Business Combinations and Noncontrolling Interests in Consolidated Financial Statements

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Scope

- Applicable to acquisitions of ***control*** of a ***business***
- ***Does not*** apply to
  - formation of joint ventures
  - acquisition of assets does not constitute a business (e.g. acquiring a portfolio of loans)
  - a combination of entities or businesses under common control (e.g. collapsing BHC charters)
  - a combination of not-for-profit organizations
    - » Does apply to mutuals and credit unions

Scope (Cont'd)

Item	New Accounting	Old Accounting
'Business' definition	Broader definition – Integrated set of activities **capable** of providing a return, dividends, lower costs or other economic benefits	Reference in the definition required that a business be **self-sustaining**

- Broader definition could capture transactions that were previously considered asset purchases

Scope (Cont'd)

Item	New Accounting	Old Accounting
Control definition – i.e., how control is obtained	Expanded definition – Control can be obtained through consolidation via FAS 167, by lapsing or removing participating rights or on staged acquisitions	Control is obtained through a **transaction** involving the acquisition of net assets or equity interests

- A bank could end up having to perform acquisition accounting, revaluing assets and liabilities at fair value, and booking goodwill without actually haven taken any action

Consideration- Measuring the Acquiree

Item	New Accounting	Old Accounting
Valuation Method	Acquisition Method – Measure and record the fair value (FV) of assets and liabilities	Purchase Method – Allocate the purchase price and costs to assets and liabilities

- Completely new valuation method based on fair value concepts
- Valuation challenges – Level 2 and Level 3 inputs
- Upon obtaining control, acquirer recognizes 100 percent of FV of assets
  and liabilities, even if target is not 100 percent acquired
- No separate valuation allowances at acquisition, as any uncertainty about collections and future cash flows is incorporated in FV measurement
- Limited exceptions – e.g. deferred tax assets/liabilities

Consideration - Goodwill

Item	New Accounting	Old Accounting
Goodwill and other intangible assets	Generally consistent with old accounting	If identifiable, recognize it (i.e., it arises from contractual/legal right or can be separated)
Goodwill	Apportioned between controlling and noncontrolling interests	Allocated to the controlling interest only

- Goodwill is still defined/measured as a residual
- Measured as: the consideration transferred by the acquirer plus any noncontrolling interest (NCI) in target plus any of acquirer's previously held interest in target less net amounts of identifiable assets assumed and liabilities acquired
- Includes both amounts assigned to the controlling interest (CI) and NCI

Consideration – Noncontrolling Interests

Item	New Accounting	Old Accounting
Noncontrolling Interest - Fair Value	Record 100 percent of fair value once control is obtained	Only controlling interest's ownership portion is recorded at fair value
Noncontrolling Interest - Goodwill	Full Goodwill Method – apportion to the controlling and NCI	Allocate to the controlling interest only

- A controlling company is required to record the whole subsidiary at fair value, including NCI(minority)
- Recording the full fair value of a controlled but partially-owned subsidiary also means partitioning goodwill between the NCI and the controlling parent

Consideration – Bargain Purchase

Item	New Accounting	Old Accounting
Bargain Purchase (negative goodwill)	Record a gain in operating income	Record extraordinary gain after reducing certain long term assets to zero

- Acquisitions of net assets below fair value
- Bargain purchases are expected to be atypical
- Most likely seen in government-assisted acquisitions

Consideration

Item	New Accounting	Old Accounting
Measurement date for equity securities issued	The acquisition date or the date when control is obtained	A few days before and after terms are agreed to and announced

- Generally is the closing date (when the acquirer legally transfers consideration and acquires assets/liabilities)
- Date at which acquirer 1.) recognizes and measures at FV acquires assets/liabilities, NCI, 2.) measures at FV consideration it has transferred (FV of equity securities issued), 3.) recognizes and measures goodwill
- Difficult to estimate actual purchase price and also goodwill until the acquisition date
- Banks could use contingency agreements to mitigate the risk

Consideration (Cont'd)

Item	New Accounting	Old Accounting
Transaction costs of the acquirer (direct external costs)	Expense as incurred	Part of the deal cost, added to goodwill

- Increase in income volatility before and after close
- Decreases goodwill and impairment risk
- Some costs must be recognized before the deal is announced, with potential stock market implications (less deal confidentiality)
- No longer part of total consideration:
  - finder's fees, advisory, legal, accounting, valuation or consulting fees, general administrative costs
  - other: costs of registering and issuing debt and equity securities – follow other applicable GAAP

Balance Sheet Impacts

Item	New Accounting	Old Accounting
Restructuring costs of acquirer	Record expenses in post acquisition periods as incurred, separate from the acquisition	Normally recorded as a liability, included in the acquisition

- Increase in income volatility after close
- Decreases goodwill and related impairment risk

Balance Sheet Impacts (Cont'd)

Item	New Accounting	Old Accounting
Valuation allowances for assets (ALLL)	Assets are stated at fair value with no separate valuation allowance	Normally stated at present value less a credit allowance

- ALLL is not carried over to the new entity, disclosure only
- Valuation challenges for fair value of loans (additional due diligence procedures)
- IT challenges

Other Balance Sheet Impacts (Cont'd)

Item	New Accounting	Old Accounting
Measurement Period	Revise comparative financial statements as if changes were made at the acquisition date for up to one year (restatement – not included in earnings)	Normal practice is to record adjustments prospectively for a period up to one year

- Change in estimate requires restatement
- Reflect new info about facts and circumstances existing at acquisition date
- Not to exceed one year from acquisition date
- Reflect an increase (decrease) in any provisional amount recognized for an identifiable asset (liability) by means of a decrease (increase) in goodwill

Other Balance Sheet Impacts (Cont'd)

Item	New Accounting	Old Accounting
Adjustments to acquired deferred tax assets and uncertain tax positions	Adjustments made within one year impact goodwill; after one year, adjustments recorded as tax expense	Normally affect goodwill regardless of timing
Assets that an acquirer does not intend to use	Fair value assuming the asset's "highest and best use" per FAS 157	Normally assigned no value or reduced value reflecting limited period of use