Business Deals in 2009 Anything But Business As Usual

By William Spizman
Managing Director, RSM McGladrey

Thanks to a recently issued standard by the Financial Accounting Standards Board (FASB) – FASB Statement No. 141 (revised 2007), Business Combinations – a number of changes may give acquiring businesses more than they bargained for if they close the deal in 2009 or later. While the modifications to business combination accounting are signs of the industry's move toward increasing the usage of a fair value model as well as further alignment with International Financial Reporting Standards, some of the revisions are significant and considered by some to be controversial.

Recognition of all assets and liabilities now required
One of the more noteworthy changes in FASB Statement No. 141 (revised 2007), also called Statement 141R, is the requirement that all assets and liabilities of the target be recognized and measured – even those in a partial acquisition. Regardless of whether 51 percent or 100 percent of the target's business is purchased, the target's assets acquired and liabilities assumed must be recognized as a whole by the buyer. That means the goodwill attributable to the part of the target that was not acquired must also be recognized, representing a conceptually different model from the pre-existing guidance.

Another fundamental change is the use of a "fair value" model rather than a "cost allocation" model to measure the assets acquired and liabilities assumed. The prior guidance relied only partially on fair value measurements and only to allocate the cost of the acquisition to the assets acquired and liabilities assumed. Further, Statement 141R uses the fair value model rather than a "carryover basis" or "book value" model to determine the non-acquired (or non-controlling) interest in the target. The prior guidance used the book value of the net assets acquired in measuring the non-controlling interest in the target.

Also, deal costs incurred by the buyer are no longer included in the purchase price of the target when accounting for a business combination. Under Statement 141R they are expensed as incurred and as the related services are rendered except for those costs incurred by the buyer to issue debt or equity securities. These issuance costs are accounted for under other generally accepted accounting principles (GAAP).

Additional pre-acquisition contingencies acknowledged
The new guidance distinguishes between contingencies of the target that are contractual and non-contractual. Those that are contractual are recognized at their fair value at the acquisition date, while those that are non-contractual are only

recognized if it is more likely than not that the contingency meets the definition of a liability or an asset in FASB Concepts Statement No. 6, Elements of Financial Statements. If that threshold is met, the contingency is recognized and measured at its acquisition-date fair value; if it's not, the contingency is not recognized in the accounting for the business combination. The pre-existing guidance relies on a model based predominantly on FASB Statement No. 5, Accounting for Contingencies, which uses a "probable" threshold for recognition and a "best estimate" approach for measurement.

Other fundamental changes affecting how an entity will account for a business combination include:

- The recognition of the fair value of earn-outs (i.e., contingent consideration) in the initial accounting for the acquisition; formerly the nature of the contingency determined whether its resolution affected purchase accounting

- The elimination of the recognition of liabilities for restructuring costs expected to be incurred since they do not represent a liability as defined in Concepts Statement 6; instead, such costs are recognized when they become obligations as defined in other existing GAAP

- The reduction of the valuation allowance in income tax expense, if a buyer determines some or all of its previously recognized valuation allowance is no longer needed as a result of the business combination – the pre-existing guidance would have reflected the effect of reducing the valuation allowance in purchase accounting, perhaps affecting the amount of goodwill or certain non-current assets recognized

- The recognition of a gain from a bargain purchase – if applying Statement 141R results in negative goodwill, the buyer is required to perform a review of the factors; if negative goodwill still exists, the buyer recognizes a gain from a bargain purchase

These are a few of the more significant changes created by Statement 141R, but the standard's many revisions will affect business combinations in different ways.

The new standard is effective for business combinations with acquisition dates that occur on or after the beginning of the first annual reporting period of the fiscal year beginning on or after Dec. 15, 2008. For calendar-year companies, the standard is applicable to business combinations with acquisition dates of Jan. 1, 2009, or later. Early adoption of Statement 141R is prohibited.

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About the Author

Bill Spizman *is a managing director at RSM McGladrey and leads the national transaction support services practice in the Great Lakes region. He specializes in transaction support and advisory services for private equity funds, private investors and business enterprises and has significant experience with midsized companies.*
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