodwill. The second component of each equals the remainder of each, that is, (1) the remainder, if any, of goodwill for financial reporting or (2) the remainder, if any, of tax-deductible goodwill. Any difference that arises between the book and tax basis of that first component of goodwill in future years is a temporary difference for which a deferred tax liability or asset is recognized based on the requirements of this Statement. ~~No deferred taxes are recognized for the second component of goodwill.~~ If that second component is an excess of tax-deductible goodwill over the reported amount of goodwill, the tax benefit for that excess is a temporary difference for which a deferred tax asset is recognized based on the requirements of this Statement (refer to paragraph 263). However, if that second component is an excess of goodwill for financial reporting over the tax-deductible amount of goodwill, no deferred taxes are recognized either at the acquisition date or in future years.~~recognized when realized on the tax return, and that tax benefit is applied first to reduce to zero the goodwill related to that acquisition, second to reduce to zero other noncurrent intangible assets related to that acquisition, and third to reduce income tax expense.~~

p. Paragraph 263, which provided an example illustrating accounting for the tax consequences of goodwill when amortization of goodwill is deductible for tax purposes, is replaced by the following:

The following example illustrates accounting for tax consequences of goodwill when tax-deductible goodwill exceeds the goodwill recorded for financial reporting at the acquisition date. The assumptions are as follows:

a. At the acquisition date, the reported amount of goodwill for financial reporting purposes is $600 before taking into consideration the tax benefit associated with goodwill and the tax basis of goodwill is $900.
b. The tax rate is 40 percent for all years.

As of the acquisition date, the goodwill for financial reporting purposes is adjusted for the tax benefit associated with goodwill by using the simultaneous equations method as follows:

The PTD is the *preliminary temporary difference* (the excess of tax goodwill over book goodwill, before taking into consideration the tax benefit associated with goodwill), and the DTA is the resulting *deferred tax asset.*

(Tax Rate ÷ (1-Tax Rate)) × PTD = DTA

In this example, the following variables are known:

Tax rate = 40 percent
PTD = $300 ($900 – $600)

The unknown variable (DTA) equals $200, and the goodwill for financial reporting purposes would be adjusted with the following entry:

DTA	200	
Goodwill		200

Goodwill for financial reporting would be established at the acquisition date at $400 ($600 less the $200 credit adjustment).

q. Paragraph 264:

~~Accounting for a business combination~~Changes in the acquirer's valuation allowance, if any, that results from the business combination shall ~~should~~ reflect any provisions in the tax law that restrict the future use of either of the combining enterprises' deductible temporary differences or carryforwards to reduce taxable income or taxes payable attributable to the other enterprise subsequent to the business combination. Any changes in the acquirer's valuation allowance should be accounted for in accordance with paragraph 266. For example, the tax law may limit the use of the acquired enterprise's deductible temporary differences and carryforwards to subsequent taxable income of the acquired enterprise included in a consolidated tax return for the combined enterprise. In that circumstance, or if the acquired enterprise will file a separate tax return, the need for a valuation allowance for some portion or all of the acquired enterprise's deferred tax assets for deductible temporary differences and carryforwards is assessed based on the acquired enterprise's *separate* past and expected future results of operations.

r. Paragraph 265(e):

Based on assessments of all evidence available at the date of the business combination in year 3 and at the end of year 3, management concludes that a valuation allowance is needed at both dates for the entire amount of the deferred tax asset related to the acquired deductible temporary differences.

The acquired enterprise's pretax financial income and taxable income for year 3 (after the business combination) and year 4 are as follows:

	Year 3	Year 4
Pretax financial income	$ 15,000	$ 10,000
Reversals of acquired deductible temporary differences	(15,000)	(10,000)
Taxable income	$ —	$ —

At the end of year 4, the remaining balance of acquired deductible temporary differences is $15,000 ($40,000 – $25,000). The deferred tax asset is $6,000 ($15,000 at 40 percent). Based on an assessment of all available evidence at the end of year 4, management concludes that no valuation allowance is needed for that $6,000 deferred tax asset. Elimination of the $6,000 valuation allowance results in a $6,000 deferred tax benefit that is reported as a reduction of deferred income tax expense because the reversal of the valuation allowance occurred after the measurement period (paragraph 30).~~there is no goodwill or other noncurrent intangible assets related to the acquisition. For the same reason, t~~Tax benefits realized in years 3 and 4 attributable to reversals of acquired deductible temporary differences are reported as a zero current income tax expense. The consolidated statement of earnings would include the following amounts attributable to the acquired enterprise for year 3 (after the business combination) and year 4:

	Year 3	Year 4
Pretax financial income	$15,000	$10,000
Income tax expense (benefit):		
Current	—	—
Deferred	—	(6,000)
Net income	$15,000	$16,000

s. Paragraph 266:

The tax law in some tax jurisdictions may permit the future use of either of the combining enterprises' deductible temporary differences or carryforwards to reduce taxable income or taxes payable attributable to the other enterprise subsequent to the business combination. If the combined enterprise expects to file a consolidated 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 (refer to paragraph 26)).~~a deferred tax asset (net of a valuation allowance, if necessary) is recognized for deductible temporary differences or carryforwards of either combining enterprise based on an assessment of the *combined* enterprise's past and expected future results of operations as~~

~~of the acquisition date. This either reduces goodwill or noncurrent assets (except long-term investments in marketable securities) of the acquired enterprise or creates or increases negative goodwill.~~

t. Paragraphs 268 and 269, which provided guidance and a related example on the recognition of carryforward tax benefits subsequent to a purchase method business combination, are deleted.

u. Footnote 18a to paragraph 270, as added previously:

> Statement 141 prohibited~~s~~ the use of the pooling-of-interests method for all business combinations initiated after June 30, 2001. FASB Statement No. 141 (revised 2007), *Business Combinations,* which replaces Statement 141, continues to prohibit the use of the pooling-of-interests method.

E23. FASB Statement No. 113, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts,* is amended as follows:

a. Paragraph 6, as amended:

> This Statement applies to all insurance enterprises to which Statement 60 applies and to participating life insurance contracts that meet the conditions in paragraph 5 of FASB Statement No. 120, *Accounting and Reporting by Mutual Life Insurance Enterprises and by Insurance Enterprises for Certain Long-Duration Participating Contracts.*[2a] Insurers may enter into various types of contracts described as reinsurance, including those commonly referred to as **fronting arrangements.** This Statement provides guidance in paragraphs 8–13 on determining whether those contracts indemnify the ceding enterprise against loss or liability and therefore meet the conditions for reinsurance accounting. Contracts that meet those conditions shall be accounted for according to the provisions of paragraphs 14–26 of this Statement; other contracts with reinsurers are accounted for as deposits. The accounting provisions for reinsurance depend on whether the contract is long duration or short duration and, if short duration, on whether the contract is considered **prospective reinsurance** or **retroactive reinsurance.** Regardless of its form, any transaction that indemnifies an insurer against loss or liability relating to **insurance risk** shall be accounted for according to the provisions of this Statement.

[2a]Paragraphs 59A–59E of Statement 60 include guidance on the initial recognition and measurement for insurance and reinsurance contracts acquired in a business combination.

E24. FASB Statement No. 120, *Accounting and Reporting by Mutual Life Insurance Enterprises and by Insurance Enterprises for Certain Long-Duration Participating Contracts,* is amended as follows:

a. The following footnote * is added at the end of paragraph 4:

> Mutual life insurance enterprises, assessment enterprises, and fraternal benefit societies (all of which are hereafter referred to as mutual life insurance enterprises) shall apply Statements 60 and 97, except as noted in the following paragraph, and shall apply Statement 113 in reporting their insurance and reinsurance activities in financial statements prepared in conformity with generally accepted accounting principles.*

*Paragraphs 59A–59E of Statement 60 include guidance on the initial recognition and measurement for insurance and reinsurance contracts acquired in a business combination.

E25. FASB Statement No. 123 (revised 2004), *Share-Based Payment,* is amended as follows:

a. Paragraph 4:

> This Statement applies to all share-based payment transactions in which an entity acquires goods or services by **issuing** (or offering to issue) its shares, **share options,** or other equity instruments (except for equity instruments held by an employee share ownership plan)[2] or by incurring liabilities to an employee or other supplier (a) in amounts based, at least in part,[3] on the price of the entity's shares or other equity instruments or (b) that require or may require **settlement** by issuing the entity's equity shares or other equity instruments. FASB Statement No. 141 (revised 2007), *Business Combinations,* provides guidance for determining whether share-based payment awards issued in a business combination are part of the consideration transferred in exchange for the acquiree, and, therefore, in the scope of Statement 141(R), or are for continued service to be recognized in the postcombination period in accordance with this Statement.

E26. FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities,* is amended as follows:

a. Paragraph 11(c), as amended:

> Contracts between an acquirer and a seller to enter into a business combination at a future date.~~Contracts issued by the entity as contingent consideration from a business combination. The accounting for contingent consideration issued in a business combination is addressed in FASB Statement No. 141, *Business Combinations.* In applying this paragraph, the issuer is considered to be the entity that is accounting for the combination using the purchase method.~~

E27. FASB Statement No. 142, *Goodwill and Other Intangible Assets,* is amended as follows:

a. Paragraph 1 and its related footnote 1:

> This Statement addresses financial accounting and reporting for intangible assets acquired individually or with a group of other assets (but not those acquired in a business combination) at acquisition. This Statement also addresses financial accounting and reporting for goodwill and other intangible assets subsequent to their acquisition. FASB Statement No. 141 (revised 2007), *Business Combinations,* ~~FASB Statement No. 141, *Business Combinations,*~~ addresses financial accounting and reporting for goodwill and other intangible assets acquired in a business combination at acquisition.[1]
>
> ~~[1]Statement 141 was issued concurrently with this Statement and addresses financial accounting and reporting for business combinations. It supersedes APB Opinion No. 16, *Business Combinations,* and FASB Statement No. 38, *Accounting for Preacquisition Contingencies of Purchased Enterprises.*~~

b. [This subparagraph has been deleted. See Status page.]

c. Paragraph 6A is added:

> This Statement does not apply to intangible assets recognized for acquired insurance contracts under the requirements of FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises,* as amended.

d. Paragraph 8, as amended:

> Except as described in Appendix D, this Statement does not change the accounting prescribed in the following pronouncements:
>
> a. FASB Statement No. 2, *Accounting for Research and Development Costs*
> b. FASB Statement No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies*
> c. [This subparagraph has been deleted. See Status page.]
> d. FASB Statement No. 50, *Financial Reporting in the Record and Music Industry*
> e. FASB Statement No. 61, *Accounting for Title Plant*
> f. FASB Statement No. 63, *Financial Reporting by Broadcasters*
> g. FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation* (paragraphs 29 and 30)
> ~~h. FASB Statement No. 72, *Accounting for Certain Acquisitions of Banking or Thrift Institutions* (paragraphs 4–7)~~
> i. FASB Statement No. 86, *Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed*

j. FASB Statement No. 109, *Accounting for Income Taxes* (a deferred tax asset)

k. FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (a servicing asset or liability).

~~l. FASB Interpretation No. 4, *Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method*~~

~~m. FASB Interpretation No. 9, *Applying APB Opinions No. 16 and 17 When a Savings and Loan Association or a Similar Institution Is Acquired in a Business Combination Accounted for by the Purchase Method.*~~

e. Paragraph 9 and its related footnotes 6, 7, and 8:

An intangible asset that is acquired either individually or with a group of other assets ~~(but not those acquired in a business combination)~~ shall be initially recognized and measured based on its fair value. The fair value of an intangible asset shall be determined based on the assumptions that market participants would use in pricing the asset. An asset that the entity does not intend to use or intends to use in a way that is not its highest and best use, such as a brand name or a research and development asset, shall nevertheless be measured at its fair value. General concepts related to the initial measurement of assets acquired in exchange transactions, including intangible assets, are provided in paragraphs ~~5–7 of Statement 141~~D2–D7 of Statement 141(R).[6] The cost of a group of assets acquired in a transaction other than a business combination shall be allocated to the individual assets acquired based on their relative fair values and shall not give rise to goodwill.[7] Intangible assets acquired in a business combination are initially recognized and measured in accordance with Statement 141(R)~~Statement 141~~.[8]

[6]Although those paragraphs refer to determining the cost of the assets acquired, ~~both paragraph 6 of Statement 141 and~~ paragraph 18 of APB Opinion No. 29, *Accounting for Nonmonetary Transactions,* notes that, in general, cost should be measured based on the fair value of the consideration given or the fair value of the net assets acquired, whichever is more reliably measurable.

[7]Statement 141(R)~~Statement 141~~ requires intangible assets acquired in a business combination that do not meet certain criteria to be included in the amount initially recognized as goodwill. Those recognition criteria do not apply to intangible assets acquired in transactions other than business combinations.

[8]~~Statement 2 and Interpretation 4 require amounts assigned to acquired intangible assets that are to be used in a particular research and development project and that *have no alternative future use* to be charged to expense at the acquisition date. Statement 141 does not change that requirement, nor does this Statement.~~

f. Footnote 9 to paragraph 11:

The useful life of an intangible asset shall reflect the period over which it will contribute to the cash flows of the reporting entity, not the period of time that it would take that entity to internally develop an intangible asset that would provide similar benefits. However, a reacquired right recognized as an intangible asset is amortized over the remaining contractual period of the contract in which the right was granted. If an entity subsequently reissues (sells) a reacquired right to a third party, the entity includes the related unamortized asset, if any, in determining the gain or loss on the reissuance.

g. Footnote 11 to paragraph 12:

~~However, both~~ Statement 2 ~~and Interpretation 4~~ requires amounts assigned to ~~acquired~~ intangible assets acquired in a transaction other than a business combination that are to be used in a particular research and development project and that have no alternative future use to be charged to expense at the acquisition date.

h. Paragraph 16:

If an intangible asset is determined to have an indefinite useful life, it shall not be amortized until its useful life is determined to be no longer indefinite. An entity shall evaluate the remaining useful life of an intangible asset that is not being amortized each reporting period to determine whether events and circumstances continue to support an indefinite useful life. If an intangible asset that is not being amortized is subsequently determined to have a finite useful life, the asset shall be tested for impairment in accordance with paragraph 17. That intangible asset shall then be amortized prospectively over its estimated remaining useful life and accounted for in the same manner as other intangible assets that are subject to amortization. Intangible assets acquired in a business combination that are used in research and development activities (regardless of whether they have an alternative future use) shall be considered *indefinite lived* until the completion or abandonment of the associated research and development efforts. During the period those assets are considered indefinite lived they shall not be amortized but shall be tested for

impairment in accordance with paragraph 17. Once the research and development efforts are completed or abandoned, the entity shall determine the useful life of the assets based on the guidance in this Statement. Consistent with the guidance in paragraph 28 of Statement 144, intangible assets acquired in a business combination that have been temporarily idled shall not be accounted for as if abandoned.

i. Paragraph 21 and its related footnote 14:

The implied fair value of goodwill shall be determined in the same manner as the amount of goodwill recognized in a business combination was~~is~~ determined. That is, an entity shall assign ~~allocate~~ the fair value of a reporting unit to all of the assets and liabilities of that unit (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination ~~and the fair value of the reporting unit was the price paid to acquire the reporting unit~~.[14] The excess of the fair value of a reporting unit over the amounts assigned to its assets and liabilities is the implied fair value of goodwill. That ~~allocation~~ assignment process shall be performed only for purposes of testing goodwill for impairment; an entity shall not write up or write down a recognized asset or liability, nor should it recognize a previously unrecognized intangible asset as a result of that allocation process.

[14]The relevant guidance in paragraphs 12–33 of Statement 141(R)~~paragraphs 35–38 of Statement 141~~ shall be used in determining how to assign~~allocate~~ the fair value of a reporting unit to the assets and liabilities of that unit. Included in that allocation would be research and development assets that meet the criteria in paragraph 32 of this Statement ~~even if Statement 2 or Interpretation 4 would require those assets to be written off to earnings when acquired~~.

j. Footnote 18 to paragraph 30:

Statement 141(R)~~Emerging Issues Task Force Issue No. 98-3, "Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business,"~~ includes guidance on determining whether an asset group constitutes a business.

k. Paragraph 33:

Some assets or liabilities may be employed in or relate to the operations of multiple reporting units. The methodology used to determine the amount of those assets or liabilities to assign to a reporting unit shall be reasonable and supportable and shall be applied in a consistent manner. For example, assets and liabilities not directly related to a specific reporting unit, but from which the reporting unit benefits, could be assigned~~allocated~~ according to the benefit received by the different reporting units (or based on the relative fair values of the different reporting units). In the case of pension items, for example, a pro rata assignment~~allocation~~ based on payroll expense might be used. For use in making those assignments, the basis for and method of determining the fair value of the acquiree and other related factors (such as the underlying reasons for the acquisition and management's expectations related to dilution, synergies, and other financial measurements) shall be documented at the acquisition date.

l. Paragraph 35, as amended, and its related footnote 21:

In concept, the amount of goodwill assigned to a reporting unit would be determined in a manner similar to how the amount of goodwill recognized in a business combination is determined. An entity would determine the fair value of the acquired business (or portion thereof) to be included in a reporting unit ~~in essence a "purchase price" for that business. The entity would then allocate that purchase price to~~ the fair value of the individual assets acquired and liabilities assumed that are assigned to the reporting unit ~~related to that acquired business (or portion thereof)~~.[21] Any excess of the fair value of the acquired business (or portion thereof) over the fair value of the individual assets acquired and liabilities assumed that are assigned to the reporting unit ~~purchase price~~ is the amount of goodwill assigned to that reporting unit. However, if goodwill is to be assigned to a reporting unit that has not been assigned any of the assets acquired or liabilities assumed in that acquisition, the amount of goodwill to be assigned to that unit might be determined by applying a "with and without" computation. That is, the difference between the fair value of that reporting unit before the acquisition and its fair value after the acquisition represents the amount of goodwill to be assigned to that reporting unit.

[21]Paragraphs 12–33 of Statement 141(R)~~Paragraphs 35–38 of Statement 141~~ provide guidance on assigning the fair value of the acquire~~allocating the purchase price~~ to the assets acquired and liabilities assumed in a business combination.

m. Paragraph 44:

For intangible assets acquired either individually or ~~with~~as part of a group of assets (in either an asset acquisition or business combination), the following information shall be disclosed in the notes to the financial statements in the period of acquisition:

a. For intangible assets subject to amortization:
   (1) The total amount assigned and the amount assigned to any major **intangible asset class**
   (2) The amount of any significant residual value, in total and by major intangible asset class
   (3) The weighted-average amortization period, in total and by major intangible asset class
b. For intangible assets *not* subject to amortization, the total amount assigned and the amount assigned to any major intangible asset class
c. The amount of research and development assets acquired in a transaction other than a business combination and written off in the period and the line item in the income statement in which the amounts written off are aggregated.

