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Six Key Considerations in Managing ASC 805 Valuation Project

For most companies, Financial Accounting Standards Board Accounting Standards Codification (ASC) 805 (formerly FAS 141R) has been in effect since 2009. While the recent wave of acquisition activity provided lessons in implementing the new standards, more transaction experience is needed to understand the full impact of ASC 805. It is clear that transaction planning, execution, accounting, and disclosure requirements together with Fair Value measurements are all affected. The following six key issues should be considered in managing an ASC 805 valuation project.

More situations will require Fair Value accounting

ASC 805 provides for a broader definition of business combination. It also expands Fair Value reporting to full, partial, or stepped acquisitions. For example, in stepped acquisitions, previous investment interests held prior to obtaining control should be accounted for at Fair Value, with any gain or loss recognized on the income statement.

Market participant perspective

Market participant rather than company-specific assumptions have to be used in valuing assets or liabilities under ASC 805. When an acquired asset is not expected to be placed into service (i.e., trade name), it may still need to be recorded as long as other potential acquirers are likely to find it valuable. Likewise, a financial forecast has to be adjusted to include market-participant synergies and exclude company-specific synergies. It is important to develop a clear understanding of how potential acquirers, strategic or financial, would have exploited the assets of the same target.

Contingent consideration

Many companies have to employ complex earn-out provisions or contingent payments to breach the bid-ask spread in M&A negotiations. ASC 805 requires these arrangements to be recognized and recorded at Fair Value. Depending on the complexity of the arrangement, advanced valuation methods such as lattice or Monte Carlo modeling may be needed to evaluate Fair Value of future contingent payments. It is imperative to ascertain if your valuation provider is fluent in such methodologies, especially when the terms of such arrangements result in an additional layer of derivative or liability accounting.

In-Process Research and Development

In-Process Research and Development (IPR&D) asset is no longer written off but recorded as an indefinite life asset. As such, IPR&D needs to be tested for impairment under ASC 350 (formerly FAS 142). Few companies evaluate IPR&D projects the same way a valuation specialist does as part of financial reporting compliance. It is imperative to understand and plan on how an initial valuation will be used in testing the asset for impairment in subsequent reporting periods.

Acquisition costs

Acquisition costs will be expensed as incurred. No longer are they booked as part of acquisition accounting, leading to lower earnings in the acquisition period.

No negative goodwill

Under old rules, negative goodwill came into play when purchase consideration was less than the Fair Value of the target's net assets. Now, the bargain element must be recognized as a gain on financial statements. A target's business enterprise value may need to be valued separately in order to estimate the amount of bargain element. This complication is often observed with smaller transactions where no quantitative analysis was produced to support the negotiated purchase price.

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