Appendix--Proposed APB Opinion: Business Combinations and Intangible Assets

Accounting Principles Board of the American Institute of Certified Public Accountants
APPENDIX

PROPOSED APB OPINION: BUSINESS COMBINATIONS AND INTANGIBLE ASSETS*

EXPOSURE DRAFT

INTRODUCTION

1. A business combination occurs when two or more corporations or a corporation and one or more unincorporated businesses are brought together into one entity. The single entity carries on the activities of previously separate, independent enterprises.

2. Two methods of accounting for business combinations are now accepted in practice — "purchase" and "pooling of interests" — and both are supported in pronouncements of the Board and its predecessor, the Committee on Accounting Procedure. The accounting treatment of a combination may affect significantly the reported financial position and net income of the combined corporation for both current and future periods. Accounting for combinations by the purchase method often involves accounting for goodwill acquired.

3. The Director of Accounting Research of the American Institute of Certified Public Accountants has published two studies on accounting for business combinations and the related goodwill: Accounting Research Study No. 5, A Critical Study of Accounting for Business Combinations, by Arthur R. Wyatt and Accounting Research Study No. 10, Accounting for Goodwill, by George R. Catlett and Norman O. Olson. The two studies describe the origin and development of the purchase and pooling of interests methods of accounting for business combinations. The studies also cite the supporting authoritative pronouncements and their influences on accounting practices and evaluate the effects of practices on financial reporting. Accounting Research Study No. 10 emphasizes accounting for goodwill acquired in a business combination but also discusses accounting for goodwill developed internally.

Scope and Effect of Opinion

4. The Board has considered the conclusions and recommendations of Accounting Research Studies Nos. 5 and 10, the discussions of the need for

* The above Exposure Draft was issued on February 23, 1970 for comment from persons interested in financial reporting by the Accounting Principles Board of the American Institute of Certified Public Accountants, and is reprinted with the Institute's permission.

1 Accounting research studies are not statements of the Board or of the Institute but are published for the purpose of stimulating discussion on important accounting matters.
and appropriateness of the two accepted methods of accounting for business combinations, and proposals for alternative accounting procedures. It has also observed the present treatments of combinations in various forms and under differing conditions. The Board expresses in this Opinion its conclusions on the two subjects of accounting for business combinations and accounting for intangible assets, including goodwill acquired in business combinations.

5. This Opinion covers the combination of a corporation and another business enterprise which may be either incorporated or unincorporated; both incorporated and unincorporated enterprises are referred to in this Opinion as companies. The conclusions of this Opinion apply equally to business combinations in which one or more companies become subsidiary corporations, one company transfers its net assets to another, and each company transfers its net assets to a newly formed corporation. The term business combination in this Opinion excludes a transfer by a corporation of its net assets to a newly formed substitute corporate entity chartered by the existing corporation and a transfer of net assets between companies under common control, such as between a parent corporation and its subsidiary or between two subsidiary corporations of the same parent.

6. The conclusions of this Opinion modify previous views of the Board and its predecessor committee on the subjects of accounting for business combinations and intangible assets. This Opinion therefore supersedes the following Accounting Research Bulletins (ARB) and Opinions of the Accounting Principles Board (APB):

- ARB No. 43, Chapter 5, Intangible Assets
- ARB No. 48, Business Combinations
- ARB No. 51, Consolidated Financial Statements, paragraphs 7, 8, and 9
- APB Opinion No. 6, Status of Accounting Research Bulletins, paragraphs 12c, 15, and 22

Since this Opinion supersedes those existing pronouncements, paragraph 82 of this Opinion should be substituted for the reference to ARB No. 51 in paragraph 49 of APB Opinion No. 11.

Summary of Conclusions

7. Business Combinations. The Board concludes that the purchase method and the pooling of interests method are both acceptable in accounting for business combinations, although not as alternative accounting procedures. A business combination which meets specified conditions requires accounting by the pooling of interests method. The conditions include, among others, that each combining company in a business combination effected by exchanging voting common stock be at least one-third the size of each of the other combining companies as measured by relative voting common stock interests. A new basis of accounting is not permitted for a
combination that meets the specified conditions, and the assets and liabilities of the combining companies are combined at their recorded amounts. All other business combinations should be accounted for as an acquisition of one or more companies by a corporation. The cost of an acquired company should be determined by the principles of accounting for the acquisition of an asset. The cost of an acquired company should be allocated to the assets acquired and liabilities assumed based on the fair values of the identifiable individual assets and liabilities, and the remainder of the cost should be recorded as goodwill.

8. Intangible Assets. The Board concludes that a corporation should record as assets the costs of intangible assets acquired from others, including goodwill acquired in a business combination. A corporation may record as assets the costs incurred to develop identifiable intangible assets but should write off as incurred the costs to develop intangible assets which are not specifically identifiable, such as goodwill. The Board also concludes that the cost of each type of intangible assets should be amortized from date of acquisition by systematic charges to income over the period estimated to be benefited. The period of amortization should not, however, exceed forty years.

BUSINESS COMBINATIONS

Present Accounting and Its Development

9. Development of Two Methods. Most business combinations before World War II were classified either as a "merger," the acquisition of one company by another, or as a "consolidation," the formation of a new corporation. Accounting for both types of combinations generally followed traditional principles for the acquisition of assets or issuance of shares of stock. The accounting adopted by some new corporations was viewed as a precedent for the combining of retained earnings and of amounts of net assets recorded by predecessor corporations as retained earnings and net assets of a new entity.

10. Emphasis shifted after World War II from the legal form of the combination to distinctions between "a continuance of the former ownership or a new ownership" (ARB No. 40, paragraph 1). New ownership was accounted for as a purchase; continuing ownership was accounted for as a pooling of interests. Carrying forward the equity, including retained earnings, of the constituents became an integral part of the pooling of interests method. Significant differences between the purchase and pooling of interests methods accepted today are in the amounts ascribed to assets and liabilities at the time of combination and the income reported for the combined enterprise.

2 The cost of an acquired company is the acquiring corporation's cost of the entire enterprise acquired.
11. **Purchase Method.** The purchase method accounts for a business combination as the acquisition of one company by another. The acquiring corporation records at its cost the acquired assets less liabilities assumed. A difference between the cost of an acquired company and the sum of the fair values of tangible and identifiable intangible assets less liabilities is recorded as goodwill. The reported income of an acquiring corporation includes the operations of the acquired company after acquisition, based on the cost to the acquiring corporation.

12. The cost of goodwill acquired in a business combination either is retained as an asset until a loss of value is evident or is amortized over an arbitrary period. Chapter 5 of ARB No. 43, issued in 1958, provided that the cost of purchased goodwill should not be written off or reduced to a nominal amount at or immediately after acquisition.

13. **Pooling of Interests Method.** The pooling of interests method accounts for a business combination as the uniting of the ownership interests of two or more companies by exchange of equity securities. No acquisition is recognized because the combination is accomplished without disbursing resources of the constituents. Ownership interests in the combining companies continue and the former bases of accounting are retained. The recorded assets and liabilities of the constituents are carried forward to the combined corporation at their recorded amounts. Income of the combined corporation includes income of the constituents for the entire fiscal period in which the pooling occurs. The reported income of the constituents for prior periods is combined and restated as income of the combined corporation.

14. The original concept of pooling of interests as a fusion of equity interests was modified in practice as use of the method expanded. The method was first applied in accounting for combinations of affiliated corporations and then extended to some combinations of unrelated corporate ownership interests of comparable size. The method was later accepted for most business combinations in which common stock was issued. New and complex securities have been issued in recent business combinations and some combination agreements provide for additional securities to be issued later depending on specified events or circumstances. Most of the resulting...

---

3 This Opinion refers to the "purchase method of accounting" for a business combination because the term is widely used and generally understood. However, the more inclusive terms "acquire" (to come into possession of) and "acquisition" are generally used to describe transactions rather than the more narrow term "purchase" (to acquire by the payment of money or its equivalent). The broader terms clearly encompass obtaining assets by issuing stock as well as by disbursing cash and thus avoid the confusion and arguments that result from describing a stock transaction as a "purchase." This Opinion does not describe a business combination accounted for by the pooling of interests method of accounting as an "acquisition" because the meaning of the word is inconsistent with the method of accounting.

4 The origin, development, and application of the pooling of interests method of accounting are traced in Accounting Research Study No. 5 and summarized in Accounting Research Study No. 10.
combinations are accounted for as poolings of interests. Some combinations
accompanied by both disbursing cash and issuing securities are now accounted
for as a "part purchase, part pooling."

15. Some accountants believe that the pooling of interests method
is the only acceptable method for a combination which meets the require-
ments for pooling. Others interpret the existing pronouncements on ac-
counting for business combinations to mean that a combination which
meets the criteria for a pooling of interests may alternatively be accounted
for as a purchase.

Appraisal of Accepted Methods of Accounting

16. The pooling of interests method of accounting is applied only to
business combinations effected by an exchange of stock and not to those
involving primarily cash, other assets, or liabilities. Applying the purchase
method of accounting to business combinations effected by paying cash, dis-
bursing other assets, or incurring liabilities is not challenged. Thus, those
business combinations effected primarily by an exchange of equity securities
present a question of choice between the two accounting methods.

17. The significantly different results of applying the purchase and
pooling of interests methods of accounting to a combination effected by an
exchange of stock stem from distinct views of the nature of the transaction
itself. Those who endorse the pooling of interests method believe than an
exchange of stock to effect a business combination is in substance a trans-
action between the combining stockholder groups and does not involve the
corporate entities. The transaction therefore neither requires nor justifies
establishing a new basis of accountability for the assets of the combined
corporation. Those who endorse the purchase method believe that the
transaction is an issue of stock by a corporation for consideration received
from those who become stockholders by the transaction. The value of the
consideration received is established by bargaining between independent
parties, and the acquiring corporation accounts for the additional assets at
their bargain — that is, current — values.

