WHAT IS A PURCHASE PRICE ALLOCATION (PPA)?

WHEN DO I NEED TO COMPLETE A PPA?

Scalar

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OVERVIEW

A purchase price allocation (PPA) represents a valuation analysis that is required under Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) topic 805, Business Combinations, when an entity acquires a controlling interest in a business. For the purposes of this article, we are assuming this hypothetical transaction qualifies as a business combination and will be accounted for by applying the acquisition method. Performing an acquisition triggers additional financial- and tax-reporting requirements, which is when a PPA comes into the picture.[1]

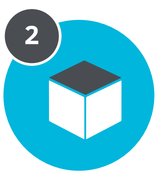
SO WHAT EXACTLY IS A PPA?

A PPA is just what it sounds like. The purchase price or the consideration paid for the business is allocated to acquired assets and assumed liabilities. The residual amount after allocating the purchase price represents goodwill. Below is a summary of the components of a PPA:

CONSIDERATION

The purchase price is defined as the price paid by the acquirer to obtain control in the acquired company. Examples of consideration include:

Cash



Stock

Contingent Consideration

[1]This article addresses acquisitions that only meet the criteria of a business combination under ASC 805-10-25-1. It is beyond the scope of this article to discuss acquisitions that do not meet the criteria that are accounted for as asset acquisitions.

NET ASSETS

Net assets refer to the total assets less the total liabilities of the acquired company. In accordance with ASC 805, in performing a PPA, all assets acquired and liabilities assumed must be reflective of fair value rather than book value. As such, there may be a need to adjust book values to fair value. Common balance sheet items that may need to be fair valued include:

- Inventory
- Property
- Plant
- Land
- Equipment (PP&E)
- Real Property
- Deferred Revenue

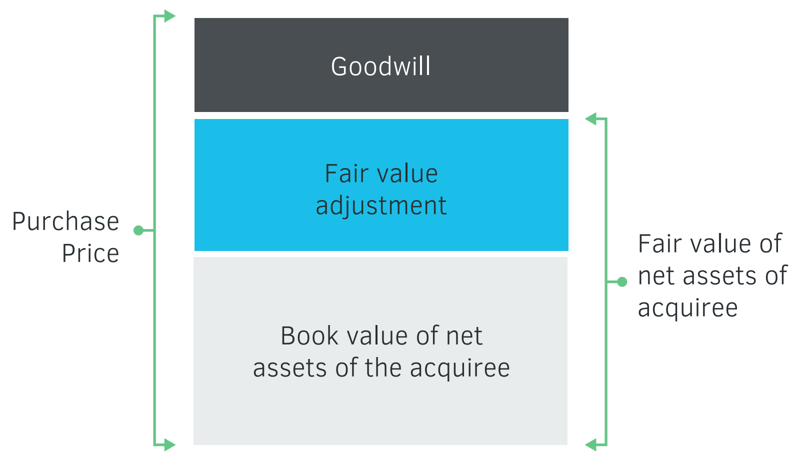
ASSETS ACQUIRED FALL INTO TWO BUCKETS: TANGIBLE AND INTANGIBLE ASSETS.

TANGIBLE ASSETS	INTANGIBLE ASSETS
Tangible assets are easy to identify because they represent physical and measurable assets. Some examples include:	Intangible assets represent nonmonetary assets that lack physical substance as compared to physical assets such as inventory and equipment. Similar to tangible assets, intangible assets are expected to generate economic returns to the acquirer in the future. Some examples of intangible assets include:
Inventory	Developed Technology, IP, & Patents
Machinery and Equipment	Customer Relationships and Contracts
Cash and Marketable Securities	Tradenames and Trademarks
Land and Real Property	

The guidance under ASC 805 defines specific criteria to determine whether an acquired intangible asset can be recognized as a separately identifiable intangible asset in a business combination. Based on ASC 805-20-55-2 through 55-3, an intangible asset must be recognized as a separate asset from goodwill if either or both of the following criteria are met:

CONTRACTUAL-LEGAL CRITERION	SEPARABILITY CRITERION
The intangible asset arises from contractual or legal rights, even if those rights are not separable or transferable.	The intangible asset can be separated from the acquired company and can be reasonably transferred, sold, licensed, rented, or exchanged without any restrictions on the transferability of the asset.

Intangible assets that meet either or both of the above criteria are recognized separately from goodwill as identifiable assets and are measured at fair value at the acquisition date. If the acquired intangible assets do not meet either of the above criteria, then the value of those intangible assets will be subsumed into goodwill.



Note: The assumed book value of net assets have been adjusted to fair value and does not include identifiable intangibles.

GOODWILL

Goodwill is essentially the amount paid for the acquired company in excess of the acquired company's net assets. Goodwill is calculated as the difference between the purchase price and total fair value of assets and liabilities of the acquired company. We note under ASC 805 that the fair value of an acquired assembled workforce does not represent a separately identifiable intangible asset and is subsumed in goodwill.

> "Calculating goodwill accurately is a critical component in the financial reporting process. Goodwill and indefinite-lived assets need to be reevaluated for impairment, and when that testing occurs depends on whether the company is public or private."

CONCLUSION

A PPA typically needs to be completed after an entity has acquired a controlling interest in a business. We recommend you discuss these events with your audit and tax professionals to ensure you are satisfying all financial- and tax-reporting requirements. At Scalar, we are happy to discuss your specific situations that may require a PPA.