Executive summary

A guide to accounting for business combinations

This Executive summary is part of RSM US LLP's A guide to accounting for business combinations and should be read in conjunction with that guide.

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Introduction

The current guidance on accounting for business combinations is captured in ASC 805. Some of the complexities involved in applying ASC 805 include the following:

- The required use of a fair-value model to account for business combinations often requires the involvement of valuation specialists—both related to management's accounting for a business combination and the auditor's testing of the amounts recognized.
- It is extremely important for the buyer to determine as *early* in the acquisition process as possible whether it has acquired a business within the scope of the business combination accounting guidance, because whether a business has been acquired or not has significant accounting implications.
- The definition of a business is one of the more challenging aspects of the business combination accounting guidance to implement in practice because that definition encompasses much more than just a group of assets or net assets that could function together as a standalone business. A significant amount of judgment may need to be exercised in determining whether a business has been acquired.
- The accounting for contingent consideration involves a number of potentially complex steps, including measuring it at fair value initially, classifying it appropriately as either an asset, liability or equity and subsequently adjusting it to fair value if it is classified as an asset or liability.

These observations and many others underscore the importance of a buyer familiarizing itself with the business combination accounting guidance before a business combination occurs. Doing so will allow the buyer to prepare for the accounting challenges that await. This summary provides the buyer with the start it needs—an overview of the accounting guidance applicable to business combinations entered into by for-profit entities.

To locate additional information on specific aspects of the business combination accounting guidance, refer to the table of contents. In addition, refer to Section 1.1.4 of the guide for definitions of acronyms and titles for authoritative and other literature references utilized throughout the guide, including this summary.

Scope

A business combination occurs when the buyer obtains control of a business through a transaction or other event. The three key elements in the definition of a business combination are the following:

1. That which is being acquired must meet the definition of a *business*. ASC 805-10-55-3A 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." The framework provided to determine whether a business (rather than a group of assets or net assets) was acquired requires consideration of whether substantially all of the fair value of the gross assets acquired are concentrated in a single identifiable asset or a group of similar identifiable assets. If that is the case, then a business was not acquired. If that is not the case, the framework requires consideration as to whether the acquired set has at least one input and one substantive process. If that is not the case, a business was not acquired. If that is the case, then the specific criteria that must be considered to determine whether the acquired set is a business depend on whether the acquired set has outputs. The threshold for concluding the acquired set is a business is higher when the acquired set does not have outputs because the acquired set must include employees that form an organized workforce when that is the case. Employees that form an organized workforce do not necessarily have to be in the acquired set to conclude it is a business when that set includes outputs. While employees that form an organized workforce may play a critical role in determining whether an acquired set is a business, it is important to keep in mind that an intangible asset for an assembled workforce is not recognized in the accounting for a business combination

2. The buyer must *obtain control* of a business. To evaluate whether control of a business has been obtained when the buyer is a for-profit entity, it must first determine whether the business is a VIE. If so, the buyer must apply the guidance in ASC 810-10 to determine whether it has a controlling financial interest in the VIE. If the buyer obtains a controlling financial interest in a business that is a VIE, the transaction or other event giving rise to that controlling financial interest should be accounted for as a business combination. If the business is not a VIE (e.g., it is a voting interest entity), the buyer must determine whether it has obtained control over the business using the same definition of control that is used in determining whether a voting interest entity should be consolidated. Under this definition, depending on the facts and circumstances, control may be obtained in several ways, including through the acquisition of a majority ownership interest in the target or as a result of minority veto rights lapsing. In addition, when the target is a limited partnership, the buyer must consider whether it holds a majority of the partnership's kick-out rights as a result of its acquisition of voting interests in that partnership.

