KPMG

Asset acquisitions

Handbook



US GAAP

November 2026

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Asset acquisitions – our perspective

The evaluation of whether an acquired set of assets and activities qualifies as a business may have significant accounting implications. For a transaction or event to be accounted for as a business combination, the acquired set must constitute a business. This is an important determination, given the different accounting models for the acquisition of a group of assets versus a business.

We expect that many transactions will qualify as asset acquisitions under the FASB's current definition of a business. Acquisitions of assets are accounted for using the cost accumulation and allocation model, rather than the fair value model that applies to business combinations.

In this Handbook, which supplements KPMG Handbook, Business combinations, we provide additional information to help entities understand the accounting for asset acquisitions.

We hope this Handbook will enhance your understanding and assist you in accounting for asset acquisitions.

Nick Burgmeier

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Acknowledgments

This Handbook has been produced by the Department of Professional Practice (DPP) of KPMG LLP in the United States.

We would like to acknowledge the efforts of the main contributors to this edition:

Nick Burgmeier

Valeriya Li

Jennifer Yruma

We would also like to acknowledge the current and former members of DPP who contributed significantly to this Handbook: Kimber Bascom, Scott Muir, Lisa Munro, David Yates.

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About this publication

This publication looks in-depth at the accounting for asset acquisitions.

Accounting literature and scope

This publication focuses on accounting for asset acquisitions under Topic 805, Business Combinations, specifically Subtopic 805-50. The guidance in Topic 805 applicable to business combinations is addressed in KPMG Handbook, Business combinations.

In addition, certain references to other topics within this publication, such as Topic 842 (leases), are addressed in other KPMG publications.

Organization of the text

Each section of this publication includes excerpts from the *FASB Accounting Standards Codification*® and overviews of the relevant requirements. We include examples to explain key concepts, and we explain the changes from legacy US GAAP.

Our commentary refers to the Codification and to other literature, where applicable. The following are examples:

- 805-10-55-4 is paragraph 55-4 of Subtopic 805-10
- S-X, Rule 11-01(d) is paragraph 11-01(d) of SEC Regulation S-X, Rule 11-01(d)
- FAS 141.24 (superseded) is paragraph 24 of FASB Statement of Financial Accounting Standards No. 141, Business Combinations
- SAB Topic 5.A is paragraph A of SEC Staff Accounting Bulletin Topic 5.A
- FRM 2010.1 is section 2010.1 of the SEC's Financial Reporting Manual
- 1995 AICPA Conf is the 1995 Twenty-Second Annual National Conference on Current SEC Developments

November 2026 edition

This edition of our Handbook has been updated to incorporate ASU 2025-07, Derivatives and Hedging (Topic 815) and Revenue from Contracts with Customers (Topic 606): Derivatives Scope Refinements and Scope Clarification for Share-Based Noncash Consideration from a Customer in a Revenue Contract. See Pending content, below, for the ASU's effective date.

Items that have been significantly updated or revised are identified throughout the Handbook with # and new items are identified with **. The Index of changes identifies all significant changes.

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Pending content

This edition of our Handbook incorporates amendments to the FASB Codification from the following ASUs.

- ASU 2023-05, Business Combinations – Joint Venture Formations (Subtopic 805-60): Recognition and Initial Measurement, which is effective for all joint ventures with a formation date on or after January 1, 2025.
- ASU 2025-07, Derivatives and Hedging (Topic 815) and Revenue from Contracts with Customers (Topic 606): Derivatives Scope Refinements and Scope Clarification for Share-Based Noncash Consideration from a Customer in a Revenue Contract, effective for annual and interim periods in fiscal years beginning after December 15, 2026.

The Codification excerpts containing the amendments from these ASUs are reproduced as if the pending content were currently effective for all entities – i.e. the amendments are not labeled as pending content in our excerpts.

Abbreviations

We use the following abbreviations in this publication.

BC Handbook	KPMG Handbook, Business combinations
IP	Intellectual property
NCI	Noncontrolling interest
R&D	Research and development
IPR&D	In-process research and development

KPMG Handbook, Business combinations

Throughout this publication, we link to other guidance that we have published. The most frequent reference is to KPMG Handbook, Business combinations, in which case we simply refer to the 'BC Handbook'. In all other cases, we provide the title of the publication being referred to.

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1. Executive summary

Subtopic 805-50 provides guidance on an acquisition of assets rather than a business. The fundamental premise of accounting for business combinations differs from the premise that applies to asset acquisitions.

- Business combinations are accounted for using the acquisition method that requires the measurement of assets acquired and liabilities assumed at fair value with limited exceptions.
- Acquisitions of assets are accounted for using the cost accumulation and allocation model.

However, Subtopic 805-50 provides only limited guidance on accounting for asset acquisitions. As a result, we refer to other sources for guidance, such as the following.

- Topic 805 on business combinations, to the extent it does not conflict with the cost accumulation model – e.g. accounting for the settlement of a preexisting relationship.
- Other existing US GAAP – e.g. Topic 450 on contingencies to account for contingent consideration.
- Superseded US GAAP on purchase business combinations in Statement 141 or APB Opinion 16, both of which were consistent with the cost accumulation model – e.g. how to allocate a reduction to the carrying amounts when the fair value of the net assets acquired exceeds the purchase consideration.

The following is a summary of significant differences in accounting for an acquisition of a group of assets versus a business.

Asset acquisition	Business combination
Initial measurement and allocation	
The acquirer measures the assets acquired based on their cost, which is generally allocated to the assets on a relative fair value basis. See chapters 3 and 4.	The acquirer measures identifiable assets and liabilities generally at fair value.
Direct acquisition-related costs	
The acquirer includes direct acquisition-related costs in the cost of the acquired assets. See section 3.2.	The acquirer expenses direct acquisition-related costs as incurred.
Contingent consideration	
For cash-settled contingent consideration, if the arrangement is in the scope of Topic 815, the acquirer initially measures contingent consideration at fair	The acquirer recognizes contingent consideration at the acquisition date and measures it at fair value. Subsequent changes to the fair value of liability-classified contingent

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Asset acquisition	Business combination
value with changes in fair value reported currently in earnings. Otherwise, the acquirer generally recognizes contingent consideration when it is probable and estimable. Subsequent changes are generally recorded as adjustments to the carrying amount of the assets. For contingent consideration indexed to or settled in the acquirer's equity, the acquirer may: • apply Topic 718 to account for the contingent consideration, if applicable; or • measure the consideration initially at fair value and subsequently account for the issuance as an equity- or liability-classified instrument under Topic 480 or Subtopic 815-40. See section 3.5.	consideration are reported currently in earnings. Equity-classified contingent consideration is not remeasured after the acquisition date, and subsequent settlement is accounted for within equity.
Share-based consideration	
If equity interests are issued as consideration for the acquisition of goods to be used or consumed in the acquirer's operations, an entity may elect to apply Topic 718 to measure the consideration transferred. If the entity does not apply Topic 718, it measures the consideration at the fair value of the equity issued or asset received, whichever is more clearly evident and therefore more reliably measurable. See Question 3.3.10.	Equity interests issued as consideration in a business combination are measured at fair value at the acquisition date.
Settlement of preexisting relationships	
There is no explicit guidance. We believe acquirers should apply Topic 805 by analogy. See section 11 of the BC Handbook.	The acquirer recognizes a gain or loss for the effective settlement of a preexisting relationship. The acquirer measures the gain or loss either: • for a noncontractual relationship, at fair value; or • for a contractual relationship, at the lesser of: — the amount by which the contract is favorable or unfavorable to the acquirer; or — the amount of stated settlement provisions in the contract available to the party to whom the contract is unfavorable.

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Asset acquisition	Business combination
Measurement period	
No concept of a measurement period exists in an asset acquisition. The acquirer must finalize all valuations of assets acquired and liabilities assumed before the next reporting date. See Question 4.1.20.	The acquirer may record provisional amounts for the assets acquired and liabilities assumed and adjust them during the measurement period, which ends the earlier of (1) one year from the acquisition date, and (2) when the acquirer has obtained all relevant information about the facts that existed at the acquisition date or learns that more information is not obtainable.
Intangible assets	
Intangible assets may qualify for recognition even though they do not meet the criteria for intangible assets acquired in a business combination. See section 4.2.	Intangible assets are recognized at fair value if they meet the contractual-legal criterion or the separability criterion. Private companies and not-for-profit entities may elect an accounting policy to subsume into goodwill noncompete agreements and customer-related intangible assets that cannot be sold or licensed separately from other assets of the business.
In-process research and development	
The portion of the purchase price allocated to IPR&D at the acquisition date is expensed immediately unless it has an alternative future use. See Question 4.2.20.	IPR&D is recognized and accounted for as an indefinite-lived intangible asset until the acquirer completes or abandons the project.
Assembled workforce	
Assembled workforce is recognized as an intangible asset. See Question 4.2.30.	Assembled workforce is recognized as a part of goodwill.
Reacquired rights	
There is no explicit guidance. The acquirer may determine the measurement basis of reacquired rights either (1) using a measurement based solely on the remaining contractual terms (by analogy to Topic 805) or (2) based on fair value.	The acquirer measures reacquired rights based solely on the remaining contractual terms.
Acquired contingencies	
Acquired contingencies are accounted for under Topic 450 (contingencies). Acquired loss contingencies are recognized if they are both probable and reasonably estimable. A legal claim that cannot be recognized as a financial asset	Acquired contingencies are recognized and measured at fair value if determinable at the acquisition date or during the measurement period. Otherwise, they are accounted for in a manner consistent with Topic 450.

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Asset acquisition	Business combination
or intangible asset is a gain contingency that is not recognized until realized. See section 4.5.	The acquirer is required to develop a systematic and rational approach to subsequent measurement, depending on the nature of the contingency.
Indemnification assets	
There is no explicit guidance. Acquirers sometimes apply Topic 805 by analogy. See section 4.5.	The acquirer records an indemnification asset at the same time and on the same basis as the indemnified item, subject to any contractual limitations and collectibility.
Goodwill	
Goodwill is not recognized. Generally, the acquirer allocates any excess cost over the fair value of the net assets acquired on a relative fair value basis only to certain nonfinancial assets acquired. See Question 4.6.10.	Any excess consideration transferred over the fair value of the net assets acquired is goodwill and is recognized as a separate asset.
Bargain purchase amount	
Similar to goodwill, the acquirer should allocate a bargain purchase amount only to certain nonfinancial assets on a relative fair value basis. See Question 4.6.10.	The acquirer recognizes a bargain purchase gain immediately in earnings.
Deferred taxes	
Because neither goodwill nor a bargain purchase gain is recognized, if the cost differs from the tax bases of the assets acquired and liabilities assumed, the simultaneous equations method is used to calculate the deferred tax assets and liabilities and the resulting adjustments to the related assets' and liabilities' carrying amounts. See section 4.7.	Recognizing deferred tax assets and liabilities results in increases or decreases to goodwill or a bargain purchase gain. See section 6 of KPMG Handbook, Accounting for income taxes.

Disclosures

Subtopic 805-50 does not require specific disclosures related to asset acquisitions. Acquirers should consider relevant disclosure requirements in other Subtopics that may apply to the transaction, such as (not exhaustive):

- Subtopic 350-30 on intangible assets;
- Subtopic 360-10 on property, plant and equipment;
- Subtopic 450-20 on loss contingencies;
- Subtopic 610-20 on gains and losses from the derecognition of nonfinancial assets
- Subtopic 730-10 on R&D costs; and
- Subtopic 845-10 on nonmonetary exchanges.

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2. Scope of Subtopic 805-50

Detailed contents

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Question 2.1.10 Does the guidance on asset acquisitions apply to a primary beneficiary when it initially consolidates a VIE that is not a business?

Question 2.1.20 Is the Topic 805 definition of a business the same as the SEC's definition used to determine reporting requirements?

Question 2.1.30 Is it possible to have a reverse asset acquisition?

Example

Example 2.1.10 Reverse asset acquisition

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Excerpt from ASC 805-50

> Entities

15-2 The guidance in the Acquisition of Assets Rather than a Business Subsections applies to all entities.

> Transactions

15-3 The guidance in the Acquisition of Assets Rather than a Business Subsections applies to a transaction or event in which assets acquired and liabilities assumed do not constitute a **business**.

15-4 The guidance in the Acquisition of Assets Rather than a Business Subsections does not apply to the initial measurement and recognition by a primary beneficiary of the assets and liabilities of a variable interest entity (VIE) when the VIE does not constitute a business. Guidance for such a VIE is provided in Section 810-10-30.

15-4A The guidance in the Acquisition of Assets Rather than a Business Subsections does not apply to the initial measurement and recognition of assets and liabilities by a joint venture upon formation. Guidance for **joint venture** formations is provided in Subtopic 805-60.

The Acquisition of Assets Rather than a Business subsections of Subtopic 805-50 provide authoritative guidance on accounting for asset acquisitions. This subsection applies to transactions that do not meet the definition of a business.

The evaluation of whether an acquired set of assets and activities constitutes a business can be particularly challenging. See section 2 of the BC Handbook for guidance on this evaluation.

Other US GAAP applies to transfers of assets between entities under common control and the formation of joint ventures. Those transactions are not in the scope of this publication. See sections 28 and 29 of the BC Handbook.

Question 2.1.10 Does the guidance on asset acquisitions apply to a primary beneficiary when it initially consolidates a VIE that is not a business?

Interpretive response: No. The guidance on asset acquisitions does not apply to a primary beneficiary when it initially consolidates a VIE that is not a business. [805-50-15-4]

In these circumstances, Subtopic 810-10 requires the primary beneficiary to recognize and measure the assets, liabilities and NCI of the newly consolidated VIE under Subtopic 805-20 as if the acquisition were a business combination. However, because the VIE is not a business, the primary beneficiary is precluded from recognizing goodwill and may recognize a gain or loss on initial consolidation (unless the primary beneficiary and the VIE are under common control). [810-10-30-1, 30-4]

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While Subtopic 810-10 generally refers to Subtopic 805-20 for initial recognition and measurement, it does not provide specific guidance on the subsequent accounting for the assets and liabilities recognized. This has led to diversity in practice on certain topics such as contingent consideration and IPR&D. The FASB recognized this diversity and added the accounting for contingent consideration and IPR&D in a VIE that is not a business to its agenda as part of the Improving the Accounting for Asset Acquisitions and Business Combinations project. That project was subsequently removed from the FASB's agenda; therefore, we believe diversity in practice will continue and the following would be acceptable for contingent consideration and IPR&D.

