

## MANUFACTURING

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## New Rules Require New Methods for M&A Accounting

### OVERVIEW

In their first major joint undertaking, the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) collaborated to create merger financial reporting standards applicable not only to the United States, but worldwide. This article explores Statement of Financial Accounting Standards (SFAS) Nos. 141R and 160.

Last year, 64% of American manufacturers were involved in some sort of merger or related activity, according to a 2007 survey by PricewaterhouseCoopers. That much activity calls for some conformity in financial reporting for mergers, says the Financial Accounting Standards Board (FASB).

### Global Impact

In their first major joint undertaking, FASB and the International Accounting Standards Board (IASB) collaborated to create merger financial reporting standards applicable not only to the United States, but worldwide.

Statement of Financial Accounting Standards (SFAS) Nos. 141R and 160, which take effect Dec. 15, 2008, mark a radical departure from traditional Generally Accepted Accounting Principles (GAAP) procedures. The IASB's International Financial Reporting Standard (IFRS) 3 and International Accounting Standard (IAS) 27, also effective Dec. 15, are less revolutionary for international business. All contain the same fundamental principles, and together they represent a significant step toward convergence.

More important, they give investors a better way to compare financial statements and assess how combining businesses are likely to function. The new rules require buyers to use the acquisition method of accounting for all mergers and acquisitions, adding consistency to statements across all business combinations.

### SFAS 141R

Under the new rules, buyers must recognize acquired assets and liabilities based on fair market values on the date the deal closes, rather than allocating acquisition costs to individual assets and liabilities based on estimated fair market values when the deal was announced. Additionally, the costs associated with completing the acquisition (such as fees to investment banks) and any anticipated restructuring costs must be recognized separately from the merger, providing a clearer picture of the actual assets and liabilities that change hands. When mergers are accomplished in stages, sometimes called step acquisitions, the new rules require buyers to recognize identifiable assets and liabilities, as well as noncontrolling interests, at their full fair market value on the acquisition date. Under existing practices, buyers use a blend of historical costs and fair value to measure assets and liabilities in step acquisitions.

### SFAS 160

Under the new rules, parent companies must report minority interests in subsidiaries as equity in the consolidated financial statements. In addition, they must clearly identify the amount of consolidated net income that's attributable to the parent company and to the minority interests.

If parent companies buy, sell or reacquire interests in subsidiaries they control, or if the subsidiaries issue additional ownership interests, the transactions must be treated as equity transactions. If a subsidiary is deconsolidated, the gain or loss is measured on the fair market value of any minority equity investment rather than on the carrying amount of the retained investment.

Last, parent companies must provide enough disclosures to clearly distinguish between their own interest and the interests of minority owners.

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CPAs & BUSINESS ADVISORS

## What FIN 48 Means to Private Manufacturers

### OVERVIEW

When the Financial Accounting Standards Board (FASB) delayed implementation of FASB Interpretation No. 48 (FIN 48) for nonpublic companies, it was issuing a reprieve, not a pardon. And now time is just about up. This article details how FIN 48 affects manufacturers.



*Manufacturers can no longer assume that issues underlying such decisions will go unnoticed. They must presume that tax authorities will have all the relevant facts, and they may find themselves with increased state income tax liability as a result.*

FIN 48 applies to all entities that prepare their financial statements according to Generally Accepted Accounting Principles (GAAP) and governs all material positions those entities take on their income tax returns. Privately held manufacturers that aren't already complying must get their financial statements in order effective for periods beginning after Dec. 15, 2007. For most businesses, this means calendar year 2008 statements.

### More Transparency

FASB issued FIN 48 in 2006 to make financial statements more transparent and comparable with respect to taxes. Businesses are always looking for ways to minimize their tax liability, and their tax returns often include positions that are open to interpretation. When the resulting tax benefits appear on financial statements, they potentially paint a too-rosy picture, because the tax positions may not ultimately withstand tax authorities' scrutiny.

Under FIN 48, companies may include tax benefits in their financial statements only if the underlying tax positions are more than 50% likely to be sustained on examination.

The tax positions FIN 48 specifically identifies include:

- Excluding potentially taxable income streams,
- Classifying a transaction, entity or position as tax-free, and
- Deciding not to file a tax return in a jurisdiction where it might be required.

Manufacturers can no longer assume that issues underlying such decisions will go unnoticed. They must presume that tax authorities will have all the relevant facts, and they may find themselves with increased state income tax liability as a result.

Many manufacturers, for example, use out-of-state vendors to supply parts for their production processes. If a vendor holds physical property owned by the manufacturer, such as tools and dies, to do the manufacturer's work, the manufacturer may be subject to income taxation in the other state(s).

### One Size Doesn't Fit All

More problematic for most companies, however, are tax positions that don't meet the "more likely than not" threshold for sustainability. In the past, companies simply bundled all their uncertain positions together and maintained a reserve large enough to cover interest and penalties that could accrue if some of the positions didn't hold up.

