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NEWSLETTER OF THE MERGERS & ACQUISITIONS PRACTICE GROUP OF MANATT, PHELPS & PHILLIPS, LLP

New Accounting Rules For Business Combinations Align U.S. Standards More Closely With International Standards

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Recently the Financial Accounting Standards Board (FASB) issued revised guidance on accounting for acquisitions under Statement of Financial Accounting Standards No. 141R (*Business Combinations)*. FAS 141R takes effect for financial statement periods beginning after December 15, 2008, so calendar-year companies will be required to implement the new standards beginning in 2009. The new accounting rules will align U.S. accounting practices more closely with international financial reporting standards.

FASB believes that the adoption of FAS 141R will increase consistency in the accounting and financial reporting of business combinations by establishing the acquisition date fair value as the measurement objective for all assets acquired and liabilities assumed in a business combination and by requiring more disclosure to reflect the nature and financial effect of the business combination.

Issued in 2001, FAS 141 mandated that every business combination be accounted for as a purchase of one company by another, rather than a merger of equals. FAS 141 also required that the assets and the liabilities acquired be recorded at fair value. FAS 141R basically extends the fair-market requirements to additional subjects.

One of the more controversial changes is the accounting for acquisition-related costs. Fees paid to investment banks, attorneys and valuation experts are no longer included in goodwill and have the potential to affect earnings. Until now, acquisition-related costs paid to third parties had been capitalized as part of the purchase price. Under FAS 141R, these fees will be considered an expense as incurred and will

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be written off against income, which could impair the net income of companies that tend to be serial acquirors. In addition, because deal costs are expenses when they are incurred, the appearance of significant spikes in such expenses could raise attention about potential transactions that are still confidential.

FAS 141R also alters the accounting relating to restructuring, earn outs and contingencies. Prior to FAS 141R, future obligations related to restructuring an acquired business were considered part of the purchase price and therefore accrued in purchase accounting. FAS 141R, however, requires restructuring costs to be accrued and expensed when incurred.

FAS 141R also requires earn out payments to be recorded at fair value at the time of the acquisition, rather than permitting the recognition of earn outs to be delayed until payment is reasonably assured. Earn out payments classified as equity would not be periodically remeasured, while earn outs to be paid in cash would periodically be remeasured with changes charged to post acquisition earnings. In addition, reserves for contingencies acquired in a transaction have to be estimated at the closing of the acquisition and recorded at fair value. These estimates will have to be revalued quarterly, with changes flowing through the income statement. Previously, reserves for contingencies did not have to be established until they were "probable."

Finally, FAS 141R changed the measurement date for valuation purposes from the date of execution of the acquisition agreement to the closing date of the deal. In mergers where regulatory approvals require lengthy periods of time between signing and closing, the difference between these two valuations can be significant.

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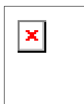

David M. Grinberg Mr. Grinberg's practice focuses on mergers and acquisitions, including tender offers, proxy contests, hostile takeovers and special committee representation, and underwritten securities offerings, including initial public offerings and public and private offerings of equity and debt.

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