Contingent consideration

We believe contingent consideration should be initially recognized at fair value consistent with the initial recognition and measurement requirements in the business combinations guidance. While Topic 810 does not provide specific guidance on the subsequent measurement of contingent consideration, we believe the contingent consideration should be remeasured to fair value each reporting period with changes in fair value reported in earnings consistent with the business combinations guidance used for initial recognition and measurement. See section 12 of the BC Handbook for initial and subsequent accounting for contingent consideration. [810-10-30-3]

However, as a result of the diversity in practice, we believe other approaches may also be acceptable for the subsequent accounting for contingent consideration depending on the facts and circumstances.

IPR&D

IPR&D is initially recognized and measured at fair value consistent with the business combinations guidance in Subtopic 805-20. However, there is diversity in the subsequent accounting and we believe either of the following approaches are acceptable.

- The amount initially allocated and recognized for IPR&D is expensed immediately in accordance with Subtopic 730-10 (research and development) unless it has an alternative future use, in which case it is accounted for as an intangible asset (see Question 4.2.20). Under this approach, the entity follows the asset acquisition approach because of the specific guidance in Subtopic 730-10.
- The IPR&D continues to be accounted for as an indefinite-lived intangible asset consistent with IPR&D acquired in a business combination. Under this approach, the entity continues to follow the business combinations guidance consistent with the initial recognition and measurement of the IPR&D as required under Subtopic 810-10. See section 17 of the BC Handbook for additional guidance on the accounting for IPR&D.

See chapter 7 of KPMG Handbook, Consolidation, for additional discussion about consolidating a VIE.

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Question 2.1.20 Is the Topic 805 definition of a business the same as the SEC's definition used to determine reporting requirements?

Background: If the transaction is an acquisition of a business as defined by the SEC, depending on the significance of the acquisition, a registrant may be subject to the Form 8-K reporting requirements to inform investors of the significant event. Additionally, a registrant may be required to file separate audited financial statements of the acquired entity under SEC Regulation S-X Rule 3-05, or Rule 8-04 for smaller reporting companies, and pro forma financial information under SEC Regulation S-X Article 11.

When a registrant acquires real estate operations, it may be required to provide abbreviated income statements under SEC Regulation S-X Rule 3-14, or Rule 8-06 for smaller reporting companies. See KPMG Handbook, SEC reporting requirements for business combinations, for discussion of the SEC rules and regulations.

Interpretive response: No. The definition of a business for SEC reporting purposes is different from the definition in Subtopic 805-10 for US GAAP accounting purposes. [S-X 11-01(d)]

The SEC's Division of Corporation Finance notes that it is possible for an entity to conclude that an acquired set of net assets meets the definition of a business in Regulation S-X, but to account for the acquired net assets as an asset acquisition under Topic 805, and vice versa. The SEC staff's evaluation of whether an acquisition is of a business or assets focuses primarily on whether the nature of the revenue-producing activity generally remains the same after the acquisition. [FRM 2010.1 – 2010.2]

Question 2.1.30 Is it possible to have a reverse asset acquisition?

Interpretive response: Yes, unless the legal acquiree is a VIE. A reverse acquisition is an acquisition in which one party is the acquiree from a legal perspective but is the acquirer from an accounting perspective (i.e. under US GAAP). However, the primary beneficiary of a VIE that is not a business is always the acquirer and therefore the legal acquirer will always be the accounting acquirer. The rest of this response applies to acquirees that are not a VIE.

Excerpt from ASC 805-40

05-2 As one example of a reverse acquisition, a private operating entity may want to become a public entity but not want to register its equity shares. To become a public entity, the private entity will arrange for a public entity to acquire its equity interests in exchange for the equity interests of the public entity. In this situation, the public entity is the legal acquirer because it issued its equity interests, and the private entity is the legal acquiree because its

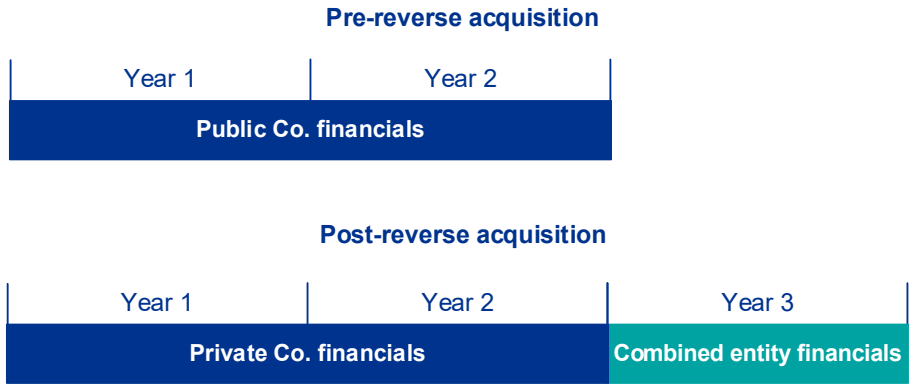
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equity interests were acquired. However, application of the guidance in paragraphs 805-10-55-11 through 55-15 results in identifying:

a. The public entity as the acquiree for accounting purposes (the accounting acquiree)
b. The private entity as the acquirer for accounting purposes (the accounting acquirer).

In the scenario illustrated in this example, the public entity (which is the accounting acquiree) meets the definition of a business and the private entity (which is the accounting acquirer) accounts for the transaction as a business combination.

For example, Public Co. acquires all the shares of Private Co. on January 1, Year 3, in a transaction accounted for as a reverse acquisition.



Private Co. becomes the predecessor, and its historical financial statements are reflected in the public entity's filings once the transaction occurs.

If the public entity (accounting acquiree) does not meet the definition of a business, the private entity (accounting acquirer) treats the acquisition as an asset acquisition.

However, when the private entity (accounting acquirer) also does not meet the definition of a business, we are aware of situations in which the SEC staff may not require the accounting acquirer's historical results to be presented as the predecessor, depending on the facts and circumstances. We recommend consulting with the auditors or accounting advisers in this situation.

Additionally, the SEC staff considers the acquisition of a private operating company by a nonoperating public shell company to be in substance a capital transaction, rather than a business combination. This transaction is equivalent to the issuance of shares by the private company for the net monetary assets of the shell company, accompanied by a recapitalization. This type of transaction is typically referred to as a reverse recapitalization. See sections 4 and 9 of the BC Handbook. [FRM 12100]

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Example 2.1.10 Reverse asset acquisition

A publicly listed life sciences company (PubCo) unsuccessfully pursued completion of a drug compound. Before the transaction described in the next paragraph, PubCo abandoned all R&D activities and terminated most of its employees. Remaining assets included cash and a minor amount of fixed assets.

PubCo is targeted by a private company (PrivateCo) looking to become a public company. The parties arrange a transaction such that PubCo acquires shares of PrivateCo in exchange for its publicly traded shares. PrivateCo is not a VIE.

After considering the guidance in paragraphs 805-10-55-11 to 55-15, the parties conclude that PrivateCo is the accounting acquirer. Additionally, after analysis of the guidance on the definition of a business, the parties determine that PubCo does not constitute a business. Therefore, the transaction is accounted for as a reverse asset acquisition, and PrivateCo records the assets of PubCo under Subtopic 805-50. If the substance of the transaction is a capital transaction due to the lack of nonmonetary assets, then the transaction may be in substance a recapitalization and accounted for as the equivalent of PrivateCo issuing shares for the net monetary assets of PubCo (see Question 2.1.30).

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3. Cost of acquired assets

Detailed contents

New item added in this edition: **
Item significantly updated in this edition: #

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3.2 Direct acquisition-related costs

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Question 3.2.10 What types of costs are considered transaction costs?

Question 3.2.20 Are costs incurred in issuing equity and debt to fund the acquisition included in the cost of the acquired assets?

3.3 Consideration in the form of noncash assets

Questions

Question 3.3.05 How does an entity determine cost when it acquires assets for noncash consideration?

Question 3.3.10 How does the acquirer measure equity instruments issued as consideration?

Question 3.3.20 How does the accounting acquirer determine the cost of the acquired assets in a reverse asset acquisition?

3.4 Acquiring an interest in an entity that holds assets

Questions

Question 3.4.10 How does the acquirer measure a previously held equity interest in a step acquisition of assets?

Question 3.4.20 How is NCI measured when less than 100% of the equity interests in an entity are acquired?

Question 3.4.25 How does the acquirer account for the contribution of previously controlled assets to an entity in exchange for a controlling financial interest?

Question 3.4.30 If the acquirer's accounting policy is to initially measure NCI at fair value, is a noncontrolling discount applied?

Examples

Example 3.4.10 Previously held equity interest in an asset acquisition

Example 3.4.20 NCI in an asset acquisition

Example 3.4.30 NCI when the acquirer transfers previously controlled assets

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Example 3.4.40 NCI when there is cash and non-cash consideration, and cash is distributed

3.5 Contingent consideration

Question

Question 3.5.10 How does an entity account for contingent consideration?#

Examples

Example 3.5.10 Contingent consideration in an asset acquisition – real estate value appreciation

Example 3.5.20 Contingent consideration in an asset acquisition – EBITDA-based earnout (after adoption of ASU 2025-07)**

3.6 Transactions not part of an asset acquisition

Questions

Question 3.6.10 How does the acquirer determine which elements of a transaction are accounted for as part of an asset acquisition versus separately?

Question 3.6.20 How does the acquirer account for the settlement of a preexisting relationship with the seller?

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Excerpt from ASC 805-50

> Acquisition Date Recognition of Consideration Exchanged

25-1 Assets commonly are acquired in exchange transactions that trigger the initial recognition of the assets acquired and any liabilities assumed. If the consideration given in exchange for the assets (or net assets) acquired is in the form of assets surrendered (such as cash), the assets surrendered shall be derecognized at the date of acquisition. If the consideration given is in the form of liabilities incurred or **equity interests** issued, the liabilities incurred and equity interests issued shall be initially recognized at the **date of acquisition**. However, if the assets surrendered are nonfinancial assets or **in substance nonfinancial assets** within the scope of Subtopic 610-20 on gains and losses from the derecognition of nonfinancial assets, the assets surrendered shall be derecognized in accordance with the guidance in Subtopic 610-20 and the assets acquired shall be treated as noncash consideration in accordance with Subtopic 610-20.

> Determining Cost

30-1 Paragraph 805-50-25-1 discusses exchange transactions that trigger the initial recognition of assets acquired and liabilities assumed. Assets are recognized based on their cost to the acquiring entity, which generally includes the transaction costs of the asset acquisition, and no gain or loss is recognized unless the **fair value** of noncash assets given as consideration differs from the assets' carrying amounts on the acquiring entity's books. For transactions involving nonmonetary consideration within the scope of Topic 845, an acquirer must first determine if any of the conditions in paragraph 845-10-30-3 apply. If the consideration given is nonfinancial assets or **in substance nonfinancial assets** within the scope of Subtopic 610-20 on gains and losses from the derecognition of nonfinancial assets, the assets acquired shall be treated as noncash consideration and any gain or loss shall be recognized in accordance with Subtopic 610-20.

30-2 Asset acquisitions in which the consideration given is cash are measured by the amount of cash paid, which generally includes the transaction costs of the asset acquisition. However, if the consideration given is not in the form of cash (that is, in the form of noncash assets, liabilities incurred, or **equity interests** issued), measurement is based on either the cost which shall be measured based on the fair value of the consideration given or the fair value of the assets (or net assets) acquired, whichever is more clearly evident and, thus, more reliably measurable. For transactions involving nonmonetary consideration within the scope of Topic 845, an acquirer must first determine if any of the conditions in paragraph 845-10-30-3 apply. If the consideration given is nonfinancial assets or in substance nonfinancial assets within the scope of Subtopic 610-20, the assets acquired shall be treated as noncash consideration and any gain or loss shall be recognized in accordance with Subtopic 610-20.

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3.1 Overview

Assets acquired in an asset acquisition are recognized based on their cost to the acquirer. Cost includes the following. [805-50-30-1 – 30-2]



Cost excludes amounts attributable to other transactions that are not part of the asset acquisition – e.g. services provided by the seller.

3.2 Direct acquisition-related costs

An acquirer includes direct acquisition-related costs in the cost of the acquired assets. These costs are described as 'transaction costs'. [805-50-30-1]

Question 3.2.10 What types of costs are considered transaction costs?

Interpretive response: Transaction costs are not defined. We believe transaction costs include direct costs to acquire the assets. [FAS 141.24]

These might include, for example, fees paid to external advisers, attorneys and accountants. Indirect costs, such as general and administrative expenses, salaries and benefits of employees, are not directly attributable to the acquisition of the assets and should not be included in the overall cost measurement of the assets acquired. [FAS 141.24]

Question 3.2.20 Are costs incurred in issuing equity and debt to fund the acquisition included in the cost of the acquired assets?

Interpretive response: No. Costs incurred in raising equity or debt to fund the acquisition of assets are accounted for under other applicable guidance.

Costs incurred when issuing equity should be accounted for as a reduction of the proceeds of the offering. Costs incurred when raising debt to fund an asset acquisition are reported as a direct deduction from the face amount of the debt and amortized into interest expense. [SAB Topic 5A, 835-30-45-1A, 45-3]

If an investment adviser provides both advisory services and debt or equity financing related to the acquisition, the acquirer should allocate the adviser's

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fees to those elements based on the relative fair values of the adviser's services. [SAB Topic 2A.6]

See Question 4.4.10 for the accounting for unamortized debt issuance costs related to debt assumed by the acquirer.

3.3 Consideration in the form of noncash assets

An acquirer includes both cash and noncash consideration transferred in the cost of the assets acquired. [805-50-30-2]

Question 3.3.05 How does an entity determine cost when it acquires assets for noncash consideration?

