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New Accounting for Business Combinations and Noncontrolling Interests

New Statements 141R and 160 require most identifiable assets, liabilities, noncontrolling interests, and goodwill acquired in a business combination to be recorded at "full fair value" and require noncontrolling interests (previously referred to as minority interests) to be reported as a component of equity, which changes the accounting for transactions with noncontrolling interest holders. The new Statements are the U.S. GAAP outcome of a joint project with the IASB.[1] Both Statements are effective for periods beginning on or after December 15, 2008, and earlier adoption is prohibited.

Statement 141R will be applied to business combinations occurring after the effective date. Statement 160 will be applied prospectively to all noncontrolling interests, including any that arose before the effective date.

Scope

Statement 141R applies to all business combinations; Statement 160 applies to the accounting for noncontrolling interests and transactions with noncontrolling interest holders in consolidated financial statements. Statement 141R defines a business combination as a transaction or other event in which an entity (the acquirer) obtains control of one or more businesses (the acquiree or acquirees), even if control is not obtained by purchasing equity interests or net assets, as in the case of control obtained by contract alone. This can occur, for example, when a minority shareholder's substantive participating rights expire.[2]

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[1] FASB Statements No. 141 (revised 2007), Business Combinations, December 2007, and No. 160, Noncontrolling Interests in Consolidated Financial Statements, December 2007, both available at www.fasb.org. The IASB is expected to replace IFRS 3, Business Combinations, and revise IAS 27, Consolidated and Separate Financial Statements, early next year.

[2] Substantive participating rights are described in EITF Issues No. 96-16, Investor's Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights, and No. 04-5, Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights, both available at www.fasb.org.

Statement 141R defines a business as an integrated set of activities and assets that are *capable* of being managed to provide a return to investors or economic benefits to owners, members, or participants. Thus a set of activities and assets may be considered a business even if it cannot currently access customers or is an "early-stage development stage entity."

New Statement 141R also applies to combinations among mutual entities,[3] but like the replaced Statement, it does not apply to formations of joint ventures, acquisitions of assets or groups of assets that do not constitute a business, combinations among entities under common control, and combinations between not-for-profit organizations or the acquisition of a for-profit business by a not-for-profit organization.[4]

The Acquisition Method

All business combinations will be accounted for by applying the acquisition method (previously referred to as the purchase method). Companies applying this method will have to identify the acquirer; determine the acquisition date and purchase price; recognize at their acquisition-date fair values the identifiable assets acquired, liabilities assumed, and any noncontrolling interests in the acquiree (with certain exceptions discussed below); and recognize goodwill or, in the case of a bargain purchase, a gain.

Identifying the Acquirer. The first step in identifying the acquirer of a voting-interest entity is to consult the guidance on control in Statement 160. If it does not provide a sufficient basis for identifying the acquirer, the indicators in Statement 141R, which are similar to those contained in Statement 141, should be considered. The acquirer in a business combination in which a variable interest entity is acquired is the primary beneficiary of the variable interest entity determined in accordance with Interpretation 46R.[5]

Acquisition Date. The acquisition date is the date the acquirer obtains control of the acquiree. This is typically the closing date. It is the only relevant date for recognition and measurement and is used to measure the fair value of the consideration paid. When the acquirer issues equity instruments as full or partial payment for the acquiree, for example, the fair value of the acquirer's equity instruments will be measured at the acquisition date, rather than an earlier measurement date as is currently required.[6]

Purchase Price. The acquirer must determine the acquisition-date fair value of the consideration paid for its interest in the acquiree. The consideration paid can include cash and other assets, equity interests, and contingent consideration, all measured at fair value at the acquisition date. Transaction costs are excluded from the acquisition accounting. They are instead accounted for under other GAAP, which may mean the costs are expensed as incurred (e.g., due diligence costs), or, to the extent applicable, treated as debt issue costs or as a cost of issuing equity securities.