3. Control can be obtained by the buyer through a *transaction or other event*. An event other than a transaction may occur through no direct action of the buyer. For example, the buyer may obtain control of an investee as a result of that investee acquiring its own shares, which has the effect of increasing the buyer's ownership interest to that of a controlling interest. Assume that an investor owns 60,000 shares in a business and the business has 150,000 shares outstanding. In this situation, the investor owns a 40% interest in the business and accounts for its investment using the equity method. If the business buys or redeems 50,000 of its own shares from other investors, those shares are retired or become treasury shares and are no longer considered outstanding. As a result, the investor's ownership interest in the business increases to 60% (the investor's 60,000 shares in the business divided by 100,000 shares outstanding). This example illustrates that an investor can become a buyer by obtaining control without transferring consideration and without undertaking any other direct action on its own behalf and be subject to the business combination accounting guidance.

Transactions that meet the definition of a business combination include, but are not limited to: (a) leveraged buyouts, (b) combinations between two or more mutual entities and (c) initial consolidation of a VIE when the VIE and PB are not under common control and the VIE is a business. Even if a transaction or other event satisfies the definition of a business combination, there are specific types of transactions explicitly excluded from the scope of the business combination accounting guidance in ASC 805. Examples include combinations between not-for-profit entities and combinations between entities under common control. Accounting for mergers and acquisitions of not-for-profit entities is covered in ASC 954-

805 and 958-805. Accounting for combinations or transfers between entities under common control is covered in ASC 805-50.

Determining whether a transaction or other event should be accounted for as a business combination or an asset acquisition has significant accounting repercussions. For example:

- Goodwill is recognized in a business combination, but not in an asset acquisition.
- Transaction costs are generally expensed as incurred and when the related services have been received by the buyer in a business combination, while the same costs are generally considered part of the cost of the assets (or net assets) in an asset acquisition.
- Assets acquired and liabilities assumed in a business combination are measured predominantly at fair value, while assets acquired and liabilities assumed in an asset acquisition are measured by allocating the total cost of the acquisition to the assets acquired and liabilities assumed on a relative fair value (or other appropriate amount) basis.

These are but a few of the reasons why it is important to draw the appropriate conclusion about whether a business combination occurred.

It is also important to note that the definition of a business used for purposes of determining whether a business combination has occurred is also used in other accounting determinations. For example, the definition of a business discussed herein is also used in determining:

- What constitutes a reporting unit for purposes of goodwill impairment testing (unless goodwill impairment testing is performed at the entity level as permitted under the private-company goodwill alternative [see Section 18.1 of the guide])
- What constitutes a business for purposes of a scope exception to the guidance on VIEs included in ASC 810-10
- Whether the guidance in ASC 810-10 on how to account for decreases in a parent’s ownership interest in a subsidiary (including decreases that result in deconsolidation) is applicable
- Whether the guidance in ASC 610-20 on how to account for the derecognition of nonfinancial or in substance nonfinancial assets is applicable to the sale of such assets
- Whether a specific type of transaction is a spinoff

An entity must consistently apply the definition of a business in these and other places in U.S. GAAP in which it is used.

Overall accounting model

The overall accounting model used to account for a business combination consists of the following four steps:

1. Identify the buyer
2. Determine the acquisition date
3. Recognize and measure, predominantly at fair value, the assets acquired, liabilities assumed and any NCI
4. Recognize and measure the goodwill or a gain from a bargain purchase

Identify the buyer

If the business over which control has been obtained is a VIE, the buyer is always the PB of the VIE as determined under the VIE consolidation model. If the business over which control has been obtained is not a VIE, the buyer is the combining entity that gains control over the business. In these situations, the identity of the buyer is typically readily apparent after considering which party is transferring cash, incurring liabilities and (or) issuing equity interests. However, if the identity of the buyer is not readily apparent after considering these factors, then certain qualitative factors should be examined in the context of the facts and circumstances of the specific business combination.

Identification of the appropriate party as the buyer in a business combination is important because it is the buyer who applies the provisions of ASC 805, and it is the target whose assets and liabilities are measured predominantly at fair value.

