A key to success for any growth company is navigating the numbers, with success and visibility in accounting and finance, preferably up and to the right. Nowadays, companies are experiencing accounting challenges as they grow their businesses, especially when the growth is through mergers and acquisitions (M&A). M&A transactions present both buyers and sellers with multiple challenges as complex requirements may result from acquisitions and company sales. Building the right process and bringing the right resources is essential for organizations to do good deals and succeed during the post-closing integration. Following are some pro-tips on how to get it right from the start:

**Due diligence**

As part of the financial accounting due diligence, companies should prioritize...
analyzing the company's assets, sales, cash flow, and GAAP earnings situation. In
the due diligence exercise, the buyer should consider whether the target’s and the
buyer's financial statements were prepared using the same accounting principles
(e.g., U.S. GAAP, IFRS as applied by IASB or something else) and the accounting
practices followed. When companies enter M&A transactions, they often inherit
dissimilar financial systems and charts of accounts, exposing them to more
significant challenges related to reporting and compliance requirements. Buyers
should understand these differences and how they affect buyers' evaluation of the
company's operations. Failure to collect all of the relevant data creates additional
challenges in financial, tax, statutory, and regulatory reporting capabilities.
Architecting an accounting due diligence process allows a buyer to understand the
transaction target early.

**Designing post-closing purchase price adjustments in definitive agreements**

Accounting plays a lead role in the definitive acquisition agreement, both in the
definitions and the design. Often, so-called “earn-out” clauses link subsequent
purchase price payments to developing financial indicators (e.g., revenue or
EBITDA). The determination of these key figures and the purchase price depends on
the underlying accounting methods. The buyer and the company will want to
calculate triggering financial indicators using their respective accounting methods.
To the extent that they do not reconcile perfectly, the parties may agree to attach to
the purchase agreement a sample calculation of the triggering indicators or
additional parameters that should be used in determining whether a purchase price
adjustment is appropriate. It is also customary to include a purchase price
adjustment mechanism based on the net working capital of the company, in which
the buyer will typically set a closing target net working capital amount as of the
closing date, or “bogey”, and there will be a dollar-to-dollar adjustment if the actual
net working capital amount as of the closing date ends up to be higher or lower than
the bogey, whether determined at closing or later adjusted after audit. The buyer
and the company will need to negotiate and agree upon the target level of net
working capital required to be available at closing. A sample net working capital
calculation schedule may help in avoiding potential disputes down the road.
Additionally, the accounting system may play a role when evaluating force majeure
clauses and possibly influence earn-out figures in events beyond the control of the
contractual parties.

**Preliminary purchase price allocation and post-merger integration**

In addition, before signing a contract, buyer should reflect on how the financial
reporting will change after closing. On the one hand, this concerns the acquiring
company's accounting treatment of the M&A transaction. Once the transaction has
been completed, on the other hand, the target business and its financial statements
have to be integrated within buyer's financial statements (and separate carve-out
financial statements or pro forma financial statements giving effect to the
transaction in prior periods, may be required. How the purchase price is allocated
among the target assets compared to the carrying value of target’s assets in target’s
or seller’s financial statements can have huge impacts of the deal’s returns. Changes to the accounting may occur if the previously applied accounting between the acquiring company and the target company is different. If the buyer happens to be a public company, the Securities and Exchange Commission and Public Company Accounting Oversight Board might have requirements and deadlines or demand changes.

**Complex intercompany agreements and transactions**

During the M&A integration trek, companies often enter into multiple intercompany transactions where they transfer assets, liabilities, revenues, and costs to achieve business efficiencies and other integration goals. These transactions can involve intercompany agreements, increasing the risk of misstatement and unreconciled intercompany balances.

**In Conclusion**

During the M&A process, the importance of a strong financial and accounting process and team can not be underestimated in navigating the numbers. Your business leaders, lawyers and bankers need to work closely with them to drive to the right goal posts.

© 2022 Foley & Lardner LLP

National Law Review, Volume XII, Number 84

**Source URL:** https://www.natlawreview.com/article/accounting-ma-deals-navigating-numbers