In a change from today's accounting requirements, contingent consideration is measured at fair value at the acquisition date and included when determining the fair value of the consideration paid. The contingent consideration is classified as equity or a liability in accordance with current GAAP. If the contingent consideration is classified as a liability, it will be remeasured to fair value until resolution and subsequent changes in the fair value will be recognized in earnings. Contingent consideration that is equity-classified is not subsequently remeasured. This contrasts with the current accounting requirements, under which contingent consideration is generally not recognized until the contingency is resolved and the consideration is paid or payable.

Recognizing and Measuring Assets, Liabilities, and Noncontrolling Interests. Under the acquisition method, the acquirer recognizes most identifiable assets acquired, liabilities assumed, and noncontrolling interests in the acquiree at their full fair value on the acquisition date. Statement 141R provides exceptions from or modifications to fair-value measurement for income taxes, employee benefits arrangements, reacquired rights, assets held for sale, indemnification assets, and share-based payment awards. All other elements, including contingent liabilities that meet the recognition threshold, are measured

[3] A mutual entity is defined as an entity other than an investor-owned entity that provides dividends, lower costs, or other economic benefits directly and proportionately to its owners, members, or participants.

[4] FASB Statement No. 141, Business Combinations, June 2001, available at www.fasb.org.

[5] FASB Interpretation No. 46 (revised December 2003), Consolidation of Variable Interest Entities, December 2003, available at www.fasb.org.

[6] EITF Issue No. 99-12, Determination of the Measurement Date for the Market Price of Acquirer Securities Issued in a Purchase Business Combination, available at www.fasb.org.

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at full fair value whether the acquirer acquires 100% or a lesser amount (i.e., a partial acquisition).

The requirements for fair-value measurement and the changes in recognition principles will change accounting practices for acquired contingencies, restructuring costs, long-lived assets, in-process research and development (IPR&D), share-based payment awards, indemnification assets, and tax benefits.

- *Contingencies* – Contractual contingencies will be recognized and measured at fair value at the acquisition date. Noncontractual contingencies, such as litigation, will be recognized only if it is more-likely-than-not (i.e., greater than 50% likely) that a liability exists at the acquisition date. A noncontractual contingency that qualifies for recognition will be measured at fair value at the acquisition date. Contingencies that are recognized as liabilities at the acquisition date are subsequently measured at the greater of the acquisition-date fair value or the amount that would be recognized in accordance with Statement 5.[7] Noncontractual contingencies that do not qualify for recognition at the acquisition date are accounted for in accordance with Statement 5.
- *Restructuring costs* – Statement 141R nullifies EITF 95-3 and requires costs associated with restructuring or exit activities that do not meet the recognition criteria in Statement 146 as of the acquisition date to be subsequently recognized as post-combination costs when those criteria are met.[8]
- *Long-lived assets* – Long-lived assets that meet the criteria for recognition apart from goodwill are recognized at fair value. In accordance with Statement 157, fair value should reflect the market participants' perspective rather than the acquirer's specific planned use or non-use of the asset.[9] However, Statement 141R requires that assets meeting the held-for-sale criteria in Statement 144 at the acquisition date be measured at fair value less costs to sell.[10]
- *IPR&D* – The acquiree's IPR&D projects are measured at fair value and recognized as an asset rather than expensed as is currently required. The IPR&D asset is treated as an indefinite-lived intangible asset and therefore not subject to amortization until the project is completed or abandoned. However, post-combination research and development costs will continue to be expensed as incurred.[11]
- *Share-based payment awards* – As is currently required, share-based payment awards are segregated into acquisition consideration and post-combination compensation based on the proportion of the requisite service period (including service required post-combination) that is complete as of the acquisition date. However, unlike current practice, the portion of the share-based payment that is part of the acquisition consideration is a temporary difference between the tax basis and the reported amount, and a deferred tax asset is therefore recognized as part of the acquisition accounting.
- *Indemnification assets* – If an acquirer receives an indemnity for the outcome of an uncertainty in connection with a business combination (e.g., environmental claims), the acquirer will recognize an indemnification asset amount equal to the recognized amount for the related contingency.
- *Tax benefits* – The aquirer's unrecognized tax benefits (e.g., net operating losses) that are recognizable as a result of the acquisition are not included in the acquisition accounting as is currently required. Instead, the amounts are recognized in income tax expense. Adjustments for recognized tax benefits related to the acquiree (e.g., adjustments to a valuation allowance) that are recognized subsequent to the acquisition date generally will be recognized in income, not as an adjustment to the acquisition accounting as is currently required.

