

Business Valuation Monitor

Value creation perspectives for corporate executives and the investment community September 2009

SFAS 141R – Treatment of Bargain Purchases

Introduction

The Financial Accounting Standards Board (“FASB”) revised Statement of Financial Accounting Standards 141, Business Combinations, in 2007. Statement No. 141, revised 2007, (SFAS 141R) was enacted to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial reports about a business combination and its effects. Effective for business combinations occurring on or after December 15, 2008, SFAS 141R replaces existing Statement 141 in its entirety. SFAS 141R introduces the concept of acquisition accounting and presents a number of modifications to the previously existing Statement 141. Among these modifications is the treatment of bargain purchases.

Bargain Purchase

A bargain purchase is a transaction accounted for as a business combination in which, on the acquisition date, the net fair value of the acquired amount of identifiable tangible and intangible assets and the liabilities assumed exceeds the aggregate cost of the transaction. Prior to SFAS 141R, the amount of the excess fair value over cost was spread as pro rata reductions of amounts assigned to long-term assets and liabilities. As revised, the entire amount of bargain purchase observed is treated as a gain on the income statement.

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SFAS 141R – Treatment of Bargain Purchases (continued)

Preparers of financial statements should note that the provisions of SFAS 141R consider that bargain purchases are anomalous since sellers of assets or business interests would generally not knowingly transfer these assets at an amount less than fair value. As such, SFAS 141R specifically notes that in those cases where the initial assessment of the transaction yields a bargain purchase outcome, preparers need to sharpen their pencils. Additionally, over concern that the treatment of the bargain element as incremental income could offer an opportunity to record inappropriate amounts in the financial statements, the Statement includes guidance for preparers to review amounts included in the computation of the bargain element. Specifically, the acquirer should review:¹

1. The assets and liabilities identified to be sure there was not an inappropriate inclusion or exclusion
2. The fair value ascribed to any non-controlling interest in the acquired entity or previously held equity interests
3. The fair value of consideration transferred

¹ Computation of the aggregate cost under SFAS 141R now includes all of the following (note that ii and iii are newly added components):

- i) Consideration transferred in accordance with SFAS 141R;
- ii) The fair value of any non-controlling interest in the acquiree; and
- iii) The acquisition-date fair value of the acquirer's previously held equity interest in the acquiree for business combinations that occur in stages.

During this review, any additional assets or liabilities identified must be recognized and measured in accordance with SFAS 141R. The acquirer will then review the procedures set forth in SFAS 141R to ensure that the measurement of all identified acquired assets and liabilities consider all available information as of the acquisition date.

There are facts and circumstances where the possibility of a bargain purchase is more prevalent. Included among these circumstances are forced or distressed sales, in which case there may be a need to quickly create liquidity on the seller's behalf for other reasons (such as the death of a key owner).

Strong internal control systems and the use of external auditors and valuation specialists can help mitigate the risk surrounding potential measurement errors in addition to following specific standards. •

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