This information also shall be disclosed separately for each material business combination or in the aggregate for individually immaterial business combinations that are material collectively if the aggregate fair values of intangible assets acquired, other than goodwill, are significant.

n. Paragraph 45:

The following information shall be disclosed in the financial statements or the notes to the financial statements for each period for which a statement of financial position is presented:

a. For intangible assets subject to amortization:
   (1) The gross carrying amount and accumulated amortization, in total and by major intangible asset class
   (2) The aggregate amortization expense for the period
   (3) The estimated aggregate amortization expense for each of the five succeeding fiscal years
b. For intangible assets *not* subject to amortization, the total carrying amount and the carrying amount for each major intangible asset class
c. The changes in the carrying amount of goodwill during the period ~~including~~showing separately:
   ~~(1) The aggregate amount of goodwill acquired~~
   ~~(2) The aggregate amount of impairment losses recognized~~
   ~~(3) The amount of goodwill included in the gain or loss on disposal of all or a portion of a reporting unit.~~
   (1) The gross amount and accumulated impairment losses at the beginning of the period
   (2) Additional goodwill recognized during the period, except goodwill included in a disposal group that, on acquisition, meets the criteria to be classified as held for sale in accordance with Statement 144
   (3) Adjustments resulting from the subsequent recognition of deferred tax assets during the period in accordance with paragraphs 30 and 30A of Statement 109, as amended
   (4) Goodwill included in a disposal group classified as held for sale in accordance with Statement 144 and goodwill derecognized during the period without having previously been reported in a disposal group classified as held for sale
   (5) Impairment losses recognized during the period in accordance with this Statement
   (6) Net exchange differences arising during the period in accordance with FASB Statement No. 52, *Foreign Currency Translation*
   (7) Any other changes in the carrying amounts during the period
   (8) The gross amount and accumulated impairment losses at the end of the period.

Entities that report segment information in accordance with Statement 131 shall provide the above information about goodwill in total and for each reportable segment and shall disclose any significant changes in the allocation of goodwill by reportable segment. If any portion of goodwill has not yet been allocated to a reporting unit at the date

the financial statements are issued, that unallocated amount and the reasons for not allocating that amount shall be disclosed.

Illustration 1 in Appendix C provides an example of those disclosure requirements.

o. Paragraph 48 and its related footnote 24:

This Statement shall be effective as follows:

a. Except as provided in (b) and (c), ~~A~~all of the provisions of this Statement shall be applied in fiscal years beginning after December 15, 2001, to all goodwill and other intangible assets recognized in an entity's statement of financial position at the beginning of that fiscal year, regardless of when those previously recognized assets were initially recognized. ~~Early application is permitted for entities with fiscal years beginning after March 15, 2001, provided that the first interim financial statements have not been issued previously.~~ In all cases, the provisions of this Statement shall be initially applied at the beginning of a fiscal year. Retroactive application is not permitted. (Refer to paragraphs 53–61 for additional transition provisions.)

~~b. As described in paragraphs 50 and 51, certain provisions of this Statement shall be applied to goodwill and other acquired intangible assets for which the acquisition date is after June 30, 2001, even if an entity has not adopted this Statement in its entirety.~~

b. This Statement shall not be applied to previously recognized goodwill and intangible assets ~~acquired in a combination between two or more mutual enterprises,~~ acquired in a combination between not-for-profit organizations; or arising from the acquisition of a for-profit business entity by a not-for-profit organization until interpretive guidance related to the application of the acquisition~~purchase~~ method to those transactions is issued (refer to paragraph 52).[24]

c. Mutual entities shall apply the provisions of this Statement to goodwill and intangible assets acquired in a combination between two or more mutual enterprises as of the beginning of the first annual period beginning on or after December 15, 2008, regardless of when those assets were initially recognized.

[24]The Board is considering issues related to application of the acquisition method to combinations between not-for-profit organizations and the acquisition of a for-profit business entity by a not-for-profit organization in a separate project. ~~The Board plans to consider issues related to the application of the purchase method to combinations between two or more mutual enterprises, combinations between not-for-profit organizations, and the acquisition of a for-profit business entity by a not-for-profit organization in a separate project.~~

p. Paragraph 49, as amended, and its related footnote 25:

Paragraphs A130–A134 of Statement 141(R) provide the transition provisions a mutual entity that had a business combination accounted for by the purchase method must apply when the mutual entity adopts this Statement. Those paragraphs address transition for (a) goodwill, (b) intangible assets, and (c) any unidentified intangible assets recognized in accordance with Statement 72 that were acquired in a business combination that occurred before the mutual entity adopts Statement 141(R). ~~Paragraph 61 of Statement 141 includes the following transition provisions related to goodwill and intangible assets acquired in business combinations for which the acquisition date was before July 1, 2001, that were accounted for by the purchase method.~~

~~a. The carrying amount of acquired intangible assets that do not meet the criteria in paragraph 39 of Statement 141 for recognition apart from goodwill (and any related deferred tax liabilities if the intangible asset amortization is not deductible for tax purposes) shall be reclassified as goodwill as of the date this Statement is initially applied in its entirety.~~

~~b. The carrying amount of (1) any recognized intangible assets that meet the recognition criteria in paragraph 39 of Statement 141 or (2) any unidentifiable intangible assets recognized in accordance with paragraph 5 of Statement 72 and required to be amortized in accordance with paragraph 8 of FASB Statement No. 147, *Acquisitions of Certain Financial Institutions*, that have been included in the amount reported as goodwill (or as goodwill and intangible assets) shall be reclassified and accounted for as an assets apart from goodwill as of the date this Statement is initially applied in its entirety.[25]~~

~~[25]For example, when a business combination was initially recorded, a portion of the acquired entity was assigned to intangible assets that meet the recognition criteria in paragraph 39 of Statement 141. Those intangible assets have been included in~~

~~the amount reported on the statement of financial position as goodwill (or as goodwill and other intangible assets). However, separate general ledger or other accounting records have been maintained for those assets.~~

q. Paragraph 50:

Goodwill acquired in a business combination for which the acquisition date is after June 30, 2001 (and following the adoption of Statement 141(R) for combinations between two or more mutual entities), shall not be amortized. ~~For example, an entity with a December 31, 2001 fiscal year-end would be required to initially apply the provisions of this Statement on January 1, 2002; if that entity completed a business combination on October 15, 2001, that gave rise to goodwill, it would not amortize the goodwill acquired in that business combination even though it would continue to amortize until January 1, 2002, goodwill that arose from any business combination completed before July 1, 2001.~~ Intangible assets other than goodwill acquired in a business combination (except for intangible assets acquired in a combination between two or more mutual entities) or other transaction for which the date of acquisition is after June 30, 2001, shall be amortized or not amortized in accordance with paragraphs 11–14 and 16 of this Statement. Intangible assets other than goodwill acquired in a combination between two or more mutual entities for which the acquisition date is after the beginning of the first annual period beginning on or after December 15, 2008, shall be amortized or not amortized in accordance with paragraphs 11–14 and 16 of this Statement.

r. Paragraph 52:

Goodwill and intangible assets ~~acquired in a combination between two or more mutual enterprises,~~ acquired in a combination between not-for-profit organizations, or arising from the acquisition of a for-profit business entity by a not-for-profit organization for which the acquisition date is after June 30, 2001, shall continue to be accounted for in accordance with Opinion 17 until the Board's project on accounting for combinations between not-for-profit organizations is completed (refer to footnote 24).

s. Paragraph C2, illustrative Note C: Goodwill:

Note C: Goodwill

The changes in the carrying amount of goodwill for the year ended December 31, 20X3, are as follows:

($000s)	Technology Segment	Communications Segment	Total
Balance as of January 1, 20X3			
Goodwill	$1,413	$1,104~~$904~~	$2,517~~$2,317~~
Accumulated impairment losses	—	(200)	(200)
	1,413	904	2,317
Goodwill acquired during year	189	115	304
Impairment losses	—	(46)	(46)
Goodwill written off related to sale of business unit	(484)	—	(484)
Balance as of December 31, 20X3			
Goodwill	1,118	1,219	2,337
Accumulated impairment losses	—	(246)	(246)
	$1,118	$ 973	$2,091

The Communications segment is tested for impairment in the third quarter, after the annual forecasting process. Due to an increase in competition in the Texas and Louisiana cable industry, operating profits and cash flows were lower than expected in the fourth quarter of 20X2 and the first and second quarters of 20X3. Based on that trend, the earnings forecast for the next five years was revised. In September 20X3, a goodwill impairment loss of $46 was recognized in the Communications reporting unit. The fair value of that reporting unit was estimated using the expected present value of future cash flows.

t. Paragraph F1 (glossary):

Goodwill

An asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized.~~The excess of the cost of an acquired entity over the net of the amounts assigned to assets acquired and liabilities assumed. The amount recognized as goodwill includes acquired intangible assets that do not meet the criteria in FASB Statement No. 141, *Business Combinations,* for recognition as an asset apart from goodwill.~~

E28. FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,* is amended as follows:

a. The table in paragraph D1, as amended:

Existing Pronouncement	Title	Apply Requirement in This Statement
FASB Statement No. 141(R)~~147~~	*Business Combinations* ~~*Acquisition of Certain Financial Institutions*~~	
	• Depositor- and borrower-relationship intangible assets	X
	• Credit cardholder intangible assets	X

E29. FASB Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities,* is amended as follows:

a. Paragraph 2 and its related footnote 2:

This Statement applies to costs associated with an *exit activity*[1] including exit activities associated with~~that does not involve~~ an entity newly acquired in a business combination~~[2]~~ or with a disposal activity covered by FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets.*[3] Those costs include, but are not limited to, the following:

a. Termination benefits provided to current employees that are involuntarily terminated under the terms of a benefit arrangement that, in substance, is not an ongoing benefit arrangement or an individual deferred compensation contract (hereinafter referred to as *one-time termination benefits*)[4]
b. Costs to terminate a contract that is not a capital lease[5]
c. Costs to consolidate facilities or relocate employees.

This Statement does not apply to costs associated with the retirement of a long-lived asset covered by FASB Statement No. 143, *Accounting for Asset Retirement Obligations.*

[1]For purposes of this Statement, an *exit activity* includes but is not limited to a *restructuring* as that term is defined in IAS 37, *Provisions, Contingent Liabilities and Contingent Assets.* Paragraph 10 of IAS 37 defines a restructuring as "a programme that is planned and controlled by management, and materially changes either: (a) the scope of a business undertaken by an enterprise; or (b) the manner in which that business is conducted." A restructuring covered by IAS 37 (paragraph 70) includes the sale or termination of a line of business, the closure of business

activities in a particular location, the relocation of business activities from one location to another, changes in management structure, and a fundamental reorganization that affects the nature and focus of operations.

~~[2]EITF Issue No. 95-3, "Recognition of Liabilities in Connection with a Purchase Business Combination," provides guidance on the accounting for costs associated with an exit activity that involves a company newly acquired in a business combination. The Board is reconsidering that guidance in its project on business combinations—purchase method procedures.~~

[3]Statement 144 addresses the accounting for the impairment of long-lived assets and for long-lived assets and disposal groups to be disposed of, including components of an entity that are discontinued operations.

[4]FASB Statements No. 87, *Employers' Accounting for Pensions,* No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits,* No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions,* and No. 112, *Employers' Accounting for Postemployment Benefits,* address the accounting for other employee benefits. APB Opinion No. 12, *Omnibus Opinion—1967,* as amended by Statement 106, addresses the accounting for deferred compensation contracts with individual employees. This Statement does not change the accounting for termination benefits, including one-time termination benefits granted in the form of an enhancement to an ongoing benefit arrangement, covered by those accounting pronouncements.

[5]FASB Statement No. 13, *Accounting for Leases,* addresses the accounting for the termination of a capital lease (paragraph 14(c)).

E30. FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity,* is amended as follows:

a. Paragraph 16 and its related footnote 9:

~~This Statement does not affect the timing of recognition of financial instruments issued as contingent consideration in a business combination. The accounting for business combinations is addressed in FASB Statement No. 141, *Business Combinations.*[9] This Statement also does not alter the measurement guidance for contingent consideration set forth in paragraphs 25–36 of Statement 141. However, when recognized, a~~Paragraphs 39–42 of FASB Statement No. 141 (revised 2007), *Business Combinations,* provide guidance for the initial recognition and measurement of consideration issued in a business combination, including contingent consideration. A financial instrument within the scope of this Statement that is issued as consideration (whether contingent or noncontingent) in a business combination shall be classified pursuant to the requirements of this Statement. Contingent consideration classified as a liability in accordance with the requirements of this Statement shall be subsequently measured at fair value in accordance with paragraph 65 of Statement 141(R).

~~[9]The Board currently is addressing the accounting for contingent consideration issued in a business combination in its project on purchase method procedures.~~

E31. FASB Statement No. 154, *Accounting Changes and Error Corrections,* is amended as follows:

a. Paragraph 24:

When there has been a change in the reporting entity, the financial statements of the period of the change shall describe the nature of the change and the reason for it. In addition, the effect of the change on income before extraordinary items, net income (or other appropriate captions of changes in the applicable net assets or performance indicator), other comprehensive income, and any related per-share amounts shall be disclosed for all periods presented. Financial statements of subsequent periods need not repeat the disclosures required by this paragraph. If a change in reporting entity does not have a material effect in the period of change but is reasonably certain to have a material effect in later periods, the nature of and the reason for the change shall be disclosed whenever the financial statements of the period of change are presented. (Paragraphs 67–73 of FASB Statement No. 141 (revised 2007), *Business Combinations*~~51–58 of FASB Statement No. 141, *Business Combinations,*~~ describe the manner of reporting and the disclosures required for a business combination.)

E32. FASB Interpretation No. 21, *Accounting for Leases in a Business Combination,* is amended as follows:

a. Paragraph 15, as amended:

In a business combination, the acquiring enterprise shall retain the previous classification in accordance with *FASB Statement No. 13* for the leases of an acquired enterprise unless the provisions of the lease are modified as indicated in paragraph 13 above.[2] (At the acquisition date, an acquirer may contemplate renegotiating and modifying leases of the business acquired. Modifications made after the acquisition date, including those that were planned at the time of the business combination, are postcombination

events that should be accounted for separately by the acquirer in accordance with the provisions of Statement 13.) The amounts assigned to individual assets acquired and liabilities assumed at the acquisition date ~~of the combination~~ shall be determined in accordance with the general guides for that type of asset or liability in FASB Statement No. 141 (revised 2007), *Business Combinations*~~paragraphs 36–39 of FASB Statement No. 141, *Business Combinations*~~. Subsequent to the recording of the amounts called for by Statement 141(R)~~Statement 141~~, the leases shall thereafter be accounted for in accordance with Statement No. 13.[3] Paragraph 16 below explains the application of this paragraph to a leveraged lease by an enterprise that acquires a lessor.

b. Paragraph 16, as amended:

In a business combination, the acquiring enterprise shall apply the following procedures to the acquired enterprise's investment as a lessor in a leveraged lease. The acquiring enterprise shall retain the classification of a leveraged lease at the date of the combination. The acquiring enterprise shall assign an amount to the acquired net investment in the leveraged lease in accordance with the general guides in Statement 141(R) ~~paragraphs 37 and 38 of Statement 141~~, based on the remaining future cash flows and giving appropriate recognition to the estimated future tax effects of those cash flows. Once determined, that net investment shall be broken down into its component parts, namely, net rentals receivable, estimated residual value, and unearned income including discount to adjust other components to present value. The acquiring enterprise thereafter shall account for that investment in a leveraged lease in accordance with the provisions of *FASB Statement No. 13.* Appendix A illustrates the application of this paragraph.

c. Footnote 4 to paragraph 18, as amended:

~~See paragraph 59 of Statement 141 for the definition of "initiated."~~

E33. FASB Interpretation No. 26, *Accounting for Purchase of a Leased Asset by the Lessee during the Term of the Lease,* is amended as follows:

a. Paragraph 5:

The termination of a capital lease that results from the purchase of a leased asset by the lessee is not the type of transaction contemplated by paragraph 14(c) of *FASB Statement No. 13* but rather is an integral part of the purchase of the leased asset. The purchase by the lessee of property under a capital lease shall be accounted for like a renewal or extension of a capital lease that, in turn, is classified as a capital lease,[1] that is, any difference between the purchase price and the carrying amount of the lease obligation shall be recorded as an adjustment of the carrying amount of the asset. The provisions of this Interpretation do not apply to leased assets acquired in a business combination.

E34. FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities,* is amended as follows:

a. Paragraph 4(h):

An entity that is deemed to be a business under the definition in FASB Statement No. 141 (revised 2007), *Business Combinations,* ~~Appendix C~~ need not be evaluated by a reporting enterprise to determine if the entity is a variable interest entity under the requirements of this Interpretation unless one or more of the following conditions exist (however, for entities that are excluded by this provision of this Interpretation, other generally accepted accounting principles should be applied):[2]

(1) The reporting enterprise, its related parties,[3] or both participated significantly in the design or redesign of the entity. However, this condition does not apply if the entity is an operating joint venture under joint control of the reporting enterprise and one or more independent parties or a franchisee.[4]
(2) The entity is designed so that substantially all of its activities either involve or are conducted on behalf of the reporting enterprise and its related parties.
(3) The reporting enterprise and its related parties provide more than half of the total of the equity, subordinated debt, and other forms of subordinated financial support to the entity based on an analysis of the fair values of the interests in the entity.
(4) The activities of the entity are primarily related to securitizations or other forms of asset-backed financings or single-lessee leasing arrangements.

b. Paragraphs 18–21 and footnote 16, which provide measurement guidance for the initial consolidation of a variable interest entity, are replaced by the following:

18. If the primary beneficiary of a variable interest entity and the variable interest entity are under common control, the primary beneficiary shall initially measure the assets, liabilities, and *noncontrolling interests*[16] of the variable interest entity at the amounts at which they are carried in the accounts of the enterprise that controls the variable interest entity (or would be carried if the enterprise issued financial statements prepared in conformity with generally accepted accounting principles).

19. Paragraphs 20 and 21 provide guidance if the primary beneficiary and variable interest entity are not under common control.

20. The initial consolidation of a variable interest entity that is a *business*[16a] is a business combination and shall be accounted for in accordance with the provisions of FASB Statement No. 141 (revised 2007), *Business Combinations.*

21. If an entity becomes the primary beneficiary of a variable interest entity that is *not* a business:

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

[16]The term *noncontrolling interests* is used in this Interpretation with the same meaning as in FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements.* That Statement defines a noncontrolling interest as "the portion of equity (net assets) in a subsidiary not attributable, directly or indirectly, to a parent."

