

Case 16-9
Commitment to Share

BuyCo is a privately held technology developer and manufacturer in the transportation industry. On October 31, 20X1, BuyCo entered into an agreement with SellCo to purchase certain assets and assume certain liabilities of SellCo (the “Transaction”). BuyCo intends to incorporate the processes, economic resources, and technology acquired in the Transaction into its existing business to serve the transportation industry with energy-efficient solutions and provide a return to its shareholders. The assets and liabilities acquired meet the definition of a business as defined in ASC 805-10, *Business Combinations: Overall*.

Pursuant to the agreement, BuyCo will transfer to the owners of SellCo cash of \$2 million and 10 million shares of BuyCo common stock. BuyCo will also assume liabilities of \$4.5 million.

The terms of the agreement define the “liquidity event period” as the period beginning at the closing of the Transaction and ending on December 31, 20X2. If BuyCo undergoes an IPO during the liquidity event period, and the 10 million shares received by SellCo in the Transaction have a fair value of less than \$20 million, BuyCo would be required to issue up to 2 million additional shares of common stock such that the total fair value of shares held by SellCo equals \$20 million (the “Share Value Commitment”). BuyCo would have sufficient authorized and unissued shares to settle the Share Value Commitment, and BuyCo would be permitted to settle in unregistered shares. The agreement requires the Share Value Commitment to be settled in shares and under no conditions will BuyCo be required to settle the Share Value Commitment in cash. BuyCo has concluded that it is more likely than not that the number of shares required to settle the Share Value Commitment will be less than 2 million.

The Transaction closed on December 31, 20X1, at which time BuyCo legally obtained control over the purchased assets and assumed liabilities of SellCo. The fair value of BuyCo common stock was \$1.85 per share on October 31, 20X1, \$1.95 per share on December 31, 20X1, and \$1.90 per share on June 30, 20X2. BuyCo hired Entity E, a third-party valuation specialist, to determine the fair value of the Share Value Commitment. On the basis of the current fair value of BuyCo common stock, the guaranteed value of \$20 million, the probability of an IPO occurring during the liquidity event period, and other relevant valuation assumptions, Entity E estimated the fair value of the Share Value Commitment to be \$1.4 million, \$450,000, and \$1.2 million on October 31, 20X1, December 31, 20X1, and June 30, 20X2, respectively.

Required:

1. What is the total consideration transferred by BuyCo in the Transaction, and how should that consideration be measured?
2. How should the Share Value Commitment be reflected on the December 31, 20X1, balance sheet of BuyCo?
3. What journal entries, if any, are required to record the change in fair value for the Share Value Commitment between December 31, 20X1, and June 30, 20X2?