Partial Acquisitions. A company that obtains control but acquires less than 100% of an acquiree records 100% of the fair value of the acquiree's assets (including goodwill), liabilities, and noncontrolling interests, excluding

[7] FASB Statement No. 5, Accounting for Contingencies, March 1975, available at www.fasb.org.

[8] FASB Statement No. 146, Accounting for Costs Associated with Exit or Disposal Activities, June 2002; EITF Issue No. 95-3, Recognition of Liabilities in Connection with a Purchase Business Combination; both available at www.fasb.org.

[9] FASB Statement No. 157, Fair Value Measurements, September 2006, available at www.fasb.org.

[10] FASB Statement No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, August 2001, available at www.fasb.org.

[11] FASB Statement No. 2, Accounting for Research and Development Costs, October 1974, available at www.fasb.org.

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the exceptions to fair-value measurement previously described, at the acquisition date. Under current requirements, an acquiring company that obtains less than 100% of an acquiree adjusts the assets and liabilities only for its proportionate ownership interest and recognizes only its portion of the goodwill of the acquiree. Noncontrolling interests are currently recorded at the acquiree's book value.

Goodwill. Goodwill is recognized as the excess of the acquisition-date fair value of the purchase price over the recognized amounts of assets, liabilities, and noncontrolling interests. If an acquirer obtains less than 100% of the acquiree at the acquisition date, goodwill is allocated to the controlling and noncontrolling interests. The amount of goodwill allocated to the controlling interest is the difference between the fair value of the controlling interest and the controlling interest's share in the fair value of the identifiable net assets acquired. Any remaining goodwill is allocated to the noncontrolling interests. This is illustrated in the boxed example.

Example: Allocating Goodwill to Controlling and Noncontrolling Interests

Assume Company A acquires 80% of Company B's outstanding common stock for $160 million in cash. The noncontrolling interests remain publicly traded and have a fair value of $35 million (i.e., the $160 million paid for the 80% interest includes a control premium). As of the acquisition date, the book value and fair value of the separately recognizable identifiable net assets acquired are $100 million and $150 million, respectively. Amounts allocated to identifiable net assets, goodwill, noncontrolling interests, and controlling interest in Company B under the current purchase method and the new acquisition method are:

Millions	Statement 141 Purchase Method	Statement 141R Acquisition Method
Identifiable net assets	$140[a]	$150[b]
Goodwill	$ 40[c]	$ 45[d]
Noncontrolling interests	$ 20[e]	$ 35[f]
Controlling interest	$160	$160

a Book value of identifiable net assets plus Company A's share of the difference between fair value and book value of identifiable net assets (($100 + (($150 – $100) × 80%))

b Fair value of identifiable net assets

c Purchase price paid by Company A less Company A's share of fair value of identifiable net assets ($160 – ($150 × 80%))

d Consideration paid by Company A plus fair value of noncontrolling interests less fair value of identifiable net assets [($160 + $35) – $150)]

e Noncontrolling interests' share of the book value of identifiable net assets ($100 × 20%)

f Fair value of noncontrolling interests

Goodwill is allocated to controlling and noncontrolling interests in the new acquisition method as follows:

Fair value of Company A's 80% interest	$160
Less: fair value of Company A's share of identifiable net assets ($150 × 80%)	(120)
Company A's share of goodwill	$ 40
Total goodwill	$ 45
Company A's share of goodwill	40
Noncontrolling Interests' share of goodwill	$ 5