[16a]Statement 141(R) provides guidance on determining whether an entity is a business.

c. Paragraph 23:

The primary beneficiary of a variable interest entity that is a business shall provide the disclosures required by Statement 141(R). The primary beneficiary of a variable interest entity that is not a business shall disclose the amount of gain or loss recognized on the initial consolidation of the variable interest entity. In addition to disclosures required by other standards, the primary beneficiary of a variable interest entity shall disclose the following (unless the primary beneficiary also holds a majority voting interest):[17]

a. The nature, purpose, size, and activities of the variable interest entity
b. The carrying amount and classification of consolidated assets that are collateral for the variable interest entity's obligations
c. Lack of recourse if creditors (or beneficial interest holders) of a consolidated variable interest entity have no recourse to the general credit of the primary beneficiary.

d. Appendix C, which provides a definition of a business, is deleted.

E35. FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes,* is amended as follows:

a. Paragraphs 12A–12B and the related heading are added as follows:

Income Tax Uncertainties Acquired in a Business Combination

12A. The tax bases used in the calculation of deferred tax assets and liabilities as well as amounts due to or receivable from taxing authorities related to prior tax positions at the date of a business combination shall be calculated in accordance with this Interpretation.

12B. The effect of a change to an acquired tax position, or those that arise as a result of the acquisition, shall be recognized as follows:

a. Changes within the measurement period that result from new information about facts and circumstances that existed as of the acquisition date shall be recognized through a corresponding adjustment to goodwill. However, once goodwill is reduced to zero, the remaining portion of that adjustment shall be recognized as a gain on a bargain purchase in accordance with paragraphs 36–38 of Statement 141(R).
b. All other changes in acquired income tax positions shall be accounted for in accordance with this Interpretation.

E36. FASB Technical Bulletin No. 84-1, *Accounting for Stock Issued to Acquire the Results of a Research and Development Arrangement,* is amended as follows:

a. Paragraph 6, as amended:

When an enterprise that is or was a party to a research and development arrangement acquires the results of the research and development arrangement in exchange for cash, common stock of the enterprise, or other consideration, the transaction is a purchase of tangible or intangible assets resulting from the activities of the research and development arrangement. Although such a transaction is not a business combination, paragraphs D2–D7 of FASB Statement No. 141 (revised 2007), *Business Combinations* ~~paragraphs 4–6 of FASB Statement No. 141, *Business Combinations,*~~ describe~~s~~ the general principles that apply in recording the purchase of such an asset.

E37. Statement 133 Implementation Issue No. E15, "Continuing the Shortcut Method after Purchase Business Combination," is amended as follows:

QUESTION

Assuming it has already adopted Statement 133, can the acquirer in a business combination ~~accounted for under the purchase method of accounting~~ continue to use the shortcut method of accounting for the hedging relationships of the acquiree that were being accounted for by the acquiree under the shortcut method of accounting at the date of the business combination? (In part, this question entails a determination of whether the ~~purchase~~ business combination results in a new inception date for the combined entity for hedging relationships entered into by the acquiree prior to the consummation of the business combination that remain ongoing at the date of the business combination.)

BACKGROUND

Company A acquires Company B in a business combination ~~accounted for under the purchase method of accounting~~. Company A and Company B both adopted Statement 133 prior to the date of the business combination. At the date of the business combination, Company A and Company B both have certain hedging relationships that have met the requirements in paragraph 68 of Statement 133 and that are being accounted for by the respective companies under the shortcut method of accounting. ~~Under the purchase method of accounting, a~~A business combination is accounted for as the acquisition of one enterprise by another enterprise. The acquiring enterprise, Company A, records the assets acquired and liabilities assumed at fair value. Assume that, at the date of the business combination, the fair value of the hedging swaps in Company B's hedging relationships is other than zero.

RESPONSE

No, unless the applicable hedging relationships meet the requirements in paragraph 68 of Statement 133 *at the date of the business combination* (which would be highly unlikely since the swap's fair value would rarely be zero at that date) and the combined organization chooses to designate the swaps and the hedged items as hedging relationships to be accounted for under the shortcut method. Company A is acquiring the individual assets and liabilities of Company B at the date of the business combination and accordingly any pre-existing hedging relationships of old Company B must be designated anew by the combined entity at the date of the business combination in accordance with the relevant requirements of Statement 133. The concept of purchase accounting follows the accounting for acquisitions of individual assets and liabilities. That is, the combined entity should account for the assets and liabilities acquired in the business combination consistent with how it would be required to account for those assets and liabilities if they were acquired individually in separate transactions. The acquisition~~purchase~~ method is based on the premise

that in an ~~purchase~~ acquisition, the acquired entity (Company B) ceases to exist and only the acquiring entity (Company A) survives. Thus, the post-acquisition hedging relationship designated by Company A is a new relationship that has a new inception date. Even in the unlikely circumstance that the new hedging relationship qualifies for the shortcut method, there would be no "continuation" of the shortcut method of accounting that had been applied by the acquired entity.

Amendments Made by Statements 141 and 147 and by FASB Staff Position FAS 141-1 and FAS 142-1 Carried Forward in This Statement

E38. This Statement nullifies the following pronouncements:

a. APB Opinion No. 16, *Business Combinations*
b. All of the AICPA Accounting Interpretations of Opinion 16
c. FASB Statement No. 10, *Extension of "Grandfather" Provisions for Business Combinations*
d. FASB Statement No. 38, *Accounting for Preacquisition Contingencies of Purchased Enterprises*
e. FASB Statement No. 79, *Elimination of Certain Disclosures for Business Combinations by Nonpublic Enterprises.*

E39. APB Opinion No. 28, *Interim Financial Reporting,* is amended as follows:

a. Paragraph 21, as subsequently amended by Statement 144:

> Extraordinary items should be disclosed separately and included in the determination of net income for the interim period in which they occur. In determining materiality, extraordinary items should be related to the estimated income for the full fiscal year. Effects of disposals of a component of an entity and unusual and infrequently occurring transactions and events that are material with respect to the operating results of the interim period but that are not designated as extraordinary items in the interim statements should be reported separately. In addition, matters such as unusual seasonal results, and business combinations~~business combinations treated for accounting purposes as poolings of interests and acquisition of a significant business in a purchase~~ should be disclosed to provide information needed for a proper understanding of interim financial reports.[3a] Extraordinary items, gains or losses from disposal of a component of an entity, and unusual or infrequently occurring items should not be pro-rated over the balance of the fiscal year.

[3a]Disclosures required in interim financial information related to a business combination are set forth in paragraph 58 of FASB Statement No. 141, *Business Combinations.*

E40. APB Opinion No. 30, *Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions,* is amended as follows:

a. Paragraph 7:

> This Opinion supersedes paragraphs 20 through 22, paragraph 29 insofar as it refers to examples of financial statements, and Exhibits A through D of APB Opinion No. 9. It also amends paragraph 13 and footnote 8 of APB Opinion No. 15, *Earnings per Share,* insofar as this Opinion prescribes the presentation and computation of earnings per share of continuing and discontinued operations. This Opinion does not modify or amend the conclusions of FASB Statement No. 109, *Accounting for Income Taxes,* paragraph 37, ~~or of APB Opinion No. 16, *Business Combinations,* paragraph 60,~~ with respect to the classification of the effects of certain events and transactions as extraordinary items. Prior APB Opinions that refer to the superseded paragraphs noted above are modified to insert a cross reference to this Opinion.[1]

E41. FASB Statement No. 95, *Statement of Cash Flows,* is amended as follows:

a. Paragraph 134(g):

> Company M purchased all of the capital stock of Company S for $950 in a business combination. ~~The acquisition was recorded under the purchase method of accounting.~~ The fair values of Company S's assets and liabilities at the date of acquisition are presented below: [The rest of the paragraph is unchanged, so is omitted.]

E42. FASB Statement No. 109, *Accounting for Income Taxes,* is amended as follows:

a. Paragraph 13:

This Statement refers collectively to the types of differences illustrated by those eight examples and to the ones described in paragraph 15 as *temporary differences.* Temporary differences that will result in taxable amounts in future years when the related asset or liability is recovered or settled are often referred to in this Statement as **taxable temporary differences** (examples (a), (d), and (e) in paragraph 11 are taxable temporary differences). Likewise, temporary differences that will result in deductible amounts in future years are often referred to as **deductible temporary differences** (examples (b), (c), (f), and (g) in paragraph 11 are deductible temporary differences). Business combinations ~~accounted for by the purchase method~~ (example (h)) may give rise to both taxable and deductible temporary differences.

E43. FASB Statement No. 128, *Earnings per Share,* is amended as follows:

a. Paragraph 59:

When common shares are issued to acquire a business in a ~~transaction accounted for as a purchase~~ business combination, the computations of earnings per share shall recognize the existence of the new shares only from the acquisition date. ~~When a business combination is accounted for as a pooling of interests, EPS computations shall be based on the aggregate of the weighted-average outstanding shares of the constituent businesses, adjusted to equivalent shares of the surviving business for all periods presented.~~ In reorganizations, EPS computations shall be based on analysis of the particular transaction and the provisions of this Statement.

E44. FASB Statement No. 142, *Goodwill and Other Intangible Assets,* is amended as follows:

a. Paragraph 11(b):

The expected useful life of another asset or a group of assets to which the useful life of the intangible asset may relate ~~(such as mineral rights to depleting assets)~~

b. Paragraph D11, which amended Interpretation 9, is deleted.

E45. FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,* is amended as follows:

a. Paragraph 5, as subsequently amended by Statement 145:

This Statement does not apply to (a) goodwill, (b) intangible assets not being amortized that are to be held and used, (c) ~~long-term customer-relationships of a financial institution, such as core deposit intangibles, credit cardholder intangibles, and~~ servicing assets, (d) financial instruments, including investments in equity securities accounted for under the cost or equity method, (e) deferred policy acquisition costs, (f) deferred tax assets, and (g) unproved oil and gas properties that are being accounted for using the successful-efforts method of accounting. This Statement also does not apply to long-lived assets for which the accounting is prescribed by:

- FASB Statement No. 50, *Financial Reporting in the Record and Music Industry*
- FASB Statement No. 63, *Financial Reporting by Broadcasters*
- FASB Statement No. 86, *Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed*
- FASB Statement No. 90, *Regulated Enterprises—Accounting for Abandonments and Disallowances of Plant Costs.*

b. Appendix D (paragraph D1):

Existing Pronouncement	Title	Apply Requirement in This Statement	Apply Existing Requirement	Existing Requirement Paragraph Number
~~FASB Statement No. 72~~	~~*Accounting for Certain Acquisitions of Banking or Thrift Institutions*~~		~~X~~	~~4~~

E46. FASB Interpretation No. 21, *Accounting for Leases in a Business Combination,* is amended as follows:

a. Paragraph 13:

If in connection with a business combination~~, whether accounted for by the purchase method or by the pooling of interests method,~~ the provisions of a lease are modified in a way that would require the revised agreement to be considered a new agreement under paragraph 9 of *FASB Statement No. 13,* the new lease shall be classified by the combined enterprise according to the criteria set forth in Statement No. 13, based on conditions as of the date of the modification of the lease.

b. Paragraph 14 and the heading preceding it:

~~**Application of FASB Statement No. 13 in a Pooling of Interests**~~

~~In a business combination that is accounted for by the pooling of interests method, each lease shall retain its previous classification under *FASB Statement No. 13* unless the provisions of the lease are modified as indicated in paragraph 13 above and shall be accounted for by the combined enterprise in the same manner that it would have been classified and accounted for by the combining enterprise.~~

c. Paragraph 19 and the heading preceding it:

ILLUSTRATION OF THE ACCOUNTING FOR A LEVERAGED LEASE IN A BUSINESS~~PURCHASE~~ COMBINATION

This appendix illustrates one way that a lessor's investment in a leveraged lease might be valued by the acquiring enterprise in a business combination ~~accounted for by the purchase method~~ and the subsequent accounting for the investment in accordance with *FASB Statement No. 13.* The elements of accounting and reporting illustrated for this example are as follows: [The rest of the paragraph is unchanged, so is omitted.]

Appendix F

AMENDMENTS TO OTHER AUTHORITATIVE LITERATURE

F1. This appendix addresses the impact of this Statement on authoritative accounting literature included in categories (*b*), (*c*), and (*d*) in the GAAP hierarchy discussed in FASB Statement No. 162, *The Hierarchy of Generally Accepted Accounting Principles.* **[Note: Only the sections that have been amended are shown in this appendix.]**

F2. [This paragraph has been deleted. See Status page.]

F3. This Statement nullifies the following FASB Staff Q&A:

a. *A Guide to Implementation of Statement 109 on Accounting for Income Taxes:* Questions 13–17, and 17A–17C.

F4. This Statement nullifies the following Emerging Issues Task Force (EITF) Issues:

a. EITF Issue No. 84-35, "Business Combinations: Sale of Duplicate Facilities and Accrual of Liabilities"
b. EITF Issue No. 85-8, "Amortization of Thrift Intangibles"
c. EITF Issue No. 85-42, "Amortization of Goodwill Resulting from Recording Time Savings Deposits at Fair Values"
d. EITF Issue No. 86-14, "Purchased Research and Development Projects in a Business Combination"
e. EITF Issue No. 88-16, "Basis in Leveraged Buyout Transactions"
f. EITF Issue No. 88-19, "FSLIC-Assisted Acquisitions of Thrifts"
g. EITF Issue No. 89-19, "Accounting for a Change in Goodwill Amortization for Business Combinations Initiated Prior to the Effective Date of FASB Statement No. 72"

h. Issue 1 of EITF Issue No. 90-5, "Exchanges of Ownership Interests between Entities under Common Control"[11]
i. EITF Issue No. 90-12, "Allocating Basis to Individual Assets and Liabilities for Transactions within the Scope of Issue No. 88-16"
j. Issue 1 of EITF Issue No. 90-13, "Accounting for Simultaneous Common Control Mergers"[12]
k. EITF Issue No. 92-9, "Accounting for the Present Value of Future Profits Resulting from the Acquisition of a Life Insurance Company"
l. EITF Issue No. 93-7, "Uncertainties Related to Income Taxes in a Purchase Business Combination"
m. EITF Issue No. 95-3, "Recognition of Liabilities in Connection with a Purchase Business Combination"
n. EITF Issue No. 95-8, "Accounting for Contingent Consideration Paid to the Shareholders of an Acquired Enterprise in a Purchase Business Combination"
o. EITF Issue No. 96-7, "Accounting for Deferred Taxes on In-Process Research and Development Activities Acquired in a Purchase Business Combination"
p. EITF Issue No. 97-8, "Accounting for Contingent Consideration Issued in a Purchase Business Combination"
q. EITF Issue No. 97-15, "Accounting for Contingency Arrangements Based on Security Prices in a Purchase Business Combination"
r. EITF Issue No. 98-1, "Valuation of Debt Assumed in a Purchase Business Combination"
s. EITF Issue No. 98-3, "Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business"
t. EITF Issue No. 99-12, "Determination of the Measurement Date for the Market Price of Acquirer Securities Issued in a Purchase Business Combination"
u. EITF Issue No. 99-15, "Accounting for Decreases in Deferred Tax Asset Valuation Allowances Established in a Purchase Business Combination As a Result of a Change in Tax Regulations"
v. EITF Issue No. 01-3, "Accounting in a Business Combination for Deferred Revenue of an Acquiree"
w. EITF Issue No. 02-17, "Recognition of Customer Relationship Intangible Assets Acquired in a Business Combination"
x. EITF Issue No. 04-1, "Accounting for Preexisting Relationships between the Parties to a Business Combination"
y. EITF Issue No. 04-2, "Whether Mineral Rights Are Tangible or Intangible Assets"
z. EITF Topic No. D-54, "Accounting by the Purchaser for a Seller's Guarantee of the Adequacy of Liabilities for Losses and Loss Adjustment Expenses of an Insurance Enterprise Acquired in a Purchase Business Combination"
aa. EITF Topic No. D-87, "Determination of the Measurement Date for Consideration Given by the Acquirer in a Business Combination When That Consideration Is Securities Other Than Those Issued by the Acquirer"
bb. EITF Topic No. D-100, "Clarification of Paragraph 61(b) of FASB Statement No. 141 and Paragraph 49(b) of FASB Statement No. 142"

F5. This Statement nullifies AICPA Practice Bulletin No. 11, "Accounting for Preconfirmation Contingencies in Fresh-Start Reporting."

F6. EITF Issue No. 85-41, "Accounting for Savings and Loan Associations under FSLIC Management Consignment Program," is amended as follows: [Added text is underlined and deleted text is ~~struck out~~.]

STATUS

Statement 141(R), issued in December 2007, nullifies Statement 147 and replaces Statement 141, which supersedes Opinion 16 ~~was issued in June 2001~~. Refer to Statement 141(R) for guidance pertaining to assigning amounts to assets acquired and liabilities assumed. ~~originally included in paragraphs 87–89 of Opinion 16 is now in paragraphs 37 and 38 of Statement 141.~~

F7. EITF Issue No. 87-12, "Foreign Debt-for-Equity Swaps," is amended as follows:

EITF DISCUSSION

The Task Force reached a consensus that the amount by which the local currency proceeds

[11]This Statement nullifies Issue 1, and FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements,* nullifies Issue 2.

[12]This Statement nullifies Issue 1, and Statement 160 nullifies Issue 2.

translated at the official exchange rate exceed the purchase cost of the loan ("the excess") should be used to reduce the basis of the long-lived assets acquired or constructed to comply with the arrangement. If the arrangement does not specifically require the acquisition or construction of long-lived fixed assets, or if the excess exceeds the cost of the assets, the excess should be used to reduce the carrying amount of existing long-lived assets other than goodwill. The excess should be applied first to reduce the basis of the fixed asset with the longest remaining life. If that asset is reduced to zero, the remaining excess should be applied to reduce the basis of the fixed asset with the next longest remaining life. If the cost of all fixed assets is reduced to zero, the remaining excess should be reported as ~~negative goodwill~~a bargain purchase as required by Statement 141(R).

The Task Force also discussed a foreign debt-for-equity swap for which (1) the foreign branch has no significant assets or liabilities other than local currency debt and has an accumulated deficit and (2) the proceeds from the debt-for-equity swap are used to extinguish the debt. The Task Force agreed that the above consensus is applicable to this transaction, resulting in the excess being reported as a bargain purchase as required by Statement 141(R)~~as negative goodwill~~.

STATUS

At the January 23-24, 2002 EITF meeting, the Task Force concluded that the guidance in Statement 141, which was issued in June 2001, does not affect the consensus guidance in this Issue.

Statement 141(R), issued in December 2007, replaces Statement 141 and provides guidance on the accounting for a bargain purchase (previously referred to as negative goodwill).

No further EITF discussion is planned.

F8. EITF Issue No. 87-21, "Change of Accounting Basis in Master Limited Partnership Transactions," is amended as follows:

EITF DISCUSSION

On the second issue, the Task Force reached a consensus that transaction costs in a roll-up should be charged to expense~~, consistent with the requirements of Opinion 16 for expenses related to a business combination accounted for under the pooling-of-interests method.~~ [Note: See STATUS section.]

