

M&A; EXECUTION PROGRAM

PART 10 OF 12 · PART 3: POST-MERGER INTEGRATION & ACCOUNTING

PART 10

CONSOLIDATION & OPENING BALANCE SHEET

The acquisition is recorded. Now the two entities must become one set of books. This session covers the mechanics of preparing the consolidated opening balance sheet, eliminating intercompany transactions, applying fair value adjustments, push-down accounting, and handling foreign currency translation.

IN THIS PART

- Elimination of intercompany transactions
- Fair value step-up entries and amortization
- Push-down accounting framework (ASC 805-50)
- FX translation on opening balance sheet
- Noncontrolling interest recognition
- Day 1 journal entries and documentation

THREE CASE STUDIES

Each session includes one fully worked case study with detailed calculations, negotiating dynamics, and CFO-level decision frameworks.

■ SESSION 10: CONSOLIDATION MECHANICS

From Two Entities to One Set of Books

After the Purchase Price Allocation is complete and the fair values are determined, the acquirer must prepare a **consolidated opening balance sheet** — the first combined financial statement that reflects both entities as a single reporting unit. This is not a simple addition of two balance sheets. It requires a disciplined series of eliminating entries, fair value step-up adjustments, and intercompany eliminations that, if done incorrectly, will cascade errors through years of future financial reporting.

The CFO who understands consolidation mechanics has a decisive advantage: the ability to anticipate how the opening balance sheet will affect future earnings, cash flow, debt covenants, and key performance metrics — and to communicate those effects clearly to the board, lenders, and investors before they appear in the financials.

The Consolidation Sequence: Four Mandatory Steps

Step 1	Record the Acquisition Entry	The acquirer records the investment in the subsidiary at total consideration paid. On the consolidated balance sheet, this investment account is eliminated against the subsidiary's equity, and all assets and liabilities are recorded at fair value per the PPA.
Step 2	Eliminate Intercompany Balances	Any receivables, payables, revenues, or expenses between the acquirer and acquired company that existed at closing must be eliminated. These transactions are internal to the consolidated entity and do not represent economic activity with outside parties.
Step 3	Apply Fair Value Step-Up Entries	Record the difference between book value and fair value for each asset and liability identified in the PPA. PP&E; stepped up to appraised value; intangibles recorded at independently valued amounts; deferred tax liabilities created for intangible step-ups.
Step 4	Record Goodwill	Record the residual goodwill as the difference between total consideration and net identifiable assets at fair value. Assign goodwill to reporting units for future impairment testing purposes.

The Opening Balance Sheet: A Complete Walk-Through

The best way to understand consolidation mechanics is to walk through a complete numerical example. Below, Parent Corp. acquires Target Co. for \$85M in cash. Target's book value of net assets is \$18M. The PPA identified \$35M of intangibles and \$32M of goodwill.

◆ OPENING BALANCE SHEET – FULL CONSOLIDATION

CONSOLIDATION – OPENING BALANCE SHEET CONSTRUCTION

Parent Target Eliminations Consolidated

Pre-Close Book Val & Adj Opening BS

ASSETS:

Cash & Equivalents \$24,200K \$3,100K (\$85,000K)pmt (\$57,700K)

+ Funded by acquisition debt +\$60,000K \$60,000K

Net Cash: \$2,300K

Accounts Receivable \$8,400K \$4,200K \$12,600K

Inventory \$5,100K \$3,800K +\$600K FV adj \$9,500K

PP&E; , net \$18,200K \$6,400K +\$4,200K FV adj\$28,800K

Customer Relationships \$0 \$0 +\$18,500K PPA \$18,500K

Developed Technology \$0 \$0 +\$12,300K PPA \$12,300K

Trade Name \$0 \$0 +\$5,800K PPA \$5,800K

Order Backlog \$0 \$0 +\$2,100K PPA \$2,100K

Goodwill \$0 \$0 +\$32,000K PPA \$32,000K

Other Assets \$3,200K \$1,100K \$4,300K

TOTAL ASSETS \$59,100K \$18,600K \$127,200K

LIABILITIES:

Accounts Payable \$4,200K \$2,400K \$6,600K

Accrued Liabilities \$2,100K \$1,600K \$3,700K

Acquisition Debt \$0 \$0 +\$60,000K \$60,000K

Deferred Tax Liability \$0 \$0 +\$10,120K DTL \$10,120K

Other Liabilities \$1,400K \$400K \$1,800K

TOTAL LIABILITIES \$7,700K \$4,400K \$82,220K

EQUITY:

Target equity eliminated: \$14,200K (\$14,200K) \$0

Parent Equity: \$51,400K \$44,980K

TOTAL LIABILITIES & EQUITY: \$127,200K

Intercompany Elimination: The Hidden Complexity

Intercompany eliminations are required whenever the parent and subsidiary have transacted with each other. Common examples include intercompany loans, management fee arrangements, inventory transfers, and shared service charges. If these are not eliminated, the consolidated financials will overstate both assets and liabilities (or revenues and expenses).