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Bargain Purchase. In a "bargain purchase" the fair value of the recognized identifiable net assets acquired exceeds the fair value of the acquirer's interest in the acquiree plus the recognized amount of any noncontrolling interests in the acquiree. In such cases, the acquirer should reevaluate the measurements of the recognized assets and liabilities at the acquisition date. If no adjustments are necessary, or if an excess remains after the adjustments, the acquirer should recognize the excess as a gain at the acquisition date. Under current accounting for "negative" goodwill, the reported amounts of specified identifiable long-lived assets are reduced to zero before any remaining amount is recognized as an extraordinary gain.

Measurement Period. Statement 141R defines the measurement period as the period after the acquisition date during which the acquirer may make adjustments to the "provisional" amounts recognized at the acquisition date. As is the case under Statement 141, the measurement period ends as soon as the acquirer receives the necessary information about facts and circumstances that existed at the acquisition date or concludes that the information cannot be obtained. Consistent with Statement 141, the measurement period may not exceed one year from the acquisition date. However, unlike today's accounting requirements, any adjustments to the provisional amounts during the measurement period are reflected by retrospectively adjusting the provisional amounts and recasting the prior-period information.

Noncontrolling Interests

Statement 160 specifies that noncontrolling interests are to be treated as a separate component of equity, not as a liability or other item outside of equity. Because noncontrolling interests are an element of equity, increases and decreases in the parent's ownership interest that leave control intact are accounted for as capital transactions (i.e., as increases or decreases in ownership) rather than as step acquisitions or dilution gains or losses. The carrying amount of the noncontrolling interests is adjusted to reflect the change in ownership interests, and any difference between the amount by which the noncontrolling interests are adjusted and the fair value of the consideration paid or received is recognized directly in equity attributable to the controlling interest (i.e., additional paid-in capital).

Step Acquisitions. Under current requirements for step acquisitions, each investment tranche is reflected in the financial statements at its cost either through the application of the equity method or in consolidation once control is obtained. Under Statement 141R, when a business combination is achieved in stages, the acquirer's interest in the acquiree includes the acquisition-date fair value of the equity interest the acquirer held in the acquiree before control is obtained. Therefore, the carrying amounts of the previously acquired tranches are adjusted to fair value as of the date control is obtained (the acquisition date), and the acquirer recognizes the differences as a gain or loss in income at the acquisition date. Amounts the acquirer previously recognized in accumulated other comprehensive income (e.g., cumulative translation adjustments recognized during the period the equity method was used to account for the investment tranches) would be included in the gain or loss recognized in income at the date control is obtained.

Loss of Control. A transaction that ends control is also a remeasurement event. Therefore, a retained interest after a sale of interests that ends control would be remeasured to fair value. The gain or loss recognized in income includes the realized gain or loss related to the portion of the ownership interest sold and the gain or loss on the remeasurement to fair value of the interest retained.

The following examples illustrate the accounting for transactions with noncontrolling interests, the first with control retained and the second with control ended.

Example: Control Retained. Assume that Company A on January 1, 20X9, acquires 60% of Company B's common stock for $700, which is the fair value of a 60% interest in Company B. The fair value of the noncontrolling interests is $400. After the acquisition, the consolidated financial statements would report the following amounts related to Company B:

Net assets (including goodwill)	$1,100
Noncontrolling interests	$ 400
Controlling interest	700
Total equity	$1,100

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Company B's net income and comprehensive income for 20X9 are zero. On January 1, 20Y0, Company A acquires an additional 20% of Company B's common stock for $250. Since Company A had control both before and after the transaction, it is treated as a capital transaction. Noncontrolling interests are reduced by the carrying amount of the proportionate interest relinquished ($400 × 20% / 40%). The difference between the carrying amount of noncontrolling interests acquired ($200) and the amount paid ($250) is reported as an adjustment to additional paid-in capital in the consolidated financial statements. After the transaction, the consolidated financial statements would report the following amounts related to Company B:

Net assets (including goodwill)	$1,100
Noncontrolling interests	$ 200
Controlling interest	900
Total equity	$1,100

Company B's net income and comprehensive income for 20Y0 again are zero. On January 1, 20Y1, Company A sells 10% of Company B's common stock for $100. Since Company A retains control of Company B after the transaction, it is recorded as a capital transaction. Noncontrolling interests are increased by the carrying amount of the interest sold by Company A ($900 × 10% / 80%). The difference between the increase to noncontrolling interests ($113) and the selling price is reported as an adjustment to additional paid-in capital in the consolidated financial statements. After the transaction, the consolidated financial statements would report the following amounts related to Company B:

Net assets (including goodwill)	$1,100
Noncontrolling interests	$ 313
Controlling interest	787
Total equity	$1,100

Example: Loss of Control. Company B's net income and comprehensive income for 20Y1 again are zero. On January 1, 20Y2, Company A sells 30% of Company B's common stock for $400. The fair value of the 40% retained interest in Company B is determined to be $525. Company A would recognize a gain on the date of the sale computed as follows:

Sales proceeds on 30% sold interest	$ 400
Fair value of 40% retained interest	525
Carrying amount of noncontrolling interests	313
	$1,238
Less: carrying amount of Company B's net assets	(1,100)
Gain recognized on January 1, 20Y2	$ 138

A Series of Transactions. Statement 160 contains guidance designed to prevent manipulation of income through a series of planned transactions designed to take advantage of the fact that obtaining or surrendering control over an investee is a remeasurement event through income. The Statement identifies the following four conditions, one or more of which may indicate that multiple arrangements should be accounted for as a single transaction:

- The arrangements are entered into at the same time or in contemplation of one another;
- They form a single transaction designed to achieve an overall commercial effect;
- The occurrence of one arrangement depends on the occurrence of at least one other arrangement; and
- One arrangement considered on its own is not economically justified, but the arrangements are economically justified when considered together.

Allocation of Income and Other Comprehensive Income. The net income and each component of other comprehensive income is attributed to the controlling and noncontrolling interests. Losses applicable to the noncontrolling interests are attributed and recorded as adjustments to the noncontrolling interests even if the losses would cause noncontrolling interests to be negative, whether or not the noncontrolling interests have an obligation to fund those losses.

Presentation and Disclosure

The new requirements for noncontrolling interests, results of operations, and comprehensive income of subsidiaries change not only the presentation of operating results and related per share information, but also equity. Statement 160 requires net income and comprehensive income to be displayed for both the controlling and the noncontrolling interests. Additional required disclosures and rec-

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Significant Changes in Accounting for Business Combinations and Noncontrolling Interests

