

NEW YORK UNIVERSITY
Stern School of Business

Acquisitions, Other Restructurings and Related Topics

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10-79 KMC

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Class web site: NYU Classes

Text: Advanced Accounting (**Custom Text** from 12th Edition – Hoyle, Schaefer & Douppnik)

Additional materials: Additional text, notes, slides and spreadsheets are distributed in class

Case materials: Primarily from annual reports and SEC filings

Course Content: This course concentrates on mergers and acquisitions, the development of consolidated financial statements, related analytical issues and selected reorganization issues such as spinoffs, splitoffs, IPOs, LBOs and Fresh Starts. It also covers accounting for companies that operate in multiple currencies and selected financial instruments.

Some representative questions for discussion include:

- What are some analysis problems associated with consolidated statements?
- Can the acquirer and the acquired both show gains in a partial acquisition?
- How does increasing an already majority ownership affect financial reporting?
- What is the impact of a bidding war on shareholders, leverage, goodwill and the future?
- Are internal profits relevant to the analysis of the entire firm?
- Can a subsidiary report a profit and the parent suffer a loss on its investment in the subsidiary (or vice versa)?
- Can the parent and the minority interest have different rates of return on the same investment (including possibly a loss for the parent and a gain for the noncontrolling interest)?
- Can a company avoid consolidation even if it owns a majority of a company?
- Can a company be required to consolidate even if it has a minority position in a company?
- How do acquisitions impact reported cash flows?
- When can a company use consolidated tax statements?
- How are IPOs and LBOs and Fresh Starts related?
- Can one company have a gain and another a loss (and a third have no gain or loss) from the same currency movements?
- How does a firm hedge future transactions in foreign currencies?

There are multiple intertwined elements to the first part of the course. One focus is on **statement development** and problem solving to understand **how the acquisition of a company affects financial statements** and to understand how several operating units of a company can combine their several individual financial statements into **consolidation statements for external presentation**. The second focus is on **several cases** that highlight selected issues affecting firms as they combine, restructure or deal with measurement issues. (A tentative list follows.)

Some selected companies and cases that may be discussed during the semester as time permits:

- | | |
|---|---|
| Biovail-Valeant – Who acquired who? | Hostess & GM - Bankruptcies |
| SBC & Bell South – Joint venture & merger | Walmart-Massmart – Transnational partial acquisition |
| Wachovia & Golden West – Rationale (Valuation) for a merger | Henderson Inc. – Intra-entity transactions (transfer pricing) |
| Morgan Stanley & Citigroup – Valuation of Smith Barney | AOLTimeWarner/Microsoft – Impairment |
| Verizon and Vodafone – End of a joint venture | Facebook/Trulia/Twitter – IPO |
| Dell – Going private | T-Mobile – IPO or Acquisition or Equity Carveout |
| CenturyLink & Qwest – Merger (Negative Equity) | Coca Cola – Reporting and Foreign Exchange |
| Medtronic & Covidien – Tax inversion | Coca Cola, GE – Hedging policies |

The second part of the course brings in some international considerations. Companies operating in multiple currencies (Coca-Cola operates in over 80 currencies) must report in a single currency. International companies are also likely to try to reduce foreign currency rate risks associated with both current and forecasted transactions.

Are you familiar with the following topics? These are covered with varying degrees of depth.

Topic	
Mergers	100% acquisition
	Partial acquisition
	Disappearance of acquired firm
	Acquired firm survives
	Purchase method
	Pooling method
	Acquisition method
	Fair values (assets & firm)
	Valuation of intangibles
	Goodwill
Consolidations	In process R & D
	Reporting units (not segments)
	Impairment testing
	IFRS' differences
	Consolidation process
	Investment in subsidiary
After acquisition	Elimination (Consolidation) entries
	Noncontrolling interest
	Income statement
	Equity method
	Cost method
	Cash Flow
	Selected Tax Issues

Topic	
Intra-Entity events	Intra-Entity sales
	Intra-Entity asset transfers
Restructurings	Impact on profits
	Pushdown accounting
	Leveraged buyouts
	IPOs
Foreign currency reporting	Spinoffs & Splitoffs
	Liquidation & Fresh starts
	Segment reporting
Foreign currency events	Exchange rates
	Comprehensive income
	Conversions -translation
	Conversions-remeasurement
	Consolidation of foreign operations
	Comprehensive income
	Spot activity
	Hedging
	Fair Value hedges
	Cash flow hedges
Firm commitments	
Forecasted events	
Hedge effectiveness	
Options	

(You should be familiar with accounting for available for sale and trading securities when we speak of foreign operations. Materials will be on NYU Classes.)

Course requirements:

Options: There are **three grading paths**. Each requires exams and written hand-ins. The first path includes short write-ups of seven cases described below. The second path includes short write-ups of three cases and a written paper described below. The combined path includes short write-ups of seven cases and the written paper with less weight on exams. It is required for graduate students.

Exams: There are three exams. All exams are open book, open note, objective exams. There are **no make-up exams**. If you cannot take an exam at the scheduled time you are expected to take it **early**. The exams will be given on the stated dates. The topics may change if the course falls behind schedule.