STATUS

Statement 141 supersedes Opinion 16 and was issued in June 2001. Statement 141 prohibits the use of the pooling-of-interests method for all business combinations initiated after June 30, 2001. As noted in paragraph 10 of Statement 141, transactions in which all entities transfer net assets or the owners of those entities transfer their equity interests to a newly formed entity (some of which are referred to as roll-up or put-together transactions) are in the scope of that Statement. However, transfers of net assets or exchanges of equity interests between entities under common control are excluded from the scope of Statement 141. (Paragraphs D11–D18 of that Statement provide accounting guidance for those transactions.) Whether a particular transaction is a business combination that should be accounted for using the purchase method or a transaction between entities under common control can be determined only after a careful analysis of all facts and circumstances.

Statement 141(R) was issued in December 2007 and replaces Statement 141. Statement 141(R) continues to exclude transfers of net assets or exchanges of equity interests between entities under common control from its scope but contains guidance on those transactions in Appendix D, "Continuing Authoritative Guidance."

F9. EITF Issue No. 91-5, "Nonmonetary Exchange of Cost-Method Investments," is amended as follows:

STATUS

Issue 2. Statement 141(R), which replaces Statement 141, was issued in December 2007. It provides guidance for identifying the acquirer in a business combination. Statement 141(R) does not affect the consensus guidance reached in this Issue. ~~Statement 141, which supersedes Opinion 16, was issued in June 2001. Statement 141 prohibits the use of the pooling-of-interests method for all business combinations initiated after June 30, 2001. The guidance for identifying an acquiring company is provided in paragraphs 15–19 of Statement 141.~~

No further EITF discussion is planned.

F10. EITF Issue No. 96-5, "Recognition of Liabilities for Contractual Termination Benefits or Changing Benefit Plan Assumptions in Anticipation of a Business Combination," is amended as follows:

STATUS

Statement 141(R), which was issued in December 2007, replaces Statement 141 and does not affect the consensus guidance reached in this Issue. ~~Statement 141, which supersedes Opinion 16, was issued in June 2001. Statement 141 prohibits the use of the pooling-of-interests method for all business combinations initiated after June 30, 2001.~~

No further EITF discussion is planned.

F11. EITF Issue No. 97-2, "Application of FASB Statement No. 94 and APB Opinion No. 16 to Physician Practice Management Entities and Certain Other Entities with Contractual Management Arrangements," is amended as follows:

Issue 2—Possibility of a Business Combination

The Task Force reached a consensus that a transaction between a PPM and a physician practice in which the PPM executes a management agreement with the physician practice is considered to be a business combination to be accounted for under Opinion 16 if (1) based on the terms of the management agreement the PPM is required to consolidate the physician practice and (2) the physician practice is a business. ~~[Note: See STATUS section.]~~ [This consensus has been nullified by Statement 141(R). Statement 141(R) defines a business combination as "a transaction or other event in which an acquirer obtains control of one or more businesses," and clarifies that an acquirer might obtain control of an acquiree by contract alone.]

~~If either criterion 1 or criterion 2 above is not met, the Task Force observed that the PPM would account for the management agreement as a service contract. The Task Force also observed that any other coincident transactions between the physician practice and the PPM, such as purchasing some or all of the physician practice assets and hiring physician practice employees, would be accounted for separately under their respective generally accepted accounting principles.~~

~~With respect to criterion 2 above, whether a physician practice is considered to be a business depends on the facts and circumstances. For example, a dentist who has recently graduated from dental school and who has incorporated but has done essentially nothing else is not considered to be a business.~~

Issue 3—Application of the Pooling-of-Interests Method of Accounting

The Task Force reached a consensus that transactions that are the subject of this Issue would not meet the criteria of the pooling-of-interests method of accounting. [Note: This consensus has been nullified by Statement 141. Statement 141 prohibited the use of the pooling-of-interests method for all business combinations initiated after June 30, 2001. Statement 141(R), which replaces Statement 141, continues to prohibit the use of the pooling-of-interests method. ~~See STATUS section.~~]

Issue 4—Application of the Purchase Method of Accounting

The Task Force decided not to address this issue. [Statement 141(R) provides guidance for applying the acquisition method to business combinations achieved by contract alone.]

STATUS

Statement 141(R) was issued in December 2007 and replaces Statement 141. Statement 141(R) nullifies the consensuses reached for Issues 2, 3, and 4. Statement 141(R) defines a business combination as "a transaction or other event in which an acquirer obtains control of one or more businesses," and clarifies that an acquirer might obtain control of an acquiree by contract alone. ~~Statement 141, which supersedes Opinion 16, was issued in June 2001. Statement 141 provides guidance on the accounting for a business combination by the purchase method. As stated in paragraph B23, that Statement does not change the consensuses reached in this Issue, except for the consensus reached in Issue 3. Because Statement 141 prohibits the use of the pooling-of-interests method for all business combinations initiated after June 30, 2001, Issue 3 is nullified for entities within the scope of Statement 141.~~

F12. EITF Issue No. 98-11, "Accounting for Acquired Temporary Differences in Certain Purchase Transactions That Are Not Accounted for as Business Combinations," is amended as follows:

a. Paragraph 1:

> Paragraph 30 of Statement 109 provides guidance on how to recognize deferred taxes in connection with a purchase business combination. The deferred taxes are recognized as part of the purchase price allocation and are not included in income in the period of the business combination. Statement 109 does not, however, provide specific accounting guidance for asset purchases that are not business combinations. Statement 109 also does not provide specific accounting guidance for payments made to obtain a future tax benefit that is in excess of the amount paid. Paragraph 16 of Statement 109 addresses recognition of deferred taxes and requires that an enterprise recognize a deferred tax liability or asset for all temporary differences. With certain specified exceptions, deferred tax expense or benefit for the year is measured as the change in an enterprise's deferred tax assets and liabilities. [Note: See STATUS section.]

b. Paragraph 3:

> The Task Force reached a consensus on Issue 1 that the tax effect of asset purchases that are not business combinations in which the amount paid differs from the tax basis of the asset should not result in immediate income statement recognition. The Task Force agreed that the simultaneous equations method should be used to record the assigned value of the asset and the related deferred tax asset or liability. (Refer to Examples 1 and 2 of Exhibit 98-11A for illustrative examples of the simultaneous equations method.) For purposes of applying this consensus, the Task Force agreed that:
>
> a. An acquired financial asset should be recorded at fair value, an acquired asset held for disposal should be recorded at fair value less cost to sell, and deferred tax assets should be recorded at the amount required by Statement 109.
> b. An excess of the amounts assigned to the acquired assets over the consideration paid should be allocated pro rata to reduce the values assigned to noncurrent assets acquired (except financial assets, assets held for disposal, and deferred tax assets). If the allocation reduces the noncurrent assets to zero, the remainder should be classified as a deferred credit. (Refer to Examples 3 and 4 of Exhibit 98-11A for illustrative examples of transactions that result in a deferred credit.) The deferred credit is not a temporary difference under Statement 109.
> c. A reduction in the valuation allowance of the acquiring company that is directly attributable to the asset acquisition should be accounted for ~~as an adjustment of the purchase price~~ in accordance with paragraph 266 of Statement 109, as amended by Statement 141(R). [Note: See STATUS section.] ~~(Refer to Example 5 of Exhibit 98-11A for an illustrative example of the simultaneous equations method when a preexisting valuation allowance will be reduced as a result of acquiring the asset.)~~ Subsequent accounting for an acquired valuation allowance (for example, the subsequent recognition of an acquired deferred tax asset by elimination of a valuation allowance established at the date of acquisition of the asset) would be in accordance with paragraphs 30 and 30A of Statement 109, as amended by Statement 141(R). ~~which would reduce to zero other noncurrent intangible assets related to that acquisition, if any, and recognize any remaining reductions in the valuation allowance in income.~~
> d. Any deferred credit arising from the application of this consensus should be amortized to income tax expense in proportion to the realization of the tax benefits that gave rise to the deferred credit. The deferred credit should not be classified as part of deferred tax liabilities or as an offset to deferred tax assets.
> e. If, subsequent to the acquisition, it becomes more likely than not that some or all of the acquired deferred tax asset will not be realized, the effect of such adjustment should be recognized in continuing operations as part of income tax expense. A proportionate share of any remaining unamortized deferred credit balance should be recognized as an offset to income tax expense.
> f. Income tax uncertainties that exist at the date of acquisition of the asset should be accounted for in accordance with Interpretation 48, as amended by Statement 141(R).

[Note: See STATUS section.]~~as follows: any unfavorable adjustments should be recognized in income and any favorable adjustments should be applied as a reduction of other noncurrent intangible assets related to the acquisition, if any, and any remaining amount of favorable adjustments should be recognized in income.~~

c. Paragraph 9:

Statement 141(R) was issued in December 2007 and replaces Statement 141. Statement 141(R) amends the guidance in paragraphs 30 and 266 in Statement 109 for business combinations. Statement 141(R) amends Statement 109 and Interpretation 48 to require changes in valuation allowances and income tax uncertainties made as a result of events and circumstances that occurred after the acquisition date to be recorded as an increase or decrease to income tax expense or, for uncertainties, in accordance with Interpretation 48.~~No further EITF discussion is planned.~~

d. Paragraph 10 is added as follows:

No further EITF discussion is planned.

e. Example 5:

Example 5, which illustrated the simultaneous equations method when a preexisting valuation allowance is reduced as a result of an asset acquisition, is deleted because it is inconsistent with the amendments made by Statement 141(R) to paragraphs 30 and 266 of Statement 109. [Note: See STATUS section.]~~**Example 5: Example of the simultaneous equations method when there is a contemporaneous reduction in a preexisting valuation allowance**~~

~~An entity acquires the stock of another corporation for $7,000,000. The principal asset of the corporation is a license with a tax basis of $2,000,000. The acquired entity had no operations and so the acquisition is accounted for as an asset purchase and not as a business combination.~~

~~The acquirer has a deferred tax asset of $1,500,000 and a valuation allowance of $1,500,000. As a result of acquiring the license, the acquirer now has a taxable temporary difference that is expected to reverse during the same period that the acquirer's deductible temporary difference is expected to reverse. (It is assumed that the taxes that otherwise would be payable upon the reversal of the acquired corporation's taxable temporary difference will be reduced as the result of the acquiring entity's preexisting deferred tax asset.) Therefore, the valuation allowance of $1,500,000 is no longer required. The tax rate is 35 percent.~~

~~In accordance with the consensus, the amounts assigned to the license, the deferred tax liability, and the amount of the deferred tax asset valuation allowance released (VAR) should be determined using the simultaneous equations method as follows (where FBB is Final Book Basis; CPP is Cash Purchase Price; and DTL is Deferred Tax Liability):~~

~~*Equation A (determine the FBB of the license):*~~

~~FBB − (Tax Rate × (FBB − Tax Basis)) + VAR = CPP~~

~~*Equation B (determine the amount assigned to the DTL):*~~

~~(FBB − Tax Basis) × Tax Rate = DTL~~

~~In the above example, the following variables are known:~~

~~Tax Basis = $2,000,000~~
~~Tax Rate = 35 percent~~
~~CPP = $7,000,000~~
~~VAR = $1,500,000~~

~~The unknown variables (FBB and DTL) are solved as follows:~~

~~*Equation A:* FBB = $7,384,615~~
~~*Equation B:* DTL = $1,884,615~~

~~Accordingly, the company would record the following journal entry:~~

~~DTA valuation allowance~~	~~$1,500,000~~	
~~License~~	~~7,384,615~~	
~~DTL~~		~~$1,884,615~~
~~Cash~~		~~7,000,000~~

F13. EITF Issue No. 99-7, "Accounting for an Accelerated Share Repurchase Program," is amended as follows:

a. Paragraph 1:

> An accelerated share repurchase program is a combination of transactions that permits an entity to purchase a targeted number of shares immediately with the final purchase price of those shares determined by an average market price over a fixed period of time. An accelerated share repurchase program is intended to combine the immediate share retirement benefits of a tender offer with the market impact and pricing benefits of a disciplined daily open market stock repurchase program. The implications of an accelerated share repurchase program for earnings-per-share (EPS) calculations and an entity's ability to account for a business combination as a pooling of interests differ, depending on how the accelerated share repurchase program is accounted for. [Note: See STATUS section.]

b. Paragraphs 6 and 7:

> ~~6. With regard to the impact of the treasury stock component of the accelerated share repurchase program on an entity's ability to account for a business combination as a pooling of interests, the entity should consider the share repurchase date (July 1, 1999 in the above example) or, with respect to postconsummation repurchases, the date on which the intent to repurchase shares is formulated to determine whether the treasury stock acquisition results in a violation of either paragraph 47(d) or paragraph 48(a) (as interpreted by SAB 96) of Opinion 16. Any resulting preconsummation tainted treasury shares could be "cured" by issuing the same amount of common stock between the purchase date (July 1, 1999 in the above example) and the date of consummation of the business combination. [Note: See STATUS section.]~~
>
> ~~7. The Task Force also discussed the effects of the forward contract in the accelerated share repurchase program on an entity's ability to account for a business combination as a pooling of interests but was not asked to reach a consensus. The Task Force agreed to discuss the impact of derivative financial instruments indexed to, and potentially settled in, a company's own stock on pooling-of-interests transactions as a separate EITF Issue at a future meeting. [Note: See STATUS section.]~~

c. Paragraph 9:

> Statement 141, which supersedes Opinion 16, was issued in June 2001. Statement 141 prohibits the use of the pooling-of-interests method for all business combinations initiated after June 30, 2001. Statement 141(R), issued in December 2007, replaces Statement 141 and continues to prohibit the use of the pooling-of-interests method of accounting for business combinations.

F14. EITF Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock," is amended as follows:

a. Paragraph 3:

> This Issue applies only to freestanding derivative financial instruments (for example, forward contracts, options, and warrants). This Issue applies to security price guarantees or other financial instruments indexed to, or otherwise based on, the price of the company's stock that are issued in connection with a ~~purchase~~ business combination and that are accounted for as contingent consideration ~~only if those instruments meet the criteria in Issue No. 97-8, "Accounting for Contingent Consideration Issued in a Purchase Business Combination," for recording as part of the cost of the business acquired in a purchase business combination (see discussion of Issue 97-8 in paragraph 58 of the STATUS section)~~. This Issue does not address the accounting for either the derivative component or the financial instrument when the derivative component is embedded in and not detachable from the financial instrument. This Issue also does not address the accounting for contracts that are issued (a) to compensate employees or (b) to acquire goods or services from nonemployees when performance has not yet occurred. However, this Issue applies to contracts issued to acquire goods or services from nonemployees when performance has occurred. This Issue does not address the accounting for contracts that are indexed to, and potentially settled in, the stock of a consolidated subsidiary (see discussion of Issue No. 00-6, "Accounting for Freestanding Derivative Financial Instruments Indexed to, and Potentially Settled in, the Stock of a Consolidated Subsidiary," and Issue No. 00-4, "Majority Owner's Accounting for a Transaction in the

Shares of a Consolidated Subsidiary and a Derivative Indexed to the Minority Interest in That Subsidiary," in paragraphs 62 and 63 of the STATUS section).

b. Paragraph 81:

Statement 141(R), which was issued in December 2007, replaces Statement 141 and nullifies Issue 97-8. Paragraph 42 of Statement 141(R) refers to this Issue for classification guidance for an acquirer's obligation to pay contingent consideration as a liability or as equity. Accordingly, contingent consideration issued in a business combination is within the scope of this Issue. ~~No further EITF discussion is planned.~~

c. Paragraph 82 is added as follows:

No further EITF discussion is planned.

F15. EITF Issue No. 01-2, "Interpretations of APB Opinion No. 29," is amended as follows:

a. Issues 1 and 1(a):

Issue 1—Whether an entity's degree of influence (controlled and consolidated versus not controlled and accounted for under the equity method) over the asset or group of assets received when compared with the asset or group of assets given up impacts the similar assessment. [Note: See STATUS section.]

Issue 1(a)—Whether the exchange of assets or groups of assets involving the receipt of a consolidated business can be considered an exchange of similar productive assets accounted for at historical cost pursuant to paragraph 21(b) of Opinion 29. [Note: See STATUS section.]

b. Paragraphs 4 and 5:

~~4. Paragraph 4(a) of Opinion 29 states that that Opinion is not applicable to a "business combination accounted for by an enterprise according to the provisions of APB Opinion No. 16, *Business Combinations*." While the acquisition of a minority interest does not meet the definition of a business combination in paragraph 5 of Opinion 16, the Task Force observed that paragraphs 5 and 43 of Opinion 16 clarify that the acquisition of a minority interest should be accounted for using the purchase method. [Note: See STATUS section.]~~

~~5. In Issue 86-29 the Task Force reached a consensus that an enterprise should account for an exchange of securities in which it acquires control of a subsidiary as a business combination in accordance with Opinion 16. However, the Task Force observed that the consensus is not intended to change the application of Opinion 16 or to eliminate the need to exercise judgment in those circumstances in which the substance of a transaction indicates that fair value accounting is not appropriate. That is, if Opinion 16 is to apply, the substance of the transaction must be a business combination. [Note: See STATUS section.]~~

c. Paragraph 7:

~~In Issue No. 98-3, "Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business," t~~The SEC Observer stated that the SEC staff will require registrants to account for the exchange of consolidated businesses, even if in the same line of business, as a fair value transaction under the guidance of Opinion 16. [Note: See STATUS section.] The SEC Observer also stated that the SEC staff believes that Opinion 16 governs the acquisition of a consolidated business when acquired for nonmonetary assets, including equity method investments.

d. Paragraph 9:

~~The determination regarding whether exchanges of certain types of assets, for example, radio stations, cable systems, and hotels, are considered exchanges of productive assets or business combinations should be based on the facts and circumstances, and should consider the definition of a business in Issue 98-3.~~

e. Paragraph 41:

~~Statement 141, which supersedes Opinion 16, was issued in June 2001. Paragraph 10 of Statement 141~~ Statement 141(R), which was issued in December 2007, replaces Statement 141 and nullifies Issue 98-3. Paragraph A2(a) of Statement 141(R) clarifies that the exchange of a business for a business is a business combination. ~~Statement 141 carries forward without reconsideration, the guidance in paragraphs 5 and 43 of Opinion 16 that require that the acquisition of a minority interest be accounted for using the~~

~~purchase method. Paragraphs 14 and A5–A7 of Statement 141 provide guidance on the accounting for acquisition of a minority interest.~~

F16. EITF Issue No. 02-5, "Definition of 'Common Control' in Relation to FASB Statement No. 141," is amended as follows:

a. Paragraph 8:

Statement 141(R), which was issued in December 2007, replaces Statement 141.~~No further EITF discussion is planned.~~

b. Paragraph 9 is added as follows:

No further EITF discussion is planned.

F17. EITF Issue No. 02-7, "Unit of Accounting for Testing Impairment of Indefinite-Lived Intangible Assets," is amended as follows:

a. Paragraph 7:

Statement 141(R), which was issued in December 2007, replaces Statement 141 and does not affect the consensus guidance reached in this Issue.~~No further EITF discussion is planned.~~

b. Paragraph 8 is added as follows:

No further EITF discussion is planned.