Interpretive response: Determining the cost of the assets acquired may be challenging if the consideration paid is not cash. Paragraph 805-50-30-2 provides general guidance and includes reference to both Topic 845 (nonmonetary transactions) and Subtopic 610-20 (derecognition of nonfinancial assets).

We believe it is important to consider the nature of the exchange as well as the nature of the assets relinquished to determine the appropriate guidance to follow. In particular, the nature of the assets relinquished may put the transaction in the scope of other US GAAP, thereby affecting the measurement of the cost of the assets acquired. For example, if the assets relinquished are a business, an entity applies the guidance in Subtopic 810-10 on deconsolidation. [610-20-15-4(b), 810-10-40-5]

The table below summarizes the basis for determining the cost of the assets acquired based on the outbound noncash consideration assuming all the requirements to derecognize the outbound asset(s) have been met under the applicable GAAP.

Outbound consideration	Basis for measuring acquired assets
Asset for which the acquirer retains control	Carrying amount of the asset transferred (by analogy to paragraph 805-30-30-8). See Question 3.4.25.
Controlling financial interest in a business	Fair value of the assets acquired. [810-10-40-5]
Financial assets	Fair value of the assets acquired. [860-20-30-1]
Nonfinancial assets (or in-substance nonfinancial assets) transferred to a noncustomer	Fair value (or stand-alone selling price of the goods or nonfinancial assets transferred if fair value cannot be reasonably estimated). [610-20-32-2 – 32-5]
Good or service to a customer	Fair value of the assets acquired (or stand-alone selling price of the goods or nonfinancial assets transferred if fair value cannot be reasonably estimated). [606-10-32-21 – 32-22]

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Outbound consideration	Basis for measuring acquired assets
Acquirer's equity instruments	Grant-date fair value [718-10-30-2 – 30-3] *or* Acquisition-date fair value of equity instruments issued, or fair value of assets acquired, whichever is more clearly evident. [805-50-30-2] See Question 3.3.10.

If none of the above guidance applies, certain nonmonetary transactions are accounted for under Subtopic 845-10. The general principle of Topic 845 is to measure the transaction at fair value. However, certain transactions are required to be measured at carryover basis in accordance with the guidance in Subtopic 845-10, if they:

- involve assets whose fair values are not determinable within reasonable limits;
- are between entities in the same line of business to facilitate sales to customers or potential customers; or
- lack commercial substance.

Question 3.3.10 How does the acquirer measure equity instruments issued as consideration?

Background: In March 2021, the FASB considered an agenda request to clarify whether equity instruments issued in an asset acquisition are either nonemployee share-based payments in the scope of Topic 718 (share-based payments) or in the scope of the Subtopic 805-50 asset acquisition model. If the asset acquired is considered a '[good] to be used or consumed in the grantor's own operations' it is in the scope of Topic 718. However, there is diversity in how that scoping literature is interpreted.

The FASB decided not to add the project to its agenda. In that discussion, the Board acknowledged a potential conflict in scoping literature and that entities could make a reasonable accounting policy election to determine the appropriate scope of the transaction. Further, multiple Board members indicated acceptance with diversity in practice on this issue.

Interpretive response: Based on the FASB discussions, for share-based payments issued in asset acquisitions for goods to be used or consumed in the acquirer's operations (e.g. the acquisition of nonfinancial assets), we believe the acquirer can elect to apply:

- Topic 718; or
- Subtopic 805-50 as well as other GAAP related to equity instruments (e.g. Topic 480 and Topic 815).

The policy election should be consistently applied (i.e. not a transaction-by-transaction election). The difference in policy could result in different amounts being included in the cost basis of the asset. For example, the measurement dates and timing of recognition could be different.

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If the transaction is not the acquisition of goods to be consumed in the acquirer's operations, the acquirer applies Subtopic 805-50 as well as other GAAP related to equity instruments (e.g. Topic 480 and Topic 815).

Topic 718 applied

An entity measures equity-classified share-based payments based on a grant-date fair value-based measurement. The entity also evaluates vesting conditions and classification of the award as either equity or a liability under Topic 718. The value of an award probable of vesting is included in the cost of assets acquired, in the same manner as if the entity paid cash for the assets. [718-10-30-2 – 30-3]

For further discussion on nonemployee awards, see KPMG Handbook, Share-based payment.

Topic 718 not applied

An entity measures the cost of the assets based on the fair value of the equity instruments issued (as of the acquisition date) or the fair value of the assets acquired – whichever is more clearly evident and therefore more reliably measurable.

In addition, the entity evaluates whether the instruments should be classified as equity, temporary equity or a liability under Topic 480 and Topic 815. If the instrument is liability-classified, any subsequent changes in fair value are recorded in earnings. Equity-classified contingent consideration is not remeasured following the acquisition date, and its subsequent settlement is accounted for within equity. For further discussion on classification as debt or equity, see KPMG Handbook, Debt and equity financing. [805-50-30-2]

Question 3.3.20 How does the accounting acquirer determine the cost of the acquired assets in a reverse asset acquisition?

Interpretive response: Because the accounting acquirer in a reverse asset acquisition is the legal acquiree, it does not transfer consideration and therefore must determine a hypothetical amount of consideration paid in the exchange.

The hypothetical consideration is the fair value of the equity interests that the accounting acquirer would have had to issue to give the owners of the legal parent the same percentage equity interest in the combined entity as they actually retained in the transaction. See Example 9.8 in the BC Handbook. [805-40-30-2]

3.4 Acquiring an interest in an entity that holds assets

An entity may acquire assets by obtaining a controlling interest in a legal entity that holds the assets. For example, an acquirer may hold a 20% interest in an entity that holds assets (e.g. real estate) that do not constitute a business and obtain an additional 50% interest in the entity so that it now holds a 70%

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interest. In that circumstance, the acquirer needs to determine how to account for its previously held interest as well as the other investors' noncontrolling interest.

Question 3.4.10 How does the acquirer measure a previously held equity interest in a step acquisition of assets?

Interpretive response: We believe an acquirer generally should value the previously held equity interest in an asset acquisition at carryover basis.

Subtopic 805-50 does not specifically address situations in which an entity obtains control of assets in which it previously held an interest. However, it indicates that assets are recognized based on their cost to the acquiring entity. We believe measuring the previously held equity interest at its carryover basis is the approach that is most consistent with this principle. [805-50-30-1]

However, we are aware of some diversity in practice in this area. We understand that, in certain circumstances, some entities remeasure a previously held equity interest to fair value at the acquisition date by analogy to the guidance on business combinations. The resulting remeasurement gain or loss is recognized in the income statement. Under this approach, the acquirer includes the fair value of the equity interest to determine the cost allocated to the acquired assets. [805-30-30-1]

However, we believe that it would not be appropriate to remeasure options to acquire a controlling interest in an entity that would result in an asset acquisition (assuming those options are not a derivative). The accounting for options to acquire a controlling interest is discussed in Question 3.2.35 of KPMG Handbook, Equity method of accounting.

Example 3.4.10 Previously held equity interest in an asset acquisition

Investor holds a 20% equity interest in Investee with a carrying amount of $40. Investor accounts for Investee under the equity method. Investor acquires the remaining 80% interest in Investee for $240. Investee's only assets are land and an unoccupied building as follows.

	Carrying amount	Fair value
Land	50	100
Building	150	200

The transaction is accounted for as an asset acquisition.

We believe there are multiple acceptable approaches to allocating cost in this scenario. Under one approach, Investor includes the carrying amount of its previously held interest ($40) in the cost of the land and building, and allocates the total cost on a relative fair value basis.

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Investor records the following journal entry to reflect the acquisition in its consolidated financial statements.

	Debit	Credit
Land[1]	93	
Building[2]	187	
Cash		240
Investment in Investee		40
To record acquisition of land and building.		

Notes:
1. ($100 ÷ ($100 + $200)) × $280.
2. ($200 ÷ ($100 + $200)) × $280.

Under another approach, Investor allocates the incremental cost of acquiring the 80% interest based on the relative fair values at the acquisition date to the previous proportionate carrying amount of each asset. Investor records the following journal entry to reflect the acquisition in its consolidated financial statements.

	Debit	Credit
Land[1]	90	
Building[2]	190	
Cash		240
Investment in Investee		40
To record acquisition of land and building.		

Notes:
1. (20% × $50) + (($100 ÷ ($100 + 200)) × $240).
2. (20% × $150) + (($200 ÷ ($100 + $200)) × $240).

Question 3.4.20 How is NCI measured when less than 100% of the equity interests in an entity are acquired?

Interpretive response: Subtopic 805-50 does not specifically address this fact pattern. We believe an acquirer has an accounting policy election to measure NCI in an asset acquisition either at (1) carryover basis or (2) fair value when the acquirer obtains a controlling interest in the entity that holds the assets. The entity should apply the accounting policy consistently.

- **Carryover basis.** Under this approach, NCI is measured based on the carrying amounts within the acquired entity. This approach was commonly used before adopting Statement No. 141(R). In the subsequent accounting under this approach, the proportion of the carryover basis allocated to the net assets acquired is attributed to NCI when such amounts are recognized in the income statement.

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- **Fair value.** Under this approach, NCI is measured at fair value on the date of acquisition. This approach analogizes to the business combinations guidance. For guidance on estimating the fair value of NCI, see section 19 of the BC Handbook. [805-30-30-1]

If an entity has an existing accounting policy for measuring NCI in an asset acquisition, it needs to follow Topic 250 (accounting changes and error corrections) to change its policy, including demonstrating that the change is preferable. [250-10-45-2]

If a subsidiary issues its own shares as consideration transferred in an asset acquisition, those shares should be presented as NCI and measured in the same manner as shares of the parent company as described in Question 3.3.10.

See Question 3.4.25 when an entity transfers a previously controlled asset to an acquired entity with NCI.

Example 3.4.20 NCI in an asset acquisition

Parent acquires an 80% interest in Subsidiary for $240. Subsidiary's only assets are land and an unoccupied building as follows.

	Carrying amount	Fair value
Land	50	100
Building	150	200

The transaction is accounted for as an asset acquisition.

Approach 1: Carryover basis

If Parent's accounting policy is to initially measure NCI in an asset acquisition at carryover basis, it calculates the amount of NCI based on the carrying amount in Subsidiary's financial statements: $200 × 20% = $40. Parent records the following journal entry in its consolidated financial statements.

	Debit	Credit
Land[1]	93	
Building[2]	187	
Cash		240
Noncontrolling interest		40
To record acquisition of building and related NCI.		

Notes:
1. ($100 ÷ ($100 + $200)) × $280.
2. ($200 ÷ ($100 + $200)) × $280.

Subsequently, Parent attributes the $40 of carryover basis allocated to the land ($13) and building ($27) to NCI when such amounts are recognized in the income statement. For example, if Parent recognizes $10 of depreciation expense in the following year, $1.44 ($10 × ($27 ÷ $187)) will be attributed to NCI.

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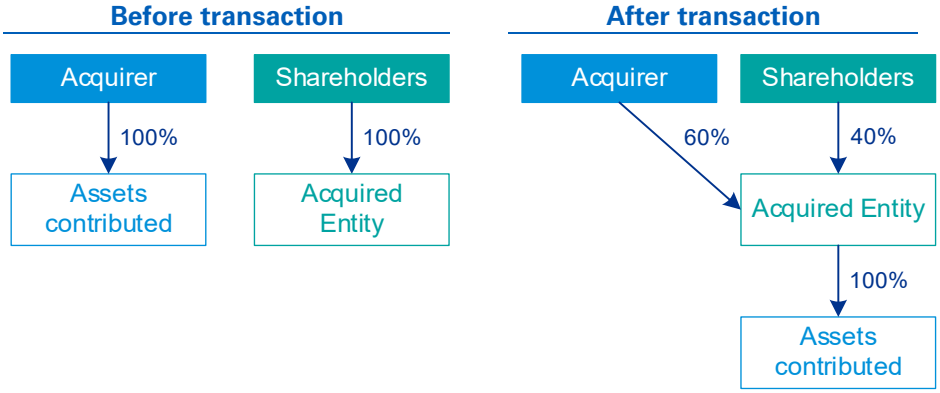
Approach 2: Fair value

If Parent's accounting policy is to initially measure NCI in an asset acquisition at fair value, it calculates fair value under Topic 820 (assumed to be $60 in this example). Parent records the following journal entry in its consolidated financial statements.

	Debit	Credit
Land	100	
Building	200	
Cash		240
Noncontrolling interest		60
To record acquisition of building and related NCI.		

Question 3.4.25 How does the acquirer account for the contribution of previously controlled assets to an entity in exchange for a controlling financial interest?

Background: An acquirer contributes previously controlled noncash assets in exchange for a controlling financial interest in another entity in a transaction accounted for as an asset acquisition. No other consideration is transferred. The following diagram illustrates the transaction.



Interpretive response: This transaction raises questions about the accounting for the contributed assets, the measurement of NCI and the measurement of the net assets acquired.

Contributed assets

This transaction involves a reduction in the acquirer's ownership interest in the contributed assets while maintaining control. In the absence of specific guidance in Subtopic 805-50, we believe entities should continue to recognize the contributed noncash assets at carryover basis. This is by analogy to the business combinations guidance that requires an entity to measure net assets

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that it controls before and after the transaction at their carrying amounts immediately before the acquisition date, with no gain or loss recognized in earnings. This would be the case even when the acquirer obtains less than 100% of the equity interests in the acquired entity. [805-30-30-8]

If the acquirer contributes cash, we believe any cash immediately distributed to the seller is accounted for as consideration transferred. Cash that stays in the entity is accounted for similar to noncash contributed assets.

Measurement of NCI

In this transaction, we believe there are effectively two components that affect the measurement of NCI in the acquired entity.

- The NCI's proportionate interest in the carrying amount of the contributed assets immediately preceding the transaction. This is consistent with the accounting for a decrease in ownership of a consolidated subsidiary while maintaining control. [805-30-30-8, 810-10-45-23]
- The value of the acquired entity's NCI (excluding the contributed assets) measured based on the acquirer's accounting policy for measuring NCI in an asset acquisition, either at carryover basis or fair value (see Question 3.4.20).