Cases: Most cases reflect current events. Cases will NOT be part of course exams. **A short (½ - 1 page) TYPED case writeup is required for cases listed in bold print.** One paragraph should describe the issues and considerations associated with the case. A second and/or a third paragraph should include your opinions about the issues. There are multiple grading options with respect to cases. See the grade guide below.

Paper: This is associated with the second (or combined) grading paths and is an 'experiential' paper. The basic requirement is a review of recent structural changes of several competing companies. A more complete write-up is included below. The industry in the paper must be okayed and there is only one person per industry.

Attendance: Attendance, completion of the cases and a review of the suggested exercises are important. You should **attend every class** to assure a good understanding of the materials. 80% attendance is the minimum acceptable attendance rate to pass the course.

Classroom performance: You are expected to be able to contribute to discussions about the exercises as well as other classroom discussions. Read the text and review the classroom exercises before class. Positive contributions include questions and well-intended responses irrespective of their accuracy and are worth extra credit.

Suggested homework: The assignments review some primary topics in each chapter and may help you prepare for exams. Do not spend too much time on any question. Instead, try to work the exercise in your own way and, if you are stuck, review the posted answer that is on NYU Classes and/or ask related questions in class. Homework suggestions are listed on the first date of the following chapter to assure some classroom discussion prior to doing the exercises.

Support materials: Visit NYU Classes early and often. It has announcements, class notes, slide shows, spreadsheets, sample exams, class videos and miscellaneous items. Many of the relevant materials will be provided as handouts.

Warning: The topics are detailed, building on materials presented earlier in the semester. Difficulties faced early in the semester should be dealt with promptly.

You are expected to follow the graduate honor code and the undergraduate code of conduct throughout the semester. We follow Stern's default policies for anything not covered here.

<i>Tentative Grading:</i>	#	Path 1	#	Path 2	#	Combined
Exam 1*		27 points		27 points		24 points
Exam 2*		27 points		27 points		24 points
Exam 3*		27 points		27 points		24 points
Classroom attendance		5 points		5 points		4 points
Cases	7	14 points	3	6 points	7	14 points
Paper				10 points		10 points
Classroom participation		Extra credit		Extra credit		Extra credit

*The exam with the highest average will be worth 42 points (39 for Combined) and the exam with the lowest average will be worth 12 points (Path 1) or 10 points (Path 2) or 9 points (Combined). This adjustment occurs **only** if all exams are taken in a timely manner. (Path 1 – 42+27+12+5+14 = 100; Path 2 – 42+27+10+5+6+10 = 100; Combined – 39+24+9+4+14+10 = 100)

Homework related notes:

Several problems and questions include parts about three different accounting methods associated with investments (**prior to consolidation**) – the full or complete equity method, the incomplete or partial equity method and the cost method. The equity methods are typically identical for subsidiary income and dividend flows. The incomplete or partial equity method and the cost method are typically identical when the focus is on intra-entity transactions.

Preliminary Schedule of Topics	Readings	Classroom Discussion	Extra Exercises*
Introduction		GE – Financial Statements Some analysis questions	
Accounting for Minority Investments – Passive Investments, Equity Method	Ch 1	(1-6 thru 1-9)	
Consolidations on Acquisition – Acquisition Method – Balance Sheet	Ch 2	(2-9,2-10) Biovail-Valeant – Who acquired who?	(1-14, 1-19),
Consolidations on Acquisition	Ch 2	(2-26,2-33)	
Consolidations –/ Valuation Issues & Cases	Case Materials	(Choose 2 of 3) Chp 2 Cases – Gillette, Wachovia, CenturyLink	(2-11,2-12,2-17,2-19)). Acquisitions
Consolidations – After Date of Acquisition – Income Statement	Ch 3	(3-4,3-7)	(2-16,,2-23)
Consolidations – After Date of Acquisition – Impairments, Cash Flows	Ch 3, Ch 6 (266-270)	(3-11 thru 3-13), (6-6, 6-7), AOLTimeWarner, Microsoft -Impairment	
Consolidations – After Date of Acquisition – Partial Acquisitions			(3-17,3-18,3-21)
Consolidations – After Date of Acquisition – Partial Acquisitions /Review	Ch 4 (145-167)	(4-2,4-4,4-12 thru 4-14)	
Exam 1 (Chaps 1 -3)			
Consolidations – After Date of Acquisition – Partial Acquisitions	Ch 4(145-167)	(4-15 thru 4-19), Slides	
Consolidations – After Date of Acquisition – Partial Acquisitions (IFRS)		(4-26), Chp 4 Case Walmart-Massmart –	Transnational Partial Acquisition
Consolidations – Taxes	Ch 7 (315 – 325)	(7-11, 7-12),	
Consolidations – Intra-Entity Transactions – Sales	Ch 5 (pp 199 - 220)	(5-23, 5-24)	(5-20c)
Consolidations – Segment & Interim Reporting		Chp 5 Case Henderson Inc,	Intra-Entity Transactions
Alternate Restructurings – IPOs, LBOs	Notes		
Alternate Restructurings – Spinoffs, Step Acquisitions, Indirect Ownership, VIEs	Ch 4 (167-174)	Case T-Mobile, Facebook	IPO or Reverse Acquisition??
Alternate Restructurings – Liquidations, Fresh Starts		Case Morgan Stanley	Step Acquisition
Foreign Currency – Introduction/Review	Ch 10	(10-4, 10-5)	
Exam 2 (Chps 4-5,7)			
Foreign Currency Conversions– (Current Method)	Ch 10	(10-6 thru 10-9)	
Foreign Currency Conversions – (Temporal Method)	Ch 10	(10-10-10-11)	
Foreign Currency – Consolidations	Ch 10	Chp 10, (10-35) Case Coca Cola	Foreign Exchange
Foreign Currency – Transactions	Ch 9, Notes	(9-1, 9-4)	(10-15,10-28)
Foreign Currency – Forwards, Hedges	Ch 9, Notes	(9-9, 9-11, 9-12) Coca Cola, GE Hedging policies	
Foreign Currency – Commitments, Forecasted Transactions	Ch 9, Notes	(9-31, 9-32)	(9-11 thru 9-13, 9-29)
Review			
Exam 3 (Chps 9 & 10)			