18. Purchase Method. The more important arguments expressing the
advantages and disadvantages of the purchase method and some of the
practical difficulties experienced in implementing it are summarized in
paragraphs 19 to 27.

19. An acquisition — Those who favor the purchase method of ac-
counting believe that one corporation acquires another company in almost
every business combination. The acquisition of one company by another
and the identities of the acquiring and acquired companies are usually ob-
vious. Generally, one company in a business combination is clearly the
dominant and continuing entity and one or more other companies cease to
control their own assets and operations because control passes to the ac-
quiring corporation. Identifying the acquirer may be difficult if the com-
bining corporations are of relatively equal size. Some who favor the purchase method would permit the parties to designate one company as the acquirer, some would account for those combinations as new entities or mutual purchases, and some would favor pooling of interests accounting.

20. A bargained transaction — Proponents of purchase accounting hold that a business combination is a significant economic event which results from bargaining between independent parties. Each party bargains on the basis of his assessment of the current status and future prospects of each constituent as a separate enterprise and as a contributor to the proposed combined enterprise. The agreed terms of combination recognize primarily the bargained values and only secondarily the costs carried by the constituents. In fact, the recorded costs are not always known by the other bargaining party.

21. Accounting by the purchase method is essentially the same whether the business combination is effected by distributing assets, incurring liabilities, or issuing stock because issuing stock is considered an economic event as significant as distributing assets or incurring liabilities. A corporation must ascertain that the consideration it receives for stock issued is fair, just as it must ascertain that fair value is received for cash disbursed. Recipients of the stock similarly appraise the fairness of the transaction. Thus, a business combination is a bargained transaction regardless of the nature of the consideration.

22. Reporting economic substance — The purchase method adheres to traditional principles of accounting for the acquisition of assets. Those who support the purchase method of accounting for business combinations effected by issuing stock believe that an acquiring corporation accounts for the economic substance of the transaction by applying those principles and by recording:

   a. All assets and liabilities which comprise the bargained costs of an acquired company, not merely those items previously shown in the financial statements of an acquired company.
   b. The bargained costs of assets acquired less liabilities assumed, not the costs to a previous owner.
   c. The fair value of the consideration received for stock issued, not the equity shown in the financial statements of an acquired company.
   d. Retained earnings from its operations, not a fusion of its retained earnings and previous earnings of an acquired company.
   e. Expenses and net income after an acquisition computed on the bargained cost of acquired assets less assumed liabilities, not on the costs to a previous owner.

23. Defects attributed to purchase method — Applying the purchase method to business combinations effected primarily by issuing stock may
entail difficulties in measuring the cost of an acquired company. The reliability of the measure is diminished if neither the fair value of the consideration given nor the fair value of the property acquired is clearly evident. Measuring fair values of assets acquired is complicated by the presence of intangible assets or other assets which do not have discernible market prices. Goodwill and other unidentifiable intangible assets are difficult to value directly, and measuring the fair values of assets acquired for stock is easier if the fair value of the stock issued is determinable. The excess of the fair value of stock issued over the sum of the fair values of the tangible and identifiable intangible assets acquired less liabilities assumed then indicates the value of unidentified intangible assets (goodwill) acquired.

24. However, the fair value of stock issued is not always objectively determinable. A market price may not be available for a newly issued security or for securities of a closely held corporation. Even an available quoted market price may not always be a reliable indicator of fair value of consideration received because the number of shares issued is relatively large, the market for the security is thin, the stock price is volatile, or other uncertainties influence the quoted price. Further, the determinable fair value of one security may not necessarily indicate the fair value of another similar, but not identical, security because their differences affect the fair value — for example, the absence of registration or an agreement which restricts a holder’s ability to sell a security may significantly affect its fair value.

25. Those who oppose applying the purchase method to some or most business combinations effected by stock also challenge the theoretical merits of the method. They contend that the goodwill acquired is stated only by coincidence at the fair value which would be determined by direct valuation. The weakness is attributed not to measurement difficulties (direct valuation of goodwill is assumed) but to the underlying basis for an exchange of shares of stock. Bargaining in that type of transaction is normally based on the market prices of the equity securities. Market prices of the securities exchanged are more likely to be influenced by anticipated earnings capacities of the companies than by evaluations of individual assets. The number of shares of stock issued in a business combination is thus influenced by values attributed to goodwill of the acquirer as well as the goodwill of the acquired company. Since the terms are based on the market prices of both stocks exchanged, measuring the cost of an acquired company by the market price of the stock issued may result in recording acquired goodwill at more or less than its fair value if determined directly.

26. A related argument is that the purchase method is improper accounting for a business combination in which a relatively large number of shares of stock is issued because it records the goodwill and fair values of only the acquired company. The critics of purchase accounting say that each group of stockholders of two publicly held and actively traded com-
panies evaluates the other stock and the exchange ratio for stock issued is often predicated on relative market values. The stockholders and management of each company evaluate the goodwill and fair values of the other. Purchase accounting is thus viewed as illogical because it records goodwill and fair values of only one side of the transaction. Those who support this view prefer that assets and liabilities of both companies be combined at existing recorded amounts, but if one side is to be stated at fair values, they believe that both sides should be recorded at fair values.

27. Criticism of the purchase method is directed not only to the theoretical and practical problems of measuring goodwill in combinations effected primarily by stock but also to accounting for goodwill after the combination. Intangible assets acquired, including goodwill, often have indeterminate useful lives, and alternative methods of accounting are followed. Some corporations amortize the cost of acquired intangible assets over a short arbitrary period to reduce the amount of the asset as rapidly as practicable, while others retain the cost as an asset until evidence shows a loss of value and then record a material reduction in a single period. Selecting an arbitrary period of amortization is criticized because it may understate net income during the amortization period and overstate later income. Retaining the cost as an asset is criticized because it may overstate net income before the loss of value is recognized and understate income in the period of write-off. Present accounting for goodwill is cited as an example of lack of uniformity because selecting among alternative methods is discretionary.

28. Pooling of Interests Method. The more important arguments expressing the advantages and disadvantages of the pooling of interests method and some of the practical difficulties experienced in implementing it are summarized in paragraphs 29 to 41.

29. Validity of the concept — Those who support the pooling of interests concept believe that a business combination arranged by an issuance of common shares is different from a purchase in that no corporate assets are disbursed to stockholders and the net assets of the issuing corporation are enlarged by the net assets of the corporation whose stockholders accept common stock of the combined corporation. There is no newly invested capital nor have owners withdrawn assets from the group since the stock of a corporation is not one of its assets. Accordingly, the net assets of the constituents remain intact but combined; the stockholder groups remain intact but combined. Aggregate income is not changed since the total resources are not changed. Consequently, the historical costs and earnings of the separate corporations are appropriately combined. In a business combination effected by exchanging stock, groups of stockholders combine their resources, talents, and risks to form a new entity which is designed to carry on in combination the previous businesses and to continue their earnings streams. The sharing of risks by the constituent stockholder groups is an
important element in a business combination effected by exchanging stock. By pooling equity interests, each group continues to maintain risk elements of its former investment and they mutually exchange risks and benefits.

30. A pooling of interests transaction is regarded as being in substance an arrangement among stockholder groups. The fractional interests in the common enterprise are reallocated—risks are rearranged among the stockholder groups outside the corporate entity. A fundamental concept of entity accounting is that a corporation is separate and distinct from its stockholders. Elected managements represent the stockholders in the bargaining to effect the combination, but the groups of stockholders usually agree on final terms in the vote which approves or disapproves a combination. Stockholders sometimes disapprove a combination proposed by management, and tender offers sometimes succeed despite the opposition of management.

31. Each stockholder group in a pooling of interests is giving up its interests in assets formerly held but is receiving back an interest in some portion of the assets formerly held in addition to an interest in the assets of the other. The clearest example of this type of combination is one in which both stockholder groups surrender their shares and receive in exchange shares of a new corporation. The fact that one of the corporations usually issues its shares in exchange for those of the other does not alter the substance of the transaction. In a mutual exchange of this sort it should be recognized that the fair values of stocks that are surrendered reflect the tangible and intangible values as much as those that are received in exchange.

32. **Consistency with other concepts**—Proponents of pooling of interests accounting point out that the pooling theory was developed within the boundaries of the historical cost system and is compatible with it. Accounting as a pooling of interests for business combinations arranged through the issuance of common shares is based on existing accounting concepts and is not an occasion for revising historical cost data. Both constituents usually have elements of appreciation and of goodwill which are recognized and offset, at least to some extent, in setting a share exchange ratio. The bargaining which takes place in setting an exchange ratio usually reflects the relative earning capacities (measured by historical cost accounts) of the constituents and frequently gives recognition to the relative market values of the two stocks, which in turn reflects this earning capacity, goodwill, or other values. Accounting recognition is given this bargaining by means of the new number of shares outstanding distributed in accordance with the bargained ratio, which has a direct effect on earnings per share after the combination.

33. **Usefulness of the concept**—Those who favor the pooling of interests method of accounting believe that the economic substance of a combination is best reflected by reporting operations up to the date of the
exchange of shares based on the same historical cost information used to
develop the separate operating results of each constituent and informative
comparison with periods prior to the business combination is facilitated
by maintaining historical costs as the basis of reporting combined opera-
tions subsequent to the combination.

34. Application of the concept — It has been observed that criteria
for distinguishing between a pooling and a purchase have eroded over the
years and that present interpretations of criteria have led to abuse. How-
ever, most accountants who support the pooling concept believe that
criteria can be redefined satisfactorily to eliminate abuses. It is their view
that the pooling of interests method of accounting for business combina-
tions is justifiable on conceptual grounds and is a useful technique and
therefore should not be abolished.