Measurement of acquired assets

While the contributed assets are measured at carryover basis, we believe the total cost of the new assets acquired should include all of the following.

- The fair value of the ownership interest in the contributed assets given up. This is consistent with the general measurement principles for noncash consideration in Subtopic 805-50 – i.e. the cost is based on the fair value of the NCI or the fair value of the net assets acquired, whichever is more clearly evident and therefore more reliably measurable. [805-30-30-2]
- The measurement of the NCI in the acquired entity (excluding the contributed assets), which is based on carryover basis or fair value (see above).
- Any other consideration transferred to the seller.

Any difference between the carrying amount of the NCI related to the contributed assets and fair value of the interest given up should be recognized in additional paid-in capital. [810-10-45-23]

Example 3.4.30 NCI when the acquirer transfers previously controlled assets

Parent acquires an 80% controlling financial interest in Subsidiary by contributing cash and equipment to Subsidiary. The cash and equipment will remain in Subsidiary and will not be transferred to the seller. Before this transaction, Subsidiary had only a single building.

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The following table summarizes the carrying amount and fair value of the assets contributed and acquired.

	Carrying amount	Fair value
Equipment	500	600
Cash	200	200
Assets contributed	700	800
Building acquired	175	200

The transaction is accounted for as an asset acquisition. No gain or loss is recognized on the transfer of the cash or equipment because Parent retains control of those assets (i.e. the assets are measured at carryover basis).

Parent includes the fair value of the ownership interest in the contributed assets given up ($160 = $800 × 20%) as part of the cost of the building.

The NCI in Subsidiary is partially measured based on the carrying amount of the contributed assets and then, depending on Parent's accounting policy, at carryover basis or fair value of Subsidiary without the contributed assets.

This example ignores the potential considerations of a control premium (see Question 3.4.30).

Approach 1: Carryover basis

Parent calculates the NCI in Subsidiary excluding the contributed assets based on the carrying amount in Subsidiary's financial statements. Therefore, the total cost of the building is the sum of (1) the fair value of the ownership interest in the contributed assets given up and (2) the carryover basis of the building.

Under this approach, Parent records the following journal entry in its consolidated financial statements.

	Debit	Credit
Building[1]	195	
Noncontrolling interest[2]		175
Additional paid-in capital[3]		20
To record acquisition of building and related NCI.		

Notes:

1. $160 (fair value of ownership interest given up in contributed assets, or 20% × $800) + $35 (20% × $175 carrying amount of building).
2. $140 (20% × $700 carrying amount of contributed assets) + $35 (20% × $175 carrying amount of building).
3. $160 (fair value of ownership interest given up in contributed assets) - $140 (20% × $700 carrying amount of contributed assets).

Under this approach, NCI is recorded at $175 while NCI's proportionate share of Subsidiary's assets based on ownership percentages is $179: 20% × $895 ($195 building + $700 carrying amount of contributed assets).

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Therefore, when the assets in Subsidiary (including the contributed assets) are recognized in the income statement, Parent will need to determine the amount attributed to the NCI in a manner other than the ownership percentages. In this example, Parent will attribute to NCI:

- 20% of the carryover basis ($700) when recognized in the income statement, consistent with its ownership percentage; and
- $35 or 17.9% ($35 ÷ $195) of the building depreciation expense.

Approach 2: Fair value

Parent calculates the NCI in Subsidiary excluding the contributed assets based on fair value under Topic 820 (assumed to be $40 in this example). Therefore, the total cost of the building is the sum of (1) the fair value of the ownership interest in the contributed assets given up and (2) the fair value of NCI excluding the contributed assets.

Under this approach, Parent records the following journal entry in its consolidated financial statements.

	Debit	Credit
Building[1]	200	
Noncontrolling interest[2]		180
Additional paid-in capital[3]		20
To record acquisition of building and related NCI.		

Notes:

1. $160 (fair value of ownership interest given up in contributed assets, or 20% × $800) + $40 (fair value of NCI excluding contributed assets).
2. $140 (20% × $700 carrying amount of contributed assets) + $40 (fair value of NCI excluding contributed assets).
3. $160 (fair value of ownership interest given up in contributed assets) - $140 (20% of the carrying amount of contributed assets).

Example 3.4.40 NCI when there is cash and non-cash consideration, and cash is distributed

Parent is 100% owned by Seller. Parent acquires 80% interest in Subsidiary by contributing cash and equipment. Before the transaction, Subsidiary had only a single building. Immediately after the contribution, Subsidiary distributes a portion of the cash to Seller who retains a 20% NCI. The remaining cash stays with Subsidiary.

The following table summarizes the carrying amount and the fair value of the assets contributed and acquired.

	Carrying amount	Fair value
Equipment	50	100
Cash	160	160

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	Carrying amount	Fair value
Total contributed	210	260
Less: Cash distributed to Seller	(135)	(135)
Assets remaining in Sub	75	125
Building acquired	150	200

The transaction is accounted for as an asset acquisition. No gain or loss is recognized on the transfer of the cash or equipment that stays in Subsidiary because Parent retains control of those assets (i.e. the assets are measured at carryover basis).

The cash that is immediately distributed to Seller is treated as consideration transferred directly to the former owners and is part of the cost of the acquired assets.

Parent includes the fair value of the ownership interest in the contributed assets given up ($25 = ($100 equipment + $25 cash) × 20%) as part of the cost of the building.

The NCI in Subsidiary is partially measured based on the carrying amount of the contributed assets and then, depending on Parent's accounting policy, at carryover basis or fair value of Subsidiary without the contributed assets.

This example ignores the potential considerations of a control premium (see Question 3.4.30).

Approach 1: Carryover basis

Parent calculates the NCI in Subsidiary excluding the contributed assets based on the carrying amount in Subsidiary's financial statements. Therefore, the total cost of the building is the sum of (1) the fair value of the ownership interest in the contributed assets given up and (2) the carryover basis of the building.

Under this approach, Parent records the following journal entry in its consolidated financial statements.

	Debit	Credit
Building[1]	190	
Noncontrolling interest[2]		45
Additional paid-in capital[3]		10
Cash[4]		135
To record acquisition of building and related NCI.		

Notes:

1. $25 (fair value of ownership interest given up in contributed assets, or 20% × $125) + $30 (20% × $150 carrying amount of building) + $135 cash distributed to Seller.
2. $15 (20% × $75 carrying amount of contributed assets) + $30 (20% × $150 carrying amount of building).

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3. $25 (fair value of ownership interest given up in contributed assets) - $15 (20% × $75 carrying amount of contributed assets).
4. Cash distributed to Seller.

Under this approach, NCI is recorded at $45 while NCI's (Seller's) proportionate share of Subsidiary's assets based on ownership percentages is $53: 20% × $265 ($190 building + $75 carrying amount of contributed assets).

Therefore, when the assets in Subsidiary (including the contributed assets) are recognized in the income statement, Parent will need to determine the amount attributed to the NCI in a manner other than the ownership percentages. In this example, Parent will attribute to NCI:

- 20% of the carryover basis ($75) when recognized in the income statement, consistent with its ownership percentage.
- $30 or 15.8% ($30 ÷ $190) of the building depreciation expense.

Approach 2: Fair value

Parent calculates the NCI in Subsidiary excluding the contributed assets based on fair value under Topic 820 (assumed to be $40 in this example). Therefore, the total cost of the building is the sum of (1) the fair value of the ownership interest in the contributed assets given up and (2) the fair value of NCI excluding the contributed assets.

Under this approach, Parent records the following journal entry in its consolidated financial statements.

	Debit	**Credit**
Building[1]	200	
Noncontrolling interest[2]		55
Additional paid-in capital[3]		10
Cash[4]		135
To record acquisition of building and related NCI.		

Notes:

1. $25 (fair value of ownership interest given up in contributed assets, or 20% × $125) + $40 (fair value of NCI excluding contributed assets) + $135 cash distributed to Seller.
2. $15 (20% × $75 carrying amount of contributed assets) + $40 (fair value of NCI excluding contributed assets).
3. $25 (fair value of ownership interest given up in contributed assets) - $15 (20% of $75 carrying amount of contributed assets).
4. Cash distributed to Seller.

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Question 3.4.30 If the acquirer's accounting policy is to initially measure NCI at fair value, is a noncontrolling discount applied?

Interpretive response: It depends. The price paid by the acquirer to obtain the controlling interest may include a control premium, in which case the per-share fair value of the NCI would be less than the per-share fair value of the acquirer's interest. For further discussion of control premiums, see section 19 of the BC Handbook. [805-20-30-8]

Quoted market prices, if available, generally provide the best evidence of fair value for NCI. Topic 820 (fair value measurement) prohibits adjustments, such as a noncontrolling discount, to quoted market prices when determining fair value. However, we believe no adjustments would be necessary, because quoted market prices reflect NCI transactions. [820-10-35-36B, 35-41C]

In the absence of quoted market prices, a noncontrolling discount may be applied when using a valuation approach that incorporates Level 2 or Level 3 inputs to estimate the fair value of an NCI.

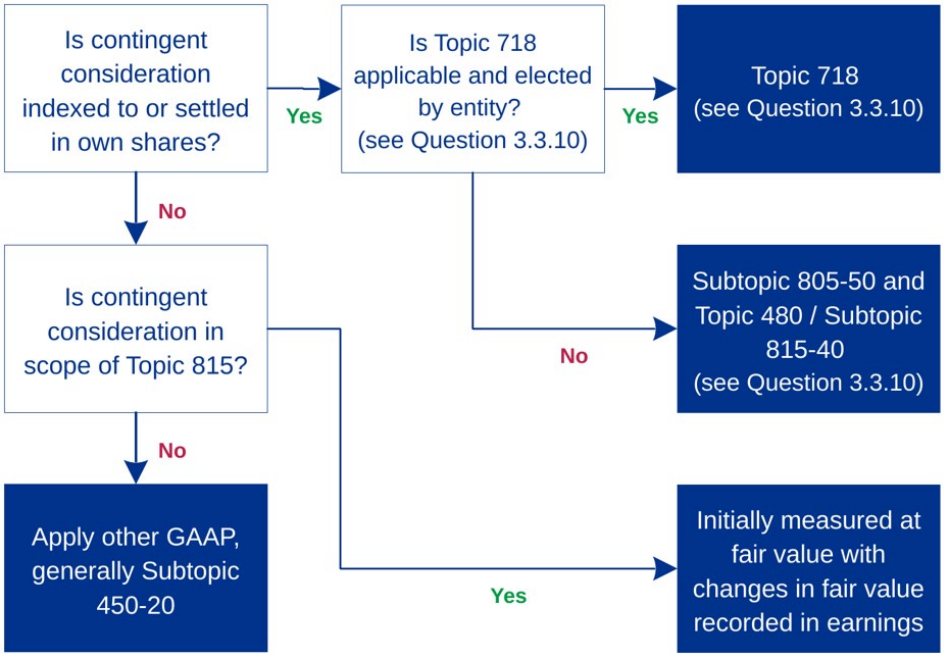
3.5 Contingent consideration

Subtopic 805-50 does not provide guidance on accounting for contingent consideration in an asset acquisition. The EITF considered providing guidance in Issue 09-2, Research and Development Assets Acquired and Contingent Consideration Issued in an Asset Acquisition, but did not reach a consensus.

Question 3.5.10 How does an entity account for contingent consideration?#

Interpretive response: The accounting for contingent consideration in an asset acquisition depends on its form as well as whether it is in the scope of specific GAAP. The following decision tree and subsequent discussion illustrate the ordering of the guidance and key considerations.

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Indexed to or settled in acquirer's equity

Contingent consideration indexed to or settled in the acquiring entity's equity shares is accounted for according to the guidance described in Question 3.3.10.

Settled in cash

Contingent consideration settled in cash is first evaluated to determine if it is in the scope of Topic 815.

- **In Topic 815.** The initial fair value of the derivative is included in the cost of the acquisition and subsequent changes in fair value are recorded in earnings. See chapter 2 of KPMG Handbook, Derivatives and hedging, for guidance on evaluating whether an arrangement is in the scope of Topic 815. [815-10-15]
- **Not in Topic 815.** The contingent consideration is generally recorded and included in the cost of the acquisition when it is both probable and reasonably estimable under Topic 450 (contingencies). However, some entities continue to apply the superseded guidance from Statement No. 141 and only record the contingent consideration when the contingency is resolved. In our experience, contingent consideration not in the scope of Topic 815 is generally recognized when incurred if it is in the form of a sales- or usage-based royalty where each sale or use over the life of the asset requires an additional payment. [450-20-25, FAS 141.27]

See Question 4.6.30 when the acquisition involves both a bargain purchase and contingent consideration.

Other considerations

If the seller retains a noncontrolling interest in a legal entity holding the assets, the acquirer may need to account for contingent consideration as a preferred

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return to the seller. This requires evaluating whether the contingent consideration is embedded in the NCI shares and whether it should be classified as debt or equity. That evaluation is beyond the scope of this publication. See chapter 6 of KPMG Handbook, Debt and equity financing.

If the acquirer's obligation is unconditional or is based on a non-substantive contingency, the consideration is not contingent and the acquirer recognizes a liability at the acquisition date.

Section 4.8 discusses the changes to the accounting for contingent consideration after the acquisition date.

Example 3.5.10 Contingent consideration in an asset acquisition – real estate value appreciation

Acquirer purchases a real estate property (land and an unoccupied building) from Seller in exchange for cash. In addition, Acquirer agrees to pay Seller cash equal to the appreciation (if any) of the value of the property over a predetermined benchmark value three years after the acquisition.

Characterizing contingent consideration

To determine the appropriate characterization and recognition for the cash-settled contingent consideration, Acquirer first determines whether the contingent consideration is in the scope of Topic 815. If it is in scope, it is initially measured at fair value (i.e. included in the cost of the real estate property) and marked to market at each reporting date.

