

Introduction

There are a few simple points to this book. The first point is that for the past few decades there has been little change in financial statement representations in private acquisition agreements. Based on recent history, however, there is reason to believe that there may be room for change within these representations. The reasons for these changes reflect changes in GAAP, changes in theories related to corporate finance and valuation, and changes in attitudes concerning responsibility for information risk.

The second point is that financial statement representations should be based on relevant financial accounting information. The information that is most likely to be relevant is that information on which the buyer bases its valuation assessment. This information is likely to vary based on the valuation technique utilized by the buyer.

As a third point, attorneys need to have a basic understanding of the concepts related to both valuation and financial accounting in order to ensure that financial accounting provisions in acquisition agreements relate to information that is relevant. In short, attorneys need to know what is relevant from a valuation perspective and whether or not that relevant information is adequately covered by “typical” financial accounting provisions. While attorneys should not be expected to master these subjects, some knowledge is necessary to ensure that they are able to prepare documents that conform with their client’s expectations.

To discuss such matters knowledgeably with their clients, attorneys need to understand the purpose for financial representations, commonly used valuation techniques, and areas within GAAP that require supplementation in light of each of the foregoing. In short, this book is an attempt to assist attorneys in opening the lines of communication between those drafting acquisition agreements and their clients.

Because acquisition transactions each have their own unique characteristics, it is not possible to craft a “one size fits all” set of financial accounting provisions. It is, however, possible to ensure that attorneys drafting these provisions have a basic understanding of the key issues within these provisions and the ability to communicate effectively with valuation and accounting professionals to ensure that they are able to draft financial accounting provisions that both achieve their client’s goals and work well within the context of the broader agreement.

In order to achieve these goals, this book presents a number of issues relevant to valuation, financial accounting and drafting acquisition agreements. Given this broad scope (multiple volumes have been written with respect to each of these topics), this book should not be viewed as a comprehensive resource, but should be useful to practitioners in indentifying issues that are likely to be confronted in the context of drafting financial accounting provisions. Additionally, footnotes have been included, so that the reader can readily seek more detail on a particular topic.

As noted below, areas of financial accounting and valuation are continually evolving and it is anticipated that some of the more specific accounting principles cited in this text will continue to change as time passes. With that being said, the reader should realize that the underlying concepts are going to remain important, notwithstanding the changes to the underlying accounting rules. In other words, the footnotes are included as a point of reference for those readers interested in digging further, but any reader should feel comfortable that reading the book without any reference to the footnotes should still allow the reader to achieve the goal of obtaining a better understanding of the concepts and issues that must be considered in drafting financial accounting provisions.

To further assist the reader, the book offers “questions” to be discussed among attorneys, clients, and valuation and accounting professionals. After having a general understanding of the underlying issues covered in the book, an attorney preparing to draft an acquisition agreement will be better prepared to have a more meaningful discussion--even if the attorney has not previously had deep exposure to issues related to valuation or financial accounting.

As with most tasks involving client counseling, a better result is likely when counsel and client are able to have a complete discussion of the client's goals and how to achieve them. The sample questions should be useful in ensuring that client and attorney have alignment on these issues, but that alignment will be more readily achieved when the attorney better understands the conceptual framework underlying the various questions.

In general, this book is an effort to help attorneys ensure alignment with their clients with respect to these issues. The key point of this book is that drafting financial accounting representations in acquisition agreements is a dynamic process that requires substantial interaction between the drafting attorneys and the client's financial advisors. The ultimate form of the financial accounting representations will vary based on a number of factors including: the structure of the acquisition, the applicable valuation techniques, the nature of the subject business, the bargaining strength of the parties, and the ability of the attorneys to successfully communicate with their client and their client's financial advisors.

Because these factors can combine to create an almost infinite number of permutations, there is no standard set of financial accounting representations that will work for every acquisition. In this regard, it is also important to note that in a single year, it is not unusual for as many as 10,000 private party acquisitions occur and the transaction terms from the vast majority of these transactions never become public.¹ As a result, it would be very difficult for even very active participants in this market to have a firm grasp on what is "standard", "market" or "commercial" in a meaningful percentage of these transactions. As such, those involved in private acquisitions need to be prepared to tailor acquisition documents to specific transactions and should not assume that it is safe to defer to some perceived standard. Effective communication between professionals involved in acquisitions is critical to ensuring that such documents can be so tailored.

This book's goal is to focus on communication and to explain some of the concepts underlying valuation techniques and financial accounting provisions, so that attorneys will be able to communicate more effectively and avoid situations like those laid out in the hypothetical involving "Big Cable" beginning in Section 1.1.

1. For the years 2009 through 2011, it was not unusual for 2,300 transactions per quarter to occur with values between \$5 and \$500 million. *See., e.g.*, Special Report: M&A Trends & Insight for Lawyers Full Year 2011, Thomson Reuters Accelus (available at: <http://meetings.abanet.org/webupload/commupload/CL560002/relatedresources/MAQ4.pdf>).