Determine the acquisition date

The acquisition date is the date that the buyer obtains control of the target, which is usually the closing date. The acquisition date may only be different from the closing date if there is a written agreement transferring control of the target to the buyer on a date other than the closing date. Identifying the appropriate acquisition date is important because it is the date at which: (a) all amounts involved in the accounting for the business combination are measured by the buyer and (b) the buyer begins consolidating the target for accounting purposes.

Recognize and measure assets acquired, liabilities assumed and any NCI

Recognition

Assets and liabilities recognized in the accounting for a business combination must meet the definitions of assets and liabilities provided in the following paragraphs of CON 6:

> 25. Assets are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events. [footnote omitted]
>
> 35. Liabilities are probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events. [footnotes omitted]

With only limited exceptions, each item acquired in a business combination that meets one of these definitions should be recognized in the accounting for the business combination. The exceptions to this general recognition principle are discussed later in this summary.

For purposes of determining whether an intangible asset should be recognized in the accounting for a business combination, the buyer must focus on whether the intangible asset: (a) arises from contractual or other legal rights or (b) is capable of both being (i) separated from the entity and (ii) sold, transferred, licensed, rented or exchanged either on its own or combined with a related contract, identifiable asset or liability. However, under the private-company intangible asset alternative (see Section 17.1 of the guide), a private company may choose to elect an accounting policy under which it does not separately recognize the following intangible assets in the accounting for a business combination: (a) intangible assets that would otherwise arise from NCAs or (b) CRI assets that cannot be separately sold or licensed. The value of these intangible assets is effectively subsumed into goodwill. If a private company elects the intangible asset alternative, the general guidance applicable to the recognition of intangible assets in ASC 805 continues to be relevant for purposes of identifying intangible assets other than those affected by the alternative.

ASC 805-20-55-11 to 55-45 lists and discusses several types of intangible assets that should be recognized separately from goodwill. Examples of such intangible assets include:

- Assets for trademarks and trade names
- Assets for acquired IPR&D

- Assets for customer contracts, customer relationships and (or) customer lists (unless the private-company intangible asset alternative has been elected, in which case such assets may or may not be recognized, depending on the facts and circumstances)

Measurement

The measurement principle applied in the accounting for a business combination is fair value. With only limited exceptions, the assets and liabilities recognized, along with any NCI recognized, are measured at their fair value. Even if less than 100% of the target is acquired, the assets acquired and liabilities assumed in a business combination are still recorded at 100% of their fair value (or other amounts measured in accordance with ASC 805). The exceptions to the general fair value measurement principle are discussed later in this summary.

The definition of fair value and related fair value measurement guidance that should be used in the accounting for a business combination can be found in ASC 820. Use of this definition and related fair value measurement guidance requires measuring the fair value of an acquired nonfinancial asset based on the highest and best use of that asset from a market participant's perspective. In other words, an entity-specific value should not be used, even for assets that the buyer does not intend to use.

NCI

When a partial acquisition occurs (which is discussed later in this summary), the acquisition-date fair value of the NCI should be recognized. When identifying the instruments that should be included in the NCI, the buyer needs to consider the financial instruments (or embedded features) of the target, or in some cases, of the buyer or a subsidiary when the payoff to the counterparty is partially or wholly based on the stock of a consolidated subsidiary, and determine whether those instruments (or embedded features) meet the definition of a liability or equity (which can be a complex determination). The financial instruments (or embedded features) that are issued by the buyer or a subsidiary and meet the requirements to be classified as equity, as well as instruments of the target that should be classified as equity in its standalone financial statements, should be considered part of the NCI in the target.

It may not be appropriate for the buyer to base the fair value of the NCI solely on the per-share consideration transferred to obtain the controlling interest because the consideration transferred to obtain the controlling interest may include a control premium. As such, in estimating the fair value of an NCI using the amount paid to obtain a controlling interest, adjustments (for a DLOC and [or] DLOM) may be required to remove the effects of the control premium.