FIN 48 is stricter. Every year companies must reconcile their total unrecognized tax benefits at the beginning and end of reporting periods, disclose the unrecognized benefits that, if recognized, could affect their income tax positions, and accrue the interest and penalties that could be assessed if the tax positions don't hold up and that are recognized in the statement of operations and in the statement of financial position.

In addition, if unrecognized tax benefits are likely to change significantly within a year of the report, companies must disclose the nature of the uncertainty, what could happen that would cause the change and an estimated range of the possible change that could occur.

### It's Time to Be Certain

FIN 48 has generated a great deal of uncertainty among businesses. Privately held companies, including manufacturers, have less than a year to address their questions; time is running out. ■

### RESOURCES

[www.irs.gov](http://www.irs.gov)  
[www.aicpa.gov](http://www.aicpa.gov)

### ACTION

"FIN 48 requires the financial statements to include any income tax position that has a greater than 50% chance of being held up to the IRS. This new requirement applies to all entities beginning for year beginning after Dec. 15, 2007."

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## Be Flexible

# Use Standard Cost Budgeting to Control Your Expenses

There are two ways for manufacturers to approach budgeting. They can assume their production will remain at set levels throughout the budget period and plan accordingly. Or they can develop standard costs to use in a flexible budget that can be adjusted to reflect actual production.

The smart choice is the latter method: standard cost budgeting. When you know your standard costs, you can identify why products end up costing more or less than you expected. Then you can take corrective actions as necessary.

### Know Where You Stand

The first step is to develop standard costs. At the beginning of each budget period, you estimate the labor, materials and overhead costs required to produce one unit of each of your products.

The assumptions you use to arrive at these figures must be reliable, because standard costs go on the books as journal entries. Make sure you're working with current, accurate base data. When you've set standard costs, multiply them by the total number of units you expect to produce to develop your production budget.

### See Where You Fall

At the end of the budget period, you'll use a variance report to compare your budgeted costs to actual results. When you receive the results, resist any immediate inclination you may have to pat yourself on the back or mull over what went wrong, because the total cost numbers won't give you the reasons for variances. You may find that one variance is offset by two other variances.

For example, let's say your standard cost to make a widget is \$350 per unit — \$200 for materials, \$100 for labor and \$50 for overhead. It should cost you \$175,000 to make 500 units, based on your standard cost.

It turns out, however, that your actual cost for 500 widgets was \$178,000. This seems strange, because the actual labor cost was only \$85 per unit, or \$42,500, rather than the \$50,000 you predicted in your production budget.

A closer look may reveal that your material costs went up to \$220 per unit and overhead

increased to \$51. That made the total actual costs \$110,000 and \$25,500, respectively, instead of the \$100,000 and \$25,000 in your production budget.

The combined \$10,500 variance in materials and overhead costs was enough to erase the \$7,500 labor savings, leaving you with an overall unfavorable variance of \$3,000. Of course, variances can also work to your advantage in any of several scenarios, such as one cost going down while the others are unchanged.

### Find the Value

The true value of standard cost budgeting is that you can break each variance into its component parts to determine the cause. In the previous example, for instance, you may find that the price of steel increased significantly during the budget period, which boosted the raw material costs incurred to produce the widget.

There are a number of reasons variances may arise, but you can't adjust for them unless you know the reasons. Instead of worrying about very small variances, follow up only when variances reach a certain threshold.

### Enlightening Effects

With standard cost budgeting, you and your managers can control costs more effectively. You understand not only where costs are changing, but why. That's the type of insight that looks good on your bottom line. ■

## RESOURCES

[www.leanadvisors.com](http://www.leanadvisors.com)

## ACTION

Developing standard costs in our budgeting process allows you to be more flexible with your analysis of variances. By breaking down your costs you can analyze where these variances happen. This will help you control costs.

## OVERVIEW

There are two ways for manufacturers to approach budgeting. They can assume their production will remain at set levels throughout the budget period and plan accordingly. Or they can develop standard costs to use in a flexible budget that can be adjusted to reflect actual production. This article looks at the latter method: standard cost budgeting.



*When you know your standard costs, you can identify why products end up costing more or less than you expected. Then you can take corrective actions as necessary.*

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*New Rules—from page 1*

### **Make Adjustments—If Necessary**

The full impact of the new rules can't be measured until they're in use, but one thing seems likely: If you're one of the manufacturers contemplating a merger or acquisition after Dec. 15, 2008, you'll want to consult your financial advisor before you complete the deal.

The new regulations may cause you to rethink the way it's structured. You can still make accounting adjustments after the merger closes, but you must record them as of the closing date rather than when they are changed. ■

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### **RESOURCES**

Statement of Financial Accounting Standards  
No. 141 (revised 2007)

Statement of Financial Accounting Standards  
No. 160

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### **ACTION**

The Financial Accounting Standards Board and the International Accounting Standards Board have collaborated to provide revised standards applicable to merger and acquisition worldwide. This will be a substantial step toward consistency on business combination reporting between United States reporting requirements and reporting under the International Accounting Standards. For mergers and acquisitions after December 15, 2008, you should become aware of these changes as it will likely affect the recording if the transaction.

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