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FAS 141 Revised (Business Combinations): Additional Guidance on Business Combinations

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Presentation Overview

- ✓ FAS 141 – A Brief Retrospective
- ✓ FAS 141 - Revised (Business Combinations)
 - ✓ Objective: Revise and improve existing guidance for purchase accounting
- ✓ Intangible Asset Valuation Process
 - ✓ More difficult than business valuation

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FAS 141 - A Brief Retrospective

- ✓ The Financial Accounting Standards Board (“FASB”) issued FAS 141 (Business Combinations) and FAS 142 (Goodwill and Other Intangible Assets) in June 2001. This marked a new era in the recognition, measurement, and disclosure of intangible assets.
- ✓ In part, this new direction on the treatment (i.e., no longer amortized) of goodwill and the recognition of acquired intangible assets was in response to the reported findings of FASB as documented in a report issued in April 2001, “Business and Financial Reporting, Challenges for the New Economy:

In recent years, many commentators have remarked on what they consider to be a disconnect between information provided in financial statements and the information needs of investors and creditors. Most recently, some have characterized this as a disconnect between "new economy" companies and "old economy" financial reporting. In particular, many have contended that financial statement users need:

- ✓ More disclosure of nonfinancial information
- ✓ More forward-looking information
- ✓ **More information about intangible assets.**

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- ✓ Specifically, FAS 141 introduced the following new principles and requirements:
 - ✓ No more *pooling of interests* method of purchase accounting...all business combinations now need to be accounted for utilizing *the purchase method*.
 - ✓ The identification of intangible assets were to be determined based on two criteria: *the contractual-legal criterion and the separability criterion*. In other words, explicit criteria for the recognition of intangible assets apart from goodwill were provided.
 - ✓ The accounting for contingent consideration did not change (i.e., included as part of the purchase price if it is determinable beyond a reasonable doubt).
 - ✓ In-Process Research and Development (uncompleted technology) is still to be expensed under FAS No. 2, if it had no alternative future use.
 - ✓ Greater disclosure in the notes to the financial statements (e.g., definite or indefinite life, weighted-average amortization period).
 - ✓ The cost of an acquired entity includes transaction expenses such as legal, accounting, and appraisal expense (i.e., transaction costs are to be capitalized).
 - ✓ GRJ Note: Purchase price allocations were to be required for all transactions not just technology-related acquisitions where there was a presumption of the existence of acquired intangible assets.

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Statement of Financial Accounting Standard No. 141 - Revised (Business Combination)

- ✓ New Guidance under FAS 141R issued December 2007 is as follows:
 - ✓ The definition of business combination was broadened to include step acquisitions and acquisitions where less than 100 percent was acquired (i.e., a noncontrolling minority interest remained). FAS 141 only provided for business combinations where consideration was transferred. The new *acquisition method* of accounting requires the identification of the acquirer (i.e., the entity that *gains control*).
 - ✓ Assets acquired, liabilities assumed and any noncontrolling interest in the acquiree is to be measured at fair value (FAS 157) as of the acquisition date. FAS 141 was a simpler cost allocation process.
 - ✓ The acquirer is required to recognize assets acquired and liabilities assumed arising out of *contractual contingencies* as of the acquisition date. Assets and liabilities arising from *noncontractual contingencies* are to be considered when they are more likely than not (i.e., they meet the definition of an asset or liability under FASB Concepts Statement No. 6)

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Statement of Financial Accounting Standard No. 141 - Revised (Business Combination)

- ✓ More New Guidance:
 - ✓ IPRD is no longer expensed on the acquisition date (indefinite life asset?)
 - ✓ Transaction and restructuring costs are also to be expensed.
 - ✓ 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.

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- ✓ Fair Value – Basic Valuation Techniques Per FAS 157
 - ✓ These would be deemed generally acceptable and reasonable valuation techniques in conformity with GAAP by Auditors
 - ✓ Market Approach
 - ✓ Income Approach
 - ✓ Cost Approach
 - ✓ New AICPA BV Standards call these *valuation approaches and methods*
- ✓ Valuation Practices – Independent Appraisers and SAS 73 Review

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Valuation Techniques Per FAS 157

- ✓ Market Approach (i.e., mark-to-market) – Uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.
 - ✓ Guideline Company Method - Equity and Reporting Unit
 - ✓ Comparable Transactions Method – Assets, Equity and Reporting Units
 - ✓ Relief from Royalty Method – Intangible Assets

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Valuation Techniques Per FAS 157

- ✓ Income Approach – Conversion of future amounts (cash flow or earnings) to a single present value.
 - ✓ Discounted Cash Flow Method – Assets, Liabilities, Equity, and Reporting Units
 - ✓ Multi-Period Excess Earnings Method – Intangible Assets

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Valuation Techniques Per FAS 157

- ✓ Cost Approach – The amount that currently would be required to replace the service capacity of an asset.
 - ✓ Replacement Cost Method – Assets
 - ✓ Rarely Seen – For FAS 141 (Business Combinations), FASB opined that this methodology does not reliably measure the value of human capital (i.e., assembled workforce).

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Presentation Summary

- ✓ FAS 141 – A Brief Retrospective – New information for users about intangible assets
- ✓ FAS 141 - Revised (Business Combinations)
 - ✓ Revise and improve purchase accounting
 - ✓ Has control been obtained?
 - ✓ Contingencies (contractual and non-contractual) now need to be considered and/or measured.
 - ✓ Noncontrolling interests of acquiree now need to be measured.
 - ✓ IPRD is just another intangible asset.
 - ✓ Transaction and restructuring costs are expensed.
- ✓ Intangible Asset Valuation Process
 - ✓ More difficult than business valuation