Within the consolidated balance sheet, the NCI in a target should be: (a) clearly identified and labeled and (b) presented separately within equity (i.e., not combined with the buyer's [i.e., parent's] equity). However, there is also additional guidance that public companies must follow and that we believe is preferable for private companies to also follow. This additional guidance could result in an NCI that includes redemption features being classified outside of permanent equity (i.e., in temporary equity) in the consolidated financial statements, which is sometimes referred to as mezzanine equity. Temporary equity is presented on the balance sheet between liabilities and equity, rather than shown as part of total liabilities or total equity.

Exceptions to overall recognition and measurement principles

The following table lists those types of assets and liabilities that are recognized and (or) measured using principles other than the general recognition and (or) measurement principles discussed earlier:

Assets or liabilities related to:	Exception to overall recognition and (or) measurement principle	Nature of exception
Leases (after the adoption of ASC 842)	Both	Whether there is an exception to the overall recognition and (or) measurement principle for leases acquired in a business combination depends on whether the target is the lessee or lessor and the classification of the lease (see Section 10.13.3 of the guide).
Certain financial assets (after the adoption of ASC 326)	Measurement	Whether there is an exception to the overall measurement principle for accounts and loans receivable acquired in a business combination depends on whether those receivables are considered PCD assets. In addition, whether there is an exception to the overall measurement principle for investments in debt securities acquired in a business combination depends on whether the buyer classifies those investments as trading, AFS or HTM and whether the investments are considered PCD assets or beneficial interests that meet the conditions in ASC 325-40-30-1A.
Contingencies (other than those involving contingent consideration and indemnifications)	Both	A contingency is recognized at its acquisition-date fair value if that fair value can be determined. For purposes of determining fair value, the guidance in ASC 820 is used. If the acquisition-date fair value of a contingency cannot be determined, then an asset or liability is recognized for the contingency if it is probable at the acquisition date that such an asset or liability exists and if its amount is reasonably estimable. The guidance in ASC 450 should be used when assessing these criteria. Regardless of whether the fair value or the reasonably estimable amount is used to measure a contingent asset or contingent liability recognized in the accounting for a business combination, both measurements must reflect the facts and circumstances as they existed on the acquisition date. In other words, both are acquisition-date measurements and should not take into consideration facts and circumstances arising after the acquisition date. An asset or liability is not recognized for a contingency in the accounting for a business combination if: (a) its fair value cannot be determined and (b) the probable and reasonably estimable criteria are not met. Instead, the contingency is disclosed and accounted for subsequent to the acquisition date in accordance with ASC 450.
Indemnification assets	Both	The recognition and measurement of indemnification assets follow the recognition and measurement of the underlying indemnified items. For example, consider a situation in which the seller in a business combination contractually indemnifies the buyer for the unfavorable

Assets or liabilities related to:	Exception to overall recognition and (or) measurement principle	Nature of exception
		resolution of the target's open litigation at the acquisition date. In this example, the buyer's accounting for the indemnification asset depends on its accounting for the litigation (i.e., the indemnified item). Collectibility and contractual limitations of the indemnification should be taken into consideration in measuring the indemnification asset.
Income taxes	Both	The guidance in ASC 805-740 and 740 is used to recognize and measure the income tax effects of a business combination.
Employee benefits	Both	Other applicable guidance in the Codification, such as that found in ASC 712 and 715, are used to recognize and measure assets and liabilities related to the target's employee benefit offerings.
Reacquired rights (when the buyer acquires a target to which it previously granted certain rights, those reacquired rights represent an intangible asset)	Measurement	The value of reacquired rights is measured based on their remaining contractual term. Future renewals should not be taken into consideration. This is the case even if market participants would renew the underlying contract.
Share-based payment awards	Measurement	ASC 718 is used to measure the value of both employee and nonemployee replacement share-based payment awards.
Assets held for sale	Measurement	Assets held for sale are measured at their fair value less costs to sell.

