NEW YORK UNIVERSITY

Stern School of Business

|  |  |  |
| --- | --- | --- |
| **Acquisitions, Other Restructurings and Related Topics**  |  | **Fall 2015**  |
| Prof. John Bildersee  |  |  | jbilders@stern.nyu.edu  |
| Tel. 212-998-0027  | 10-79 KMC  | Class web site: NYU Classes  |

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

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

**Mini case materials**: Primarily from annual reports and SEC filings

***Course Content and Objectives:*** This course concentrates on events causing material discontinuities in financial statements thereby complicating analyses and projections. These include mergers and acquisitions, the development of consolidated financial statements, related analytical issues such as taxes 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.

There are multiple intertwined foci for the course. One focus is understandingand interpreting the equity method for investments and the acquisition method for business combinations and the impact of business restructurings. The second focus is discussion of **several mini cases** highlighting selected issues affecting firms as they combine, restructure or deal with measurement issues.

The course reflects the reality that many companies operate internationally. Companies operating in multiple currencies (Coca-Cola operates in over 80 currencies) must report in a single currency and typically try to reduce foreign currency rate risks associated with both current and forecasted transactions.

Some representative questions for discussion include:

How are acquisitions, LBOs and Fresh Starts related?

What are some analysis problems associated with consolidated statements?

How can management ‘manipulate’ 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 noncontrolling interest have different rates of return on the same investment?

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 consolidations impact reported cash flows?

What are the restrictions keeping companies from using fully consolidated tax statements?

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?

***Selected companies and mini cases that may be discussed during the semester as time permits:***

Biovail-Valeant – Who acquired who?

SBC & Bell South – Joint venture & merger

Wachovia & Golden West – Rationale (Valuation) for a merger

Morgan Stanley & Citigroup – Valuation of Smith Barney

Verizon and Vodafone – End of a joint venture

Sears Holding – Spinoff

CenturyLink & Qwest – Merger (Negative Equity)

Pfizer & AstraZeneca – Tax inversion?

Hostess & GM - Bankruptcies

Google & Motorola – Goal of an acquisition

Walmart-Massmart **–** Transnational partial acquisition

Henderson Inc. – Intra-entity transactions (transfer pricing)

AOLTimeWarner/Microsoft – Impairment

Facebook/Trulia/Twitter – IPO

T-Mobile – IPO or Acquisition or Equity Carveout

Coca Cola – Reporting and Foreign Exchange

Coca Cola, GE – Hedging policies

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

|  |  |
| --- | --- |
| Topic |  |
| Minority investments | Trading securities |
|  | Available for sale securities |
|  | Equity method – minority investments |
| 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 |
|  | In process R & D |
|  | Reporting units (not segments) |
|  | Impairment testing |
|  | Pushdown accounting |
|  | IFRS differences |
| Consolidations | Consolidation process |
|  | Investment in subsidiary |
|  | Consolidation (elimination) entries |
|  | Noncontrolling interest |
| After acquisition | Income statement |
|  | Equity method |
|  | Cost method |
|  |  Cash flow |
|  |  |
| Topic |  |
| Taxes | Affiliated groups |
|  | Consolidation requirements |
|  | Intangibles and foreign operations |
|  | Taxation of internal flows |
| Intra-Entity events | Intra-Entity sales |
|  | Intra-Entity asset transfers |
|  | Transfer pricing |
|  | Impact on profit allocation |
| Restructurings | Leveraged buyouts |
|  | IPOs |
|  | Spinoffs & Splitoffs |
|  | Liquidation & Fresh starts |
|  | Segment reporting |
| Foreign currency reporting | Exchange rates |
|  | Comprehensive income |
|  | Conversions -translation |
|  | Conversions-remeasurement |
|  | Consolidation of foreign operations |
|  | Comprehensive income |
| Foreign currency events | 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 mini cases described below. The second path includes short write-ups of three mini cases and a written paper described below. The combined path includes short write-ups of seven mini 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.

***Mini Cases:***Most mini cases reflect current events and offer an opportunity for classroom discussion.Mini cases will NOT be part of course exams. A **short** (½ - 1 page) **TYPED** writeup is **required for mini cases listed in bold print**. One paragraph should describe the issues and considerations associated with the mini case. A second and/or a third paragraph should include your opinions about the issues. There are multiple grading options with respect to the mini 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. Alternate topics reflecting course materials are acceptable

***Attendance****:* Attendance, completion of the mini 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.**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| *Tentative Grading:*  | # | Path 1 | # | Path 2 | # | Combined |
| Exam 1\*  |  | 27 points  |  | 27 points  |  | 22 points  |
| Exam 2\*  |  | 27 points  |  | 27 points  |  | 22 points  |
| Exam 3\*  |  | 27 points  |  | 27 points  |  | 22 points  |
| Classroom attendance  |  |  5 points  |  |  5 points  |  |  5 points  |
| Mini cases  | 7 | 14 points | 3 |  6 points | 7 | 14 points |
| Paper |  |  |  | 10 points |  | 15 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 – 37+20+9+5+14+15 = 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.