F18. EITF Issue No. 02-11, "Accounting for Reverse Spinoffs," is amended as follows:

a. Footnote 1 to paragraph 4:

Under the consensus reached in Issue 11 of Issue No. 01-2, "Interpretations of APB Opinion No. 29, *Accounting for Nonmonetary Transactions,*" the subsidiary should meet the definition of a business as set forth in Statement 141(R) ~~Issue No. 98-3, "Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business"~~; otherwise, the transaction represents a dividend-in-kind and should be recorded at fair value.

b. Paragraph 11:

Statement 141(R), which was issued in December 2007, replaces Statement 141 and includes the definition of a business.~~No further EITF discussion is planned.~~

c. Paragraph 12 is added as follows:

No further EITF discussion is planned.

F19. EITF Issue No. 02-13, "Deferred Income Tax Considerations in Applying the Goodwill Impairment Test in FASB Statement No. 142," is amended as follows:

a. Paragraph 11:

Statement 141(R), which was issued in December 2007, replaces Statement 141 and does not affect the consensus guidance reached in this Issue.~~No further EITF discussion is planned.~~

b. Paragraph 12 is added as follows:

No further EITF discussion is planned.

F20. EITF Issue No. 04-3, "Mining Assets: Impairment and Business Combinations," is amended as follows:

a. Paragraph 13:

Statement 141(R), which was issued in December 2007, replaces Statement 141 and does not affect the consensus guidance reached in this Issue.~~No further EITF discussion is planned.~~

b. Paragraph 14 is added as follows:

No further EITF discussion is planned.

F21. EITF Topic No. D-101, "Clarification of Reporting Unit Guidance in Paragraph 30 of FASB Statement No. 142," is amended as follows:

Paragraph 30 of Statement 142 includes the following guidance for determining reporting units:

> A reporting unit is an operating segment or one level below an operating segment (referred to as a component).[17] A component of an operating segment is a reporting unit if the component constitutes a business[18] for which discrete financial information is available and segment management[19] regularly reviews the operating results of that component. However, two or more components of an operating segment shall be aggregated and deemed a single reporting unit if the

components have similar economic characteristics.[20] An operating segment shall be deemed to be a reporting unit if all of its components are similar, if none of its components is a reporting unit, or if it comprises only a single component. The relevant provisions of Statement 131 and related interpretive literature shall be used to determine the reporting units of an entity.

[17]For purposes of determining reporting units, an operating segment is as defined in paragraph 10 of FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information.*

[18]~~Emerging Issues Task Force Issue No. 98-3, "Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business,"~~ FASB Statement No. 141 (revised 2007), *Business Combinations,* includes guidance on determining whether an asset group constitutes a business.

[19]Segment management consists of one or more segment managers, as that term is defined in paragraph 14 of Statement 131.

[20]Paragraph 17 of Statement 131 shall be considered in determining if the components of an operating segment have similar economic characteristics. . . .

The determination of whether a component constitutes a business requires judgment based on specific facts and circumstances. The guidance in FASB Statement No. 141 (revised 2007), *Business Combinations,*~~in Issue No. 98-3, "Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business,"~~ should be considered in determining whether a group of assets constitutes a business. ~~That guidance states that, among other things, "for a transferred set of activities and assets to be a business, it must contain all of the inputs and processes necessary for it to continue to conduct normal operations after the transferred set is separated from the transferor." The fact that operating information (revenues and expenses) exists for a component of an operating segment does not mean that the component constitutes a business. For example, a component for which operating information is prepared might be a product line or a brand that is part of a business rather than a business itself.~~ [The remainder of this topic has been omitted.]

F22. AICPA Statement of Position 78-9, *Accounting for Investments in Real Estate Ventures,* is amended as follows:

a. Paragraph .27:

Differences that arise from a business combination with a venture~~ accounted for as a purchase~~ should be accounted for in accordance with the provisions of FASB Statement No. 141 (revised 2007), *Business Combinations.*[†] ~~Paragraph 35 of FASB Statement No. 141 states that the acquiring entity should allocate the cost of an acquired entity to the assets acquired, including intangible assets, and liabilities assumed based on their estimated fair values at date of acquisition.[‡] The division believes that an excess of the cost of the investment acquired over the equity in the underlying net assets usually would be ascribed to the fair values of real property interest owned by the venture.~~ However, any excess of the cost of an acquired entity over the net of the amounts assigned to assets acquired and liabilities assumed should be recognized as goodwill and should not be amortized.[‖] [Revised, ~~March 2003~~ December 2007, to reflect conforming changes necessary due to the issuance of FASB Statement No~~s~~. 141(R)~~ and 142~~.]

[†]~~FASB Statement No. 141, *Business Combinations,* supersedes APB Opinion 16. [Footnote added, March 2003, to reflect conforming changes necessary due to the issuance of FASB Statement No. 141.]~~

[‡]~~Paragraphs 35–39 of FASB Statement No.141 provide guidance on the recognition of assets, including intangible assets, and liabilities apart from goodwill. [Footnote added, March 2003, to reflect conforming changes necessary due to the issuance of FASB Statement No. 141.]~~

[‖]Paragraphs 12–14 of FASB Statement No. 142, *Goodwill and Other Intangible Assets,* provide guidance on intangible assets subject to amortization. [Footnote added, March 2003, to reflect conforming changes necessary due to the issuance of FASB Statement No. 142.]

F23. AICPA Statement of Position 90-7, *Financial Reporting by Entities in Reorganization Under the Bankruptcy Code,* is amended as follows:

a. Paragraph .38:

Entities that adopt fresh-start reporting in conformity with paragraph .36 should apply the following principles:

- The reorganization value of the entity should be assigned~~allocated~~ to the entity's assets and liabilities in conformity with the procedures specified by FASB Statement No. 141 (revised 2007), *Business Combinations.* If any portion of the reorganization value cannot be attributed to specific tangible or identified intangible assets of the emerging entity, such amounts should be reported as

goodwill in accordance with paragraph 6 of FASB Statement No. 142, *Goodwill and Other Intangible Assets.*

- ~~Each liability existing at the plan confirmation date, other than deferred taxes, should be stated at present values of amounts to be paid determined at appropriate current interest rates.~~
- Deferred taxes should be reported in conformity with generally accepted accounting principles. If not recognizable at the plan confirmation date, initial recognition (that is, by elimination of the valuation allowance) of tax b~~B~~enefits realized from preconfirmation net operating loss carryforwards and deductible temporary differences should be reported as a reduction to income tax expense ~~should first reduce reorganization value in excess of amounts allocable to identifiable assets and other intangibles until exhausted and thereafter be reported as a direct addition to paid-in capital~~.
- Changes in accounting principles that will be required in the financial statements of the emerging entity within the twelve months following the adoption of fresh-start reporting should be adopted at the time fresh-start reporting is adopted.

[Revised, ~~March 2003~~December 2007, to reflect conforming changes necessary due to the issuance of FASB Statement Nos. 141(R) ~~and 142~~.]

b. Paragraph .64:

A general restructuring of liabilities involves negotiation between the parties in interest. The negotiation and distribution under the confirmed plan constitutes an exchange of resources and obligations. By analogy, the guidance provided by ~~APB Opinion 16~~FASB Statement 141(R) for recording liabilities assumed in a business combination ~~accounted for as a purchase~~ should be applied in reporting liabilities by an entity emerging from Chapter 11.

F24. AICPA Statement of Position 93-6, *Employers' Accounting for Employee Stock Ownership Plans,* is amended as follows:

a. Paragraph .102:

Current Guidance	*Impact of SOP*
~~EITF Issue No. 88-27, *Effect of Unallocated Shares in an Employee Stock Ownership Plan on Accounting for Business Combinations*~~	~~The SOP does not deal with this issue and accordingly does not supersede the consensus. The consensus is reprinted in this appendix.~~

F25. AICPA Statement of Position 96-1, *Environmental Remediation Liabilities,* is amended as follows:

a. Paragraph .147:

Recording an environmental remediation liability usually results in a corresponding charge to income, and the guidance herein with respect to the income statement refers to such charges. In certain situations, such as those described in FASB EITF Issues 90-8 and 89-13 (see reprints of these EITF Issues in appendix A [paragraph .173]), it may be appropriate to capitalize environmental remediation costs. ~~Also, in conjunction with the initial recording of a purchase business combination or the final estimate of a preacquisition contingency at the end of the allocation period following the guidance in FASB Statement No. 141, *Business Combinations*, the environmental remediation liability is considered in the determination and allocation of the purchase price. By analogy to the accounting for a purchase business combination, the recording of an environmental remediation liability in conjunction with the acquisition of property would affect the amount recorded as an asset.~~ Finally, the recording of the receipt of property as a contribution received following the guidance in FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made*,

should include the effect of any environmental remediation liability that is recorded in conjunction with the contribution. [Revised, ~~June 2004~~ December 2007, to reflect conforming changes necessary due to the issuance of FASB Statement No. 141(R).~~*~~]

~~*FASB Statement No. 141, *Business Combinations,* supersedes APB Opinion No. 16, *Business Combinations.*~~

F26. AICPA Statement of Position 00-3, *Accounting by Insurance Enterprises for Demutualizations and Formations of Mutual Insurance Holding Companies and for Certain Long-Duration Participating Contracts,* is amended as follows:

a. Paragraph .04:

A demutualization or formation of an MIHC in and of itself does not constitute a change in ownership that requires a change in the historical accounting bases or **carrying amounts** of assets and liabilities. ~~Paragraph 24 of Financial Accounting Standard Board (FASB) Technical Bulletin (TB) 85-5, *Issues Relating to Accounting for Business Combinations*, states in part, "In the special case of a mutual or cooperative enterprise that converts to stock ownership for purposes of effecting a business combination, the conversion is not a shift of equity ownership from one group of equity owners to another. It is a shift from a form of organization that has no substantive equity ownership to one that has."~~ This SOP does not address what constitutes a change in ownership or reporting entity that would require a change in basis for the reported assets and liabilities.

F27. AICPA Statement of Position 01-6, *Accounting by Certain Entities (Including Entities With Trade Receivables) That Lend to or Finance the Activities of Others,* is amended as follows:

a. Paragraphs .15(c) and .15(d):

~~*c. Regulatory Capital Disclosures for Business Combinations.*[34] Following a business combination accounted for as a pooling of interests, the prior-year disclosures should—~~

~~(1) Contain quantitative disclosures limited to the combined Tier I, Tier II, and total capital, or net worth, as applicable, and related assets or risk-weighted assets, as applicable, and the ratios derived therefrom~~

~~(2) Not compare such ratios to either statutory or regulatory capital adequacy or prompt corrective action minimums, the mandated minimums of either premerged entity, or a composite of the premerged entities' mandated minimums~~

~~(3) Include a discussion of whether the entities, precombination, were required to hold capital in excess of statutory regulatory minimums in order to be considered well and/or adequately capitalized, and the reasons for those amended minimums~~

~~(4) Include a statement that there was not a determination by regulatory authorities as to the capital adequacy or prompt corrective action category of the combined entity relative to the premerger combined amounts and ratios presented~~

~~*d.* Following a business combination accounted for as a purchase, because prior capital position can be less relevant as a result of capital repatriation to former owners and the effects of purchase accounting adjustments and the push-down of basis, judgment should be used as to relevant disclosures. Minimum disclosures should include the capital position of the purchaser at the prior period end and information to highlight comparability issues, such as significant capital requirements imposed or agreed to during the regulatory approval process, and the effects of purchase accounting, if any, on regulatory capital determination.~~

~~[34] In June 2001, the FASB issued FASB Statement No. 141, *Business Combinations,* which supersedes APB Opinion 16, *Business Combinations.* FASB Statement No. 141, which applies to all business combinations except those between not-for-profit enterprises, requires that all business combinations initiated after June 30, 2001 be accounted for using the purchase method. The provisions of FASB Statement No. 141 are applicable to business combinations accounted for by the purchase method completed after June 30, 2001.~~

F28. AICPA Statement of Position 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer,* is amended as follows:

a. Footnote 7 to paragraph .03(d):

~~In June 2001, the FASB issued FASB Statement No. 141, *Business Combinations*, which supersedes Accounting Principles Board (APB) Opinion No. 16, *Business Combinations*. FASB~~

~~Statement No. 141, which applies to all business combinations except to combinations of two or more not-for-profit organizations, the acquisition of a for-profit business entity by a not-for-profit organization, and combinations of two or more mutual enterprises, requires that all business combinations initiated after June 30, 2001, be accounted for using the purchase method. The provisions of FASB Statement No. 141 are applicable to business combinations accounted for by the purchase method completed after June 30, 2001.~~ In December 2007, the FASB issued FASB Statement No. 141 (revised 2007), *Business Combinations*, which requires that all business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008, be accounted for using the acquisition method, except for those between two or more not-for-profit organizations, and the acquisition of a for-profit business entity by a not-for-profit organization.

b. Paragraph .04:

Loss accruals or valuation allowance. Valuation allowances should reflect only those losses incurred by the investor after acquisition—that is, the present value of all **cash flows expected at acquisition**[10] that ultimately are not to be received. For loans that are acquired by completion of a transfer, it is not appropriate, at acquisition, to establish a loss allowance. For loans acquired in a ~~purchase~~ business combination, the initial recognition of those loans should be the present value of amounts to be received.

c. Paragraph .23 (glossary):

Cash flows expected at acquisition. The investor's estimate, at acquisition, of the amount and timing of undiscounted principal, interest, and other cash flows expected to be collected.[1] This would be the investor's best estimate of cash flows, including the effect of prepayments if considered, that is used in determining the acquisition price, and, in a business combination, the investor's estimate of fair value for purposes of ~~acquisition price allocation~~assignment in accordance with FASB Statement No. 141 (revised 2007), *Business Combinations.*

Completion of a transfer. Completion of a transfer (1) that satisfies the conditions in paragraph 9 of Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, to be accounted for as a sale; (2) in a ~~purchase~~ business combination; or (3) to a newly created subsidiary if the transferee has written the loan down to its fair value with the intent of transferring the stock of the subsidiary as a dividend to the shareholders of the parent company; or (4) that is a contribution receivable or a transfer that satisfies a prior promise to give.

Initial investment. The amount paid to the seller plus any fees paid or less any fees received.[3] In a business combination~~ accounted for as a purchase~~, the assignment~~allocation~~ of fair value to loans or groups of loans should be in accordance with FASB Statement No. 141 (revised 2007), *Business Combinations.*

F29. AICPA Statement of Position 05-1, *Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection With Modifications or Exchanges of Insurance Contracts,* is amended as follows:

a. Footnote 5 to paragraph .16:

If the replaced contract was acquired in a ~~purchase~~ business combination, any present value of future profits ~~established in accordance with EITF Issue No. 92–9, "Accounting for the Present Value of Future Profits Resulting from the Acquisition of a Life Insurance Company,"~~ should be accounted for in a similar manner.

F30. AICPA Practice Bulletin No. 4, *Accounting for Foreign Debt/Equity Swaps,* is amended as follows:

a. Paragraph .05:

FASB Statement No. 141 (revised 2007), *Business Combinations,* provides guidance for ~~deals with~~ the acquisition of assets (paragraphs D2 to D7~~4 to 8~~). ~~and with determining the cost of an acquired company (paragraphs 20 to 34). FASB Statement No. 141 provides that assets acquired should be recorded based on the fair value of assets surrendered, liabilities incurred, or equity interests issued, unless the fair value of the assets acquired received is more clearly determinable ("cost may be determined either by the fair value of consideration given up or by the fair value of assets acquired, whichever is the more~~

~~clearly evident"). Paragraph 20 states that the same accounting principles apply to determining the cost of assets acquired individually, those acquired in a group, and those acquired in business combinations.~~ APB Opinion 29, *Accounting for Nonmonetary Transactions*, paragraph 18, provides similar guidance. [Revised, December 2007~~July 2004~~, to reflect the conforming changes necessary due to the issuance of FASB Statement No. 141(R).~~*~~]

~~*FASB Statement No. 141 supersedes APB Opinion No. 16, *Business Combinations*.~~

b. Paragraph .07:

Debt/equity swaps have characteristics similar to both the acquisition of assets contemplated by FASB Statement No. 141(R) and APB Opinion No. 29 and the receipt of assets in satisfaction of a loan contemplated by FASB Statement No. 15, as amended by FASB Statement No. 144. Since the secondary market for debt of financially troubled countries is presently considered to be thin, it may not be the best indicator of the value of the equity investment or of net assets received. In light of this thin secondary market and of the unique nature of the transaction, it is also necessary to examine the value of the equity investment or net assets received. The committees therefore believe that in arriving at the fair value of a debt/equity swap, both the secondary market price of the loan given up and the fair value of the equity investment or net assets received should be considered. It is the responsibility of management to make the valuation considering all of the circumstances. It is the responsibility of independent auditors to become satisfied that the valuation is based on reasonable methods and assumptions, including, as needed, information from independent appraisals. Factors to consider in determining current fair values include the following:

- Similar transactions for cash
- Estimated cash flows from the equity investment or net assets received
- Market value, if any, of similar equity investments
- Currency restrictions, if any, affecting dividends, the sale of the investment, or the repatriation of capital

[Revised, ~~July 2004~~December 2007, to reflect the conforming changes necessary due to the issuance of FASB Statements No. 141(R).~~†~~ ~~and No. 144.~~]

~~†FASB Statement No. 141 supersedes APB Opinion No. 16, *Business Combinations*.~~

F31. AICPA Practice Bulletin No. 6, *Amortization of Discounts on Certain Acquired Loans*, is amended as follows:

a. Paragraph .02:

This practice bulletin addresses the accounting and reporting by purchasers of loans in fiscal years beginning on or before December 15, 2004 (1) that are acquired in a ~~purchase~~ business combination, bought at a discount from face value in a transaction other than a business combination, or transferred to a newly created subsidiary after having been written down to fair value with the intent of transferring the stock of the subsidiary as a dividend to the shareholders of the parent company and (2) for which it is not probable that the undiscounted future cash collections will be sufficient to recover the face amount of the loan and contractual interest. [As amended, effective for loans purchased in fiscal years beginning on or before December 15, 2004, by Statement of Position 03-3.]