Classification or designation of acquired assets and assumed liabilities

There are many instances in which U.S. GAAP: (a) requires an entity to determine the classification of a transaction, instrument or agreement (e.g., whether an investment in a debt security should be classified as trading, AFS or HTM), which then dictates its accounting or (b) allows an entity to designate a transaction, instrument or agreement in a particular manner (e.g., when a derivative instrument has been properly designated as a hedging instrument), which then has repercussions on its accounting. In general, when leases within the scope of ASC 840 (prior to the adoption of ASC 842) or insurance contracts within the scope of ASC 944-10 are acquired in a business combination, the classification of those leases and insurance contracts should be based on the terms, conditions and other relevant factors in existence at their inception, or if applicable, upon their most-recent modification. After the adoption of ASC 842, for leases within its scope, the buyer should retain the target's lease classification as of the acquisition date, provided it was determined appropriately by the target, except when the lease is modified in conjunction with the business combination and the modification is not accounted for as a separate contract in accordance with ASC 842-10-25-8, in which case the classification of the lease should be reassessed on the acquisition date. If the acquired lease is modified in conjunction with the business combination and the modification is accounted for as a separate contract, the classification of the lease prior to the modification is retained and the classification of any lease in the separate contract (which was created by the modification) is determined on the acquisition date.

For all transactions, instruments or agreements other than those related to leases within the scope of ASC 840 or 842 or insurance contracts within the scope of ASC 944-10, the buyer's classification or designation should be based on applying the relevant authoritative literature to the terms, conditions and other relevant factors in existence on the acquisition date.

Recognize goodwill or a gain from a bargain purchase

The amount of goodwill or gain from a bargain purchase to be recognized in conjunction with a business combination is determined as follows:

	Consideration transferred (measured predominantly at fair value)
+	Acquisition-date fair value of any NCI (in the case of a partial acquisition)
+	Acquisition-date fair value of the buyer's PHEI in the target (in the case of a step acquisition)
=	Total (i.e., fair value of the target as a whole)
-	Net assets acquired by the buyer (which is 100% of the target's net assets measured predominantly at fair value)
=	Goodwill (if positive); Gain from a bargain purchase (if negative)

The sum of the first three elements can also be thought of as the fair value of the target as a whole and the amount of goodwill can also be thought of as the excess of the fair value of the target as a whole over the net assets acquired by the buyer (which is 100% of the target's net assets measured predominantly at fair value).

This approach to determining goodwill results in the recognition of 100% of goodwill, not just the buyer's portion of goodwill. Recognizing 100% of goodwill results from: (a) including in the fair value of the target as a whole both the fair value of any NCI and the fair value of any PHEI of the buyer in the target and (b) recognizing 100% of the fair value (or other measured amount) of the net assets acquired by the buyer.

Consideration transferred

All consideration transferred, other than employee and nonemployee replacement share-based payment awards, is recognized in the accounting for the business combination at its acquisition-date fair value. This includes contingent consideration and equity securities transferred by the buyer to the sellers (including rollover equity), which should reflect the value of the combined entity. When the buyer repays the seller's debt in conjunction with a business combination, it must consider whether such repayment represents additional consideration transferred or repayment of an assumed liability.

Based on the applicable authoritative literature, contingent consideration must be classified as an asset, liability or equity on the acquisition date. In practice, it is unusual for contingent consideration to meet all of the necessary conditions that are required for equity classification.

Both employee and nonemployee replacement share-based payment awards are measured using the measurement principles in ASC 718. In some cases, the value of replacement share-based payment awards under ASC 718 must be allocated to both precombination and postcombination periods. That portion allocated to the precombination period represents an element of consideration transferred in the business combination, and that portion allocated to the postcombination period represents future compensation costs or other costs for goods or services to be recognized after the acquisition date.

Partial acquisition

A partial acquisition occurs when the buyer in a business combination acquires less than 100%, but more than 50%, of the target. In other words, the buyer acquires a controlling interest, but not a 100% interest, in the target. For example, the buyer acquires 65% of the target in a single transaction.