35. The concept of a uniting or fusing of stockholder groups on which
pooling of interests accounting is based implies a broad application of the
method because every combination effected by issuing stock rather than by
disbursing cash or incurring debt is potentially a pooling of interests unless
the combination significantly changes the relative equity interests. How-
ever, so broad an application results in applying the pooling of interests
method to numerous business combinations that many observers, including
some who favor pooling of interests accounting, agree should be accounted
for by the purchase method. Some proponents of pooling of interests ac-
counting support a restriction on the difference in size of combining
interests because a significant sharing of risk cannot occur if one combining
interest is minor or because a meaningful mutual exchange does not occur
if the combination involves a relatively small number of shares. Some
others believe that a size restriction would aid in eliminating abuses of the
pooling method in practice. Other proponents of the pooling of interests
method, however, believe that there is no conceptional basis for a size re-
striction and that establishing a size restriction would seriously impair
pooling of interests accounting.

36. Defects attributed to pooling of interests method — Those who
oppose the pooling of interests method of accounting doubt that the method
is supported by a concept. In their view it has become essentially a method
of accounting for an acquisition of a company without recognizing the
current fair values of the assets and goodwill underlying the transaction.
The concept of a pooling of interests was described in general terms in the
past — for example, as a continuity of equity interests or as a combination
of two or more interests of comparable size. The descriptions tend to be
contradictory. For example, accountants do not agree on whether or not
relative size is part of the pooling of interests concept. Attempts to define
the concept in terms of broad criteria for applying the accounting method
have also been unsuccessful. At least, criteria which have been given as
general guides to be weighed together rather than as firm rules to be fol-
APPENDIX

have not achieved their purposes of clearly delineating business combinations which are poolings of interests. Indeed, many opponents of the pooling of interests method of accounting believe that effective criteria cannot be found and that applying the method without effective criteria results in accounting as a pooling of interests for numerous business combinations which are clearly in economic substance the acquisition of one company by another.

37. Some critics point out that the method was first applied to combining interests of comparable size and that pronouncements on business combinations have never sanctioned applying pooling of interests accounting to all or almost all business combinations effected by exchanging stock. All pronouncements have indicated that a large disparity in the size of the combining interests is evidence that one corporation is acquiring another. The context shows that the 90 percent and 95 percent examples given in ARB No. 48 were intended as illustrations of disparities in size so large as to inhibit applying pooling of interests accounting and were not intended to be examples of boundaries between the pooling and purchase methods.

38. Other criteria restricting application of pooling of interests accounting, such as those prohibiting future disposals of stock received in a combination and providing for continuation of management, were added to the size restriction. Those criteria have, however, tended to weaken the concept of relative equality of the uniting interests because they are unilateral, that is, they are applied only to the stockholders and management of the “acquired” company.

39. The most serious defect attributed to pooling of interests accounting by those who oppose it, is that it does not accurately reflect the economic substance of the business combination transaction. They believe that the method ignores the bargaining which results in the combination and accounts only for the amounts previously shown in accounts of the combining companies. The acquiring corporation does not record assets and values which usually influence the final terms of the combination agreement with consequent effects on subsequent balance sheets and income statements. The combined earnings streams, which are said to continue after a pooling of interests, can continue unchanged only if the cost of the assets producing those earnings is identical for the acquiring corporation and the acquired company. That coincidence rarely occurs because the bargaining is based on current fair values and not past costs.

40. Pooling of interests accounting is also challenged because the amount of assets acquired less liabilities assumed is determined without regard to the number of shares of stock issued. The result does not reflect the presumption that a corporation issues stock only for value received and, in general, the greater the number of shares issued, the larger the consideration to be recorded.

41. Traditional principles of accounting for acquisitions of assets en-
compass all business combinations because every combination is effected by distributing assets, incurring liabilities, issuing stock, or some blend of the three. Those who oppose the pooling of interests method believe that a departure from the traditional principles is justified only if evidence shows that financial statements prepared according to other principles either better reflect the economic significance of a combination or produce a superior financial report. In their opinion, the characteristics of a business combination do not justify departing from traditional principles of accounting to accommodate the pooling of interests method.

**OPINION**

42. The Board finds merit in both the purchase and pooling of interests methods of accounting and accepts neither method to the exclusion of the other. The Board concludes that the arguments in favor of the purchase method of accounting are persuasive for most business combinations but that they are less persuasive if voting common stock is issued to effect a combination of companies of relatively the same size. The Board also concludes that arguments in favor of the pooling of interests method of accounting are persuasive if voting common stock is issued to effect a combination of companies of relatively the same size but less persuasive if the combining companies are of disparate size. Therefore, the Board concludes that most business combinations should be accounted for by the purchase method but that some combinations should be accounted for by the pooling of interests method. The two methods are not alternatives in accounting for the same business combination.

43. The Board believes that accounting for business combinations will be improved significantly by specifying the circumstances in which each method should be applied and the procedures which should be followed in applying each method. The distinctive conditions which require pooling of interests accounting are described in paragraphs 44 to 47, and combinations involving all of those conditions should be accounted for as described in paragraphs 48 to 62. All other business combinations should be treated as the acquisition of one company by another and accounted for by the purchase method as described in paragraphs 63 to 89.

44. **Conditions for Pooling of Interests Method.** A business combination which meets all of the conditions specified and explained in paragraphs 45 to 47 should be accounted for by the pooling of interests method. The conditions are classified by (1) attributes of the combining companies, (2) the manner of effecting the combining transaction, and (3) the absence of planned transactions.

45. **Combining companies**—The two conditions in this group relate to certain attributes of the combining companies, either individually or in relation to each other.

   a. Each combining company has been an active, independent company for at least two years before the plan of combination is initiated.
This condition means that each company is not or has not been within the preceding two years a subsidiary or division of another corporation. A plan of combination is initiated on the earlier of the date that a plan is announced or the date that stockholders of a combining company are notified in writing of an exchange offer.

b. Each combining company is not less than one-third the size of each other combining company, that is, each company is not more than three times the size of each of the other combining companies.

The size of a combining company is measured by its voting common stock ownership interest at the date the plan of combination is consummated. To compare sizes of combining companies, the number of shares of outstanding voting common stock of each company is expressed in terms of an equivalent number of shares of common stock of the resulting combined corporation. The equivalent number of shares of the combined corporation for each combining company is the number of shares that would be received by its stockholders if all of its outstanding voting common stock were exchanged in the combination.

For the size computations, the voting common stock ownership interest of a combining company includes the number of shares of common stock outstanding at the date the plan of combination is consummated plus those shares of stock of that company which were previously outstanding during the period beginning two years preceding the date the combination is initiated but were exchanged for a convertible debt security, convertible preferred stock, or other security which has the right to become common stock, all as restated in terms of its current outstanding stock.

46. **Combining transaction** — The six conditions in this group relate to the manner of effecting the combination.

a. The combination is effected in a single transaction or is completed in accordance with a specific plan within one year after the plan is initiated.

Alteration of the terms of exchange constitutes initiation of a new plan of combination.

A business combination completed in more than one year from the date of initiation of a plan meets this condition if the delay is beyond the control of the combining companies because proceedings of a regulatory authority or litigation prevents completing the combination.

b. A corporation offers and issues only common stock with rights identical to those of the majority of its outstanding voting common stock in exchange for substantially all of the voting common stock interest of another company at the date the plan of combination is consummated.

The plan to issue voting common stock in exchange for voting common
stock may include provisions to distribute cash or other consideration for fractional shares, for shares held by dissenting stockholders, and the like but may not include a pro rata distribution of cash or other consideration. However, the total distributions of cash or other consideration may not exceed the limits described in the explanations of this condition.

An exchange of substantially all of the voting common stock for this condition means that 90 percent or more of the outstanding common stock of a combining company is exchanged between the dates the plan of combination is initiated and consummated for the voting common stock issued by another corporation (issuing corporation) to effect the combination. However, 90 percent of the outstanding common stock of a combining company is compared with the number of shares of stock exchanged for common stock reduced by the effects of certain treasury stock transactions and intercorporate investments in the stock being issued to effect the combination. Reductions relate to shares of common stock of the corporation issuing stock to effect the combination which are

(i) held as an investment by the other combining company at the date the plan of combination is initiated,
(ii) acquired by the other combining company after the date the plan of combination is initiated, and
(iii) acquired as treasury stock by the issuing corporation after the date of combination is initiated.

The number of shares of stock of the issuing corporation in the three categories are restated as the equivalent number of shares of the other combining company determined by the ratio of exchange of stock and the total is deducted from the number of shares of stock of the combining company which are exchanged. Condition (b) is not met if the reduced number of shares of stock exchanged is less than 90 percent of the outstanding common stock interest of the company at the date the plan of combination is consummated.

5 The shares of common stock exchanged between the two dates does not include shares of common stock of a combining company acquired by the issuing corporation before and held at the date the plan of combination is initiated, regardless of the form of consideration. Common stock held at March 1, 1970 results in an exception to the 90 percent minimum exchange and is explained in paragraph 113.

6 The number of shares of treasury stock excludes those shares which a corporation acquired for purposes other than business combinations, such as stock option and compensation plans, providing (1) the stock is acquired under a systematic pattern of stock reacquisitions established at least two years before the plan of combination is initiated and (2) the number of shares is reasonable in relation to the number of shares reacquired before the plan of combination is initiated.

7 Computation of the 90 percent minimum exchange may be illustrated by an example. Corporation A and Corporation B each have 20,000 shares of voting common stock outstanding on January 22, 1977. On that date Corp. A and Corp. B initiate a plan to combine by an exchange of one share of common stock of Corp. A for each two shares of common stock of Corp. B.