Statement 141 & ARB 51	**Statements 141R & 160**
Definition of a business—A business is defined as a *self-sustaining* integrated set of activities and assets conducted and managed for the purpose of providing a return to investors. An early-stage development stage entity is presumed not to be a business.	The definition is expanded. A business or group of assets no longer must be self-sustaining to be a business; it must be *capable* of generating a revenue stream. The previous presumption that an early-stage development stage entity is not a business has been removed.
Measuring equity instruments issued—Equity instruments issued by the acquirer as consideration are measured using the price a few days before and after the measurement date (i.e., date when the terms and conditions have been agreed and the acquisition announced).	Equity instruments issued by the acquirer as consideration are measured at fair value on the acquisition date.
Acquisition-related costs—The purchase price includes the direct costs of the business combination.	Direct costs of a business combination are not part of the acquisition accounting. Instead they are accounted for under other GAAP and generally will be expensed if they are not costs associated with issuing debt or equity securities.
Contingent consideration—Contingent consideration based on earnings is recognized as an adjustment to the purchase price when the contingency is resolved and consideration is issued or issuable. Contingent consideration based on the acquirer's security price is recognized as an adjustment to paid-in capital when the contingency is resolved and the consideration is issued or issuable.	Contingent consideration is recognized and measured at fair value on the acquisition date. Subsequent changes in fair value of liability-classified contingent consideration are recognized in earnings and not as an adjustment to the purchase price. Equity-classified contingent consideration is not remeasured after the acquisition date.
Recognizing and measuring assets acquired, liabilities assumed, and noncontrolling interests—The assets acquired and liabilities assumed are adjusted only for the acquirer's share of the fair value. Noncontrolling interests and their share of the acquiree's assets and liabilities are measured based on the carrying amount of the recognized assets and liabilities in the acquiree's financial statements.	Whether the acquirer acquires all or a partial interest in the acquiree, the full fair value of the assets acquired, liabilities assumed, and noncontrolling interests is recognized. The carrying amounts of previously acquired tranches are adjusted to fair value at the date control is obtained, and the acquirer recognizes the differences as a gain or loss in income at the acquisition date.
Contingencies—If the fair value of a contingent liability is not readily determinable at the acquisition date, a contingent liability is recognized at the date of acquisition only if it is probable and reasonably estimable. It is measured at the best estimate of the settlement amount, rather than its fair value.	A liability is recognized at fair value on the acquisition date for contractual contingencies. A liability is recognized at fair value on the acquisition date for noncontractual contingencies if it is more-likely-than-not that the liability exists.
Restructuring costs—Restructuring costs for plans to be implemented subsequent to the acquisition are recognized as a liability in purchase accounting if criteria established in EITF 95-3 are met within a short period of time after the acquisition date.	Restructuring costs are not recognized as a liability in acquisition accounting unless the criteria in Statement 146 are met at the acquisition date.
IPR&D—The fair value of intangible assets to be used in IPR&D projects that have no alternative future use is charged to expense at the acquisition date.	The acquiree's IPR&D projects are recognized as an intangible asset and measured at fair value. The IPR&D asset is treated as an indefinite-lived intangible asset and therefore is capitalized, but it is not subject to amortization until the project is completed or abandoned.
Tax benefits—The acquirer's unrecognized tax benefits that are recognizable as a result of an acquisition are recorded in purchase accounting at the acquisition date. A decrease in a valuation allowance related to the acquiree's tax benefits is an adjustment to the purchase accounting.	The acquirer's unrecognized tax benefits that are recognizable as a result of an acquisition are recognized as a reduction of income-tax expense. Adjustments to recognized tax benefits related to the acquiree that are recognized subsequent to the acquisition date are generally recognized in income rather than as an adjustment to the acquisition accounting.
Increases in ownership interest—The cost of each investment tranche is reflected in the financial statements with a separate purchase adjustment and goodwill amount related to each tranche.	Increases in the parent's share of ownership after control is obtained are accounted for as capital transactions.
Decreases in ownership interest—Decreases in ownership interest generally result in a gain or loss.	Decreases in the parent's share of ownership while retaining control are accounted for as capital transactions. A transaction that results in the loss of control results in a gain or loss comprising a realized portion related to the portion sold and an unrealized portion on the retained noncontrolling investment that is remeasured to fair value.

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onciliations include a separate schedule that shows the effects of any transactions with the noncontrolling interests on the equity attributable to the controlling interest.

Convergence

The IASB is expected to issue its standards soon with substantially converged conclusions. The primary differences between the FASB and IASB standards are expected to relate to measuring noncontrolling interests and recognizing contingencies. The two sets of standards will use the same language except for areas where they reached different conclusions. The IASB standards, IFRS 3 and IAS 27, are expected to be effective for periods beginning on or after July 1, 2009, with early adoption permitted.

The descriptive and summary statements above are not intended to be a substitute for the text of FASB Statements 141R and 160 or for the text of any other potential or cited requirements. Reporting entities complying with applicable requirements or complying with SEC filing requirements should consult the texts of the requirements, the particular circumstances to which the requirements are to be applied, and their accounting and legal advisors.

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