While the arrangement may meet the definition of a derivative, an instrument qualifies for the scope exception from derivative accounting in subparagraph 815-10-15-59(b) when (1) the financial instrument is not exchange traded, (2) the underlying is a unique, nonfinancial asset, and (3) the nonfinancial asset related to the underlying is owned by the party that would not benefit under the contract from an increase in the fair value of the nonfinancial asset.

In this example, Acquirer concludes the contingent consideration agreement is not exchange traded, and the underlying asset (the property) is a uniquely identifiable real estate. In addition, Acquirer does not benefit under the settlement terms of the contingent consideration arrangement from an increase in the fair value of the property. This is because the contract requires Acquirer to potentially pay additional amounts to Seller if the fair value of the property increases.

Characterizing the transaction

The acquisition is not a business combination because the assets acquired do not meet the definition of a business. Therefore, accounting for contingent consideration under the guidance for a business combination is not appropriate.

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Accounting for the contingent consideration

Acquirer recognizes a liability in its financial statements for the contingent consideration only when it is both probable and reasonably estimable under Topic 450.

In this example, because of the uncertainty related to the future market value of the property, Acquirer does not initially recognize the contingent consideration but instead discloses the contingency in its consolidated financial statements.

See Question 4.8.10 and Example 4.8.10 regarding the accounting for the additional cost when contingent consideration is recognized after the acquisition date.

Example 3.5.20 Contingent consideration in an asset acquisition – EBITDA-based earnout (after adoption of ASU 2025-07)**

Background

ASU 2025-07, Derivatives and Hedging (Topic 815) and Revenue from Contracts with Customers (Topic 606): Derivatives Scope Refinements and Scope Clarification for Share-based Noncash Consideration from a Customer in a Revenue Contract, introduces a scope exception from derivative accounting. This scope exception applies to non-exchange-traded contracts for which settlement is based on operations or activities specific to one of the parties to the contract. Subtopic 815-10's Example 14A, Case H, reproduced below, illustrates how this scope exception applies to an EBITDA-based earnout arrangement.

The ASU is effective for annual and interim periods in fiscal years beginning after December 15, 2026 and may be applied either on a prospective or modified retrospective basis. See chapter 2 of KPMG Handbook, Derivatives and hedging, for additional discussion.

Excerpt from ASC 815-10

• > Example 14A: Certain Contracts That Are Not Traded on an Exchange—Underlyings Based on Operations or Activities Specific to One of the Parties to the Contract

• • > Case H: Earnout Arrangement—Underlying Based on Earnings Activity

55-143N Entity A acquires a patent from Entity B. As part of the transaction, Entity A and Entity B enter into an earnout arrangement whereby Entity A will pay Entity B $3 for each $1 that earnings before interest, taxes, depreciation, and amortization (EBITDA) associated with the manufacturing and sale of products that rely on that patent is in excess of $1 million on the 1-year anniversary of the purchase date. If EBITDA associated with the manufacturing and sale of products using the patent does not exceed $1 million, Entity A does not owe Entity B any amounts under the earnout arrangement.

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55-143O The arrangement contains one underlying: an earnings measure (EBITDA) related to the manufacturing and sale of products that rely on the patent acquired by Entity A. The underlying is not based on a market rate, market price, market index, or the price or performance (including default) of a financial asset or financial liability of one of the parties to the contract as described in paragraph 815-10-15-59(e)(1) and (e)(2). Also, the exclusions related to contracts involving an entity's own equity or call options and put options on debt instruments as described in paragraph 815-10-15-59(e)(3) and (e)(4) do not apply. Therefore, the underlying qualifies for the scope exception in paragraph 815-10-15-59(e).

Accounting for the contingent consideration

Because the scope exception introduced by ASU 2025-07 applies in the above FASB Example, Entity A (the acquirer) recognizes a liability in its financial statements for the contingent consideration only when the consideration is both probable and reasonably estimable under Topic 450.

See Question 4.8.10 and Example 4.8.10 regarding the accounting for the additional cost when contingent consideration is recognized after the acquisition date.

3.6 Transactions not part of an asset acquisition

The acquirer and seller may enter into other transactions at or near the same time with the asset acquisition. For example, the acquirer may obtain a license to a drug compound and engage the seller to perform follow-on R&D services.

In this case, the acquirer allocates the consideration paid between the assets acquired and the services to be received (usually based on relative fair values) and recognizes the services over the relevant service period. For example, payments to the seller for R&D activities should be expensed under Topic 730 (R&D). See section 2.3 of KPMG Handbook, Research and development. [730-10-25-1, 25-2(d)]

Question 3.6.10 How does the acquirer determine which elements of a transaction are accounted for as part of an asset acquisition versus separately?

Interpretive response: Subtopic 805-50 does not provide guidance on distinguishing elements of an asset acquisition from elements of a service transaction. The EITF considered providing guidance in Issue 09-2 but did not reach a consensus.

To determine which elements of a transaction should be accounted for as part of the asset acquisition and which should be accounted for as a separate transaction, we believe acquirers may analogize to the relevant guidance on determining what is part of a business combination. See sections 2 and 11 of the BC Handbook. [805-10-55-18]

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Question 3.6.20 How does the acquirer account for the settlement of a preexisting relationship with the seller?

Background: An asset acquisition may effectively settle a preexisting relationship between the acquirer and seller. For example, a tenant might purchase the building it occupies from the owner, effectively settling its preexisting lease.

Interpretive response: In the absence of specific guidance, we believe it is appropriate for an acquirer to analogize to the guidance on business combinations. That guidance requires the acquirer to measure the settlement at the lesser of: [805-10-55-21]

- the amount by which the contract is favorable or unfavorable to the acquirer on the acquisition date; and
- the amount of a contractual termination payment that would be required of the party to whom the contract is unfavorable.

This amount affects the gain or loss recognized when assets or liabilities under the preexisting relationship are derecognized. See section 11 of the BC Handbook.

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4. Allocating the cost of an asset acquisition

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Excerpt from ASC 805-50

> Allocating Cost

30-3 Acquiring assets in groups requires not only ascertaining the cost of the asset (or net asset) group but also allocating that cost to the individual assets (or individual assets and liabilities) that make up the group. The cost of such a group is determined using the concepts described in the preceding two paragraphs. The cost of a group of assets acquired in an asset acquisition shall be allocated to the individual assets acquired or liabilities assumed based on their relative fair values and shall not give rise to goodwill. The allocated cost of an asset that the entity does not intend to use or intends to use in a way that is not its highest and best use, such as a brand name, shall be determined based on its relative fair value. See paragraph 805-50-55-1 for an illustration of the relative fair value method to assets acquired outside a business combination.

30-4 See paragraphs 740-10-25-49 through 25-55 for guidance on the accounting for acquired temporary differences in certain purchase transactions that are not accounted for as business combinations.

4.1 Overview

An acquiring entity allocates the cost of an asset acquisition to the assets acquired generally based on their relative fair values. Fair value is determined under Topic 820.

Goodwill is not recognized in an asset acquisition. It is recognized only in a business combination because, for example, it represents the synergies expected to be attained through the combinations of businesses or the value of an assembled workforce. Additionally, when the net fair value of the assets acquired and liabilities assumed is greater than the cost, a bargain purchase gain is not recognized in an asset acquisition. [805-50-30-3]

Question 4.1.10 Is obtaining a valuation of acquired assets and liabilities required in an asset acquisition?

Interpretive response: Although the acquired assets and liabilities in an asset acquisition are not recorded at fair value, the accumulated cost of the acquisition is allocated to the acquired assets and liabilities based on their relative fair values. To make the appropriate allocation, an entity likely will need to obtain valuations of assets and liabilities whose fair values rely on valuation methodologies requiring significant estimation. Intangible assets typically fall in this category, but other assets and liabilities may as well.

For example, if a single asset is acquired, valuing the asset is not required to allocate the cost. However, if a bundle of assets that includes intangible assets is acquired, obtaining the fair value of the assets is required to appropriately allocate the cost to the acquired assets. Generally, given the difficulty and

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subjectivity associated with valuing intangible assets, obtaining a valuation of the assets may be necessary.

Question 4.1.20 Does the concept of a measurement period exist for asset acquisitions?

Interpretive response: No. Although in a business combination, the acquirer may record provisional amounts for the assets acquired and liabilities assumed and adjust them during the measurement period, no such concept exists in an asset acquisition; this is regardless of the size or complexity of the asset acquisition.

All accounting for the asset acquisition must be completed by the next reporting date after the consummation of the transaction. This may present operational challenges for a transaction that occurs late in a fiscal period, if the transaction is clearly an asset acquisition or if there is uncertainty about whether the transaction represents an asset acquisition or a business combination.

Entities are required to follow a two-step model to determine whether a set of assets and activities is a business. The first step of the model, the screening test, requires entities to evaluate whether substantially all of the fair value of the gross assets acquired is concentrated in a single asset or a group of similar assets. [805-10-55-3A – 55-9]

- If so, the set is not a business.
- If not, under the second step of the model, the set is a business if it includes at least one input and at least one substantive process.

An entity may be able to quickly conclude that an acquired set is a business, for example, because it is clear that the value of the gross assets acquired is spread across several asset classes and the set includes both inputs and substantive processes. In those circumstances, an entity is permitted to record provisional amounts and adjust them during the measurement period.

However, in some cases, it may not be immediately clear whether the acquired set is a business. For example, there may be a significant concentration of value in a single asset or a group of similar assets, such that an entity would need to perform a detailed evaluation to determine whether the screening test is met. In those circumstances, for transactions occurring close to the end of a fiscal period, an entity may need to act quickly to obtain relevant fair value information to perform the test.

An incorrect assessment about whether a transaction is an asset acquisition or a business combination would result in errors in the financial statements.

4.2 Intangible assets acquired in an asset acquisition

An entity recognizes intangible assets acquired in an asset acquisition and in a business combination regardless of whether the selling entity recognized the

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intangible assets before the sale transaction. For example, an acquirer recognizes acquired market-ready technology as an intangible asset.

The fair value of intangible assets acquired individually or with a group of assets is determined under Topic 820, just as the fair values of the tangible assets acquired and the liabilities assumed are determined. Topic 820 requires fair value to be based on the assumptions that market participants would use in pricing the asset, even if the entity does not intend to use the asset, or intends to use it in a way that is not its highest and best use. For guidance on estimating the fair value of intangible assets, see section 17 of the BC Handbook. [820-10-35-9]

Once fair value has been determined for each of the individual assets, the cost of the group of assets (including transaction costs) is allocated to the individual assets based on their relative fair values. However, if the ownership of, or a license to, internal-use software is acquired, we believe Subtopic 350-40 requires entities to allocate the consideration paid on a relative 'stand-alone price' basis. The stand-alone price of an element is the price at which a customer would purchase that component separately. [805-50-30-3, 350-40 Glossary, 350-40-30-4]

The fact that no goodwill (or bargain purchase gain) can be recognized in an asset acquisition emphasizes the importance of a rigorous process to identify and fully value all assets and liabilities included in the group of assets acquired.

Question 4.2.10 How does the process of identifying intangible assets in an asset acquisition differ from a business combination?

Interpretive response: For an intangible asset to be recognized in a *business combination*, it needs to meet one of two criteria in the definition of 'identifiable': [805-20 Glossary]

- it is separable – e.g. capable of being separated from the entity and sold or otherwise disposed of; or
- it arises from contractual or other legal rights – regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

These criteria may be useful in distinguishing between the types of recognized intangible assets acquired in transactions other than business combinations. However, intangible assets acquired in an *asset acquisition* may qualify for recognition even if they do not meet either the contractual-legal criterion or the separability criterion for being an identifiable asset. [350-30-25-4]

This lower threshold may result in more intangible assets recognized in an asset acquisition than in a similar transaction that qualifies as a business combination.

The conceptual basis for applying the legal and separability criteria in Topic 805 only in a business combination is that because goodwill arises only in a business combination, criteria are needed to distinguish between identifiable intangible assets that are otherwise acquired and goodwill that is acquired in a business combination. However, where intangible assets are acquired

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individually or as part of a group of assets not constituting a business, the FASB believes the arm's-length, bargained nature of the exchange with a market participant provides sufficiently reliable evidence of existence and fair value to support recognition. For this reason, it did not create special identification and recognition criteria for such transactions. [350-30-25-4]

We believe intangible assets that may be recognized in an asset acquisition but would not be recognized in a business combination could include: [350-30-25-4]

- noncontractual employee base (i.e. an assembled workforce);
- noncontractual customer base; and
- a unique manufacturing process.

When performing the screening test to determine whether substantially all of the fair value of the gross assets acquired is concentrated in a single asset or a group of similar assets and therefore is not a business, an entity should follow the business combinations guidance to identify and measure the intangible assets in the acquired set, rather than the asset acquisitions guidance.

Question 4.2.20 Is IPR&D recognized in an asset acquisition?

Interpretive response: Yes. However, Topic 730 (R&D) requires immediate expensing of amounts assigned to IPR&D assets acquired in a transaction (other than a business combination) that are to be used in a particular research and development project and that have no alternative future use. Therefore, in an asset acquisition, amounts allocated to IPR&D that has no alternative use are expensed. See section 2.3 of KPMG Handbook, Research and development, for guidance related to accounting for purchased IPR&D. [350-30-35-6, 35-7]

Example 4.2.10 IPR&D assets acquired

Pharma acquires a Phase 2 drug candidate, a computer, software and a database used in the research and development of the drug candidate. Pharma accounts for the transaction as an asset acquisition.

Pharma evaluates whether each asset used in the project has an alternative future use. Pharma concludes that both the computer and the software can be used in future research and development projects and capitalizes the cost allocated to them as computer equipment and internal-use software, respectively. Pharma concludes that the Phase 2 drug candidate does not have an alternative future use and expenses the cost allocated to it immediately. Additionally, Pharma concludes that the database is specific to this research and development project and therefore does not have an alternative future use. The cost allocated to it is also expensed immediately.

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Question 4.2.30 Is an acquired workforce recognized in an asset acquisition?