F32. AICPA Practice Bulletin No. 14, *Accounting and Reporting by Limited Liability Companies and Limited Liability Partnerships,* is amended as follows:

a. Paragraph .05:

~~An LLC formed by combining entities under common control or by conversion from another type of entity initially should state its assets and liabilities at amounts at which they were stated in the financial statements of the predecessor entity or entities as indicated in paragraphs D-11–D-12 of FASB Statement No. 141, *Business Combinations*. [Revised, June 2004, to reflect the conforming changes necessary due to the issuance of FASB Statement No. 141.~~*~~]~~

~~*FASB Statement No. 141 supersedes APB Opinion No. 16, *Business Combinations*.~~

b. Paragraph .16:

~~For limited liability companies formed by combining entities under common control or by conversion from another type of entity, the notes to~~

~~the financial statements for the year of formation should disclose that the assets and liabilities previously were held by a predecessor entity or entities. LLCs formed by combining entities under common control are required to make the disclosures in paragraph D-18 of FASB Statement No. 141. [Revised, June 2004, to reflect the conforming changes necessary due to the issuance of FASB Statement No. 141.[*]]~~

~~[*]FASB Statement No. 141 supersedes APB Opinion No. 16, *Business Combinations.*~~

F33. AICPA Audit and Accounting Guide, *Agricultural Producers and Agricultural Cooperatives,* is amended as follows:

a. Footnote * at the beginning of Chapter 10:

~~The effective dates of FASB Statements No. 141, *Business Combinations*, and No. 142, *Goodwill and Other Intangible Assets*, were deferred for combinations between two or more mutual enterprises (cooperatives are mutual enterprises) to allow the FASB time to consider whether there are any unique attributes of mutual enterprises to justify an accounting treatment different from that provided in those Statements. That means that mutual enterprises will continue to account for business combinations and acquired intangible assets following the guidance in APB Opinion No. 16, *Business Combinations*, and APB Opinion No. 17, *Intangible Assets*, until a final Statement on combinations of mutual enterprises is issued and effective.~~

~~In June 2005, the FASB, in a joint project with the IASB, issued an exposure draft of a proposed FASB Statement entitled, *Business Combinations—a replacement of FASB Statement No. 141.* This proposed Statement seeks to improve financial reporting by requiring the acquisition method be applied to more business combinations, including those involving only mutual entities and those achieved by contract alone. The FASB and the IASB (the Boards) believe that applying a single method of accounting to all business combinations will result in more comparable and transparent financial statements. The Boards expect that a final Statement on business combinations will be issued in the first half of 2007 (in conjunction with the issuance of a final standard on noncontrolling interests). The Boards will review the target effective date of those Statements near the end of redeliberations. More information on this project is available on the FASB Web site at www.fasb.org.~~

F34. AICPA Audit and Accounting Guide, *Depository and Lending Institutions: Banks and Savings Institutions, Credit Unions, Finance Companies and Mortgage Companies*, is amended as follows:

a. Paragraph 8.94:

Paragraph 4 of SOP 03-3 prohibits "carrying over" or creating valuation allowances in the initial accounting of all loans acquired in a transfer that are within the SOP's scope. The prohibition of the valuation allowance carryover applies to the purchase of an individual loan, a pool of loans, a group of loans, and loans acquired in a ~~purchase~~ business combination. Finally, new disclosures are required, in addition to those already required by other accounting literature, including FASB Statements No. 5, *Accounting for Contingencies*; No. 114; No. 115; and No. 118, *Accounting by Creditors for Impairment of a Loan—Income Recognition and Disclosures.* See the SOP for additional guidance pertaining to debt instruments within its scope not discussed here.

b. Paragraph 9.41:

SOP 03-3 prohibits "carrying over" or creation of valuation allowances in the initial accounting of all loans acquired in a transfer that are within the scope of the SOP. The prohibition of the valuation allowance carryover applies to the purchase of an individual loan, a pool of loans, a group of loans, and loans acquired in a ~~purchase~~ business combination. SOP 03-3 is effective for loans showing evidence of credit quality deterioration acquired in fiscal years beginning after December 15, 2004. Early adoption is encouraged. For problem loans acquired in fiscal years beginning on or before December 15, 2004, and within the scope of Practice Bulletin No. 6, paragraphs 7 and 8 of SOP 03-3, as they apply to decreases in cash flows expected to be collected, should be applied prospectively for fiscal years beginning after December 15, 2004. For additional discussion of SOP 03-3, see Chapter 8, "Loans."

c. Paragraph 12.06:

Identifiable intangible assets may be acquired individually, as part of a group of assets, or in a ~~purchase~~ business combination. They include, among others, core deposit intangibles (the value of long-term deposit relationships), and credit-card customer lists (the value of long-term credit-card relationships).

d. Paragraph 12.07:

~~Goodwill arises in a business combination. It represents the excess of the cost of an acquired entity over the net of the amounts assigned to assets acquired and liabilities assumed. The amount recognized as goodwill includes acquired intangible assets that do not meet the criteria in paragraph 39 of FASB Statement No. 141, *Business Combinations*, for recognition as assets apart from goodwill.~~

e. Paragraph 16.23:

~~*Carryover tax basis of assets and liabilities* in a transaction that is accounted for under the purchase method of accounting in accordance with FASB Statement No. 141, *Business Combinations*~~

f. Paragraph 17.62 and the heading preceding it:

~~**Regulatory Capital Disclosures for Business Combinations**~~

~~Paragraph 15(*d*) of SOP 01-6 states: "Following a business combination accounted for as a purchase, because prior capital position can be less relevant as a result of capital repatriation to former owners and the effects of purchase accounting adjustments and the push-down of basis, judgment should be used as to relevant disclosures. Minimum disclosures should include the capital position of the purchaser at the prior period end and information to highlight comparability issues, such as significant capital requirements imposed or agreed to during the regulatory approval process, and the effects of purchase accounting, if any, on regulatory capital determination."~~

g. Paragraphs 19.08–19.17 and the headings preceding them:

~~**Accounting and Financial Reporting**~~[2]

~~19.08 Accounting for business combinations involving financial institutions is similar to that for other enterprises.[‡] FASB Statement No. 141, *Business Combinations*, and FASB Statement No. 142, *Goodwill and Other Intangible Assets*, are the primary source of guidance, except for combinations of two or more mutual enterprises (e.g., the combination of two credit unions). For combinations between two or more mutual enterprises, FASB Statements No. 141 and No. 142 will not be effective until interpretive guidance related to the application of the purchase method to those transactions is issued. On June 30, 2005, the FASB issued an exposure draft, *Business Combinations—a replacement of FASB Statement No. 141*. This proposed statement would apply prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual period beginning on or after December 15, 2006. In addition to the above-mentioned pronouncements, various EITF Issues address accounting issues related to business combinations, including EITF Topic No. D-97, *Push Down Accounting*, EITF Issue No. 98-3, *Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or a Business Combination*, EITF Issue No. 04-1, *Accounting for Preexisting Relationships between Parties to a Business Combination*, and EITF Issue No. 05-6, *Determining the Amortization Period for Leasehold Improvements Purchased after Lease Inception or Acquired in a Business Combination*.~~

~~19.09 In accordance with FASB Statement No. 141, business combinations should be accounted for using the purchase method. An acquiring institution shall allocate the cost of an acquired institution to the assets acquired and liabilities assumed based on their estimated fair values at date of acquisition. Prior to that allocation, the acquiring institution~~

shall (*a*) review the purchase consideration if other than cash to ensure that it has been valued in accordance with the requirements in paragraphs 20–23 of FASB Statement No. 141 and (*b*) identify all of the assets acquired and liabilities assumed, including intangible assets that meet the recognition criteria in paragraph 39 of FASB Statement No. 141, regardless of whether they had been recorded in the financial statements of the acquired institution. The excess of the cost of an acquired institution over the net of the amounts assigned to assets acquired and liabilities assumed shall be recognized as an asset referred to as goodwill. An acquired intangible asset that does not meet the criteria in paragraph 39 of FASB Statement No. 141 shall be included in the amount recognized as goodwill.

19.10 For assets and liabilities acquired for which there is not an active market, determining fair values usually involves estimating cash flows and discounting those cash flows at prevailing market rates of interest. Demand deposits are valued at their face amount plus any accrued interest. FASB Statement No. 91 provides that purchases of loans or groups of loans should be recorded at their net cost, which includes the cost to the seller plus any fees paid less any fees received. The difference between this amount and the expected amounts to be received should be accounted for as an adjustment of yield over the life of the loan. SOP 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer*,[3] provides guidance as to the accounting and reporting by purchasers of certain loans for which it is not probable that the undiscounted future cash collections will be sufficient to recover the face amount of the loan and contractual interest. Paragraph 14 of FASB Statement No. 114, as amended, provides guidance as to the determination of the effective interest rate when loans are acquired at a discount because of a change in credit quality or rate, or both.

19.11 FASB Statement No. 142 addresses financial accounting and reporting for intangible assets acquired individually or with a group of other assets (but not those acquired in a business combination) at acquisition. The Statement also addresses financial accounting and reporting for goodwill and other intangible assets subsequent to their acquisition. See Chapter 12 for a discussion of the requirements of FASB Statement No. 142. FASB Statement No. 141, *Business Combinations*, addresses financial accounting and reporting for goodwill and other intangible assets acquired in a business combination at acquisition. After initial recognition, goodwill and other intangible assets acquired in a business combination shall be accounted for in accordance with the provisions of FASB Statement No. 142.

FASB Statement No. 72, *Accounting for Certain Acquisitions of Banking or Thrift Institutions*, as Amended

19.12 FASB Statement No. 72 applies only to acquisitions between two or more mutual enterprises that are financial institutions. Paragraph 4 of FASB Statement No. 72 states that, in a business combination accounted for by the purchase method, intangible assets acquired that can be separately identified should be assigned a portion of the total cost of the acquired enterprise if the fair values of those assets can be reliably determined. The fair values of such assets that relate to depositor or borrower relationships shall be based on the estimated benefits attributable to the relationships that exist at the date of acquisition without regard to new depositors or borrowers that may replace them. Those identified intangible assets shall be amortized over the estimated lives of those existing relationships. Identified intangible assets shall be reviewed for impairment in accordance with FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*.[4]

19.13 Paragraph 5 of FASB Statement No. 72, as amended, states that if, in such a

business combination, the fair value of liabilities assumed exceeds the fair value of tangible and identified intangible assets acquired, that excess constitutes an unidentifiable intangible asset. That asset shall be amortized to expense over a period no greater than the estimated remaining life of the long-term interest-bearing assets acquired. Amortization shall be at a constant rate when applied to the carrying amount of those interest-bearing assets that, based on their terms, are expected to be outstanding at the beginning of each subsequent period. The prepayment assumptions, if any, used to determine the fair value of the long-term interest-bearing assets acquired also shall be used in determining the amount of those assets expected to be outstanding. However, if the assets acquired in such a combination do not include a significant amount of long-term interest-bearing assets, the unidentifiable intangible asset shall be amortized over a period not exceeding the estimated average remaining life of the existing customer (deposit) base acquired. The periodic amounts of amortization shall be determined as of the acquisition date and shall not be subsequently adjusted except as provided by paragraph 6 of FASB Statement No. 72. Notwithstanding the other provisions of paragraph 5 of FASB Statement No. 72, as amended, the period of amortization shall not exceed 40 years.

19.14 Paragraph 6 of FASB Statement No. 72, as amended, states that paragraph 14 of FASB Statement No. 142 specifies that an entity should evaluate the remaining useful life of an intangible asset that is being amortized each reporting period to determine whether events and circumstances warrant a revision to the remaining period of amortization. In no event, however, shall the useful life of the unidentifiable intangible asset described in paragraph 5 of FASB Statement No. 72, as amended, be revised upward.

Impairment and Disposal Accounting for Certain Acquired Long-Term Customer-Relationship Intangible Assets

19.15 Paragraph 6 of FASB Statement No. 147, *Acquisitions of Certain Financial Institutions*, states that the provisions of FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, apply to long-term customer-relationship intangible assets, except for servicing assets, recognized in the acquisition of a financial institution. Examples of long-term customer-relationship intangible assets include depositor- and borrower-relationship intangible assets, credit cardholder intangible assets, and servicing assets. Servicing assets, however, are tested for impairment under FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*.[5]

Branch Acquisitions

19.16 Depository institutions may acquire branch office locations. Such transactions typically involve the assumption of deposit liabilities by the acquiring institution in exchange for the receipt of a lesser amount of cash, or other assets, such as loans. In accordance with paragraph 5 of FASB Statement No. 147, the acquisition of all or part of a financial institution that meets the definition of a business combination shall be accounted for by the purchase method in accordance with FASB Statement No. 141.

19.17 Refer to FASB Statement No. 147, paragraph 9, to determine if the acquisition is not a business combination. If the transferred net assets and activities do not constitute a business combination,[6] that transaction shall be accounted for in accordance with paragraphs 4–8 of FASB Statement No. 141. As discussed in paragraph 9 of FASB Statement No. 142, such transactions do not give rise to goodwill.

[5]FASB Statement No. 147, except for transactions between two or more mutual enterprises, removed acquisitions of financial

~~institutions from the scope of both FASB Statement No. 72 and FASB Interpretation No. 9.~~

~~[†]The FASB has an ongoing project to develop guidance on the accounting for combinations between two or more mutual enterprises. Currently this project is under redeliberation by FASB. Readers should monitor the FASB Website for updates on this project.~~

~~[3]The AICPA has recently issued a Technical Practice Aid, *Application of SOP 03-3*, Accounting for Certain Loans or Debt Securities Acquired in a Transfer, *to Debt Securities*. For additional information visit the AICPA Web site.~~

~~[4]The staff of the FASB issued FASB Staff Position (FSP) FAS 144-1, *Determination of Cost Basis for Foreclosed Assets under FASB Statement No. 15*, Accounting by Debtors and Creditors for Troubled Debt Restructurings, *and the Measurement of Cumulative Losses Previously Recognized under Paragraph 37 of FASB Statement No. 144*, Accounting for the Impairment or Disposal of Long-Lived Assets. This FSP was effective immediately. If applying this FSP results in changes to previously reported information, the cumulative effect of the accounting change should be reported as of the beginning of the first period ending after November 11, 2003. The requirements of this FSP may be applied by restating previously issued financial statements for one or more years with a cumulative-effect adjustment as of the beginning of the first year restated.~~

~~[5]See footnote 1 in paragraph 19.04.~~

~~[6]EITF Issue No. 98-3, *Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or a Business Combination*, provides guidance on determining whether an asset group constitutes a business.~~

F35. AICPA Audit Guide, *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities*, is amended as follows:

a. Exhibit 3-1:

Exhibit 3-1
Derivatives Excluded From FASB Statement No. 133

- "Regular-way" security trades
- Normal purchases and normal sales
- Certain insurance contracts, generally those within the scope of FASB Statements No. 60, *Accounting and Reporting by Insurance Enterprises*; No. 97, *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments*; and No. 113, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts*
- Certain financial guarantee contracts
- Certain contracts that are not traded on an exchange, generally those that are based on nonfinancial assets that are not readily convertible to cash
- Derivatives that serve as impediments to sales accounting
- Investments in life insurance, generally those accounted for under FASB Technical Bulletin No. 85-4, *Accounting for Purchases of Life Insurance*
- Certain investment contracts, generally those accounted for under paragraph 4 of FASB Statement No. 110, *Reporting by Defined Benefit Pension Plans of Investment Contracts*, paragraph 12 of FASB Statement No. 35, *Accounting and Reporting by Defined Benefit Pension Plans*, as amended by FASB Statement No. 110, or paragraphs 4 and 5 of AICPA SOP 94-4, *Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined-Contribution Pension Plans*
- Certain loan commitments
- Contracts issued or held by the entity that are both indexed to its own stock* and classified as equity
- Contracts issued by the entity that are subject to FASB Statement No. 123 (revised 2004), *Share Based Payment* (while they are within the scope of that FASB Statement)
- Contracts between an acquirer and a seller in a business combination to buy or sell a business at a future date~~Contracts issued by the entity as contingent consideration from a business combination.[‡] In applying this exclusion, the issuer is considered to be the entity that is accounting for the combination using the purchase method~~
- Forward contracts that require settlement by the reporting entity's delivery of cash in exchange for the acquisition of a fixed number of its equity shares (forward purchase contracts for the reporting entity's shares that require physical settlement) that are accounted for under paragraphs 21 and 22 of FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*

*Refer to FASB Statement No. 150, EITF Issues No. 00-4, "Majority Owner's Accounting for a Transaction in the Shares of a Consolidated Subsidiary and a Derivative Indexed to the Minority Interest in that Subsidiary," No. 00-6, "Accounting for Freestanding Derivative Financial Instruments Indexed to, and Potentially settled in, the Stock of a Consolidated Subsidiary," No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock," and No. 01-6, "The Meaning of 'Indexed to a Company's Own Stock,'" for additional guidance.

~~[‡]The accounting for contingent consideration issued in a business combination is addressed in FASB Statement No. 141, *Business Combinations*.~~

F36. AICPA Audit and Accounting Guide, *Entities With Oil and Gas Producing Activities*, is amended as follows:

a. Paragraphs 1.70–1.74:

~~1.70 The FASB staff issued FSP FAS 142-2,[**] *Application of FASB Statement No. 142*, Goodwill and Other Intangible Assets, *to Oil and Gas Companies*. The purpose of this FSP is to address whether oil and gas drilling rights (mineral interests) that are held under lease or other contractual arrangement are intangible assets subject to the disclosure and classification provisions of FASB Statement No. 142. The FASB staff acknowledges that the accounting framework in FASB Statement No. 19 for oil- and gas-producing entities is based on the level of established reserves—not whether an asset is tangible or intangible. Accordingly, the FASB staff believes that the scope exception in paragraph 8(b) of FASB Statement No. 142 extends to its disclosure provisions for drilling and mineral rights of oil- and gas-producing entities. However, an entity is not precluded from providing information about its drilling and mineral rights in addition to the information required by FASB Statement No. 69, *Disclosures about Oil and Gas Producing Activities*.~~

~~Business Combinations~~

~~1.71 FASB Statement No. 141, *Business Combinations*, addresses financial accounting and reporting for business combinations and supersedes APB Opinion No. 16, *Business Combinations*, and FASB Statement No. 38, *Accounting for Preacquisition Contingencies of Purchased Enterprises*. All business combinations in the scope of the Statement are to be accounted for using one method, the purchase method.~~

~~1.72 The Statement requires that intangible assets be recognized as assets apart from goodwill if they meet one of two criteria, the contractual-legal criterion or the separability criterion. To assist in identifying acquired intangible assets, the Statement also provides an illustrative list of intangible assets that meet either of those criteria.~~

~~1.73 FASB Statement No. 141 requires numerous disclosures including disclosure of the primary reasons for a business combination and the allocation of the purchase price paid to the assets acquired and liabilities assumed by major balance sheet caption. When the amounts of goodwill and intangible assets acquired are significant in relation to the purchase price paid, disclosure of other information about those assets is required, such as the amount of goodwill by reportable segment and the amount of the purchase price assigned to each major intangible asset class.~~

~~1.74 FASB Statement No. 141 contains extensive accounting guidance and requirements about business combinations including the application of the purchase method and accounting for goodwill and other intangible assets acquired.~~

~~[**] On April 30, 2004, the FASB issued FASB Staff Position (FSP) No. 141-1 and 142-1, *Interaction of FASB Statements No. 141*, Business Combinations, *and No. 142*, Goodwill and Other Intangible Assets, and EITF Issue No. 04-2, "Whether Mineral Rights Are Tangible or Intangible Assets." The FSP clarifies some inconsistent language between FASB Statements No. 141 and No. 142 and states that mineral rights should be accounted for consistent with their substance.~~

b. The glossary:

goodwill. An asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized ~~The excess of the cost of an acquired entity over the net of the amounts assigned to assets acquired and liabilities assumed~~. The amount recognized as goodwill includes acquired intangible assets that do not meet the criteria in FASB Statement No. 141 (revised 2007), *Business Combinations*, for recognition as an asset apart from goodwill.