Corp. A issues 9,600 shares of its common stock to holders of 19,200 shares of Corp. B
The 90 percent minimum exchange applies to each combining company except the corporation that issues stock to effect the business combination. If a corporation issues stock for the stock of more than one combining company, a reduction for treasury stock acquired by the issuing corporation (iii above) should be allocated to the exchanged shares of each combining company in proportion to the total number of shares of stock the issuing corporation could potentially issue in the combination.

*A new corporation formed to issue its stock* to effect the combination of two or more companies meets condition (b) if (1) the number of shares of each company exchanged to effect the combination is not less than 90 percent of its voting common stock outstanding at the date the combination is

<table>
<thead>
<tr>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Other information:</td>
</tr>
<tr>
<td>Computations for condition (b):</td>
</tr>
<tr>
<td>Common stock of Corp. B outstanding on November 13, 1977—</td>
</tr>
<tr>
<td>Outstanding on date plan of combination is initiated</td>
</tr>
<tr>
<td>Treasury stock acquired on May 4, 1977</td>
</tr>
<tr>
<td>Outstanding on date plan is consummated</td>
</tr>
<tr>
<td>90 percent</td>
</tr>
<tr>
<td>Common stock of Corp. B acquired in exchange for voting common stock of Corp. A (excludes 100 shares acquired for cash, 300 shares acquired before date plan is initiated, and 200 shares remaining outstanding as minority interest)</td>
</tr>
<tr>
<td>Reduced by—</td>
</tr>
<tr>
<td>Common stock of Corp. A held by Corp. B at date plan is initiated, restated as equivalent number of Corp. B shares in ratio of 2 to 1 (200 × 2)</td>
</tr>
<tr>
<td>Common stock of Corp. A acquired by Corp. B after date plan is initiated, restated as equivalent number of Corp. B shares in ratio of 2 to 1 (100 × 2)</td>
</tr>
<tr>
<td>Common stock of Corp. A acquired as treasury stock, less shares regularly reacquired for compensation, restated as equivalent number of Corp. B shares in ratio of 2 to 1 [(890 − 500) × 2]</td>
</tr>
<tr>
<td>Computed number of shares of common stock for comparison with 90 percent minimum</td>
</tr>
<tr>
<td>The shares acquired in exchange for voting common stock of Corp. A equals at least 90 percent of the outstanding voting common stock interest of Corp. B at the date the plan is consummated. The condition that substantially all shares are exchanged is met.</td>
</tr>
</tbody>
</table>
consummated and (2) condition (b) would have been met had any one of the combining companies issued its stock to effect the combination on essentially the same basis. Several separate computations may be required for provision (2) — each of the combining companies in turn should be assumed to have issued stock to effect the combination. The assumed exchange of stock should be based on the ratios of exchange of stock of the individual companies for that of the new corporation. Each separate computation should recognize the applicable reductions in categories (i), (ii), and (iii). A combination effected through a new corporation meets provision (2) if at least one of the existing combining companies could have satisfied condition (b) by issuing its stock.

**Condition (b) relates to issuing common stock for the common stock interests in another company.** Hence, a corporation issuing stock to effect the combination may assume the debt securities of the other company or may exchange substantially identical securities or common stock for debt and other outstanding equity securities of the other combining company. An issuing corporation may also distribute cash to holders of debt and equity securities that either are callable or redeemable and may retire those securities.

*A business combination effected by a transfer of the net assets of a company may meet condition (b) providing all of the net assets of the company at the date the plan is consummated are transferred for stock of the issuing corporation. The combining company may retain temporarily cash, receivables, or marketable securities to settle liabilities, contingencies, or items in dispute if the plan provides that the assets remaining after settlement are to be transferred to the corporation issuing the stock to effect the combination. The stock issued to effect the combination must be all common stock unless both preferred and common stocks of the other combining company are outstanding at the date the plan is consummated. If so, the combination may be effected by issuing all common stock or by issuing common and preferred stock in the same proportions as the outstanding common and preferred stock equities of the other combining company. In addition, certain transactions in common stock of the combining companies are considered to affect the issue of stock to measure the condition on the same basis as an exchange of stock. First, the total number of shares of common stock issued to effect the combination should be divided between those applicable to the preferred stock equity and those applicable to the common stock ownership interest in the combining company if both types of securities are outstanding. Second, the number of shares of common stock applicable to the common stock ownership interest should be reduced for specified intercorporate investments and certain treasury stock transactions of the issuing corporation. Reductions comprise:
Shares of common stock of the corporation issuing stock to effect the combination which are
(i) held as an investment by the other combining company at the date the plan of combination is initiated,
(ii) acquired by the other combining company after the date the plan of combination is initiated, and
(iii) acquired as treasury stock by the issuing corporation after the date the plan of combination is initiated
and shares of common stock of the combining company held as an investment by the issuing corporation at the date the plan of combination is initiated but restated as a number of shares of the issuing corporation based on the ratio of the number of outstanding shares of common stock of the combining company at the date the plan is consummated to the number of shares of common stock issued to transfer the assets which are applicable to the common stock ownership interest.

The reduced number of shares of stock must equal 90 percent or more of the number of shares issued for the common stock ownership interest of the combining company to meet condition (b).\textsuperscript{9}

\textsuperscript{8} Note 6, page 11.
\textsuperscript{9} An example of the computation assumes facts similar to those in note 7.

Corporation C and Corporation D each have 20,000 shares of voting common stock outstanding on January 22, 1977. On that date Corp. C and Corp. D initiate a plan to combine by a transfer of the net assets of Corp. D to Corp. C in exchange for 10,000 shares of common stock of Corp. C. Corp. C issues 10,000 shares of its common stock to Corp. D on November 13, 1977.

Other information:

\textbf{Computations for condition (b):}

\begin{tabular}{l|r}
\textbf{No. of} & \textbf{Shares} \\
\hline
Common stock of Corp. C issued on November 13, 1977 & 10,000 \\
90 percent & 9,000 \\
Common stock of Corp. C issued for net assets of Corp. D & 10,000 \\
Reduced by— & \\
Common stock of Corp. C held by Corp. D at date plan is initiated & 200 \\
Common stock of Corp. C acquired by Corp. D after date plan is initiated & 100 \\
Common stock of Corp. C acquired as treasury stock, less shares regularly reacquired for compensation (890 — 500) & 390 \\
Common stock of Corp. D held by Corp. C at date plan is initiated, restated as equivalent number of Corp. C shares in & \\
\end{tabular}
c. The relative interests of individual common stockholders in each of the combining companies are not realigned by the exchange of securities to effect the combination.

This condition means that each individual common stockholder of each combining company receives a voting common stock interest exactly in proportion to his relative common stock interest before the combination is effected. Thus no common stockholder is denied or surrenders his potential share of a voting common stock interest in a combined corporation.

d. The voting rights to which the common stock ownership interests in the resulting combined corporation are entitled are exercisable by the stockholders; the stockholders are neither deprived nor restricted in exercising those rights for a period.

This condition is not met, for example, if shares of common stock issued to effect the combination are transferred to a voting trust.

e. A combining company other than the corporation issuing stock to effect the combination distributes no more than normal dividends and reacquires no more than a normal number of shares of common stock after the date the plan of combination is initiated.

The normality of dividends is determined in relation to earnings during the period and to the previous dividend policy for purposes of this condition. The normal number of shares of stock reacquired is determined by the pattern of reacquisitions of stock before the plan is initiated.

f. The combination is resolved at the date the plan is consummated and no provisions of the plan relating to the issue of securities or other consideration are pending.

This condition means that (1) the combined corporation does not agree to contingently issue additional shares of stock or distribute other consideration at a later date to the former stockholders of a combining company or (2) the combined corporation does not issue or distribute to an escrow agent common stock or other consideration which is to be either transferred to common stockholders or returned to the corporation at the time the contingency is resolved.

An exception to this condition is a provision that the number of shares of common stock issued to effect the combination may be revised for the ratio of 1.98 to 1 based on 19,800 shares of Corp. D stock outstanding on date plan is consummated \((300 \div 1.98)\) 152 842

Computed issue of shares of common stock for comparison with 90 percent minimum 9,158

The reduced shares issued for the transfer of all net assets equals at least 90 percent of the shares issued and the condition is met.
later settlement of a contingency at a different amount than that recorded by a combining company.

47. Absence of planned transactions — The three conditions in this group relate to certain future transactions.

a. The combined corporation does not agree directly or indirectly to retire or reacquire all or part of the common stock issued to effect the combination.

b. The combined corporation does not enter into other financial arrangements for the benefit of the former stockholders of a combining company, such as a guaranty of loans secured by stock issued in the combination, which in effect negates the exchange of equity securities.

c. The combined corporation does not intend or plan to dispose of a significant part of the assets of the combining companies within two years after the combination except to eliminate duplicate facilities or excess capacity and those assets that would have been disposed of in the ordinary course of business of the separate company.

Pooling of Interests Method of Accounting

48. A business combination which meets all of the conditions in paragraphs 44 to 47 should be accounted for by the pooling of interests method. Appropriate procedures are described in paragraphs 49 to 62.

49. Assets and Liabilities Combined. The recorded assets and liabilities of the separate companies generally become the recorded assets and liabilities of the combined corporation. The combined corporation therefore recognizes those assets and liabilities recorded in conformity with generally accepted accounting principles by the separate companies at the date the combination is consummated.

50. The combined corporation records the historical-cost based amounts of the assets and liabilities of the separate companies because the existing basis of accounting continues. However, the separate companies may have recorded assets and liabilities under differing methods of accounting and the amounts may be adjusted to the same basis of accounting if the change would otherwise have been appropriate for the separate company. A change in accounting method to conform the individual methods should be applied retroactively, and financial statements presented for prior periods should be restated.