Interpretive response: Yes. Although Topic 805 states that an assembled workforce is not an intangible asset to be recognized apart from goodwill when acquired in a business combination, Subtopic 350-30 (intangible assets) indicates that when an assembled workforce is acquired in other than a business combination, it is an intangible asset to be recognized. [350-30-25-4]

However, the existence of an assembled workforce may be an indicator of a substantive process when considering whether the acquisition is a business combination or an asset acquisition. See section 2 of the BC Handbook.

Question 4.2.40 Does an entity recognize defensive intangible assets in an asset acquisition?

Interpretive response: Yes. Subtopic 805-50 addresses assets that the acquirer intends not to use or to use in a way other than their highest and best use (e.g. a brand name). [805-50-30-3, 350-30-25-5]

That Subtopic requires these assets to be recognized in an asset acquisition on the basis of their relative fair values. An entity measures fair value under Topic 820, based on the asset's highest and best use by market participants.

Question 4.2.50 How does an acquirer measure a reacquired right in an asset acquisition?

Background: As an example to explain the concept of a reacquired right, Acquirer previously granted Start-Up a license to a drug compound. Start-Up began related R&D activities but had to discontinue those activities and lay off most of its employees because it ran out of funding. Acquirer buys all shares of Start-Up, thereby reacquiring rights to the license. The transaction is an asset acquisition because Start-Up is no longer a business.

Interpretive response: In the absence of specific guidance, we believe an acquirer has an accounting policy election to allocate cost to a reacquired right based on either: [805-20-30-20]

- its fair value under Topic 820 (fair value measurement); or
- its remaining contractual term, regardless of assumptions market participants would make about renewals, by analogy to the guidance on business combinations. See section 7 of the BC Handbook.

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Question 4.2.60 How does an insurance company account for acquired insurance and reinsurance contracts in an asset acquisition?

Interpretive response: There is no specific guidance on the acquisition of insurance and reinsurance contracts in an asset acquisition. However, Subtopic 944-805 provides guidance on how to recognize and measure these contracts in a business combination (see paragraphs 7.020 to 7.022 in the BC Handbook).

In the absence of other guidance, we believe analogy to Subtopic 944-805 is appropriate. This guidance requires an acquirer to carry forward the acquiree's classification of an acquired insurance or reinsurance contract.

The acquirer measures assets and liabilities for the insurance and reinsurance contracts in accordance with its own accounting policies for such contracts. Accordingly, the acquirer recognizes an intangible asset (or occasionally a liability) for the difference between the fair value of the contracts acquired and the respective amount the acquirer recognized using its accounting policies. Subsequently, the asset (or other liability) is measured on a basis consistent with the related insurance or reinsurance liability. [944-805-30-1, 35-1]

Example 4.6.07 illustrates the accounting for these contracts in an asset acquisition.

Question 4.2.70 How are contract assets and liabilities related to a customer contract accounted for in an asset acquisition?

Interpretive response: There is no specific guidance on the acquisition of contract assets and liabilities in an asset acquisition. However, acquired contract assets and liabilities in a business combination are measured under Topic 606 as if the acquirer had originated the contract. For business combinations, this is an exception to the recognition and measurement guidance in Topic 805 (see paragraphs 7.025d through 7.025h in the BC Handbook).

We understand that the SEC staff has objected to applying the business combination exception for contract assets and liabilities by analogy in an asset acquisition. As a result, an entity that acquires a customer contract in an asset acquisition determines whether the contract gives rise to a contract asset or liability and measures those items at fair value. As discussed in Question 4.6.10, excess costs and bargain purchase generally are not allocated to the contract asset or liability.

4.3 Leases

An acquirer may obtain an interest in a lease in an asset acquisition. For example, an acquirer may purchase a tenant-occupied real estate property and assume the role of the lessor. Alternatively, the acquirer may assume the role

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of a lessee, for example if it acquires a legal entity that is not a business that has leased office space.

Subtopic 805-50 contains no specific guidance on the accounting for lease contracts in an asset acquisition.

For detailed guidance on accounting for lease contracts, see KPMG Handbook, Leases. [842-10-65-1]

Question 4.3.10 Does the acquirer reassess lease classification in an asset acquisition?#

Interpretive response: It depends. This is because under Topic 842, the classification of a lease is reassessed only in specific circumstances. See Question 11.1.90 in KPMG Handbook, Leases, for additional discussion of those circumstances.

Question 4.3.20 How does an acquirer account for its interest in an acquired lease in an asset acquisition?

Interpretive response: If the acquirer assumes the role of lessee, it will recognize a right-of-use asset and a lease liability. See Question 4.3.10 for a discussion of the circumstances in which the acquirer should reassess lease classification in an asset acquisition. If the acquirer assumes the role of lessor, the accounting depends on whether the lease is classified as an operating lease or a sales-type or direct financing lease. In either case, the acquirer also recognizes related intangible assets. For detailed guidance on accounting for leases in an asset acquisition, see Question 11.1.190 in KPMG Handbook, Leases.

4.4 Acquired liabilities

Liabilities assumed in an asset acquisition are generally measured at fair value under Topic 820 at the acquisition date. See Question 4.6.10 on allocating costs.

Question 4.4.10 Are unamortized debt issuance costs of assumed debt recognized in an asset acquisition?

Interpretive response: No. The seller's unamortized debt issuance costs are not recognized with debt assumed in the asset acquisition because these costs do not meet the definition of an asset. Further, the unamortized debt issuance

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costs are not factored into the fair value measurement of the debt at the acquisition date.

See Question 3.2.20 for a discussion on accounting for costs incurred in issuing new debt to fund an asset acquisition.

4.5 Acquired contingencies

If the acquirer acquires or assumes a contingency in an asset acquisition, it accounts for the contingency under Topic 450 (contingencies). Loss contingencies are recorded when they are probable and can be reasonably estimated. In contrast, gain contingencies are not recognized until the contingency is resolved. [450-20-25-2, 450-30-25-1]

If there is a significant contingent liability associated with the acquired assets, the seller may agree to indemnify the acquirer for losses associated with that liability. Subtopic 805-50 does not provide guidance on accounting for indemnification arrangements.

Question 4.5.10 How does an acquirer account for its right to receive an indemnity granted by the seller in an asset acquisition?

Interpretive response: In the absence of specific guidance, we believe it is appropriate for an acquirer to analogize to the guidance in Topic 805 on indemnification assets.

Under that guidance, if the indemnification relates to an asset or liability that is an exception to Topic 805's recognition or fair value measurement principles, the acquirer recognizes an indemnification asset on the same basis as the indemnified item, subject to any contractual limitations and collectibility. See section 7 of the BC Handbook. [805-20-25-28]

An acquirer may not recognize an indemnification asset at an amount that exceeds the indemnified liability. If the acquirer is entitled to receive an amount in excess of the loss, it should account for that excess as a gain contingency. [450-30-25-1]

Example 4.5.10 Indemnity granted for acquired contingency

Parent acquires all of the shares in Subsidiary, whose assets consist of a real estate property (land and an unoccupied building). Parent determines that the acquisition qualifies as an asset acquisition and not a business combination.

There is ongoing litigation against Subsidiary by some of its former employees for asbestos claims related to the property. The seller agrees to indemnify Parent for asbestos-related claims against Subsidiary up to an aggregate of $3.5 million.

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After consulting with legal counsel, Parent concludes that it should recognize a $2.1 million liability under Subtopic 450-20 (loss contingencies) for asserted and unasserted asbestos claims. Parent also recognizes an indemnification asset of $2.1 million, the lesser of the accrual recognized for the indemnified item ($2.1 million) and the contractual limitation ($3.5 million).

Question 4.5.20 Is a right to receive a plaintiff's future cash flows recognized as an acquired asset?#

Interpretive response: It depends. An acquirer's right to a plaintiff's future cash flows from litigation is a financial asset if there is an enforceable judgment and the cash flows are contractually fixed, and the acquirer obtains either: [860-10-55-10 – 55-11]

- control of the legal entity that is the plaintiff; or
- a contractual right to receive the plaintiff's cash flows, and the acquirer and plaintiff are unrelated third parties.

If a contract to receive a third-party plaintiff's future cash flows from litigation is not a financial instrument, it might still be a derivative. See KPMG Handbook, Derivatives and hedging, for guidance on evaluating whether a contract meets the definition of a derivative. [815-10-15]

If not a financial asset or derivative, the acquirer would evaluate whether the acquired rights meet the definition of an asset in Concepts Statement 8 and the intangible asset recognition criteria in Subtopic 350-30 (see Question 4.2.10). For example, an acquirer may purchase a litigation right directly from a plaintiff in bankruptcy through an auction process in which the acquirer obtains the rights of the plaintiff. In that case, the arm's-length, bargained nature of the exchange with a market participant in a stand-alone transaction may provide sufficiently reliable evidence of existence and fair value to support recognition. [350-30-25-4]

In other cases, the rights acquired may not meet the definition of an asset or the recognition criteria in Subtopic 350-30 because there is no reliable evidence of existence and fair value to support recognition. In those other cases, an acquirer accounts for a right to receive a plaintiff's future cash flows from litigation as a gain contingency. [450-30-25-1]

4.6 Goodwill and bargain purchase amounts

4.6.10 Overview

The cost of the acquired assets and liabilities assumed may differ from their combined fair value.

- When the cost is greater than fair value of the assets acquired and liabilities assumed, Subtopic 805-50 specifically prohibits recognizing goodwill.
- When the fair value of the net assets is greater than the cost, a bargain purchase gain is not recorded. Although there is no specific guidance for

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bargain purchases, Subtopic 805-50 prohibits recognition of gains or losses on asset acquisitions unless the fair value of noncash consideration transferred exceeds its carrying amount. [805-50-30-1]

If the cost significantly exceeds the fair value of the assets acquired and liabilities assumed, that may indicate the presence of another arrangement between the acquirer and the seller that needs to be separately accounted for (e.g. a service arrangement). See section 3.6.

Alternatively, if there is more than an insignificant amount of goodwill present, that may indicate that the acquirer obtained a substantive process and therefore the acquired set of assets and activities may be a business. See section 2 of the BC Handbook. [805-10-55-9]

Question 4.6.10 How is an excess or shortfall of cost allocated in an asset acquisition?

Interpretive response: A difference between the cost and the fair value of a group of assets acquired and liabilities assumed generally should be allocated to assets only, not to both assets and liabilities. The conceptual basis for this view is that the liabilities assumed are viewed as part of the cost of the assets acquired.

Excess cost

When the cost of the group of assets is greater than the fair value of the group, goodwill is not recorded. The acquirer first confirms that all assets have been identified and allocated value. As opposed to the recognition criteria applied in a business combination (e.g. the contractual-legal or separability criteria for intangible assets), assets acquired in an asset acquisition may qualify for recognition even though they do not meet the contractual-legal or separability criteria. For example, an assembled workforce, which is subsumed into goodwill in a business combination is recognized as an asset in an asset acquisition (see section 4.2). [350-30-25-4]

Once all assets have been recognized, the excess cost is allocated to the nonfinancial assets acquired. This allocation causes each acquired asset to be recognized at an amount greater than its individual fair value.

We do not believe that excess cost should be allocated to financial assets or indefinite-lived intangible assets because that could result in an immediate recognition of an impairment loss related to those assets. This would be inconsistent with the general principle that there should be no immediate gain or loss recognized as part of the asset acquisition.

Therefore, consistent with the view expressed in the superseded cost allocation guidance in FASB Statement No. 141, we do not expect adjustments to be allocated to the initially measured amounts of: [FAS 141.44]

- financial assets (excluding investments in equity method investees);
- assets acquired that are classified as held-for-sale; based on the guidance in paragraph 360-10-45-12, an asset that is acquired and that will be sold (rather than held and used) is held for sale if the sale is probable and

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expected to be completed within one year of the acquisition date, and all other held-for-sale criteria are probable of being met within a short period following the acquisition (usually within three months);

- deferred tax assets;
- postretirement benefit plan assets; and
- other current assets (including inventory).

In addition, we also do not expect adjustments to be allocated to:

- indefinite-lived intangible assets;
- contract assets recognized for contracts with customers; and
- indemnification assets.

Although indefinite-lived intangibles should not be allocated an amount greater than their fair value because this would result in an immediate impairment charge under Topic 350, long-lived assets (such as property, plant and equipment and finite-lived intangibles) should be allocated excess cost and recorded above their fair value because those assets are measured for impairment under Topic 360. Under the Topic 360 model, whereby those long-lived assets are first tested for recoverability together with their associated asset groups through comparison to undiscounted cash flows, it is unlikely that a recently acquired asset group would fail the recoverability test or that an immediate impairment would be recorded.

Bargain purchase amount

Similar to situations in which there is excess purchase cost, when the fair value of the net assets acquired exceeds purchase consideration, a bargain purchase gain is not recorded. The acquiring entity should first confirm that the fair values of acquired assets have been appropriately determined and all assumed liabilities have been identified and allocated value.

We believe an acquirer should generally allocate a bargain purchase amount in the same manner as excess cost except that the bargain purchase should also be allocated to indefinite-lived intangible assets. The exception for indefinite-lived intangible assets is appropriate because it would not result in an immediate recognition of an impairment loss.

If a bargain purchase remains after allocating the bargain purchase amount to eligible assets (including indefinite-lived intangible assets), we believe an entity should allocate the bargain amounts to the remaining assets to avoid recognizing a bargain gain unless other GAAP indicates specific requirements for how those assets should be initially measured in an asset acquisition. If other GAAP precludes further allocation and a bargain purchase still remains, it would be appropriate to recognize a gain.

If other relevant GAAP subsequently requires asset(s) to be measured at fair value (e.g. Topic 815 on derivative instruments) – in which case there would be a gain recognized in that reporting period – the subsequent measurement and resulting gain should generally be recorded in accordance with that GAAP.

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Example 4.6.05 Favorable and unfavorable contracts acquired in exchange for no consideration

Oil Co enters into an asset acquisition in which it acquires two contracts for capacity on a transmission pipeline from Seller. One contract is considered unfavorable and one is considered favorable. Oil Co. does not transfer any consideration to Seller.

The unfavorable contract includes $10 million of remaining take-or-pay payments. Neither Oil Co, nor any other company, would use the capacity related to the unfavorable contract because no oil and gas reserves remained in the area of the pipeline.