*This is a minimal list of extra exercises. You may prefer to do more.

Optional Paper: Choose a two digit or three digit SIC industry (or a three digit NAICS code or a two digit ISIC code). Select three of the five largest companies in the industry (usually by sales or size in dollars) and one other company in the industry that interests you. Include appropriate references.

Go back three fiscal years for each company and then review the series of structural changes that have occurred during the past three years.

Consider three types of structural changes:

Internal changes such as board upheavals¹, changes in segments and changes in geographical focus

External changes such as spinoffs and acquisitions

Financial changes such as substantial changes in the financial structure

The following issues are representative of some of your considerations. The issues may vary from industry to industry and company to company.

Does there seem to be a single consistent strategy associated or announced in relation to the activities of a company the past three years?

Has change in the company been driven more by internal growth or structural changes?

Are there a few major changes or many minor changes?

Are the companies in the industry following similar paths to change?

Are the firms continuously active or are the changes irregular?

Do the firms seem reactive to each other?

How has the changes impacted each company's financial structure?

How has the changes impacted each company's position in the industry?

Include a separate one page summary or outline of key bits of information. Summaries will be compiled for redistribution to the contributors. The paper is due at the start of the last week of classes.

¹ Changes in boards are always happening. This refers to activist shareholders such as Carl Icahn (Dell & Apple), Warren Buffett (Coca Cola), William Ackman (JC Penney & Allergan) and others encouraging changes in management or financing.

There **were** three acceptable consolidation methods. Pooling has been disallowed for new acquisitions since 2001. The purchase method has been disallowed for new acquisitions since December 2008. The acquisition method is the only acceptable method for new acquisitions today. However, consolidated statements today include elements of all three methods with the no longer allowed methods slowly disappearing from the financial statements as the associated assets and liabilities age.

Summary of Consolidation Methods	Acceptable Acquisition Method	Not Acceptable after 2008 Purchase Method	Not Acceptable after 2001 Pooling
Values	Fair Value	Mix	Book Value
Type of financial consideration	Any	Any	Stock primarily
Amount of financial consideration	Fair value	Adjusted fair value	Book value
Valuation adjustments on 100% acquisition	100% adjustment	100% adjustment	None
Valuation adjustments on partial (less than 100%) acquisition	100% adjustment	Acquired portion only	None
Assets discovered And Goodwill	New intangibles for parent and Noncontrolling interest	New intangibles For parent only	None None
Consolidation of the subsidiary	Include only events after the acquisition	Include only events after the acquisition	Treated as having been together forever

Additional comments:

Investment Accounting			
Ownership	<20%	20-50%	>50%
Available for Sale*	X		
Trading*	X		
Equity Method		X	
Equity Method			X- prior to consolidation
Cost Method			X- prior to consolidation

*Similar to accounting for foreign exchange

Business in Foreign Currencies

Conversions to Dollars for Reporting			Transactions		
Conversions before Consolidation			Consolidation In dollars	Spot Market Risk	Hedging Forward Markets Neutralizes Risk
Translation	Remeasurement				
Major Operations	Minor Operations				
Net Assets	Net Monetary Assets				
Comprehensive Income	Income				
			Commitments	Forecasted Events	

Cases must be typed. Written material will not be accepted or reviewed. The amount of credit will be guided by this summary. Be concise; assume you are summarizing the relevant issues for management. Use at least 1½ line spacing, normal page borders and size 11 font. Use one paragraph to summarize the underlying issues and one paragraph to describe your opinion.

Dimension	Poor (√-)	Average (√)	Excellent (√+)
Statement of the Issues and driving Forces	Partial recognition of the factors	Identification of the factors	Thorough identification of the factors and their impacts
Opinion Based on the Above	Failure to link factors to your opinion	Partial integration of the identified factors into your opinion	Full integration of the factors into your opinion