51. Stockholders' Equity Combined. The stockholders' equities of the separate companies are also combined as a part of the pooling of interests method of accounting. The combined corporation records as capital the capital stock and capital in excess of par or stated value of outstanding stock of the separate companies. Similarly, retained earnings or deficits of the separate companies are combined and recognized as retained earnings.
of the combined corporation. The amount of outstanding shares of stock of the combined corporation at par or stated value may exceed the total amount of capital stock of the separate combining companies; the excess should be deducted first from the combined other contributed capital and then from the combined retained earnings. The combined retained earnings could be misleading if shortly before or as a part of the combination transaction one or more of the combining companies adjusted the elements of stockholders' equity to eliminate a deficit; therefore, the elements of equity before the adjustment should be combined.

52. A corporation which distributes treasury stock to effect a combination accounted for by the pooling of interests method should first account for the effective retirement of those shares of stock at the time of their distribution. The issuance of the shares for the common stock interests of the combining company is then accounted for the same as the issuance of previously unissued shares.

53. Accounting for common stock of one of the combining companies which is held by another combining company at the date a combination is consummated depends on whether the stock is the same as that which is issued to effect the combination or is the same as the stock which is exchanged in the plan of combination. An intercorporate investment of a combining company in the common stock of the corporation issuing additional stock in a combination is in effect returned to the resulting combined corporation in the combination. The combined corporation should account for the investment as treasury stock. In contrast, an intercorporate investment in the common stock of other combining companies (not the one issuing stock in the combination) is an investment in stock that is exchanged in the combination for the common stock issued. The stock in that type of intercorporate investment is in effect eliminated in the combination. The combined corporation should account for that investment as stock retired as part of the combination.

54. Reporting Combined Operations. A corporation which applies the pooling of interests method of accounting to a combination should report results of operations for the period in which the combination occurs as though the companies had been combined as of the beginning of the period. Results of operations for that period thus comprises those of the separate companies from the beginning of the period to the date the combination is consummated and those of the combined operations from that date to the end of the period. A combined corporation should disclose in notes to financial statements the revenue, extraordinary items, and net income of each of the separate companies from the beginning of the period to the date the combination is consummated. The information relating to the separate companies may be as of the end of the interim period nearest the date that the combination is consummated.

55. Similarly, balance sheets and other financial information of the
separate companies as of the beginning of the period should be presented as though the companies had been combined at that date. Financial statements and financial information of the separate companies presented for prior years should also be restated on a combined basis to furnish comparative information. All restated financial statements and financial summaries should indicate clearly that financial data of the previously separate companies are combined.

56. Expenses Related to Combination. All expenses related to effecting a business combination accounted for by the pooling of interests method should be deducted in determining the net income of the resulting combined corporation for the period in which the expenses are incurred. Thus, all costs to effect the combination and integrate the operations are expenses of the combined corporation and are not direct reductions of stockholders' equity. Those expenses include, for example, registration fees, costs of furnishing information to stockholders, fees of finders and consultants, salaries and other expenses related to services of employees, and costs and losses of combining operations of the previously separate companies and instituting efficiencies.

57. Disposition of Assets After Combination. A combined corporation may dispose of those assets of the separate companies which are duplicate facilities or excess capacity in the combined operations. Losses or estimated losses on disposal of specifically identified duplicate or excess facilities should be deducted in determining the net income of the resulting combined corporation. However, a loss estimated and recorded while a facility remains in service should not include the portion of the cost that is properly allocable to anticipated future service of the facility.

58. Profit or loss on other dispositions of assets of the previously separate companies may require special disclosure. Specific treatment of a profit or loss on those dispositions is warranted because the pooling of interests method of accounting would have been inappropriate (paragraph 47) if the combined corporation were committed or planned to dispose of a significant part of the assets of one of the combining companies. The Board therefore concludes that a combined corporation should disclose separately a profit or loss resulting from the disposal of a significant part of the assets of the previously separate companies, providing

the profit or loss is material in relation to the net income of the combined corporation and
the disposition is within two years after the combination is consummated.

The disclosed profit or loss, less applicable income tax effect, should be classified as an extraordinary item unless the disposals are part of customary business activities of the combined corporation.

59. Date of Recording Combination. A business combination accounted for by the pooling of interests method should be recorded as of the date the combination is consummated. Therefore, even though a busi-
ness combination is consummated before one or more of the combining companies first issues its financial statements as of an earlier date, the financial statements should be those of the combining company only and not those of the resulting combined corporation. A combining company should, however, disclose in notes to financial statements the substance of a combination consummated before financial statements are issued and the effects of the combination on reported financial position and results of operations (paragraph 62). Earlier financial statements of the separate companies should be combined to present comparative financial statements in reports of the resulting combined corporation dated after a combination is consummated.

60. A corporation may have acquired common stock of another combining company as part of a business combination which has been initiated but not consummated as of the date of financial statements. The corporation should record as an investment the common stock of the other combining company acquired before the statement date. Common stock acquired by disbursing cash or other assets or by incurring liabilities should be recorded at cost. Stock acquired in exchange for common stock of the issuing corporation should, however, be recorded at the proportionate share of underlying net assets as recorded by the other company at the date acquired if the corporation expects the combination to meet the conditions requiring the pooling of interests method of accounting. Until the appropriate method of accounting for the combination is known, the investment and net income of the investor corporation should include the proportionate share of earnings or losses of the other company.

61. Disclosure of a Combination. A combined corporation should disclose in its financial statements that a combination which is accounted for by the pooling of interests method occurred during the period. The basis of current presentation and restatements of prior periods may be disclosed in the financial statements by captions or by references to notes.

62. Notes to financial statements of a combined corporation for the period in which a business combination is accounted for by the pooling of interests method should disclose the following:

a. Name and brief description of the companies combined, except a corporation whose name is carried forward to the combined corporation.

b. Description and number of shares of stock issued in the business combination.

c. Method of accounting for the combination — that is, by the pooling of interests method.

d. Details of the results of operations of the previously separate companies for the period before the combination is consummated that are included in the current combined net income (paragraph 54).
The details should include revenue, extraordinary items, net income, and other changes in stockholders' equity.

e. Descriptions of the nature of adjustments of net assets of the combining companies to adopt the same accounting practices and of the effects of the changes on net income reported previously by the separate companies (paragraph 50).

f. Details of an increase or decrease in retained earnings from changing the fiscal year of a combining company. The details should include at least revenue, expenses, extraordinary items, net income and other changes in stockholders' equity.

g. Reconciliations of amounts of revenue and earnings previously reported by the corporation that issues the stock to effect the combination with the combined amounts currently presented in financial statements and summaries. A new corporation formed to effect a combination may instead disclose the earnings of the separate companies which comprise combined earnings for prior periods.

h. Details of the effects of a business combination consummated before the financial statements are issued but either incomplete as of the date of the financial statements or initiated after that date (paragraph 59). The details should include revenue, net income, earnings per share, and the effects of anticipated changes in accounting methods as if the combination had been consummated at the date of the financial statements (paragraph 50).

The information disclosed in notes to financial statements should also be furnished on a pro forma basis in materials on a proposed business combination which is given to stockholders of combining companies.

Purchase Method of Accounting

63. Principles of Historical-Cost Accounting. Accounting for a business combination by the purchase method should follow principles normally applicable under historical-cost accounting to recording acquisitions of assets and issuances of stock and to accounting for assets and liabilities after acquisition.

64. Acquiring assets — The general principles to apply the historical-cost basis of accounting to an acquisition of an asset depend on the nature of the transaction:

a. An asset acquired by exchanging cash or other corporate assets is recorded at cost — that is, at the amount of cash disbursed or the fair value\(^\text{10}\) of other assets distributed.

\(^{10}\) In general, fair value implies a result equivalent to that of a cash transaction. That is, the fair values of assets received or distributed are approximately the amounts of cash that would have been paid or received between independent parties.
b. An asset acquired by incurring liabilities is recorded at cost—that is, at the present value of the amounts to be paid.

c. An asset acquired by issuing shares of stock of the acquiring corporation is recorded at the fair value of the asset received—that is, shares of stock issued are recorded at the fair value of the considerations received for the stock.

The basis of accounting is that which is given (assets distributed or liabilities incurred) in the first two principles but that which is received in the third principle because a corporation issues stock to recognize equity contributions by owners.

65. The general principles must be supplemented to apply them in certain transactions. Thus, the fair value of an asset received for stock issued may not be reliably determinable, or the fair value of an asset acquired in an exchange may be more reliably determinable than the fair value of a noncash asset given up. Restraints on measurement have led to the practical rule that assets acquired for other than cash, including shares of stock issued, should be stated at “cost” when they are acquired and “cost” may be determined either by the fair value of the consideration given or by the fair value of the property acquired, whichever is the more clearly evident.11 “Cost” is the term accountants apply to the amount at which an entity records an asset at the date it is acquired whatever its manner of acquisition, and that “cost” forms the basis for historical-cost accounting.

66. Allocating cost—Acquiring assets in groups requires not only ascertaining the cost of the assets as a group but also allocating the cost to the individual assets which comprise the group. The cost of a group is determined by the principles described in paragraphs 64 and 65. The cost of the group is then assigned to the individual assets acquired on the basis of the fair value of each. A difference between the sum of the fair values of the tangible and identifiable intangible assets acquired less liabilities assumed and the cost of the group is evidence of unspecified intangible values.

67. Accounting after acquisition—The nature of an asset and not the manner of its acquisition determines an acquirer's subsequent accounting for the cost of that asset. The basis for measuring the cost of an asset—whether amount of cash paid, fair value of an asset received or given up, amount of a liability incurred, or fair value of stock issued—has no effect on the subsequent accounting for that cost, which is retained as an asset, depreciated, amortized, or otherwise matched with revenue.

