Columbia Business School

M&A Accounting a Practitioner's Perspective, ACCTB8025, Fall 2023 A-Term

Course Syllabus

I. Contact Details

Prof. Andreas Ohl
Email: andreas.ohl@pwc.com

Office hours: By appointment

Teaching Assistants: TBD

II. Course Prerequisites

B6001 Financial Accounting
B6300 Corporate Finance

Students must have some knowledge of accounting and finance prior to enrolling in this course.

III. Course Description

This half semester course will explore the financial reporting aspects of an array of common M&A transactions. Companies pursue transactions for a variety of reasons, but the fundamental reason is value creation. The financial statements are the primary means through which management communicates what was acquired, how it plans to create value and ultimately a scorecard of their success. We will discuss numerous examples to gain an understanding of how transaction motivations can drive the structure of a transaction and in turn dramatically change how it is reported. While we will touch on the perspectives of all participants in the financial reporting ecosystem at times, the primary focus is on the users of this information. Specifically, this means gaining an understanding of the information content of financial reports as it relates to transactions. Finally, we will touch on how the emerging area of ESG reporting fits into the picture. The objective is to obtain a level of literacy with respect to the accounting and reporting considerations relevant to transactions to enable the student to become an effective deal advisor.

Substantive areas covered include:

- Going it alone and the missing intangibles – Whether a company develops its own assets in house or gets access to them from third parties there is often a significant mismatch between when the cost and benefit appear in earnings.
- Alliances and joint ventures - The risk reward relationship is different than going it alone, the impact on reported results can be significant.
- Acquisitions - We will explore adding value through financial due diligence, understand the reporting implications of various M&A structures with a deep dive on contingent consideration and consider industry implications with a focus on banking deals.

- Harvesting value - What are the common structures to exit a business and what are the reporting implications for the seller and the divested business

The focus will be from the perspective of a strategic player. We will address the interactions with financial investors at various stages.

Topic	Class #
Build vs buy	1
Joint ventures and alliances	2-3
Acquisitions	4-11
Harvesting value	12

IV. Course Objective

The primary objective of the course is to provide insight into the issues an M&A advisor encounters that impact reporting to investors and other capital providers. After taking this course, students will be able to i) identify deal issues and the common structures to navigate them, ii) advise clients on the trade offs between economic/business objectives and the implications for executing the deal, and iii) understand how to interpret the reporting of deals in financial statements and other management communications.

IV. Class Schedule

First class: September 5th
Last class: October 12th
No class: September 28th
Final exam: Take home final

Days	Time	Room
Tues/Thurs	4:10	Kravis 640

V. Required Reading

No textbook is required. Required readings are available on CANVAS and will consist of a compilation of articles, cases and papers. Select podcasts and links to PwC guides as reference material will also be provided. Slides will be posted on CANVAS prior to each class. A two page background on the concepts that will be discussed in class will be posted on CANVAS prior to each class. Reviewing the material in advance is required to properly understand what will be discussed in class.

VI. Case Studies

Case #1 - R&D structures
Case #2 – Financial due diligence
Case #3 – Bank acquisition

Case #4 – Contingent consideration
Case #5 – Impairment test

VII. Grading

2 Quizzes - 10%
4 Homework assignments 20%
Class participation 20%
Take home final exam - 40%
Project 10%

The final exam will consist of a number of fact patterns. The student will be asked to make a recommendation to management based on the facts presented. For example, how might the structure be changed to address a concern management has with respect to the impact of the transaction on current year earnings.

For the project, in a group of 4, chose a public company and assume it is acquired. What might some of the deal issues be and what are their reporting implications? What would the purchase price allocation look like? The deliverable is a presentation for the acquirer management to discuss these matters of 15 slides or less.

VIII. Course Outline

Class 1 The Missing Intangibles: In the modern economy, most companies create value by deploying intangibles such as brands, technology and human capital. Unfortunately, accounting rules in most cases treat investments in such assets as expenses. As a result, near term earnings are depressed, while future periods don't reflect the full cost of doing business. This disadvantages organic growth relative to acquisitions. We will explore how the investments companies make in a build or a buy scenario can be very similar from an economic perspective but have a very different earnings and EBITDA profile. We will also consider what is different about human capital. We will review an example that illustrates the differences in key metrics such as EPS, ROI and EBITDA. We will also discuss how this reality varies by industry. Finally, we will discuss how the rise of ESG can possibly help mitigate this issue.