◆ INTERCOMPANY ELIMINATION ENTRIES

INTERCOMPANY ELIMINATION EXAMPLES

EXAMPLE 1: INTERCOMPANY LOAN

Parent has loaned Target \$2,000,000 (exists at closing)

Parent books: Note Receivable \$2,000,000

Target books: Note Payable \$2,000,000

ELIMINATION ENTRY:

Dr: Note Payable (Target): \$2,000,000

Cr: Note Receivable (Parent): \$2,000,000

Both sides disappear – net effect = \$0

EXAMPLE 2: INTERCOMPANY MANAGEMENT FEE (PRE-CLOSE)

Parent charged Target \$180,000 management fee in acquisition year

Target expensed \$180,000; Parent recognized \$180,000 revenue

ELIMINATION ENTRY:

Dr: Management Fee Revenue (Parent): \$180,000

Cr: Management Fee Expense (Target): \$180,000

Both revenue and expense eliminated – net = \$0

EXAMPLE 3: INVENTORY TRANSFER WITH MARKUP

Parent sells inventory to Target at cost + 20% markup

\$500,000 inventory transfer; markup = \$83,333

Target still holds inventory at closing (not yet sold to customers)

ELIMINATION ENTRY:

Dr: Revenue (Parent): \$500,000

Cr: COGS (Target): \$416,667

Cr: Inventory (markup reduction): \$83,333

Inventory on consolidated BS at original cost, not marked-up cost

Push-Down Accounting: Recording FV on the Subsidiary's Books

Under ASC 805-50, an acquired entity has the option (but is not required) to apply **push-down accounting** — recording the acquisition-date fair values and goodwill directly on its own separate financial statements. This simplifies consolidation and gives the subsidiary's standalone financials a fresh-start basis. However, it also means the subsidiary's EBITDA will include higher amortization charges from the stepped-up intangibles, which must be understood by lenders and covenant analysts.

■ PUSH-DOWN ACCOUNTING AND DEBT COVENANTS

If the acquired subsidiary has its own credit facility with EBITDA-based covenants, push-down accounting will increase depreciation and amortization charges on the subsidiary's standalone books. This reduces reported EBITDA and may trigger covenant violations. The CFO must review all subsidiary credit agreements before electing push-down and negotiate covenant relief if necessary. Many acquisition credit agreements anticipate this with an 'Acquisition Accounting Adjustments' add-back to the EBITDA definition.

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1****CASE STUDY 1****EuroTech Precision GmbH**

FX Translation on Opening Balance Sheet — EUR Subsidiary Into USD Parent

Background

US-based Precision Holdings Inc. acquires EuroTech Precision GmbH, a German manufacturer, for EUR 62 million (USD equivalent at closing: \$68.2M at 1.10 USD/EUR). EuroTech's functional currency is EUR. The consolidated opening balance sheet must translate all of EuroTech's assets and liabilities into USD at the acquisition-date spot rate — and then manage ongoing FX translation going forward.

◆ EUROTECH FX TRANSLATION MECHANICS

EUROTECH – FX TRANSLATION ON OPENING BALANCE SHEET

Acquisition Date: January 1; Spot Rate: 1.10 USD/EUR

EuroTech Balance Sheet (EUR) EUR Amount Rate USD Amount

Cash: EUR 2,800K 1.10 \$3,080,000

Accounts Receivable: EUR 4,600K 1.10 \$5,060,000

Inventory (at FV per PPA): EUR 3,200K 1.10 \$3,520,000

PP&E; (at FV per PPA): EUR 8,400K 1.10 \$9,240,000

Customer Relationships (PPA): EUR 14,000K 1.10 \$15,400,000

Technology (PPA): EUR 8,600K 1.10 \$9,460,000

Goodwill (PPA residual): EUR 22,400K 1.10 \$24,640,000

TOTAL ASSETS: EUR 64,000K 1.10 \$70,400,000

(Note: total USD ≈ acquisition consideration + net liabilities)

Accounts Payable: EUR (2,100K) 1.10 (\$2,310,000)

Deferred Tax Liability: EUR (4,200K) 1.10 (\$4,620,000)

