FASB FINANCIAL ACCOUNTING STANDARDS BOARD

MEMO

Topic No.	**8**
Issue Date	**June 7, 2021**
Meeting Date	**PCC Meeting June 22, 2021**

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Project	**Improving the Accounting for Business Combinations and Asset Acquisitions**
Project Stage	**Initial Deliberations**
Issues	**Private Company Council Meeting, Costs and Benefits of Accounting for Contingent Consideration in a Business Combination**

Memo Purpose

1. The purpose of this memo is to update the Private Company Council (PCC) on the project on improving the accounting for asset acquisitions and business combinations and to facilitate a discussion with PCC members about the accounting for contingent consideration in business combinations (both at the acquisition date and subsequent to that date).

Questions for PCC Members

Business Combinations:

1. What cost savings, if any, would be realized by removing the requirement for the acquirer to recognize the fair value of contingent consideration at the acquisition date?

2. How significant would the cost savings be if remeasurement was performed annually or based on a significant change in expectations (as opposed to each reporting period)?

3. If the acquirer was required to account for changes in the value of contingent consideration through an offset to purchase accounting (rather than through earnings), how would that affect the cost of accounting for contingent consideration?

Disclosures: Users participating in staff outreach requested information about the expected timing and probability of contingent consideration payments, disaggregated by performance metric or milestone event.

4. Would that information be useful for private company users? If so, please explain how and why.

Project Objective

2. The objective of this project is to improve the accounting for asset acquisitions and business combinations by narrowing the differences between those two acquisition models. In addressing the areas within the scope of this project, the Board directed the staff to consider the existing requirements in both acquisition models, as well as other alternatives to narrow the differences and improve the accounting. Narrowing the differences may not necessarily require that the accounting be identical under both models.

Background

3. Accounting for business acquisitions requires that the acquirer recognize and measure the assets acquired and liabilities assumed at their fair values with limited exceptions. The acquirer also is required to measure the consideration “paid” for the business or the total consideration transferred, which includes the fair value of a contingent consideration arrangement. The excess of total consideration transferred over the fair value of assets and liabilities acquired is recognized as goodwill, while the excess of the fair value of assets and liabilities acquired over total consideration transferred is recognized as other income (bargain purchase gain).
4. If the assets acquired and liabilities assumed do not meet the GAAP definition of a business, and the transaction or event is not within the scope of other GAAP, the transaction is accounted for under Subtopic 805-50, Business Combinations—Related Issues. That is, assets and liabilities are recognized on the basis of their cost to the acquiring entity, which generally includes the transaction costs of the asset acquisition. The cost of the asset group should be allocated to the individual assets acquired or liabilities assumed based on their relative fair values. Because the cost of the asset group is fully allocated to the assets acquired and liabilities assumed, no goodwill is recognized in an asset acquisition.
5. In addition to the different measurement models described in paragraphs 3 and 4, there are numerous areas in which explicit differences exist between the accounting for acquisitions of a business versus acquisitions of assets. In this project, the Board considered a full inventory of those differences and decided to address several issues, including contingent consideration, which is further described below.

Contingent Consideration

6. Contingent consideration often is used in the acquisition of a business to:

   (a) Close the gap in price or value expectations between the buyer and the seller of the business.

   (b) Allow the buyer to share the risk associated with the future performance of the acquired business with the seller by structuring some of the payment upfront and the remainder contingent on future performance or events.

   (c) Allow the seller to participate in the upside of the performance of the business post-transaction.

7. Examples of contingent consideration arrangements include:

   (a) Example 1: Cash-settled non-earnings-based contingent consideration:

   > DEF Corp. acquires a real estate company (ABC Corp.). As part of the overall transaction, DEF Corp. agrees to pay ABC Corp. cash equal to the appreciation of the properties owned by ABC Corp. over a specific benchmark—two years after acquisition.

   (b) Example 2: Cash-settled earnings-based contingent consideration:

   > DEF Corp. acquires G Corp. As part of the agreement, the terms dictate that DEF Corp. must pay the former owners of G Corp. cash ranging from $0 to $10 million on the basis of an earnings-based formula.

8. Contingent consideration is defined in the Master Glossary of the Codification as follows:

   > Usually an obligation of the **acquirer** to transfer the additional assets or equity interests to the former **owners** of an **acquiree** as part of the exchange for **control** of the acquiree if specified future events occur or conditions are met. However, contingent consideration also may give the acquirer the right to the return of previously transferredconsideration if specified conditions are met.

   The contingent consideration definition applies when there is an acquisition of a business because the terms *acquirer* and *acquiree* relate specifically to business combination accounting. However, in practice, contingent payment terms in an asset acquisition also are referred to as contingent consideration.

9. The acquirer in a business combination first considers whether the contingent consideration arrangement is part of the acquisition or if it is a separate transaction. For example, an arrangement in which the payments to a selling shareholder/employee are automatically forfeited if employment terminates are separate from the acquisition and are accounted for as compensation for post-combination services. The acquirer also must assess whether the financial instruments guidance (including Topic 815, Derivatives and Hedging) applies to the contingent consideration, which, if applicable, requires measurement and recognition at fair value. If the financial instruments guidance does not apply, the accounting depends on whether the transaction is a business combination or an asset acquisition.

10. Business combinations guidance requires the acquirer to measure and recognize the obligations and rights associated with contingent consideration arrangements at their acquisition-date fair values. For contingent consideration classified as an asset or a liability, the acquirer recognizes subsequent changes in the fair value of contingent consideration through earnings until the contingency is settled. An acquirer recognizes and measures the fair value of contingent consideration classified as equity at fair value at the acquisition date. However, those arrangements are not remeasured after initial measurement. Settlement of equity-classified contingent consideration is accounted for within equity.

11. For asset acquisitions, there is diversity in practice in how acquirers account for contingent consideration at the acquisition date. The acquirer in an asset acquisition may account for contingent consideration in the following ways:

    (a) By recognizing a liability if the contingent event is deemed probable (in practice, generally considered to be an event that has a 75-percent or greater likelihood of occurrence) and can be reasonably estimated.

    (b) By recognizing when the contingency is resolved.

    (c) By analogizing to the equity method model and recognizing a liability for the lesser of the following:

        i. The maximum amount of contingent consideration
        ii. The excess of the fair value of the net assets acquired over the initial consideration paid.

Project Update

12. At the May 26, 2021 Board meeting, the staff shared recent feedback received from users, practitioners, and preparers on the current accounting for contingent consideration, including information utility, cost, and complexity of providing that information. The Board directed the staff to bring to a future Board meeting the initial and subsequent accounting for contingent consideration in a business combination, including a summary and analysis of outreach with private company stakeholders.