68. Acquiring Corporation. A corporation which distributes cash or other assets or incurs liabilities to obtain the assets or stock of another company is clearly the acquirer. The identities of the acquirer and the

---

11 ARB No. 24: the substance was retained in slightly different words in Chapter 5 of ARB No. 43 and ARB No. 48.
acquired company are usually evident in a business combination effected by the issue of stock. The acquiring company normally issues the stock and commonly is the larger company. The acquired company may, however, survive as the corporate entity, and the nature of the negotiations sometimes clearly indicate that a smaller corporation acquires a larger company. If a new corporation is formed to issue stock to effect a business combination to be accounted for by the purchase method, one of the existing combining companies should be considered the acquirer. The Board concludes that presumptive evidence of the acquiring corporation in combinations effected by an exchange of stock is obtained by identifying the former common stockholder interests of a combining company which either retain or receive the larger portion of the voting rights in the combined corporation. That corporation should be treated as the acquirer unless other evidence clearly indicates that another corporation is the acquirer.

69. Determining Cost of an Acquired Company. The same accounting principles apply to determining the cost of assets acquired individually, those acquired in a group, and those acquired in a business combination. A cash payment by a corporation measures the cost of acquired assets less liabilities assumed. Similarly, the fair values of other assets distributed, such as marketable securities or properties, and the fair value of liabilities incurred by an acquiring corporation measure the cost of an acquired company. The present value of a debt security represents the fair value of the liability, and a premium or discount should be recorded for a debt security issued with an interest rate fixed materially above or below the rate for an otherwise comparable security.

70. The distinctive attributes of preferred stocks make some issues similar to a debt security while others possess common stock characteristics, with many gradations between the extremes. Determining cost of an acquired company may be affected by those characteristics. For example, the fair value of a nonvoting, nonconvertible preferred stock which lacks characteristics of common stock may be determined by comparing the specified dividend and redemption terms with comparable securities and by assessing market factors. Thus although the principle of recording the fair value of consideration received for stock issued applies to all equity securities, senior as well as common stock, the cost of a company acquired by issuing senior equity securities may be determined in practice on the same basis as for debt securities.

71. The quoted market price of an equity security issued to effect a business combination may be used to approximate the fair value of an acquired company if that market price represents fair value (paragraph 65). If, however, the reliability of the quoted market price of stock, either preferred or common, as an indicator of fair value is in doubt (paragraph 24), an estimate of the consideration received is required even though measuring directly the fair values of assets received is difficult. Both the
consideration received, including goodwill, and the extent of the adjustment of the quoted market price of the stock issued should be weighed to determine the fair value to be recorded. All aspects of the acquisition, including the negotiations, should be studied, and independent appraisals may be used as an aid in determining the fair value of securities issued. Consideration other than stock distributed to effect an acquisition may provide evidence of the total fair value received.

72. The cost of a company acquired either by disbursing cash or other assets, incurring debt, or issuing stock includes the direct costs of acquisition. However, indirect and general expenses related to acquisitions are deducted as incurred in determining net income.

73. Controlling interests — The principles of determining the cost of an acquired company described in paragraphs 69 to 72 also apply to the cost of a controlling interest in a company. A corporation may acquire a controlling interest but not the entire ownership interest of another company. The acquiring corporation should determine a fair value of the acquired company on the same basis as an acquired interest of 100 percent and record the cost of the assets acquired, including goodwill, and liabilities assumed on the basis of that fair value. The minority interest in the acquired company should be reflected at the fair value at the date the corporation acquires control.

74. If a corporation acquires control of another company by purchasing or exchanging securities at various dates, it in effect acquires the other company when the total investment constitutes control and should then account for the acquisition. Investments before control is achieved are classified as intercorporate investments. The fair value of the acquired company should be computed when the investment becomes a controlling interest.

75. Contingent Consideration. A business combination agreement may provide for the issuance of additional shares of a security or the transfer of cash or other consideration contingent on specified events or transactions in the future. Some agreements provide that a portion of the consideration be placed in escrow to be distributed or to be returned to the transferor when specified events occur. Either debt or equity securities may be placed in escrow, and amounts equal to interest or dividends on the securities during the contingency period may be paid to the escrow agent.

76. The Board concludes that the consideration for an acquired company which is recorded at the date of acquisition should be cash and other assets distributed and securities issued unconditionally at that date. Consideration which is issued or issuable at the expiration of the contingency period or which is held in escrow pending the outcome of the contingency should be disclosed but not recorded as a liability or shown as outstanding securities until the outcome of the contingency is determinable beyond reasonable doubt. An issue or distribution of securities or other consider-
ation should then be recorded retroactively as of the date of acquisition and financial statements of intervening periods should be restated appropriately. In general, additional consideration at resolution of contingencies based on earnings should result in an additional element of cost of an acquired company, but additional consideration at resolution of contingencies based on security prices has no effect on the recorded cost of an acquired company.

77. Contingency based on earnings — Additional consideration may be contingent on maintaining or achieving specified earnings levels in future periods. On a later date when the earnings level indicates beyond reasonable doubt that additional consideration will be distributable, the acquiring corporation should record the current fair value of the consideration issued or issuable. The cost of the acquired company should be retroactively increased by the amount of the additional consideration, and amortization and depreciation of costs of affected assets should be restated in financial statements presented for prior periods.*

78. Contingency based on security prices — Additional consideration may be contingent on the market price of a specified security issued to effect a business combination. Unless the price of the security at least equals the specified amount on a specified date or dates, the acquiring corporation is required to issue additional equity or debt securities or transfer cash or other assets sufficient to make the current fair value of the total consideration equal to the specified amount. The securities issued unconditionally at the date the combination is consummated should be recorded at that date at the specified amount. On a later date when market prices indicate beyond reasonable doubt that additional consideration will be distributable, the acquiring corporation should record the current fair value of the additional consideration issued or issuable. However, the amount previously recorded for securities issued at the date of acquisition should simultaneously be reduced retroactively to the lower fair value of those securities at the date the additional securities are recorded; the cost of the acquired company is therefore not affected by the contingency provision. Reducing the value of debt securities previously issued to their later fair value results in recording at a discount those debt securities and additional debt securities issued. The discount should be amortized from date the securities are issued, retroactively for the debt securities issued originally.

79. Interest or dividends during contingency period — Amounts paid to an escrow agent representing interest and dividends on securities held in escrow should be accounted for according to the accounting for the securities. That is, until the disposition of the securities in escrow is determinable beyond reasonable doubt, payments to the escrow agent should not be recorded as interest expense or dividend distributions. Interest expense and dividends should be recorded retroactively for the prior periods if the

* This provision effectively amends paragraph 62 of APB Opinion No. 15.
escrow securities are distributed later to former stockholders of the acquired company.

80. **Tax effect of imputed interest**—A tax reduction resulting from imputed interest on contingently issuable stock reduces the fair value recorded for contingent consideration based on earnings and increases additional capital recorded for contingent consideration based on security prices.

81. **Compensation in contingent agreements**—The substance of some agreements for contingent consideration is to provide compensation for services or use of property, and the additional consideration given should be accounted for as expenses of the appropriate periods.

82. **Recording Assets Acquired and Liabilities Assumed.** An acquiring corporation should allocate the cost or fair value of an acquired company, determined by applying paragraphs 69 to 81, to the assets acquired and liabilities assumed. Allocation should follow the principles described in paragraph 66.

First, all identifiable assets acquired, either individually or by type, and liabilities assumed in a business combination should be recorded at their fair values at date of acquisition whether or not shown in the financial statements of the acquired company.

Second, the difference between the cost of the acquired company and the sum of the fair values of the identifiable assets acquired less liabilities assumed should be recorded as goodwill. The market or appraisal values of identifiable assets acquired less liabilities assumed may sometimes exceed the cost of the acquired company. If so, the values otherwise assignable to noncurrent assets acquired (except long-term investments in marketable securities) should be reduced by a proportionate part of the excess to determine the fair values; so-called “negative goodwill” should not be recorded unless those assets are reduced to zero value.

Thereafter, assets and liabilities should be accounted for in the same manner as similar assets and liabilities, that is, as receivables, inventories, depreciable assets, liabilities to pay cash, and so forth.

Independent appraisals may be used as an aid in determining the fair values of some assets and liabilities. The effect of taxes should also be considered in assigning fair values to individual assets (paragraph 84).

83. **General guides for determining fair values of the individual assets acquired and liabilities assumed, except goodwill, are:**

   a. Marketable securities at current net realizable values.
   b. Claims receivable at present values of amounts to be received determined at appropriate current interest rates, less allowances for uncollectibility and collection costs, if necessary.
   c. Inventories:
      
      (1) Finished goods and merchandise at estimated selling prices less the sum of (a) costs of disposal, and (b) a reasonable profit allowance for the selling effort of the acquiring corporation.
      (2) Work in process at estimated selling prices of finished goods
less the sum of (a) costs to complete, (b) costs of disposal, and (c) a reasonable profit allowance for the completing and selling effort of the acquiring corporation based on profit for similar finished goods.

(3) Raw materials at current replacement costs.

d. Plant and equipment at current replacement costs for similar capacity unless the expected future use of the assets indicates a lower value to the acquirer. Plant and equipment of the acquired company which will be sold or held for later sale rather than used by the acquirer, at current net realizable value.

e. Intangible assets which can be identified and named, including contracts, patents, franchises, customer and supplier lists, and favorable leases, at appraised values.

f. Other assets, including land, natural resources, and nonmarketable securities, at appraised values.

g. Accounts and notes payable, long-term debt, and other claims payable at present values of amounts to be paid determined at appropriate current interest rates.

h. Liabilities and accruals — for example, accruals for pension cost, warranties, vacation pay, deferred compensation — at present values of amounts to be paid determined at appropriate current interest rates.

i. Other liabilities and commitments, including unfavorable leases, contracts, and commitments and plant closing expense incident to the acquisition, at present values of amounts to be paid determined at appropriate current interest rates.