F37. AICPA Audit and Accounting Guide, *Federal Government Contractors,* is amended as follows:

a. Paragraph 3.100:

~~Government contract clauses are in many cases very different from those found in the commercial marketplace. Accordingly, contractors~~

~~should carefully evaluate their government contracts and legal rights arising from those contracts when identifying intangible assets under the purchase method of accounting. Paragraph 39 of FASB Statement No. 141, *Business Combinations*, requires intangible assets acquired in a business combination to be recognized apart from goodwill if the intangible asset *(a)* arises from a contractual or other legal right or *(b)* is separable, that is, is capable of being separated or divided from the acquired entity and sold, transferred, licensed, rented or exchanged. Appendix A to FASB Statement No. 141 provides additional guidance relating to the recognition of acquired intangible assets apart from goodwill. Accounting for intangible assets upon acquisition when the intangibles are acquired individually or with a group of other assets (but not those intangibles acquired in a business combination) follows guidance in FASB Statement No. 142, *Goodwill and Other Intangible Assets.*[7] FASB Statement No. 142 indicates that goodwill and intangible assets that have indefinite useful lives will not be amortized but, rather, will be tested at least annually for impairment. Intangible assets with finite useful lives will continue to be amortized over their useful lives, but without the constraint of an arbitrary useful life "ceiling."~~

~~[7]Paragraph 11 of FASB Statement No. 142 has been amended by FSP FAS 141-1 and FAS 142-1, *Interaction of FASB Statements No. 141*, Business Combinations, *and No. 142*, Goodwill and Other Intangible Assets, *and EITF Issue No. 04-2*, "Whether Mineral Rights Are Tangible or Intangible Assets."~~

F38. AICPA Audit and Accounting Guide, *Investment Companies,* is amended as follows:

a. Paragraph 8.32:

~~Investment companies usually combine in tax-free reorganizations. In such reorganizations, shares of one company are exchanged for substantially all the shares or assets of another company. The primary purpose of such combinations is to reduce operating costs and improve performance by spreading certain fixed costs over a larger asset base. The composition of the acquired investment company's portfolio is usually less important to the acquiror than the overall size of the acquired pool of assets. Following a combination, portfolios of investment companies are often realigned, subject to tax limitations, to fit the objectives, strategies, and goals of the surviving company. Adjusting the carrying amounts of assets and liabilities or determining exchange formulas is usually unnecessary, because a significant portion of the net assets of investment companies (that is, investments) are stated at fair value and liabilities are generally short-term. However, adjustments may be necessary in certain circumstances when funds have different valuation policies (for example, valuing securities at the bid price versus the mean of the bid and asked price).~~

b. Paragraphs 8.36–8.38:

~~8.36 Merger-related expenses (mainly legal, audit, proxy solicitation, and mailing costs) are addressed in the plan of reorganization and are generally paid by the fund incurring the expense, although the adviser may waive or reimburse certain merger-related expenses, subject to SEC limits. Such costs are charged to expense currently. There are numerous factors and circumstances to consider in determining which entity bears merger-related expenses. For example, the target fund might bear the expenses when merging is an alternative to liquidating the fund. An acquiring fund might bear the expenses when its goal is the growth of its assets by acquiring the target fund.~~

~~8.37 Tax-free business combinations of investment companies are accounted for by a method that closely approximates the accounting followed for tax purposes. Companies combined in a nontaxable exchange of shares should carry forward the historical cost basis of investment securities to the surviving entity. The amount of unrealized appreciation or depreciation and the amount of undistributed investment company income of the acquired fund at the date of acquisition, if significant, should be disclosed separately to report meaningful information about the fund's performance. The acquired fund's portfolio should be monitored, as substantial turnover of the acquired fund's portfolio securities may jeopardize the tax-free status of the reorganization. If the carrying value of the acquired investment company's liabilities differs materially from~~

~~their fair value on the acquisition date, refer to FASB Statement No. 141, *Business Combinations*, for guidance on recognition of the liabilities by the surviving entity.~~

~~8.38 The costs of purchases and proceeds from sales of portfolio securities that occurred in the effort to realign the fund's portfolio should be excluded in the portfolio turnover calculation. The amount of excluded purchases and sales should be disclosed in a note. (See Form N-1A, Item 8, Instruction 4(d)(iii).)~~

c. Paragraph 8.40:

~~Disclosures for all business combinations should include a summary of the essential elements of the combination, that is, the effective date, the number and fair value of shares issued by the surviving company, the exchange ratio, the tax status, and tax attributes. The separate and combined aggregate net assets should be presented as of the date of combination. (See Appendix E, "Illustrative Financial Statement Presentation for Tax-Free Business Combinations of Investment Companies.")~~

d. Appendix E, "Illustrative Financial Statement Presentation for Tax-Free Business Combinations of Investment Companies," is deleted.

F39. AICPA Audit and Accounting Guide, *Life and Health Insurance Entities,* is amended as follows:

a. Paragraph 11.74:

Paragraph 4 of SOP 03-3 prohibits "carrying over" or creating valuation allowances in the initial accounting of all loans acquired in a transfer that are within the SOP's scope. The prohibition of the valuation allowance carryover applies to the purchase of an individual loan, a pool of loans, a group of loans, and loans acquired in a ~~purchase~~ business combination. Finally, new disclosures are required, in addition to those already required by other accounting literature, including FASB Statements No. 5, No. 114, No. 115 and No. 118. See the SOP for additional guidance pertaining to debt instruments within its scope not discussed here.

b. Exhibit 12-2:

~~**Exhibit 12-2**~~

~~**FASB Staff Announcements Regarding Accounting by the Purchaser for a Seller's Guarantee of the Adequacy of Liabilities For Losses and Loss Adjustment Expenses of an Insurance Enterprise Acquired in a Purchase Business Combination**[1]~~

~~**November 14, 1996**~~

~~On November 14, 1996, a FASB representative made the following announcement at the EITF meeting.~~

~~The Insurance Companies Committee of the AICPA has notified the FASB staff that questions have been raised regarding whether FASB Statement No. 113, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts*, or APB Opinion No. 16, *Business Combinations*, should be applied to guarantees of the adequacy of liabilities existing at the acquisition date of a business combination, whether or not they are identified, for losses and loss adjustment expenses of short-duration insurance or reinsurance contracts of insurance enterprises (reserve guarantees) when the insurance enterprise is acquired in a business combination accounted for as a purchase. It appears that certain provisions of Statement 113 and Opinion 16 conflict with regard to accounting for those reserve guarantees.~~

~~Reserve guarantees may be provided by a seller to indemnify a purchaser for unanticipated increases in the liabilities for losses and loss adjustment expenses of the subject insurance enterprise. They are most often provided with regard to liabilities for losses and loss adjustment expenses for coverages with long payout periods (long-tail coverages) for which the ultimate liability and/or the timing of the payout is difficult to estimate (for example, liabilities for losses and loss adjustment expenses relating to environmental and asbestos exposures). The selling and purchasing enterprises may, or may not, be insurance enterprises, and similar guarantees are provided in a business combination accounted for as a purchase that does not involve an insurance enterprise.~~

~~The scope of this announcement is limited to the accounting by a purchaser for reserve guarantees relating to the adequacy of liabilities existing at the acquisition date of a business combination, whether or not they are identified, for short-duration insurance contracts of an insurance enterprise when provided by a seller in a business combination accounted for as a purchase in accordance with the provisions of Opinion 16. This announcement should not be applied to a business combination accounted for as a pooling of interests or to other transactions that are not within the scope of Opinion 16, such as spin-offs or initial public offerings.~~

~~The FASB staff believes that a purchaser, when accounting for reserve guarantees provided by a selling enterprise in a business combination accounted for as a purchase under the provisions of Opinion 16, should *not* apply paragraphs 22–24 of Statement 113, which address retroactive reinsurance arrangements. Reserve guarantees may be, and often are, provided between enterprises that are not insurance enterprises. The staff does not view reserve guarantees as being different from other guarantees of the existence of assets or the adequacy of liabilities often provided by the seller in a business combination accounted for as a purchase. The staff therefore believes that guarantees should be accounted for consistently regardless of whether or not the seller or purchaser is an insurance enterprise.~~

~~The FASB staff believes that changes in the liabilities for losses and loss adjustment expenses of the purchaser resulting from the continuous review process and the differences between estimates and payments for claims should be recognized in income by the purchaser in the period in which estimates are changed or payments are made in accordance with FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises*; this includes those liabilities acquired in a business combination and subject to the reserve guarantee. The purchaser should at the same time recognize a receivable for the amount due from the seller under the reserve guarantee, subject to management's assessment of the collectibility of that amount, with a corresponding credit to income. Changes in the balance of the receivable that occur subsequent to recording the business combination should be included in income in the period that the estimates are changed (or payments are received, if resulting from differences between estimates and payments) and should not affect the acquiring enterprise's accounting for the business combination.~~

~~The Task Force observed that this announcement should be applied either as a change in accounting principle in accordance with APB Opinion No. 20, *Accounting Changes*, or prospectively to new business combinations entered into after November 14, 1996.~~

~~The SEC Observer noted that the SEC staff believes it is preferable to present the effects of the loss guarantee on a gross rather than net basis. The SEC Observer noted that any receivable from the seller should not be netted against the related liability in the balance sheet or in supporting information such as footnotes or SEC Industry Guide 6 disclosures. The SEC Observer also expressed a preference that (a) any expense associated with increased reserves be reported as a component of other claim losses and loss adjustment expenses, and (b) other claim losses and loss adjustment expenses not be reduced by the effect of the reserve guarantee.~~

~~However, after discussion of these preferences with the Task Force, the SEC staff indicated that it would not object to claim losses and loss adjustment expenses being reported net of the effect of the reserve guarantee in the income statement. A net presentation is appropriate only if the effects of the reserve guarantee are disclosed separately in the notes to the financial statements, in the SEC Industry Guide 6 disclosures including the reconciliation of claims reserves, and in the loss ratio information. In addition, the SEC staff believes the effects of such an arrangement on operations and cash flows should be clearly disclosed in management's discussion and analysis.~~

~~November 20, 1997~~

~~On November 20, 1997, a FASB representative made the following announcement at the EITF meeting:~~

~~A FASB representative announced that the FASB staff has received questions about whether *EITF Abstracts*, Topic No. D-54, *"Accounting by the Purchaser for a Sellers Guarantee of the Adequacy of Liabilities for Losses and*~~

~~*Loss Adjustment Expenses of an Insurance Enterprise Acquired in a Purchase Business Combination*,"~~ applies to the purchasers accounting for an arrangement in which the seller obtains reinsurance from a *third-party* reinsurer who agrees to directly indemnify the *purchaser* for increases in the liabilities for losses and loss adjustment expenses that existed at the acquisition date of a purchase business combination. The staff believes that the applicability of Topic D-54 to that and other arrangements that have circumstances that are similar to, but not the same as, the circumstances addressed in Topic D-54 should be determined based upon the specific facts and circumstances.[2] In order for the purchaser to apply the provisions of Topic D-54:

1. The seller must agree to participate in increases in the liabilities for losses and loss adjustment expenses that existed at the acquisition date of the purchase business combination. The seller may agree to indemnify the purchaser without remaining directly obligated for increases in the liabilities (for example, by funding its obligation through a reinsurance arrangement).
2. The guarantee arrangement between the purchaser and the seller must be contemporaneous with, and contingent on, the purchase business combination. The specific facts and circumstances should be considered in determining whether the guarantee arrangement is contemporaneous with the purchase business combination. The staff observes that to be contemporaneous, the guarantee arrangement should commit to *all* significant terms simultaneous with the consummation date of the purchase business combination. The absence of agreement on the significant terms, or the intention to establish or amend those terms at a later date, would result in the application of the provisions of FASB Statement No. 113, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts*, to that guarantee arrangement. The fact that the purchaser is at risk for the subject increases in the liabilities for losses and loss adjustment expenses for any period after the effective date of the purchase business combination would indicate that the guarantee arrangement was not contemporaneous with that combination.

Illustrations

Following are explanations of how the above factors would be applied to illustrative guarantee arrangements between the seller and the purchaser, or between the seller, the purchaser, and one or more third parties:

1. Topic D-54 applies to a guarantee arrangement that is entered into contemporaneously with a purchase business combination in which the seller obtains a third-party indemnification (for example, a reinsurance arrangement) to reimburse the purchaser directly for unexpected increases in the liabilities for losses and loss adjustment expenses. However, the purchaser should apply the provisions of Statement 113 to an arrangement entered into directly by the purchaser with a third-party reinsurer because such an arrangement cannot be viewed as being contingent on the purchase business combination and because the seller has not participated in the arrangement.
2. The purchaser should apply Statement 113 to a guarantee arrangement that the seller and the purchaser enter into after the purchase business combination (regardless of whether the guarantee arrangement is in the form of a reinsurance arrangement) because that guarantee arrangement would not be contemporaneous with the purchase business combination.

Observation Related to Sellers Accounting

The staff also observes that the *selling* enterprise should apply the provisions of Statement 113 (assuming that the seller is an insurance enterprise to which the provisions of Statement 113 apply) to a reinsurance arrangement that it enters into before or after a purchase business combination, even if the *purchaser* is identified as the direct beneficiary of that reinsurance arrangement.

Business Combinations

Statement 141, which supersedes Opinion 16, was issued in June 2001. Statement 141 prohibits the use of the pooling-of-interests method for all business combinations initiated after June 30, 2001.

[1] This Exhibit is taken from the FASB EITF Abstracts. FASB Statement No. 141, *Business Combinations*, as amended, addresses financial accounting and reporting for business combinations and supersedes APB Opinion No. 16. FASB Statement No. 141 prohibits the use of the pooling-of-interests method. The provisions of FASB Statement No. 141 apply to all business combinations initiated after June 30, 2001. FASB Statement No. 141 also applies to all business combinations accounted for using the purchase method for which the date of acquisition is July 1, 2001, or later. FASB Statement No. 141 does not apply, however, to combinations of two or more mutual enterprises. The FASB had a project addressing the combinations of two or more mutual enterprises which is now included in an exposure draft titled *Business Combinations—A Replacement of FASB Statement No. 141*. All insurance companies, including mutual insurance companies, will fall under the scope of the exposure draft. Readers should remain alert to a final pronouncement, due out in the first half of 2007.

[2] This announcement is combined with Topic D-54 in *EITF Abstracts.*

F40. AICPA Audit and Accounting Guide, *Property and Liability Insurance Companies,* is amended as follows:

a. Footnote ## to Table 1-1 in paragraph 1.84:

> The FASB has issued two exposure drafts related to business combinations: *Business Combinations—a Replacement of FASB Statement No. 141*, and *Consolidated Financial Statements, Including Accounting and Reporting of Noncontrolling Interests in Subsidiaries—a replacement of ARB No. 51.* Readers should remain alert to final pronouncements.

b. Paragraph 5.42:

> Paragraph 4 of SOP 03-3 prohibits "carrying over" or creating valuation allowances in the initial accounting of all loans acquired in a transfer that are within the SOP's scope. The prohibition of the valuation allowance carryover applies to the purchase of an individual loan, a pool of loans, a group of loans, and loans acquired in a purchase business combination. Finally, new disclosures are required, in addition to those already required by other accounting literature, including FASB Statements No. 5, No. 114, No. 115 and No. 118. See the SOP for additional guidance pertaining to debt instruments within its scope not discussed here.

c. Exhibit 6-1:

> **Exhibit 6-1**
>
> **Topic D-54, *EITF Abstracts,* FASB Staff Announcements Regarding Accounting by the Purchaser for a Seller's Guarantee of the Adequacy of Liabilities for Losses and Loss Adjustment Expenses of an Insurance Enterprise Acquired in a Purchase Business Combination**[1]
>
> On ***November 14, 1996,*** a FASB representative made the following announcement at the EITF meeting:
>
> > The Insurance Companies Committee of the AICPA has notified the FASB staff that questions have been raised regarding whether FASB Statement No. 113, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts*, or APB Opinion No. 16, *Business Combinations*, should be applied to guarantees of the adequacy of liabilities existing at the acquisition date of a business combination, whether or not they are identified, for losses and loss adjustment expenses of short-duration insurance or reinsurance contracts of insurance enterprises (reserve guarantees) when the insurance enterprise is acquired in a business combination accounted for as a purchase. It appears that certain provisions of Statement 113 and Opinion 16 conflict with regard to accounting for those reserve guarantees.
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> > Reserve guarantees may be provided by a seller to indemnify a purchaser for unanticipated increases in the liabilities for losses and loss adjustment expenses of the subject insurance enterprise. They are most often provided with regard to liabilities for losses and loss adjustment expenses for coverages with long payout periods (long-tail coverages) for which the ultimate liability and/or the timing of the payout is difficult to estimate (for example, liabilities for losses and loss adjustment expenses relating to environmental and asbestos exposures). The selling and purchasing enterprises may, or may not, be insurance enterprises, and similar guarantees are provided in a business combination accounted for as a purchase that does not involve an insurance enterprise.
> >
> > The scope of this announcement is limited to the accounting by a purchaser for reserve guarantees relating to the adequacy of liabilities existing at the acquisition date of a

business combination, whether or not they are identified, for short-duration insurance contracts of an insurance enterprise when provided by a seller in a business combination accounted for as a purchase in accordance with the provisions of Opinion 16. This announcement should not be applied to a business combination accounted for as a pooling of interests or to other transactions that are not within the scope of Opinion 16, such as spin-offs or initial public offerings.

The FASB staff believes that a purchaser, when accounting for reserve guarantees provided by a selling enterprise in a business combination accounted for as a purchase under the provisions of Opinion 16, should *not* apply paragraphs 22–24 of Statement 113, which address retroactive reinsurance arrangements. Reserve guarantees may be, and often are, provided between enterprises that are not insurance enterprises. The staff does not view reserve guarantees as being different from other guarantees of the existence of assets or the adequacy of liabilities often provided by the seller in a business combination accounted for as a purchase. The staff therefore believes that guarantees should be accounted for consistently regardless of whether or not the seller or purchaser is an insurance enterprise.