When a partial acquisition occurs, the acquisition-date fair value of the NCI (35% in the example in the preceding paragraph) should be recognized and taken into consideration in measuring the amount of goodwill or gain from a bargain purchase that should be recognized as a result of the business combination. In other words, in a partial acquisition, the acquisition-date fair value of the NCI represents one part of the fair value of the target as a whole. Additional information related to the initial accounting for the NCI is provided earlier in this summary.

Step acquisition

A step acquisition occurs when the buyer in a business combination has a PHEI in the target and acquires an additional interest in the target that results in the buyer obtaining control. For example, on November 1, 20X9, the buyer owns a 30% equity interest in the target. On November 2, 20X9, the buyer acquires an additional 35% equity interest in the target, which ultimately provides the buyer with a 65% controlling interest in the target. As a result of acquiring the additional 35% equity interest, the buyer has acquired the target for accounting purposes and must account for this acquisition as a business combination. A step acquisition is also referred to as a business combination achieved in stages.

When a step acquisition occurs, the buyer must recognize either: (a) a gain for the excess of the acquisition-date fair value of the buyer’s PHEI in the target over the carrying value of that interest or (b) a loss for the excess of the carrying value of the buyer’s PHEI in the target over the acquisition-date fair value of that interest. It may not be appropriate for the buyer to base the fair value of its PHEI in the target solely on the per-share consideration transferred to obtain the controlling interest because the consideration transferred to obtain the controlling interest may include a control premium. As such, in estimating the fair value of any PHEI in the target using the amount paid to obtain a controlling interest, adjustments (for a DLOC and [or] DLOM) may be required to remove the effects of the control premium.

Bargain purchase

A bargain purchase results from the excess of net assets acquired by the buyer (which is 100% of the target’s net assets measured predominantly at fair value) over the sum of: (a) consideration transferred (measured predominantly at fair value), (b) the fair value of any NCI and (c) the fair value of any PHEI of the buyer in the target. Gains from bargain purchases are expected to occur infrequently. When one does result from the buyer’s preliminary accounting for a business combination, the buyer must perform a thorough self review of: (a) the accuracy and completeness of the identifiable assets acquired and liabilities assumed and (b) the appropriateness of the procedures used to measure the individual components within each element of the goodwill calculation and the results of applying those procedures. If a gain from a bargain purchase still exists after the buyer performs this thorough self review, then the buyer should recognize a gain from a bargain purchase in its income statement and prepare its disclosure explaining why a bargain purchase resulted from the business combination. The gain should be attributed entirely to the buyer (i.e., none of the gain should be attributed to any NCI).

Measurement period adjustments

The buyer may not be able to complete its accounting for a business combination by the time it has to issue its financial statements that include the acquisition date. If this is the case, then the buyer should recognize provisional amounts in its financial statements and has up to one year from the acquisition date to finalize those amounts. If the buyer’s accounting for a business combination reflected in its financial statements is incomplete, then the buyer must disclose that fact and identify all amounts included in its financial statements that are provisional.

An adjustment during the measurement period is only reflected as a measurement period adjustment if it results from the buyer: (a) obtaining additional information about the facts and circumstances that existed as of the acquisition date and (b) determining that if this additional information had been known, it would have affected the recognition or measurement of some element of the business combination accounting (e.g., recognition or measurement of an acquired asset or assumed liability) as of the acquisition date. If an adjustment does not meet both of these criteria, it is not considered a measurement period adjustment and as such, is not reflected in the accounting for the business combination. In these situations, oftentimes the adjustment affects the buyer's operating income.