An acquiring corporation does not record as a separate asset the goodwill previously recorded by an acquired company and does not record deferred income taxes recorded by an acquired company before its acquisition. An acquiring corporation should record periodically the accrual of interest on assets and liabilities recorded at acquisition date at the discounted values of amounts to be received or paid.

84. The market or appraisal values of specific assets and liabilities determined in paragraph 83 may differ from the income tax bases of those items. Estimated future tax effects of differences between the tax bases and amounts otherwise appropriate to assign to an asset or a liability are one of

12 Replacement cost may be determined directly if a used asset market exists for the assets acquired. Otherwise, the replacement cost should be approximated from replacement cost new less estimated accumulated depreciation.

13 Fair values should be ascribed to specific assets; identifiable assets should not be included in goodwill.

14 An accrual for pension cost should be the greater of (1) the excess, if any, of the actuarially computed value of vested benefits over the amount of the pension fund or (2) accrued pension cost computed in conformity with the accounting policies of the acquiring corporation for one or more of its pension plans.
the variables in estimating fair value. Amounts assigned as fair values should, for example, recognize that the fair value of an asset to an acquirer is less than its market or appraisal value if all or a portion of the market or appraisal value is not deductible for income taxes. The impact of tax effects on fair value depends on numerous factors, including imminence or delay of realization of the asset value and the possible timing of tax consequences. Since differences between fair values and tax bases are not timing differences (APB Opinion No. 11, Accounting for Income Taxes, paragraph 13), the acquiring corporation should not record deferred tax accounts at the date of acquisition.

85. The rate-making process for regulated businesses whereby rates are established on a cost-of-service basis (Addendum to APB Opinion No. 2) affects the application of this Opinion. Accordingly, acquired property subject to the regulatory process should be stated at amounts (usually historical original cost at present) which are estimated to be recoverable through depreciation and amortization allowances under the rate-making policies of the applicable rate-regulating agency. The cost of acquired assets, tangible and intangible, recognized under the provisions of this Opinion in excess of the amounts referred to in the preceding sentence should be deferred and charged to income over future periods which may differ from the periods charged for regulatory purposes. The Board expresses neither agreement nor disagreement with property and depreciation bases required or allowed for rate-making purposes.

86. Acquisition Date. The statement of income of an acquiring corporation for the period in which a business combination occurs should include income of the acquired company after the date of acquisition by including the revenue and expenses of the acquired operations based on the cost to the acquiring corporation. The Board believes that the date of acquisition of a company should ordinarily be the closing date of a business combination, the date assets are received and other assets are given or stock is issued. The parties may for convenience designate as the effective date the end of an accounting period between the dates a business combination is announced and closed. The designated date is acceptable for accounting purposes if a written agreement provides that effective control of the acquired company is transferred to the acquiring corporation on that date without restrictions except those required to protect the stockholders or other owners of the acquired company—for example, restrictions on significant changes in the operations until closing, permission to pay dividends equal to those regularly paid before the effective date, and the like.

87. The cost of an acquired company and the fair values of assets acquired and liabilities assumed should be determined as of the acquisition date. If the cost of an acquired company is based on the fair value of securities issued (paragraph 71), their market value for a reasonable period before and after the date the terms of the acquisition are agreed to and announced should be considered.
88. Disclosure in Financial Statements. Notes to the financial statements of the acquiring corporations for the period in which a business combination occurs should include the following:

a. Name and a brief description of the acquired company.
b. Method of accounting for the combination—that is, by the purchase method.
c. Period for which results of operations of acquired company are included in the income statement of the acquiring corporation.
d. Cost of acquired company and, if applicable, the number of shares of stock issued or issuable and the amount assigned to the issued and issuable shares.
e. Description of the plan for amortization of acquired goodwill, the amortization method, and period.
f. Contingent payments, options, or commitments specified in the acquisition agreement and their proposed accounting treatment.

Information relating to several relatively minor acquisitions may be combined for disclosure.

89. Notes to the financial statements of the acquiring corporation for the period in which a business combination occurs should include as supplemental information the following results of operations on a pro forma basis:

a. Results of operations for the current period as though the companies had combined at the beginning of the period, unless the acquisition was at or near the beginning of the period.
b. Results of operations for the immediate preceding period as though the companies had combined at the beginning of that period if comparative financial statements are presented.

The supplemental pro forma information should as a minimum show revenue, income before extraordinary items, net income, and earnings per share. To present pro forma information, income taxes, interest expense, preferred stock dividends, depreciation and amortization of assets, including goodwill, should be adjusted to their accounting bases recognized in recording the combination. Pro forma presentation of results of operations of periods prior to the combination transaction should be limited to the immediate preceding period.

INTANGIBLE ASSETS

Nature of Intangible Assets

90. Accounting for an intangible asset involves the same kinds of problems as accounting for other long-lived assets, namely, determining an initial carrying amount, accounting for that amount after acquisition under normal business conditions (amortization), and accounting for that amount if the value declines substantially and permanently. Solving the problems
is complicated by the characteristics of an intangible asset: its lack of physical qualities makes evidence of its existence elusive, its value is often difficult to estimate, and its useful life may be indeterminable.

91. Various intangible assets differ in their characteristics, their useful lives, their relations to operations, and their later dispositions. Intangible assets may be classified on several different bases:

Identifiability — separately identifiable or lacking specific identification.
Manner of acquisition — acquired singly, in groups, or in business combinations or developed internally.
Expected period of benefit — limited by law or contract, related to human or economic factors, or indefinite or indeterminant duration.
Separability from an entire enterprise — rights transferable without title, salable, or inseparable from the enterprise or a substantial part of it.

Present Accounting for Intangible Assets

92. Accounting for Costs at Acquisition. Present principles of accounting for intangible assets are generally similar to those for tangible, long-lived assets such as property, plant, and equipment. Intangible assets acquired from other entities are recorded at cost when acquired. Costs incurred to develop specifically identifiable intangible assets are often recorded as assets if the periods of expected future benefit are reasonably determinable. Costs of developing other intangible assets are usually recorded as expenses when incurred.

93. Accounting for Deferred Costs After Acquisition. Intangible assets have been divided into two classes for purposes of accounting for their costs: (a) those with a determinable term of existence because it is limited by law, regulation, or agreement, or by the nature of the asset, and (b) those having no limited term of existence and no indication of limited life at the time of acquisition. The cost of a type (a) intangible asset is amortized by systematic charges to income over the term of existence or other period expected to be benefited. The cost of a type (b) intangible asset may be treated in either of two ways: (1) the cost may be retained until a limit on the term of existence or a loss of value is evident, at which time the cost is amortized systematically over the estimated remaining term of existence or, if worthless, written off as an extraordinary item in the income statement, or (2) the cost may be amortized at the discretion of management by charges to income even though no present evidence points to a limited term of existence or a loss of value. The cost of an intangible asset may not be written off as a lump sum to capital surplus or to retained earnings (ARB No. 43, Chapter 5 and APB Opinion No. 9).

Basis for Conclusions

94. Cost of Intangible Assets. Accounting for the costs that a corporation incurs to develop identifiable intangible assets is beyond the scope of
this Opinion. Certain of those costs, for example, research and development costs and preoperating costs, present unusual accounting problems which need to be studied separately. The costs of developing goodwill and other intangible assets with indeterminate lives are ordinarily not distinguishable from the current costs of operations and are thus not assignable to specific assets.

95. Ascertaining the cost of intangible assets acquired either singly or in groups, including intangible assets acquired in a business combination, from other businesses or individuals is discussed in paragraphs 64 to 67 and 69 to 85.

96. Treatment of Costs. Costs of intangible assets which have fixed or reasonably determinable terms of existence are now amortized by systematic charges to income over their terms of existence. Differences of opinion center on the amortization of acquired intangible assets with lives which cannot be estimated reliably either at the date of acquisition or perhaps long after, for example, goodwill and trade names.

97. The literature on business combinations and goodwill, including Accounting Research Study No. 10, Accounting for Goodwill, contains at least four possible accounting treatments of goodwill and similar intangible assets:

a. Retain the cost as an asset indefinitely unless a reduction in its value becomes evident.

b. Retain the cost as an asset but permit amortization as an operating expense over an arbitrary period.

c. Retain the cost as an asset but require amortization as an operating expense over its estimated limited life or over an arbitrary but specified maximum and minimum period.

d. Deduct the cost from stockholders' equity at the date acquired.

98. Arguments for nonamortization — The two of the four accounting proposals which do not involve amortization of goodwill as an operating expense are based in part on the contention that goodwill value is not consumed or used to produce earnings in the same manner as various property rights and therefore net income should not be reduced by amortization of goodwill. Further, net income should not be reduced by both amortization of goodwill and current expenditures that are incurred to enhance or maintain the value of the acquired intangible assets. All methods of amortizing goodwill are criticized as arbitrary because the life of goodwill is indefinite and an estimated period of existence is not measurable. The basis for proposing that the cost of goodwill be retained as an asset until a loss in value becomes evident is that the cost incurred for acquired goodwill should be accounted for as an asset at the date acquired and in later periods and the cost should not be reduced as long as the value of the asset is at least equal
to that cost. The basis for proposing that the cost of goodwill be deducted from stockholders' equity at the date acquired is that the nature of goodwill differs from other assets and warrants special accounting treatment. Since goodwill attaches only to a business as a whole and its value fluctuates widely for innumerable reasons, estimates of either the terms of existence or current value are unreliable for purposes of income determination.