Class 2/3 JVs and Alliances: Instead of going it alone, many companies chose to partner. We will discuss common business issues encountered in putting such arrangements in place, such as dispute resolution mechanisms, governance provisions and compensation plans, and how they can meaningfully change key financial metrics. The type of partner, strategic vs financial, can impact the funding structure, with knock on effects on the metrics of both parties. We will translate theory into practice by analyzing an actual R&D funding structure used by companies.

Class 4 An M&A accounting introduction: M&A is often the most significant investment a company will make. Given the wide array of transaction structures, the impact of the go forward financial metrics of a company can be quite complex. As a baseline we will walk through an example of a strategic acquisition and discuss the common issues that arise such as determining the acquirer, and the purchase price. We will discuss goodwill. The S&P 500 has several trillion dollars of goodwill. So what does it represent, is it more than just synergies and should it be amortized? The discussion around goodwill is a good entry point into the question of how much should people focus on the earnings impact of M&A is needed given the rise of non-gaap reporting in earnings releases.

Class 5/6/7 Making the buy decision: We will discuss the key elements of financial due diligence, including i) validating the value proposition through analysis of historical and projected financial data, ii) what adjustments are made to normalize EBIDTA for purposes of determining the purchase price and arranging financing? iii) what is a quality of earnings analysis, vi) discussing the impact of historical accounting positions of the seller, and v) discussing how purchase price mechanisms tied to financial reporting metrics impact the buyer's cash out of pocket. We will work through an example of a private equity acquisition throughout this section. An FDD expert will join us for class 6 to work through how the seller's reported EBITDA would change as a result of the facts in the case. This adjusted EBITDA is then the basis for adjusting the preliminary purchase price and lining up the necessary financing.

Class 8 is canceled – Time will be made up by adding 10 minutes to classes 1-7

Class 9 Acquisitions: There are many other deal and related accounting issues that arise from acquisitions. In this case we will with the assistance of a expert in banking deals look more closely at deals through a sector lens. Banking deals have been quite dynamic in 2023 given the turmoil in the sector. In this class we will discuss:

- How banks typically generate cash flow and what went wrong for the failed banks
- Events in the preceding years contributing to failure, including: build-up and concentration of deposits (particularly above FDIC insurance limits), a historically low interest rate environment, and ease of access to capital (particularly for start-ups and other venture capital funded entities)
- What a bank run means, how it can be self-fulling, and how paper losses ultimately turned into real losses in the billions
- What happens when a banks fails and the FDIC takes over
- The characteristics of an FDIC-assisted transaction, how these transactions differ from normal acquisitions in the banking sector, and the potential benefits to the parties involved
- The pool of buyers for failed banks and other deal / regulatory considerations (e.g., "too big to fail")
- The assets and liabilities typically acquired through FDIC-assisted and more typical banking transactions, requiring valuation analysis for financial reporting purposes
- Accounting and financial reporting considerations: determination of purchase consideration (if any), bargain purchase implications, opening balance sheet, etc.
- Lessons learned and what the future may hold for the banking sector

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Class 10: Contingent Consideration Arrangements: These arrangements are often part of a deal, particularly in times of uncertainty when buyers and sellers struggle to agree on a price. These arrangements have many other uses that we will discuss. They also have accounting complexities that can impact the earnings of the acquirer in unpredictable ways in the future. Finally, they can be quite difficult to value. Without knowing the value, it is not possible to know the price paid and therefore the amount of an investment being made. Differing views on the value can be part of what makes these arrangements interesting. We will be joined by a valuation expert to work through different methods of modelling such arrangements.

Class 11: Other considerations: We will discuss how tax is different for deals, what is different about cross-border deals, is a SPAC an acquisition and what are impairments and what do they tell us?

Class 12 Harvesting value: While the base case is to operate the acquired assets and realize synergies and other sources of value, companies need to continuously consider whether are the optimal owner of these assets. We will discuss some of the numerous mechanisms to unlock value that have a different impact of financial metrics of the company. These include:

- Spin-offs
- Split-offs
- Sale
- Contribution of a business to a joint venture
- Admitting a minority investor

While the impact on the company's financial metrics is important, the ultimate objective is to maximize the value of the assets or business that is being monetized. This requires the preparation of separate F/S for the business in question (i.e., carve-out financial statements). We will return to the acquisition example from class #5 and analyze what happens if a portion of the acquired business will subsequently be sold. We will discuss the key inputs and gain an understanding from both the perspective of the company as well as prospective investors.