Oil Co determines the cost of acquisition to be the fair value of the liability assumed – which is the $10 million unfavorable contract. In this example, the effects of discounting are assumed to be insignificant.

The $10 million liability is recognized at the date of acquisition. Oil Co then allocates the $10 million of cost to the favorable contract intangible asset.

Example 4.6.07 Asset acquisition of a shell insurance company

ABC Insurance Company (ABC) purchases XYZ Insurance Company (XYZ) for $70 in an asset acquisition, and incurs transaction costs of $10.

Immediately before the acquisition, XYZ entered into an agreement with its parent to reinsure its insurance contracts under a 100% coinsurance agreement. XYZ is a shell insurance company because it does not retain any insurance risk and was acquired primarily for its insurance licenses.

The fair value of the assets and liabilities acquired are as follows.

	Fair value
Investments	50
Insurance licenses	15
Insurance contracts – claim liabilities	(160)
Reinsurance contracts – reinsurance recoverable	165
Total	70

ABC accounts for the acquisition of insurance and reinsurance contracts in accordance with Question 4.2.60 and measures the insurance and reinsurance contracts consistent with the guidance in Subtopic 944-805. Therefore, ABC measures the insurance and reinsurance contracts consistent with its own accounting policies and recognizes an intangible asset (or liability) for the difference between those amounts and the fair value of those contracts.

Therefore, the net assets to be recorded (before considering transaction costs) are as follows.

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	Amount recorded
Investments	50
Insurance licenses	15
Insurance contracts – claim liabilities	(175)
Reinsurance contracts – reinsurance recoverable	175
Insurance contract intangible asset, net – insurance contracts[1]	15
Other liability – ceded reinsurance contracts[2]	(10)
Total	70

Notes:
1. $175 - $160.
2. $175 - $165.

The total cost of the transaction is $80 ($70 of cash transferred plus $10 of transaction costs). The $80 cost is greater than the $70 fair value.

Because goodwill is not recorded in an asset acquisition, ABC would allocate the excess cost to eligible assets. However, ABC concludes that none of the assets acquired are eligible for excess allocation (see Question 4.6.10).

- The investments are financial assets and therefore not eligible.
- The insurance licenses are indefinite-lived intangible assets and therefore not eligible.
- The reinsurance recoverable is a financial asset and therefore not eligible.
- The claim liabilities and other liability – ceded reinsurance contracts are not eligible because excess allocation is generally only allocated to assets, and not to both assets and liabilities.
- The insurance contract intangible asset is created due to the difference between the fair value and estimated amount of the claim liabilities that is not eligible for excess allocation. Because excess costs cannot be allocated to the claim liabilities, this balance similarly would not change (or would be ineligible).

Because all of the assets are ineligible, ABC records an expense for the excess amount. ABC records the following journal entry.

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	Debit	Credit
Expense	10	
Investments	50	
Insurance license intangible assets	15	
Reinsurance recoverables – ceded claim liabilities	175	
Insurance contract intangible asset – insurance contracts	15	
Claim liabilities		175
Other liability – ceded reinsurance contracts		10
Cash		80
To record asset acquisition of XYZ Insurance Company.		

Question 4.6.20 How does the accounting acquirer account for excess cost in a reverse asset acquisition?

Interpretive response: The approach outlined in Question 4.6.10 also applies to reverse asset acquisitions.

In reverse asset acquisitions, there may be instances in which cost, which includes the fair value of the hypothetical consideration transferred (see Question 3.3.20), exceeds the fair value of the net assets acquired (mainly attributed to cash or other financial assets).

Additionally, there may be few or no nonfinancial assets held by the legal parent (accounting acquiree). In that case, the difference between the cost and the fair value of the net assets acquired should be evaluated to determine whether there were other elements that should be accounted for separately. For example, a portion of the cost might be considered employee compensation or a cost to issue equity.

4.6.20 Contingent consideration when there is a bargain purchase amount

A bargain purchase amount could arise if the transaction includes only a small fixed payment and a potentially significant amount of contingent consideration that is not recognized at the acquisition date. In that circumstance, a question arises about how to measure the bargain purchase amount.

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Question 4.6.30 How does the acquirer measure a bargain purchase amount when contingent consideration is also included?

Interpretive response: Subtopic 805-50 does not specifically address this fact pattern, and we have observed diversity in practice. Some acquirers measure a bargain purchase amount by analogizing to the guidance in Topic 323 while others follow other US GAAP as described in section 3.5. We recommend that entities consult with their accounting advisers, auditors or the SEC staff before analogizing to Topic 323.

We believe this is an accounting policy election that an entity should apply consistently. If an entity has a previous accounting policy, it needs to follow Topic 250 (accounting changes and error corrections) to change its policy, including demonstrating that the change is preferable. [250-10-45-2]

Analogy to Topic 323

While some entities analogize to the Topic 323 guidance on recognizing contingent consideration in the acquisition of an equity method investment, this analogy is not appropriate if the contingent consideration is in the scope of Topic 815, in which case the liability should be recorded at fair value.

Under this analogy, when there is a bargain purchase amount and the agreement includes contingent consideration, the acquirer recognizes a liability equal to the lesser of: [323-10-35-2A, 55-2B]

- the maximum amount of contingent consideration; or
- the excess of the fair value of the net assets acquired over the initial consideration paid (e.g. the bargain purchase amount).

This liability reduces the bargain purchase amount initially allocated to the assets acquired.

When the contingency is ultimately resolved, any additional contingent consideration issued or issuable over the amount that was initially recognized as a liability is considered an additional cost of the acquisition. We believe this additional amount should be allocated to the qualifying assets on a relative fair value basis (see Question 4.8.10). [323-10-35-14A]

Apply other US GAAP

Alternatively, an acquirer may elect not to analogize to Topic 323 and follow other US GAAP, as described in section 3.5. Even though this approach results in a greater bargain purchase amount, we believe it is also acceptable because that amount is allocated to the assets acquired, rather than recognized as a bargain purchase gain.

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Example 4.6.10 Asset acquisition where fair value exceeds cost#

ABC Corp. acquires a group of assets in an asset acquisition for $8,000 cash and additional consideration up to a maximum of $1,500 contingent on the successful commercial development of technology.

To determine the appropriate characterization and recognition of the contingent consideration, ABC first determines whether the contingent consideration is in the scope of Topic 815. If it is in scope, it is initially measured at fair value (i.e. included in the cost of the asset acquisition) and marked to market at each reporting date.

While the arrangement may meet the definition of a derivative, an instrument qualifies for the scope exception from derivative accounting in subparagraph 815-10-15-59(b) when (1) the financial instrument is not exchange traded, (2) the underlying is a unique, nonfinancial asset, and (3) the nonfinancial asset related to the underlying is owned by the party that would not benefit under the contract from an increase in the fair value of the nonfinancial asset.

In this example, ABC concludes that the contingent consideration agreement is not exchange traded, and the underlying asset (the technology) is a uniquely identifiable nonfinancial asset whose value is most affected by commercial success. ABC does not benefit under the settlement terms of the contingent consideration arrangement from an increase in the fair value of the asset; this is because the contract requires ABC to pay additional amounts to the seller upon successful commercialization, and ABC concludes that successful commercialization would increase the value of the underlying asset (i.e. the seller benefits because it receives the payment). In addition, the successful commercial development milestone relates to operations or activities of ABC. Therefore, after adoption of ASU 2025-07, the contingent payment would also qualify for the scope exception in subparagraph 815-10-15-59(e) for non-exchange-traded contracts that have underlyings based on operations or activities specific to one of the parties to the contract.

Therefore, ABC concludes that the contingent consideration is not in the scope of Topic 815. Accordingly, ABC determines that the contingent consideration is in the scope of Topic 450.

At the time of the acquisition, ABC determines that the occurrence of the future event is not probable. ABC determines that the fair value of the assets acquired is $10,000, consistent with the highest and best use of the assets by market participants.

Deferred income taxes and transaction costs are not considered in this example.

The fair values of the assets acquired are as follows.

	Fair value
Inventory	2,500
Equipment	4,000
Tradename	1,500
IPR&D	2,000

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The fair value of the acquired assets ($10,000) is greater than the cash cost excluding contingent consideration ($8,000). ABC does not have a policy for these types of transactions and can choose from the approaches in Question 4.6.30.

Approach 1: Analogy to Topic 323

ABC records a liability equal to the lesser of the maximum amount of contingent consideration ($1,500) or the bargain purchase amount excluding the contingent consideration ($2,000). In this case, a liability is recorded for $1,500.

ABC allocates the bargain purchase amount of $500 ($2,000 - $1,500) to all of the assets acquired except inventory (see Question 4.6.10).

	Fair value	Relative fair value %	Allocation of bargain purchase	Amount to record
Equipment	4,000	53.3%	(267)	3,733
Tradename	1,500	20.0%	(100)	1,400
IPR&D	2,000	26.7%	(133)	1,867
Totals	7,500	100.0%	(500)	7,000

ABC records the following journal entry.

	Debit	Credit
Inventory	2,500	
Equipment	3,733	
Tradename	1,400	
IPR&D asset	1,867	
Cash		8,000
Liability to sellers		1,500
To record acquisition of assets.		

The $1,867 allocated to IPR&D is expensed immediately if it has no alternative future use.

	Debit	Credit
R&D expense	1,867	
IPR&D asset		1,867
To record R&D expense for IPR&D.		

Approach 2: Apply other US GAAP

ABC does not initially recognize a liability for contingent consideration. ABC allocates the $2,000 bargain purchase amount to all of the assets acquired except inventory (see Question 4.6.10).

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	Fair value	Relative fair value %	Allocation of bargain purchase	Amount to record
Equipment	4,000	53.3%	(1,067)	2,933
Tradename	1,500	20.0%	(400)	1,100
IPR&D	2,000	26.7%	(533)	1,467
Totals	7,500	100.0%	(2,000)	5,500

ABC records the following journal entry.

	Debit	Credit
Inventory	2,500	
Equipment	2,933	
Tradename	1,100	
IPR&D asset	1,467	
Cash		8,000
To record acquisition of assets.		

The $1,467 allocated to the IPR&D is expensed immediately if it has no alternative future use.

	Debit	Credit
R&D expense	1,467	
IPR&D asset		1,467
To record R&D expense for IPR&D.		

Example 4.6.15 Contingent consideration is the only consideration#

ABC Corp. acquires a group of assets comprising a single IPR&D asset and inventory in an asset acquisition. The only potential consideration in the arrangement is a payment of $250 on the successful commercial development of the IPR&D.

To determine the appropriate characterization and recognition of the contingent consideration, ABC first determines whether the contingent consideration is in the scope of Topic 815. If it is in scope, it is initially measured at fair value (i.e. included within the cost of the asset acquisition) and marked to market at each reporting date.

While the arrangement may meet the definition of a derivative, an instrument qualifies for the scope exception from derivative accounting in subparagraph 815-10-15-59(b) when (1) the financial instrument is not exchange traded, (2) the underlying is a unique, nonfinancial asset, and (3) the nonfinancial asset

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related to the underlying is owned by the party that would not benefit under the contract from an increase in the fair value of the nonfinancial asset.

In this example, ABC concludes that the contingent consideration agreement is not exchange traded, and the underlying asset (the IPR&D) is a uniquely identifiable nonfinancial asset whose value is most affected by commercial success. In addition, ABC does not benefit under the settlement terms of the contingent consideration arrangement from an increase in the fair value of the asset because the contract requires ABC to pay additional amounts to the seller upon successful commercialization and ABC concludes successful commercialization would increase the value of the underlying asset (i.e. the seller benefits because it receives the payment).

In addition, the successful commercial development milestone relates to operations or activities of ABC. Therefore, after adoption of ASU 2025-07, the contingent payment would also qualify for the scope exception in subparagraph 815-10-15-59(e) for non-exchange-traded contracts that have underlyings based on operations or activities specific to one of the parties to the contract.

Therefore, ABC concludes that the contingent consideration is not in the scope of Topic 815. Accordingly, ABC determines that the contingent consideration is in the scope of Topic 450.

At the date of acquisition, ABC determines that a successful commercial development of the IPR&D is not probable.

The following are the fair values of the assets acquired.

	Fair value
Inventory	5
IPR&D	95

The fair value of the acquired assets ($100) is greater than the cash cost excluding contingent consideration ($0). ABC does not have a policy for these types of transactions and can choose from the approaches in Question 4.6.30.

Approach 1: Analogy to Topic 323

ABC recognizes a liability of $100, which is the lesser of the maximum amount of the contingent consideration ($250) or the bargain purchase amount excluding contingent consideration ($100). ABC allocates the cost to the assets on a relative fair value basis and records the following.

	Debit	Credit
Inventory	5	
IPR&D asset	95	
Liability to Seller		100
To recognize acquisition of assets.		

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The IPR&D asset is expensed immediately if it has no alternative future use.

	Debit	Credit
R&D expense	95	
IPR&D asset		95
To recognize R&D expense for IPR&D.		

Approach 2: Apply other US GAAP

ABC does not initially recognize a liability for contingent consideration. ABC allocates the $100 bargain purchase amount to the assets as follows (see Question 4.6.10).

- ABC allocates the bargain purchase amount to IPR&D to the extent of its fair value of $95.
- ABC allocates the remaining $5 to inventory because the measurement basis of inventory will not require ABC to immediately recognize a gain or loss.

As a result, ABC does not recognize IPR&D and inventory at the time of acquisition.

Example 4.6.20 Asset acquisition where cost exceeds fair value

Parent acquires Subsidiary in a nontaxable transaction. Subsidiary owns a hotel property. Parent pays $505,000 in cash and incurs $80,000 of acquisition-related costs. The transaction is an asset acquisition.

As of the acquisition date, Subsidiary has the following net assets.

	Book and tax basis	Fair value
Cash	10,000	10,000
Land	50,000	80,000
Building	650,000	700,000
Other fixed assets	20,000	20,000
Accounts payable	(5,000)	(5,000)
Debt	(300,000)	(300,000)
Equity	(425,000)	(505,000)

Although the cost of $585,000 (cash $505,000 + acquisition related costs $80,000) is greater than the fair value of the net assets acquired ($505,000), the excess is not recorded as goodwill. Instead, the excess is allocated only to nonfinancial assets (see Question 4.6.10) on a relative fair value basis.