Measurement period adjustments are recorded in the period in which they occur. In other words, historical financial statements are not retrospectively adjusted. While the measurement period adjustment is recorded in the period in which it occurs, it is still measured as of the acquisition date. In addition, the buyer also needs to consider the income statement effects (if any) that would have resulted in the intervening period if the measurement period adjustment (hypothetically) had been recorded as of the acquisition date. For this purpose, the intervening period is the period from the acquisition date through the period that ended before the adjustment occurred. For example, if the acquisition by an entity with a calendar year end occurred on November 30, 20X1 and the measurement period adjustment occurs in May 20X2, which is subsequent to the issuance of the December 31, 20X1 financial statements, the intervening period is December 1, 20X1 through April 30, 20X2. One of the disclosures a buyer is required to provide for measurement period adjustments is the amount (i.e., portion) of a measurement period adjustment made to individual income statement item(s) in the current period that would have been recognized in previous periods if the adjustment had been retrospectively recorded as of the acquisition date (which, in the preceding example, would be the amount of the measurement period adjustment attributable to December 20X1).

Subsequent accounting

Once an asset or liability is recognized in the accounting for a business combination, the subsequent accounting for that asset or liability typically follows the accounting guidance otherwise applicable to those assets and liabilities. For example, property, plant and equipment recognized in the accounting for a business combination should subsequently be depreciated and reviewed for impairment like any other property, plant and equipment.

Certain assets and liabilities recognized in the accounting for a business combination merit unique subsequent accounting guidance given their nature, the recognition and measurement principles applied to them in the accounting for the business combination and (or) the subsequent accounting guidance applicable to the same assets and liabilities not acquired in a business combination. This subsequent accounting guidance applies only if the adjustment being considered is not a measurement period adjustment. Those items for which unique subsequent accounting guidance exists, as well as a brief overview of that guidance, are provided in the following table:

Item	Overview of subsequent accounting guidance
Accounts and loans receivable that are not considered PCD assets after the adoption of ASC 326	Immediately after the business combination accounting, an allowance for credit losses should be recognized through credit loss expense (which is often referred to as recognizing a day-one loss).
Investments in debt securities classified as HTM that are not considered PCD assets or beneficial interests that meet the conditions in ASC 325-40-30-1A	Immediately after the business combination accounting, an allowance for credit losses should be recognized through credit loss expense (which is often referred to as recognizing a day-one loss).

Item	Overview of subsequent accounting guidance
Reacquired rights	The amortization period for an intangible asset representing reacquired rights is its remaining contractual period (i.e., renewals are not considered in determining the amortization period).
Contingent assets and liabilities	A systematic and rational accounting policy based on the nature of the contingent asset or liability should be used to subsequently account for that asset or liability. In essence, the buyer must adopt an accounting policy related to its subsequent accounting for contingent assets and contingent liabilities and that accounting policy should refer to other relevant U.S. GAAP as appropriate and should be consistently applied to similar contingent assets and liabilities.
Indemnification assets	Adjustments to the carrying amount of an indemnification asset follow any adjustments made to the underlying indemnified item. In other words, the same basis that is used to measure the indemnified asset or liability is used to measure the indemnification asset. Collectibility and contractual limitations of the indemnification should be taken into consideration when remeasuring an indemnification asset. In many cases, the subsequent accounting adjustments to the indemnified asset or liability and the indemnification asset will offset each other in the same line item of the income statement (i.e., the changes would effectively be reflected on a net basis in the income statement). Indemnification assets are removed from the books only upon collection, sale or other loss of rights to the benefits provided by the indemnification.
Contingent consideration	The subsequent accounting for contingent consideration depends on whether the contingent consideration is classified as an asset, liability or equity. Contingent consideration classified as equity is not remeasured in subsequent accounting periods. Contingent consideration classified as an asset or liability is remeasured to its fair value at the end of each reporting period, and the change in fair value is reflected in income or expense. While not common, the only exception would be if the contingent consideration qualifies for and is designated as a hedging instrument in a hedge relationship for which ASC 815-20-35 requires the change in fair value to be recognized in OCI. The change in the fair value of contingent consideration that is not a derivative should be reflected on the income statement in a line item that is included within operating expense or income. The line item in the income statement where the change in the fair value of contingent consideration that is a derivative should be reflected depends on the facts and circumstances.

