

B. Deleted by SAB 103

C. Deleted by SAB 103

D. Financial Statements of Oil and Gas Exchange Offers

Facts: The oil and gas industry has experienced periods of time where there have been a significant number of "exchange offers" (also referred to as "roll-ups" or "put-togethers") to form a publicly held company, take an existing private company public, or increase the size of an existing publicly held company. An exchange offer transaction involves a swap of shares in a corporation for interests in properties, typically limited partnership interests. Such interests could include direct interests such as working interests and royalties related to developed or undeveloped properties and indirect interests such as limited partnership interests or shares of existing oil and gas companies. Generally, such transactions are structured to be tax-free to the individual or entity trading the property interest for shares of the corporation. Under certain circumstances, however, part or all of the transaction may be taxable. For purposes of the discussion

in this Topic, in each of these situations, the entity(ies) or property(ies) are deemed to constitute a business.

The fundamental accounting issues in exchange transactions involve determining the basis at which the properties exchanged should be recorded and deciding what prior financial results of the entities should be reported. In this regard, Statement 141 specifies that a business combination be accounted for using the purchase method. Statement 141 speaks specifically to business combinations between nonaffiliated enterprises. When affiliated enterprises (under common control) are involved, the guidance in paragraphs D11–D13 of Statement 141 should be followed. In particular, paragraph D12 states:

When accounting for a transfer of assets or exchange of shares between entities under common control, the entity that receives the net assets or the equity interest shall initially recognize the assets and liabilities transferred at their carrying amounts in the accounts of the transferring entity at the date of transfer.

Paragraph D13 states:

The purchase method of accounting shall be applied if the effect of the transfer or

exchange * * * is the acquisition of all or a part of the noncontrolling equity interests in a subsidiary.

The staff has developed administrative policies which it has followed with respect only to the financial statements of oil and gas exchange offers included in filings with the Commission and the conclusions expressed in this Topic should not be analogized to other circumstances.

Question 1: What are the staff's general guidelines in determining the appropriate basis of accounting in an exchange transaction?

Interpretive Response: The staff believes the basis of accounting should be determined pursuant to the provisions of Statement 141, if it is applicable. Accordingly, where unrelated parties are involved, it is appropriate to apply purchase accounting based on the fair value of either the stock issued or the properties involved.

The following chart shows the method of accounting to be used under some relatively simple sets of circumstances.

ACCOUNTING—BASED ON STATUS OF ISSUING ENTITY

Condition	Public company ¹	Non-public company ²
High degree of common ownership or common control between issuing corporation and offerees ³ .	Purchase accounting based on fair value of stock ⁴ .	Entities under common control—carry-over basis
All other, <i>i.e.</i> , without common ownership or control.	Purchase accounting based on fair value of stock.	Purchase accounting based on fair value of properties.

¹ Issuing corporation is an existing public company before the exchange offer with an established market for its stock (includes situations involving use of a shell company established by a public company).

² Issuing corporation is not public prior to the exchange offer and thus has no established market for its stock.

³ Common control ordinarily exists where the issuing corporation acts as general partner for the offeree partnership(s). Where all the following conditions apply, common control will be considered to exist between the issuing corporation and the offerees even though the issuer does not exercise the same legal powers as a general partner:

- The issuer or its survivor initially acquired the property for exploration and development *and*
- Other investors were of a passive nature, solicited to provide financing with the hope of a return on their investment, and
- The issuer or its survivor has continued to exercise day-to-day managerial control.

⁴ In rare instances, such as when the property interest owners accepting the exchange offer acquire a majority of the voting shares of the company emerging from the exchange transaction, reorganization accounting may be considered appropriate. In such cases, the particular facts and circumstances should be reviewed with the Commission staff.

This chart reflects the staff's view that purchase accounting is generally appropriate except in situations where the principles for transactions involving common control apply. When a non-public entity acts as offeror to a group of related entities, the transaction is essentially a reorganization, and thus there is no basis for a change in the cost basis of the properties involved. If an existing public company (with an established market for its stock) has common ownership or control with the offerees, and the offerees acquire a majority interest in the emerging company, a question may arise as to

whether the transaction is a reorganization.

Question 2: In some situations, a non-public issuer may be affiliated with some but not all of the offerees. Assuming the nonaffiliated offerees are not deemed "co-promoters" of the new entity, how should such a transaction be accounted for?

Interpretive Response: The property interests acquired from affiliated and nonaffiliated parties should each be accounted for as though acquired in separate exchange offer transactions. Thus in some circumstances, it may be necessary to record the interests owned by affiliated persons at predecessor cost

while recording the interests of nonaffiliated persons as a purchase.

Example: Facts—D Company (a non-public company) forms a shell, E Company, to become its successor and to sponsor an exchange offer. E makes the exchange offer to four entities: A, B, C and D. A and B are unaffiliated; C is a limited partnership sponsored by D. The shareholders of D will become the principal or controlling shareholders of E.

Basis of Accounting—Since there is no market for E's stock, it should record the properties received from C and from D at their predecessor cost. The properties received from A and B