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The excess of $80,000 ($585,000 - $505,000) is allocated as follows.

	Fair value	Relative percentage	Allocated excess	Total allocated value
Land	80,000	10.0%	8,000	88,000
Building	700,000	87.5%	70,000	770,000
Other fixed assets	20,000	2.5%	2,000	22,000
Total	800,000	100.0%	80,000	880,000

See Example 4.7.10 for an illustration of the recognition of deferred taxes for this asset acquisition.

4.7 Deferred taxes

Temporary differences acquired in an asset acquisition are accounted for under Topic 740 (income taxes). Fundamentally, the accounting for deferred taxes in an asset acquisition is the same as in a business combination. However, because neither goodwill nor a bargain purchase gain is recognized in an asset acquisition, recognizing deferred tax assets or liabilities for temporary differences in an asset acquisition results in adjusting the carrying amount of the related assets and liabilities. [740-10-25-49 – 25-55]

There are significant nuances to accounting for deferred taxes in an asset acquisition that are not addressed in this publication. For further discussion, see section 10 of KPMG Handbook, Accounting for income taxes.

Question 4.7.10 How are deferred taxes for temporary differences measured in an asset acquisition?

Interpretive response: If the cost differs from the tax bases of the assets acquired and liabilities assumed, the simultaneous equations method is used to calculate the deferred tax assets and liabilities and the resulting adjustments to the related assets' and liabilities' carrying amounts. [740-10-25-50 – 25-52, 55-170 – 55-201]

The following factor is applied to each initial temporary difference to calculate the amount of the deferred tax asset or liability and the corresponding adjustment to the carrying amount of the related asset or liability.

Factor = Tax rate ÷ (1 – Tax rate)

However, if an acquirer recognizes a valuation allowance on an acquired deferred tax asset at the time of the asset acquisition, we believe the simultaneous equation should not be used to calculate the deferred tax asset and the related valuation allowance. The valuation allowance is generally

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recognized separately from the accounting for the purchase. For further discussion, see section 10 of KPMG Handbook, Accounting for income taxes.

Example 4.7.10 Asset acquisition where cost exceeds fair value, including deferred taxes

Continuing Example 4.6.20, the last step to finalize the accounting for the asset acquisition is to recognize deferred taxes. Subsidiary is a C corporation for tax purposes, and the acquisition is nontaxable. The initial temporary differences are future taxable amounts of $38,000, $120,000 and $2,000 for the land, building, and other fixed assets, respectively.

Assuming a tax rate of 21%, a factor of 0.265822 (21% ÷ (1 - 21%)) is applied to the initial temporary differences, resulting in deferred tax liabilities of $10,101, $31,899 and $532 for the land, building and other fixed assets respectively. These amounts are added to the initial carrying amounts of the assets to arrive at their final carrying amounts of $98,101, $801,899 and $22,532 respectively.

The steps are shown in the following table.

	Tax basis	Initial carrying amount	Initial temporary difference	Factor	Deferred tax liability	Final carrying amount
Land	50,000	88,000	38,000	.265822	10,101	98,101
Building	650,000	770,000	120,000	.265822	31,899	801,899
Other fixed assets	20,000	22,000	2,000	.265822	532	22,532
Totals	720,000	880,000	160,000	.265822	42,532	922,532

Parent checks that these amounts have been calculated correctly by multiplying the final temporary differences by the tax rate.

	Tax basis	Final carrying amount	Final temporary difference	Tax rate	Deferred tax liability
Land	50,000	98,101	48,101	21%	10,101
Building	650,000	801,899	151,899	21%	31,899
Other fixed assets	20,000	22,532	2,532	21%	532
Totals	720,000	922,532	202,532	21%	42,532

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4.8 Subsequent accounting

Excerpt from ASC 805-50

> Accounting After Acquisition

35-1 After the acquisition, the acquiring entity accounts for the asset or liability in accordance with the appropriate generally accepted accounting principles (GAAP). The basis for measuring the asset acquired or liability assumed has no effect on the subsequent accounting for the asset or liability.

The acquirer subsequently accounts for the assets and liabilities under appropriate US GAAP. The subsequent accounting is not affected by the basis for the initial measurement of the asset acquired or liability assumed. [805-50-35-1]

Question 4.8.10 When a liability for contingent consideration is recognized/adjusted after the acquisition date, how does the acquirer recognize the additional cost?#

Interpretive response: If a contingent consideration arrangement is in the scope of Topic 815, any changes in fair value are reported currently in earnings, rather than adjusting the carrying amount of the acquired assets. [815-10-35-2]

If contingent consideration not in the scope of Topic 815 is recognized subsequent to the acquisition date (e.g. because payment of the contingent consideration becomes probable), the additional cost is allocated to the assets acquired generally following the approach described in Question 4.6.10. We believe it is appropriate to use the assets' fair values as of the original acquisition date, consistent with the general principle that cost is allocated to the assets acquired based on their relative fair values at the acquisition date. [805-50-30-3]

If a liability for contingent consideration that does not meet the definition of a derivative is subsequently reduced (or an asset is recognized for refundable contingent consideration), the acquirer reduces the carrying amounts of the acquired assets, following the approach described in Question 4.6.10.

In our experience, contingent consideration not in the scope of Topic 815 is generally recognized as a period cost when incurred if it is in the form of a sales- or usage-based royalty where each sale or use over the life of the asset requires an additional payment. However, depending on the payment terms and nature of the asset, capitalization of payments characterized as a royalty may be appropriate.

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Question 4.8.20 Is additional cost allocated to acquired IP capitalized if the IP was considered IPR&D at the acquisition date?

Interpretive response: It depends. We believe it is appropriate to capitalize the additional cost allocated to acquired IP if the R&D project is complete when the additional cost is incurred and otherwise meets the definition of an asset.

In contrast, if the additional cost is incurred before the R&D project is complete, the additional cost would continue to be expensed, unless the asset has an alternative future use.

Our view is based on an SEC staff speech that addressed allocating contingent consideration to acquired technology in business combinations accounted for under a cost accumulation model. In that speech, the staff indicated that amounts allocated to acquired technology should not be expensed as IPR&D unless the related technology remains in the R&D phase when the contingent consideration is recognized. [1995 AICPA Conf]

For example, when an acquirer of a drug candidate obtains final FDA approval that triggers a milestone payment to the seller, it recognizes a liability and allocates the additional cost to the acquired assets based on the relative fair value allocation at the acquisition date as described in Question 4.6.10. The amount allocated to the acquired technology is capitalized, because it is no longer IPR&D.

Example 4.8.10 Allocating contingent consideration when the contingency is resolved#

ABC Corp. acquires a group of assets in an asset acquisition for $8,000 cash and additional consideration up to a maximum of $4,000 contingent on successfully developing acquired technology into a marketable product.

To determine the appropriate characterization and recognition of the contingent consideration, ABC first determines whether the contingent consideration is in the scope of Topic 815. If it is in scope, it is initially measured at fair value (i.e. included within the cost of the asset acquisition) and marked to market at each reporting date.

While the arrangement may meet the definition of a derivative, an instrument qualifies for the scope exception from derivative accounting in subparagraph 815-10-15-59(b) when (1) the financial instrument is not exchange traded, (2) the underlying is a unique, nonfinancial asset, and (3) the nonfinancial asset related to the underlying is owned by the party that would not benefit under the contract from an increase in the fair value of the nonfinancial asset.

In this example, ABC concludes that the contingent consideration agreement is not exchange traded, and the underlying asset (the technology) is a uniquely identifiable intangible asset whose value is most affected by commercial success. In addition, ABC does not benefit under the settlement terms of the contingent consideration arrangement from an increase in the fair value of the asset because the contract requires ABC to pay additional amounts to the seller

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upon successful commercialization and ABC concludes successful commercialization would increase the value of the underlying asset (i.e. the seller benefits because it receives the payment).

In addition, the successful development milestone relates to operations or activities of ABC. Therefore, after adoption of ASU 2025-07, the contingent payment would also qualify for the scope exception in subparagraph 815-10-15-59(e) for non-exchange-traded contracts that have underlyings based on operations or activities specific to one of the parties to the contract.

Therefore, ABC concludes that the contingent consideration is not in the scope of Topic 815. Accordingly, ABC determines that the contingent consideration is in the scope of Topic 450.

At the time of the acquisition, ABC determines that the occurrence of the future event is not probable, and therefore it does not recognize a liability for the contingent consideration.

ABC determines that the fair value of the assets acquired is $10,000 consistent with the highest and best use of the assets by market participants.

Deferred income taxes and transaction costs are not considered in this example.

On the acquisition date, ABC recognizes the assets acquired based on their relative fair values, as follows.

	Fair value	Relative percentage	Allocated amount
Technology	7,000	70%	5,600
Tradename	2,000	20%	1,600
Equipment	1,000	10%	800
Totals	10,000	100%	8,000

At the acquisition date, the technology is IPR&D without an alternative future use, and therefore ABC expenses the $5,600 allocated to it.

One year after the acquisition, ABC has successfully developed the technology into a marketable product, which triggers the obligation to pay the additional $4,000 of consideration. Therefore, ABC recognizes an additional liability of $4,000.

ABC treats the additional contingent consideration as an additional element of cost and allocates the amount to all of the assets based on their relative fair values on the acquisition date.

	Fair value	Relative fair value %	Additional allocation
Technology	7,000	70%	2,800
Tradename	2,000	20%	800
Equipment	1,000	10%	400
Totals	10,000	100%	4,000

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ABC capitalizes the $2,800 allocated to the technology, because it is no longer IPR&D. ABC records the following journal entry.

	Debit	Credit
Technology	2,800	
Tradename	800	
Equipment	400	
Liability		4,000
To record additional consideration in asset acquisition.		

Question 4.8.30 Does the acquirer catch up depreciation when recognizing additional cost basis from contingent consideration after the acquisition date?

Interpretive response: We understand that practice in this area is mixed.

Some acquirers recognize depreciation and amortization on the incremental cost prospectively from the date those amounts are capitalized. The basis for this approach is by analogy to superseded guidance on accounting for purchase business combinations. [APB 16.80, FAS 141.31]

Alternatively, some acquirers 'catch up' the depreciation and amortization expense to the amounts the acquirer cumulatively would have recognized if the incremental cost had been recognized at the acquisition date. This approach is based on an analogy to current US GAAP on measurement period adjustments for business combinations. [805-10-25-17]

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Definitions

The following are select definitions from Topic 805.

Excerpts from ASC 805-10

Business

55-3A An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs, or other economic benefits directly to investors or other owners, members, or participants. To be considered a business, an integrated set must meet the requirements in paragraphs 805-10-55-4 through 55-6 and 805-10-55-8 through 55-9.

20 Glossary

Business Combination

A transaction or other event in which an acquirer obtains control of one or more businesses. Transactions sometimes referred to as true mergers or mergers of equals also are business combinations.

Equity Interests

Used broadly to mean ownership interests of investor-owned entities; owner, member, or participant interests of mutual entities; and owner or member interests in the net assets of not-for-profit entities.

Fair Value

The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Goodwill

An asset representing the future economic benefits arising from other assets acquired in a business combination or an acquisition by a not-for-profit entity that are not individually identified and separately recognized. For ease of reference, this term also includes the immediate charge recognized by not-for-profit entities in accordance with paragraph 958-805-25-29.

Joint Venture

An entity owned and operated by a small group of businesses (the joint venturers) as a separate and specific business or project for the mutual benefit of the members of the group. A government may also be a member of the group. The purpose of a joint venture frequently is to share risks and rewards in developing a new market, product, or technology; to combine complementary technological knowledge; or to pool resources in developing production or other facilities. A joint venture also usually provides an arrangement under which each joint venturer may participate, directly or indirectly, in the overall management of the joint venture. Joint venturers thus have an interest or relationship other than as passive investors. An entity that is a subsidiary of one of the joint venturers is not a joint venture. The ownership of a joint venture seldom changes, and its equity interests usually

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are not traded publicly. A minority public ownership, however, does not preclude an entity from being a joint venture. As distinguished from a corporate joint venture, a joint venture is not limited to corporate entities.

Noncontrolling Interest

The portion of equity (net assets) in a subsidiary not attributable, directly or indirectly, to a parent. A noncontrolling interest is sometimes called a minority interest.

The following excerpt from Topic 810 describes the usual condition for a controlling financial interest.

Excerpt from ASC 810-10

> Entities

15-8 For legal entities other than limited partnerships, the usual condition for a controlling financial interest is ownership of a majority voting interest, and, therefore, as a general rule ownership by one reporting entity, directly or indirectly, of more than 50 percent of the outstanding voting shares of another entity is a condition pointing toward consolidation. The power to control may also exist with a lesser percentage of ownership, for example, by contract, lease, agreement with other stockholders, or by court decree.

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Index of changes

This index lists the significant additions and changes made in this edition to assist you in locating recently added or updated content. The following symbols are used throughout this Handbook to indicate the types of revisions made in this edition:

** new item
# significant updates or revisions to the item

3. Cost of acquired assets

Question

Question 3.5.10 How does an entity account for contingent consideration?#

Example

Example 3.5.20 Contingent consideration in an asset acquisition – EBITDA-based earnout (after adoption of ASU 2025-07)**

4. Allocating the cost of an asset acquisition

Questions

Question 4.3.10 Does the acquirer reassess lease classification in an asset acquisition?#

Question 4.5.20 Is a right to receive a plaintiff's future cash flows recognized as an acquired asset?#

Question 4.8.10 When a liability for contingent consideration is recognized/adjusted after the acquisition date, how does the acquirer recognize the additional cost?#

Examples

Example 4.6.10 Asset acquisition where fair value exceeds cost#

Example 4.6.15 Contingent consideration is the only consideration#

Example 4.8.10 Allocating contingent consideration when the contingency is resolved#

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- Share-based payment
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- Statement of cash flows
- Tax credits
- Transfers and servicing of financial assets

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