After the buyer in a business combination obtains control over the target, its ownership interest in the target may change for a number of reasons. With certain exceptions: (a) if the buyer still has control of the target after a change in its ownership interest (i.e., the buyer's ownership interest increases or decreases, but the buyer still maintains control), the change in ownership interest is accounted for as an equity transaction or (b) if the buyer loses control of the target after a change in its ownership interest, a gain or loss is recognized upon the deconsolidation of the target.

Part of the business combination or not part of the business combination

The buyer must determine whether there are any other relationships or transactions (perhaps occurring in the same timeframe or at the same time as the business combination) between it and the target, the target's employees and (or) the sellers of the target that should be accounted for separate from the business combination. Examples of such other relationships or transactions include:

- Payments made to settle preexisting relationships between the buyer and the target
- Payments made to the target's employees or former owners for future services
- Payments to reimburse the sellers for transaction costs they paid on behalf of the buyer
- Payments to reimburse the target for restructuring costs incurred at the request of the buyer

In determining whether relationships or transactions that will or may result in payments to the target's employees should be accounted for separate from the business combination, the buyer should first consider whether the payments to the employees are forfeited upon termination of employment (i.e., whether the payments are contingent upon employment). If the payments to an employee are contingent upon that employee's continued employment after the acquisition date, then those payments should be accounted for separate from the business combination as compensation. In determining whether other relationships or transactions between the buyer and the target, the target's employees and (or) the sellers should be accounted for separate from the business combination, the buyer should consider the following questions:

- Why did the buyer, target, target's employees, sellers and (or) other involved parties form the relationship or enter into or modify the transaction?
- Who initiated the relationship or transaction?
- When was the relationship or transaction entered into or modified?

The purpose of these questions is to determine which party or parties benefit from the other relationship or transaction.

In some cases, accounting for a transaction or other relationship separate from the business combination will require the buyer to recognize a gain or loss (e.g., the effective settlement of a lawsuit between the buyer and the target as a result of the business combination).

Transaction costs of the buyer are not treated as part of the consideration transferred in a business combination. These costs are expensed as incurred and when the related services have been received by the buyer unless other U.S. GAAP provides different guidance, which is the case for debt and equity issuance costs. The buyer's transaction costs should still be recognized by the buyer even if they are paid by the target, the sellers, the buyer's parent or another related party. If a related party is providing the acquisition services, the buyer needs to consider whether the billings from the related party for those services are comparable to market rates for those services. If one service provider provides multiple acquisition services with different accounting models, the buyer needs to consider whether the billings from that service provider have been properly allocated to the different services provided. Transaction costs of the sellers paid by the buyer are part of the consideration transferred.

Disclosures

The disclosure requirements for business combinations center on satisfying the following two objectives: (1) users of the buyer's financial statements are able to evaluate the *nature* of the business combination and (2) users of the buyer's financial statements are able to evaluate the *financial effects* of the business combination. Many specific disclosures are required to satisfy these objectives. However, if complying with these specific disclosure requirements does not fully satisfy the stated disclosure objectives, then the buyer must provide any incremental information that would result in the full satisfaction of those objectives.

Disclosures are required for business combinations that occur: (a) during the current financial reporting period and (b) after the end of the current reporting period, but before the buyer's financial statements for that period are issued or available to be issued.

A separate disclosure objective applies to adjustments that are recorded in the current reporting period to the accounting for a business combination that occurred in either the current or a previous reporting period. That disclosure objective requires the buyer to disclose information that enables the users of its financial statements to evaluate the financial effects of those adjustments. Again, specific disclosures are required to satisfy this objective. If this objective is not satisfied by disclosing the information required by the specific disclosure requirements, then the buyer must provide the incremental information that would result in the full satisfaction of the objective.

In addition to the disclosures required by ASC 805, there are many other disclosure requirements in U.S. GAAP that might also apply to certain aspects of the accounting for a business combination. For example, if the buyer acquires the obligation to provide employee benefits such as pension benefits and other postretirement benefits as part of a business combination, the buyer must provide all of the disclosures related to these employee benefit obligations that are required under the applicable U.S. GAAP.

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