

Accounting for Step Acquisitions in Business Combinations (ASC 805)

We've seen a couple of cases recently where a controlling interest in a target company was acquired along with some provision for future acquisition. The most recent example contemplated an option for the buyer to purchase the remaining non-controlling interest, which looked like a call option exercisable at a price determined by the target's average two year trailing annual net earnings. Alternatively, the seller had a quasi-put option giving him the right to put the remaining, non-controlling interest back to the buyer at a price determined by the same calculation, based on trailing annual net earnings.

At first, we figured we might have to value these "options to buy" as if they were contingent consideration, but after further consideration, we determined the step transaction was in fact two separate, discrete transactions, and our job in running the purchase price allocation, was to consider the acquisition of the initial controlling interest known to have been acquired. In this case, 70 percent of the total equity was acquired in the first step, which we were asked to evaluate, leaving 30 percent available at the option of the Buyer or the Seller. We simply imputed the purchase price derived for the 70 percent interest to the remaining 30 percent interest to assume 100 percent had been acquired. We found support for this position in ASC 805:

According to ASC 805-20-30, the acquirer shall measure the identifiable assets acquired, the liabilities assumed, and any non-controlling interests in the target at their acquisition date fair values. Further, a business combination may occur when an entity acquires enough, but less than 100 percent of, voting shares to obtain control. In such cases, the acquirer recognizes in its consolidated financial statements the assets acquired, liabilities assumed, and the non-controlling interest at 100 percent of their acquisition-date fair values, regardless of its level of controlling interest. The FASB has indicated that once an acquirer obtains control of an entity, it controls 100 percent of its assets, not just a portion of them.

ASC 805 requires companies to record 100 percent of the fair value of assets acquired and liabilities assumed when control is obtained, even if less than 100 percent of a business is acquired. This differs from Statement 141 and its related interpretive guidance, which required that only the controlling interest's share of the assets acquired and liabilities assumed be recognized at fair value and the remainder at book value. The FASB reasoned that once an acquirer obtains control of an entity, it controls all of an asset, not just a portion of it.