**You are expected to follow Stern’s honor codes of conduct throughout the semester. Cheating will not be tolerated. It will result in the vacating of exam scores and an F for the course.**

***Default policies:*** Policies not outlined here will be covered by the Stern default policies document attached to this syllabus.

*Course schedule:*

|  |  |  |  |
| --- | --- | --- | --- |
| Preliminary Schedule of Topics | Readings | Classroom Discussion | Extra Exercises\* |
| Introduction  |  | GE – Financial StatementsSome 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 – Income Statement | Ch 3 |  |  |
| Consolidations – After Date of Acquisition – Impairments, Cash Flows | Ch 3, Ch 6 (270-274) | (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 (149-170) | (4-2,4-4,4-12 thru 4-14)  |  |
| **Exam 1 (Chaps 1 -3)**  |  |  |  |
| Consolidations – After Date of Acquisition – Partial Acquisitions  | Ch 4(149-170)  | (4-15 thru 4-19), Slides | (4-26) |
| Consolidations – Intra-Entity Transactions – Sales | Ch 5 (pp 203-224) | (**(**5-23, 5-24), **Chp 4 Case Walmart-Massmart –**  | **Transnational Partial Acquisition** |
| Consolidations – Taxes | Ch 7 (321-331) | (7-11, 7-12), **Chp 5 Case Henderson** | **Intra-Entity Transactions** |
| Alternate Restructurings – IPOs, LBOs | Notes |  |  |
| Alternate Restructurings – Spinoffs, Step Acquisitions, Indirect Ownership, VIEs | Ch 4 (170-175) | **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) **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/ Review  | Ch 9, Notes  | (9-31, 9-32)  | (9-11 thru 9-13, 9-29)  |
| **Exam 3 (Chps 9 & 10)**   |  |  |  |

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

***Sample 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 upheavals[[1]](#footnote-1), 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? Does it appear to be successful?

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 6:00 PM New York City time on the date of the final exam during the final exam period. Delivery by email is required even if hard copy is also handed in.

***Mini case grade guide:*** 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. There is a one page limit.

|  |  |  |  |
| --- | --- | --- | --- |
| 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 |

**These topics are discussed in varying degrees of depth.**

|  |  |
| --- | --- |
| Topic |  |
| Minority Investments | Trading securities |
|  | Available for sale securities |
|  | Equity method – minority investments |
| 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 |
|  | In process R & D |
|  | Reporting units (not segments) |
|  | Impairment testing |
|  | IFRS’ differences |
| Consolidations | Consolidation process |
|  | Investment in subsidiary |
|  | Elimination (Consolidation) entries |
|  | Noncontrolling interest |
| After acquisition | Income statement |
|  | Equity method |
|  | Cost method |
|  | Cash Flow |
|  | Pushdown accounting |
|  |  |
| Topic |  |
| Taxes | Tax on internal flows |
|  | Affiliated groups |
|  | Requirements for tax consolidation |
|  | Intangibles and international issues |
| Intra-Entity events | Intra-Entity sales |
|  | Intra-Entity asset transfers |
|  | Impact on profits |
| Restructurings | Reverse acquistions |
|  | Leveraged buyouts (LBOs) |
|  | IPOs |
|  | Spinoffs & Splitoffs |
|  | Liquidation & Fresh starts |
|  | Segment reporting |
| Foreign currency reporting | Exchange rates |
|  | Comprehensive income |
|  | Conversions -translation |
|  | Conversions-remeasurement |
|  | Consolidation of foreign operations |
|  | Comprehensive income |
| Foreign currency events | Spot activity |
|  | Hedging |
|  | Fair Value hedges |
|  | Cash flow hedges |
|  | Firm commitments |
|  | Forecasted events |
|  | Hedge effectiveness |
|  | Options |

*A Quick Overview and Summary:* 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**  | **New intangibles** | New intangibles | None |
| And Goodwill | **for parent and** | For parent only | None |
|  | **Noncontrolling interest** |  |  |
| **Consolidation of the subsidiary** | **Include only events** | Include only events | Treated as having |
|  | **after the acquisition** | after the acquisition | 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 |  | Commitments |
| Comprehensive Income | Income |  | Forecasted Events |

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. [↑](#footnote-ref-1)