Bank Debt: EUR (1,700K) 1.10 (\$1,870,000)

All opening BS items translated at SPOT RATE

(acquisition date rate – this is the INITIAL MEASUREMENT)

GOING FORWARD – ONGOING FX TRANSLATION (ASC 830):

Monetary assets/liabilities: closing rate each period

Non-monetary items (PP&E;, intangibles): historical rate

Goodwill: closing rate (remeasured each period)

FX translation differences: CTA (Cumulative Translation

Adjustment) in Other Comprehensive Income – NOT P&L;

EXCEPT: if EUR/USD moves to 1.05 by year end:

Goodwill FX loss: EUR 22.4M × (1.10-1.05) = \$1,120,000 CTA

■ THE CTA TRAP FOR CFOS

Cumulative Translation Adjustment (CTA) lives in Other Comprehensive Income and does not affect net income — until the foreign subsidiary is sold or liquidated, at which point all accumulated CTA is reclassified to the income statement in a single period. A CFO managing a large EUR-functional subsidiary must track CTA balances carefully. At disposal, a positive CTA (USD strengthened vs EUR) will be a gain; a negative CTA will be a potentially significant loss.

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CASE STUDY 2

Atlas Manufacturing Group*Intercompany Inventory Profits — Elimination That Took Three Months to Resolve***Background**

Atlas Manufacturing Group acquired Component Works LLC, a supplier that had been selling directly to Atlas for four years. At closing, Component Works had \$2.4M of Atlas-branded inventory on its books — manufactured for Atlas at a standard markup of 22%. Simultaneously, Atlas carried \$1.8M of Component Works' products in its own finished goods inventory. The intercompany elimination was complex because both entities held inventory from the other.

◆ BIDIRECTIONAL INTERCOMPANY ELIMINATION

ATLAS — BIDIRECTIONAL INTERCOMPANY INVENTORY ELIMINATION

PRE-CLOSE INTERCOMPANY BALANCES (at acquisition date):

Component Works — Atlas-branded WIP inventory: \$2,400,000

Cost to Component Works: \$1,967,213 (= \$2.4M / 1.22)

Markup to eliminate: \$432,787

Atlas — Component Works products in finished goods: \$1,800,000

Cost to Component Works (at transfer price): \$1,475,410

Markup embedded in Atlas inventory: \$324,590

ELIMINATION ENTRIES:

Entry 1 — Component Works WIP markup:

Dr: Retained Earnings (Component Works): \$432,787

Cr: Inventory (Component Works): \$432,787

Entry 2 — Atlas finished goods markup:

Dr: Retained Earnings (Atlas): \$324,590

Cr: Inventory (Atlas): \$324,590

TOTAL INVENTORY REDUCTION: \$757,377

CONSOLIDATED BALANCE SHEET IMPACT:

Inventory reduced by \$757,377 on combined BS

Retained earnings reduced correspondingly

When this inventory is sold to external customers,
the profit will be recognized externally at that point

RESOLUTION: Required 11 weeks to fully document

all intercompany transactions going back 4 years

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CASE STUDY 3

Summit Capital Partners — Portfolio Consolidation*Noncontrolling Interest (NCI) — Partial Acquisition Accounting***Background**

Summit Capital Partners acquires 80% of Nexus Services Group for \$64M, with the remaining 20% held by the founding family (a noncontrolling interest). Under ASC 805, the NCI must be measured at fair value on the acquisition date — which means goodwill is grossed up to reflect the full 100% entity value, not just the 80% acquired.

◆ NCI — FULL GOODWILL METHOD

NCI — FULL GOODWILL METHOD (ASC 805 DEFAULT)

Summit acquires 80% for: \$64,000,000

Implied 100% enterprise value: $\$64M / 0.80 = \$80,000,000$

Net identifiable assets at FV: \$38,000,000

GOODWILL CALCULATION (FULL GOODWILL / 100%):

100% FV of entity: \$80,000,000

Net identifiable assets at FV: (\$38,000,000)

FULL GOODWILL: \$42,000,000

OPENING BALANCE SHEET EQUITY SECTION:

Summit (80%) controlling interest equity:

 $\$80M \text{ EV} \times 80\% - \text{net assets } 80\% = \$25,600,000$

Noncontrolling Interest (NCI, 20%):

 $\$80M \times 20\% = \$16,000,000$

TOTAL EQUITY: \$41,600,000

GOING FORWARD:

NCI receives its 20% share of subsidiary net income

NCI shown separately in equity section each period

If Summit acquires remaining 20%: equity transaction,

not a new business combination — no new goodwill