The FASB staff believes that changes in the liabilities for losses and loss adjustment expenses of the purchaser resulting from the continuous review process and the differences between estimates and payments for claims should be recognized in income by the purchaser in the period in which estimates are changed or payments are made in accordance with FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises*; this includes those liabilities acquired in a business combination and subject to the reserve guarantee. The purchaser should at the same time recognize a receivable for the amount due from the seller under the reserve guarantee, subject to management's assessment of the collectibility of that amount, with a corresponding credit to income. Changes in the balance of the receivable that occur subsequent to recording the business combination should be included in income in the period that the estimates are changed (or payments are received, if resulting from differences between estimates and payments) and should not affect the acquiring enterprise's accounting for the business combination.

The Task Force observed that this announcement should be applied either as a change in accounting principle in accordance with APB Opinion No. 20, *Accounting Changes*, or prospectively to new business combinations entered into after November 14, 1996.

The SEC Observer noted that the SEC staff believes it is preferable to present the effects of the loss guarantee on a gross rather than net basis. The SEC Observer noted that any receivable from the seller should not be netted against the related liability in the balance sheet or in supporting information such as footnotes or SEC Industry Guide 6 disclosures. The SEC Observer also expressed a preference that (1) any expense associated with increased reserves be reported as a component of other claim losses and loss adjustment expenses, and (2) other claim losses and loss adjustment expenses not be reduced by the effect of the reserve guarantee.

However, after discussion of these preferences with the Task Force, the SEC staff indicated that it would not object to claim losses and loss adjustment expenses being reported net of the effect of the reserve guarantee in the income statement. A net presentation is appropriate only if the effects of the reserve guarantee are disclosed separately in the notes to the financial statements, in the SEC Industry Guide 6 disclosures including the reconciliation of claims reserves, and in the loss ratio information. In addition, the SEC staff believes the effects of such an arrangement on operations and cash flows should be clearly disclosed in management's discussion and analysis.

At the ***November 20, 1997*** meeting, FASB representatives announced that the FASB staff has received questions about whether *EITF Abstracts*, Topic No. D-54, *Accounting by the Purchaser for a Seller's Guarantee of the Adequacy of Liabilities for Losses and Loss Adjustment Expenses of an Insurance Enterprise Acquired in a Purchase*

Business Combination, applies to the purchaser's accounting for an arrangement in which the *seller* obtains reinsurance from a *third-party* reinsurer who agrees to directly indemnify the *purchaser* for increases in the liabilities for losses and loss adjustment expenses that existed at the acquisition date of a purchase business combination. The staff believes that the applicability of Topic D-54 to that and other arrangements that have circumstances that are similar to, but not the same as, the circumstances addressed in Topic D-54 should be determined based upon the specific facts and circumstances.[2] In order for the purchaser to apply the provisions of Topic D-54:

1. The seller must agree to participate in increases in the liabilities for losses and loss adjustment expenses that existed at the acquisition date of the purchase business combination. The seller may agree to indemnify the purchaser without remaining directly obligated for increases in the liabilities (for example, by funding its obligation through a reinsurance arrangement).
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1. Topic D-54 applies to a guarantee arrangement that is entered into contemporaneously with a purchase business combination in which the seller obtains a third-party indemnification (for example, a reinsurance arrangement) to reimburse the purchaser directly for unexpected increases in the liabilities for losses and loss adjustment expenses. However, the purchaser should apply the provisions of Statement 113 to an arrangement entered into directly by the purchaser with a third-party reinsurer because such an arrangement cannot be viewed as being contingent on the purchase business combination and because the seller has not participated in the arrangement.
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Observation Related to Seller's Accounting

The staff also observes that the *selling* enterprise should apply the provisions of Statement 113 (assuming that the seller is an insurance enterprise to which the provisions of Statement 113 apply) to a reinsurance arrangement that it enters into before or after a purchase business combination, even if the *purchaser* is identified as the direct beneficiary of that reinsurance arrangement.

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Statement 141, which supersedes Opinion 16, was issued in June 2001. Statement 141 prohibits the use of the pooling-of-interest method for all business combinations initiated after June 30, 2001.

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[1]This Exhibit is taken from the FASB EITF Abstracts. FASB Statement No. 141, *Business Combinations*, as amended, addresses financial accounting and reporting for business combinations and supersedes APB Opinion No. 16. FASB Statement No. 141 prohibits the use of the pooling-of-interests method. The provisions of FASB Statement No. 141 apply to all business combinations initiated after June 30, 2001. FASB Statement No. 141 also applies to all business combinations accounted for using the purchase method for which the date of acquisition is July 1, 2001, or later. FASB Statement No. 141 does not apply, however, to combinations of two or more mutual enterprises. The FASB currently has a project on the agenda addressing the combinations of two or more mutual enterprises. The FASB had a project addressing the combinations of two or more mutual enterprises which is now included in a larger project titled *Business Combinations: Purchase Methods Procedures*, for which the Board expects to issue an exposure draft in the second quarter of 2005. All insurance companies, including mutual insurance companies, will fall under the scope of the project. Readers should remain alert to final pronouncements.

[2]This announcement is combined with Topic D-54 in *EITF Abstracts*.

Appendix G

DIFFERENCES BETWEEN FASB STATEMENT NO. 141 (REVISED 2007), *BUSINESS COMBINATIONS,* AND IFRS 3, *BUSINESS COMBINATIONS* (AS REVISED IN 2007)

Introduction

G1. This Statement and the revised IFRS 3 are the result of the FASB's and the IASB's projects to improve the accounting for and reporting of business combinations. The first phase of those projects led to FASB Statement No. 141, *Business Combinations,* and IFRS 3, *Business Combinations.* In 2002, the FASB and the IASB agreed to jointly reconsider their guidance for applying the purchase method (now called the acquisition method) of accounting for business combinations. The objective of the joint effort was to develop a common and comprehensive standard for the accounting for business combinations that could be used for both domestic and international financial reporting. Although the Boards reached the same conclusions on most of the issues addressed in the project, they reached different conclusions on a few matters.

G2. On those matters on which the Boards reached different conclusions, each Board includes its own requirements in its version of the standard. This appendix identifies and compares those paragraphs in which the FASB and the IASB have different requirements. This appendix does not identify nonsubstantive differences. For example, this appendix does not identify differences in terminology that do not change the meaning of the guidance such as the FASB using the term *earnings* and the IASB using the term *profit or loss.*

G3. Most of the differences identified in this appendix arise because of the Boards' decision to provide guidance for accounting for business combinations that is consistent with other existing FASB standards or IASB IFRSs. Many of those differences are being considered in current projects or are candidates for future convergence projects, which is why the Boards allowed those differences to continue at this time.

Guidance	Statement 141(R)	IFRS 3 (as revised in 2007)
Scope exception for not-for-profit organizations	Statement 141(R) does not apply to combinations between not-for-profit organizations or the acquisition of a for-profit business by a not-for-profit organization. The FASB is developing guidance for the accounting for mergers and acquisitions by not-for-profit organizations in a separate project. [paragraph 2(d)]	IFRSs generally do not have scope limitations for not-for-profit activities in the private or public sector. Therefore, this scope exception is not necessary for the revised IFRS 3.
Definition of acquirer and identifying the acquirer	The guidance on *controlling financial interest* in ARB No. 51, *Consolidated Financial Statements,* as amended, is used to identify the acquirer, unless the acquirer is the primary beneficiary of a variable interest entity. The primary beneficiary of a variable interest entity always is the acquirer and the determination of which party is the primary beneficiary is made in accordance with FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities,* not based on the guidance in ARB 51 or paragraphs A11–A15. [paragraphs 3(b) and 9]	The guidance on control in IAS 27, *Consolidated and Separate Financial Statements,* is used to identify the acquirer. The revised IFRS 3 does not have guidance for primary beneficiaries because it does not have consolidation guidance equivalent to Interpretation 46(R). [Appendix A and paragraph 7]

Definition of control	*Control* has the meaning of *controlling financial interest* in paragraph 2 of ARB 51, as amended, and interpreted by Interpretation 46(R). [paragraph 3(g)]	*Control* is defined as the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. [Appendix A]
Definition of fair value	*Fair value* is defined in paragraph 5 of FASB Statement No. 157, *Fair Value Measurements,* as 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. [paragraph 3(i)]	*Fair value* is defined as the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's-length transaction. The IASB has a separate project in which it is considering the definition of fair value and related measurement guidance. [Appendix A]
Operating leases	Regardless of whether the acquiree is the lessee or the lessor, Statement 141(R) requires the acquirer to recognize an intangible asset if the terms of an operating lease are favorable relative to market terms or a liability if the terms are unfavorable relative to market terms. Accordingly, an acquirer measures the acquisition-date fair value of an asset that is subject to an operating lease in which the acquiree is the lessor separately from the lease contract. [paragraphs A17 and A58]	The revised IFRS 3 requires the acquirer to take into account the terms of a lease in measuring the acquisition-date fair value of an asset that is subject to an operating lease in which the acquiree is the lessor. This is consistent with the guidance in IAS 40, *Investment Property.* Accordingly, the revised IFRS 3 does not require the acquirer of an operating lease in which the acquiree is the lessor to recognize a separate asset or liability if the terms of an operating lease are favorable or unfavorable compared to market terms as is required for leases in which the acquiree is the lessee. [paragraphs B29 and B42]

Guidance	Statement 141(R)	IFRS 3 (as revised in 2007)
Noncontrolling interest in an acquiree	**Initial Recognition** Statement 141(R) requires the noncontrolling interest in an acquiree to be measured at fair value. [paragraph 20]	**Initial Recognition** The revised IFRS 3 permits an acquirer to measure the noncontrolling interest in an acquiree either at fair value or as its proportionate share of the acquiree's identifiable net assets. [paragraph 19]
	Disclosures Statement 141(R) requires an acquirer to disclose the valuation technique(s) and significant inputs used to measure fair value. [paragraph 68(p)]	**Disclosures** Because an acquirer is permitted to choose between two measurement bases for the noncontrolling interest in an acquiree, the revised IFRS 3 requires an acquirer to disclose the measurement basis used. If the noncontrolling interest is measured at fair value, the acquirer must disclose the valuation techniques and key model inputs used. [paragraph B64(o)]

Assets and liabilities arising from contingencies	**Initial Recognition** Statement 141(R) requires the acquirer to recognize as of the acquisition date assets acquired and liabilities assumed that arise from *contingencies* at their acquisition-date fair values if their acquisition-date fair values can be determined during the measurement period. If the acquisition-date fair value of an asset or a liability cannot be determined during the measurement period, the acquirer shall recognize an asset or a liability at the acquisition date if (a) information available before the end of the measurement period indicates that it is probable that an asset existed or that a liability had been incurred at the acquisition date and (b) the amount of the asset or liability can be reasonably estimated. The asset or liability shall be measured using the guidance provided in FASB Statement No. 5, *Accounting for Contingencies,* and FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss,* for application of similar criteria in paragraph 8 of Statement 5. Contingencies that do not meet the recognition criteria as of the acquisition date are not recognized at the acquisition date and are accounted for in accordance with other applicable GAAP, including Statement 5, as appropriate. [paragraphs 23 and 24]	**Initial Recognition** The revised IFRS 3 requires the acquirer to recognize a contingent liability assumed in a business combination if it is a present obligation that arises from past events and its fair value can be measured reliably. [paragraphs 22 and 23]

Guidance	Statement 141(R)	IFRS 3 (as revised in 2007)
	Subsequent Measurement Statement 141(R) requires that an acquirer develop a systematic and rational basis for subsequently measuring and accounting for assets and liabilities arising from contingencies depending on their nature. [paragraph 60]	**Subsequent Measurement** The revised IFRS 3 carries forward the existing requirements that a contingent liability recognized in a business combination must be measured subsequently at the higher of the amount that would be recognized in accordance with IAS 37, *Provisions, Contingent Liabilities and Contingent Assets,* or the amount initially recognized less, if appropriate, cumulative amortization recognized in accordance with IAS 18, *Revenue.* [paragraph 56]
	Disclosures For an asset or liability arising from a contingency recognized at the acquisition date, Statement 141(R) requires that the acquirer disclose the nature of the contingency, the amount recognized, and the measurement basis applied. For contingencies that are not recognized at the acquisition date, Statement 141(R) requires that the acquirer include the disclosures required by Statement 5 in the footnote that describes the business combination. [Statement 141(R), paragraphs 68(j) and 68(jj)]	**Disclosures** The revised IFRS 3 carries forward the existing disclosure requirements in IAS 37 and requires an acquirer to disclose the reasons that the fair value of a contingent liability cannot be measured reliably, if applicable. [paragraphs B64(j) and B67(c)]

Assets and liabilities for which the acquirer applied other U.S. GAAP or IFRSs rather than the recognition and measurement principles	Statement 141(R) and the revised IFRS 3 provide exceptions to the recognition and measurement principles for particular assets and liabilities that the acquirer accounts for in accordance with other U.S. GAAP or IFRSs. For example, income taxes and employee benefit arrangements are accounted for in accordance with existing U.S. GAAP or IFRSs. Differences in the existing guidance might result in differences in the amounts recognized in a business combination. For example, differences between the recognition and measurement guidance in FASB Statement No. 109, *Accounting for Income Taxes,* and IAS 12, *Income Taxes,* might result in differences in the amounts recognized in a business combination related to income taxes. [Statement 141(R), paragraphs 26–28; the revised IFRS 3, paragraphs 24–26]
Replacement share-based payment awards	Statement 141(R) requires an acquirer to account for share-based payment awards that it exchanges for awards held by employees of the acquiree in accordance with FASB Statement No. 123 (revised 2004), *Share-Based Payment,* and the revised IFRS 3 requires the acquirer to account for those awards in accordance with IFRS 2, *Share-based Payment.* Differences between Statement 123(R) and IFRS 2 might cause differences in the accounting for share-based payment awards entered into as part of the business combination. In addition, the implementation guidance differs because of the different requirements in Statement 123(R) and IFRS 2. [Statement 141(R), paragraphs 32, 43–46, and A91–A106; the revised IFRS 3, paragraphs 30 and B56–B62]

Guidance	Statement 141(R)	IFRS 3 (as revised in 2007)
Contingent consideration	**Initial Classification** Statement 141(R) and the revised IFRS 3 require an acquirer to classify contingent consideration as an asset, a liability, or equity on the basis of other U.S. GAAP or IFRSs, respectively. Differences in the related U.S. GAAP or IFRSs might cause differences in the initial classification and, therefore, might cause differences in the subsequent accounting. [Statement 141(R), paragraph 42; the revised IFRS 3, paragraph 40]	
	Subsequent Measurement Contingent consideration classified as an asset or liability is measured subsequently at fair value. The changes in fair value are recognized in earnings unless the contingent consideration is a hedging instrument for which FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities,* requires the subsequent changes to be recognized in other comprehensive income. [paragraph 65]	**Subsequent Measurement** Contingent consideration classified as an asset or liability that: (a) Is a financial instrument and is within the scope of IAS 39, *Financial Instruments: Recognition and Measurement,* is measured at fair value, with any resulting gain or loss recognized either in profit or loss or in other comprehensive income in accordance with that IFRS. (b) Is not within the scope of IAS 39 is accounted for in accordance with IAS 37 or other IFRSs as appropriate. [paragraph 58]

Subsequent measurement and accounting for assets, liabilities, or equity instruments	In general, after a business combination, an acquirer measures and accounts for assets acquired, liabilities assumed or incurred, and equity instruments issued in accordance with other applicable U.S. GAAP or IFRSs, depending on their nature. Differences in the other applicable guidance might cause differences in the subsequent measurement and accounting for those assets, liabilities, and equity instruments. [Statement 141(R), paragraphs 60 and 66; the revised IFRS 3, paragraphs 54 and B63]	
Goodwill by reportable segment disclosures	Statement 141(R) requires that the acquirer disclose for each business combination that occurs during the period or in the aggregate for individually immaterial business combinations that are material collectively and that occur during the period, the amount of goodwill by reportable segment, if the combined entity is required to disclose segment information in accordance with FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information*, unless such disclosure is impracticable. Similar to IAS 36, *Impairment of Assets*, paragraph 45 of FASB Statement No. 142, *Goodwill and Other Intangible Assets*, requires disclosure of this information in the aggregate by each reportable segment, not for each material business combination that occurs during the period or in the aggregate for individually immaterial business combinations that are material collectively and that occur during the period. [paragraph 68(1)]	The disclosure by reportable segment is not required by the revised IFRS 3. Paragraph 134 of IAS 36 requires an entity to disclose the aggregate carrying amount of goodwill allocated to each cash-generating unit (group of units) for which the carrying amount of goodwill allocated to that unit (group of units) is significant in comparison with the entity's total carrying amount of goodwill. This information is not required to be disclosed for each material business combination that occurs during the period or in the aggregate for individually immaterial business combinations that are material collectively and occur during the period.

Guidance	Statement 141(R)	IFRS 3 (as revised in 2007)
Pro forma disclosures	The disclosures required by this paragraph apply only to acquirers that are *public business enterprises,* as described in paragraph 9 of Statement 131. If comparative financial statements are presented, Statement 141(R) requires disclosure of *revenue and earnings* of the combined entity for the comparable prior reporting period as though the acquisition date for all business combinations that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period (*supplemental pro forma* information). [paragraph 68(r)]	The disclosures required by this paragraph apply to all acquirers. The revised IFRS 3 does not require the disclosure of *revenue and profit or loss* of the combined entity for the comparable prior period even if comparative financial statements are presented. [paragraph B64(q)]
Disclosure of a goodwill reconciliation	Statement 141(R) requires an acquirer to provide a goodwill reconciliation in accordance with the requirements of Statement 142. Statement 141(R) amends the requirement in Statement 142 to align the level of detail in the reconciliation with that required by the IASB. As a result, there is no substantive difference between the FASB's and the IASB's requirements, however, the guidance is contained in different standards. [paragraph 72(d)]	The revised IFRS 3 requires an acquirer to provide a goodwill reconciliation and provides a detailed list of items that should be shown separately. [paragraph B67(d)]

Disclosures of the financial effects of adjustments to the amounts recognized in a business combination	Statement 141(R) does not require this disclosure.	The revised IFRS 3 requires the acquirer to disclose the amount and an explanation of any gain or loss recognized in the current period that (a) relates to the identifiable assets acquired or liabilities assumed in a business combination that was effected in the current or previous reporting period and (b) is of such a size, nature, or incidence that disclosure is relevant to understanding the combined entity's financial statements. [paragraph B67(e)]
Effective date	Statement 141(R) is required to be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Early application is prohibited. [paragraph 74]	The revised IFRS 3 is required to be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after July 1, 2009. Early application is permitted. [paragraph 64]
Income taxes	Statement 141(R) and the revised IFRS 3 require the subsequent recognition of acquired deferred tax benefits in accordance with Statement 109 or IAS 12, respectively. Differences between Statement 109 and IAS 12 might cause differences in the subsequent recognition. Also, in accordance with U.S. GAAP, the acquirer is required to recognize changes in the acquired income tax positions in accordance with FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes,* as amended by Statement 141(R). [Statement 141(R), paragraph 77; the revised IFRS 3, paragraph 67]	