99. Accounting on the Historical-Cost Basis. All assets which are represented by deferred costs are essentially alike in historical-cost based accounting. They result from expenditures or owners' contributions and are expected to increase revenue or reduce costs to be incurred in future periods. If future benefit or the period to be benefited is questionable, the expenditure is usually treated as a current expense and not as a deferred cost. Associating deferred costs with the revenue or period to which they are expected to relate is a basic problem in historical-cost based accounting both in measuring periodic income and in accounting for assets. The basic accounting treatment does not depend on whether the asset is a building, a piece of equipment, an element of inventory, a prepaid insurance premium, or whether it is tangible or intangible. The cost of goodwill and similar intangible assets is therefore essentially the same as the cost of land, buildings, or equipment under historical-cost based accounting. Deducting the cost of an asset from stockholders' equity (either retained earnings or capital surplus) at the date incurred does not match costs with revenue.

100. Accounting for the cost of a long-lived asset after acquisition normally depends on its estimated life. The cost of assets with perpetual existence, such as land, is carried forward as an asset without amortization, and the cost of assets with finite lives is amortized by systematic charges to income. Goodwill and similar intangible assets do not clearly fit either classification; their lives are neither infinite nor specifically limited, but are indeterminate. Thus, although the principles underlying present practice (paragraphs 92 and 93) conform to the principles of accounting for similar types of assets, their applications have lead to alternative treatments. Amortizing the cost of goodwill and similar intangible assets on arbitrary bases in the absence of evidence of limited lives or decreased values may recognize expenses and decreases of assets prematurely, but delaying amortization of the cost until a loss is evident may recognize the decreases after the fact.

101. A Practical Solution. A solution to this dilemma is to set minimum and maximum amortization periods. This accounting follows from the observation that few, if any, intangible assets last forever, although some may seem to last almost indefinitely. Allocating the cost of goodwill or other intangible assets with an indeterminate life over time is necessary because the value almost inevitably becomes zero at some future date. Since the date of which the value becomes zero is indeterminate, the end of the useful life must necessarily be set arbitrarily at some point or within some range of time for accounting purposes.
Opinion

102. **Acquisition of Intangible Assets.** The Board concluded that a corporation should record as assets the costs of intangible assets acquired from other enterprises or individuals. The costs of developing an identifiable intangible asset may be recorded as an asset, but costs of developing, maintaining, or restoring intangible assets which are not specifically identifiable, have indeterminate lives, or are inherent in a continuing business and related to an enterprise as a whole—such as goodwill—should be deducted from income when incurred.

103. Individual intangible assets should be segregated by their nature, and the cost of each identifiable asset and acquired goodwill should be recorded separately.

   a. The cost of an intangible asset or a group of intangible assets acquired in a separate purchase should be determined by the principles described in paragraphs 64 to 67.

   b. The costs of identifiable intangible assets acquired in a business combination should be determined by allocating the cost of the acquired company as described in paragraphs 82 to 87.

   c. The portion of the cost of an acquired company not allocated to tangible assets, identifiable intangible assets, and liabilities should be designated as the cost of goodwill (paragraph 82).

The same principles determine the cost of goodwill acquired even though a corporation acquires a controlling interest in a company but not the entire ownership interest (paragraphs 73 and 74).

104. **Amortization of Intangible Assets.** The Board believes that the value of intangible assets at any one date eventually disappears and that the recorded costs of intangible assets should be amortized by systematic charges to income over the periods estimated to be benefited. Factors which should be considered in estimating the useful lives of intangible assets include:

   a. Legal, regulatory, or contractual provisions may limit the maximum useful life.

   b. Provisions for renewal or extension may alter a specified limit on useful life.

   c. Effects of obsolescence, demand, competition, and other economic factors may reduce a useful life.

   d. A useful life may parallel the service life expectancies of individuals or groups of employees.

   e. Expected actions or competitors and others may restrict present competitive advantages.

   f. An apparently unlimited useful life may in fact be indefinite and benefits cannot be reasonably projected.
g. An intangible asset may be a composite of many individual factors with varying effective lives.

The method of amortization of intangible assets should be determined from the related factors and the periodic amortization should be reasonable.

105. The Board concludes that the straight-line method of amortization of equal annual amounts should be applied unless a corporation demonstrates that another systematic method is more appropriate. The financial statements should disclose the method and period of amortization. Amortization of acquired goodwill and of other acquired intangible assets not deductible in computing income taxes payable does not create a timing difference, and allocation of income taxes is inappropriate.

106. The cost of each type of intangible asset should be amortized on the basis of the estimated life of that specific asset and should not be written off in the period of acquisition. Analysis of all factors should result in a reasonable estimate of the useful life of most intangible assets. A reasonable estimate of the useful life may often be based on upper and lower limits even though a fixed existence is not determinable. The period of amortization should not, however, exceed forty years. Analysis at the time of acquisition may indicate that the indeterminate lives of some intangible assets are likely to exceed forty years and the cost of those assets should be amortized over the maximum period of forty years, not an arbitrary shorter period.

107. A corporation should evaluate the periods of amortization continually to determine whether later events and circumstances warrant revised estimates of useful lives. If estimates are changed, the unamortized cost should be allocated to the increased or reduced number of remaining periods in the revised useful life but not to exceed forty years after acquisition. Estimation of value and future benefits of an intangible asset may indicate that the unamortized cost should be reduced significantly by a deduction in determining net income (APB Opinion No. 9, paragraph 21). However, a single loss year, or even a few loss years together, does not necessarily justify an extraordinary charge to income for all or a large part of the unamortized cost of intangible assets.

108. Excess of Acquired Net Assets Over Cost. The value assigned to net assets acquired should not exceed the cost of an acquired company because the general presumption in historical-cost based accounting is that net assets acquired should be recorded at not more than their cost. The total market or appraisal values of identifiable assets acquired less liabilities assumed in a few business combinations may exceed the cost of the acquired company. An excess over cost should be allocated to reduce proportionately the values assigned to noncurrent assets (except long-term investments in marketable securities) in determining their fair values (paragraph 82). If the allocation reduces the noncurrent assets to zero value, the remainder of the excess over cost should be classified as a deferred credit and should
be amortized systematically to income over the period estimated to be benefited but not in excess of forty years. The method and period of amortization should be disclosed. No part of the excess of acquired net assets over cost should be added directly to stockholders' equity at the date of acquisition.

109. Disposal of Goodwill. Ordinarily goodwill and similar intangible assets cannot be disposed of separately from the enterprise as a whole. An acquired company or large segment of it may, however, subsequently be sold or otherwise liquidated, and all or a portion of the unamortized cost of the goodwill recognized in the acquisition should be included in the cost of the assets sold.

**Effective Date**

110. The provisions of this Opinion shall be effective to account for business combinations initiated after June 30, 1970 and intangible assets recognized in those business combinations or otherwise acquired after June 30, 1970. Business combinations initiated before June 30, 1970 and consummated after that date under the original terms may be accounted for in accordance with this Opinion or the applicable previous pronouncements of the Board and its predecessor committee.

111. The provisions of this Opinion should not be applied retroactively for business combinations consummated before June 30, 1970 or to intangible assets acquired before June 30, 1970, whether in those business combinations or otherwise.

112. The Board encourages the application on a prospective basis to all intangible assets held on June 30, 1970 of the provision in paragraphs 104 to 107 of this Opinion which requires amortization of all intangible assets over the periods described.

113. If a corporation holds as an investment on March 1, 1970 a minority interest in the common stock of another company and the corporation initiates after June 30, 1970 a plan of combination with that company, the resulting business combination may be accounted for by the pooling of interests method providing

the combination is completed within five years after June 30, 1970 and
the combination meets all conditions specified in paragraphs 44 to 47, except that
the corporation which effects the combination issues common stock for
at least 90 percent of the outstanding common stock interest, as described in paragraph 46(b), of the other combining company not already held at March 1, 1970 (rather than 90 percent of all of the common stock interest of the combining company).\(^\text{15}\)

The investment in common stock held on March 1, 1970 should not be accounted for as treasury stock or retired stock at the date of the combina-

\(^{15}\) The exception does not affect the measure of relative size described in paragraph 45(b).
tion. Instead, the excess of cost over the investor corporation's proportionate equity in the net assets of the combining company at or near the date the stock investment was acquired should be allocated to identifiable assets of the combining company at the date the combination is consummated on the basis of the fair values of those assets at the combination date. The unallocated portion of the excess should be assigned to an unidentified intangible asset (goodwill) and should be accounted for according to applicable previous pronouncements of the Board and its predecessor committee. The cost of goodwill should not be amortized retroactively but may be amortized prospectively under the provision of paragraph 112. If the cost of the investment is less than the investor's equity in the net assets of the combining company, that difference should reduce proportionately the recorded amounts of noncurrent assets (except long-term investments in marketable securities) of the combining company.

Notes

Opinions of the Accounting Principles Board present the conclusions of at least two-thirds of the members of the Board, which is the senior technical body of the Institute authorized to issue pronouncements on accounting principles. Council of the Institute has resolved that Institute members should disclose departures from Board Opinions in their reports as independent auditors when the effect of the departures on the financial statements is material or see to it that such departures are disclosed in notes to the financial statements and, where practicable, should disclose their effects on the financial statements (Special Bulletin, "Disclosure of Departures from Opinions of the Accounting Principles Board," October 1964). Members of the Institute must assume the burden of justifying any such departures.

Covering all possible conditions and circumstances in an Opinion of the Accounting Principles Board is usually impracticable. The substance of transactions and the principles, guides, rules, and criteria described in Opinions should control the accounting for transaction not expressly covered.

Unless otherwise stated, Opinions of the Board are not intended to be retroactive. They are not intended to be applicable to immaterial items.
part

IV

TAX