The Problems of Stage Acquisition Under the New Consolidation Accounting Standards

James G.S. Yang, Department of Accounting and Finance Montclair State University, Montclair, NJ, USA
Frank J. Aquilino, Department of Accounting and Finance Montclair State University, Montclair, NJ, USA

ABSTRACT

This article discusses some important components of how the accounting standards of consolidated financial statements have changed under FASB Nos. 141R and 160. Goodwill consists of both the parent and the noncontrolling interest. Noncontrolling interest includes goodwill and is treated as equity, rather than a liability. Consolidation is based on the fair value of the subsidiary’s net assets. If the parent acquired the subsidiary in multiple stages, the accounting method may have to change from the cost method to the equity method. And, any gains or losses from the previous investment must be recognized. After the controlling interest is reached, consolidation is required and goodwill is established. Any disposition of an investment in a subsidiary is treated as an equity transaction. This article emphasizes the complexity of stage acquisition.

KEYWORDS


INTRODUCTION

The subject of consolidated financial statements went through a revolutionary change under FASB Nos. 141R and 160 in 2009. It contains many important elements. Goodwill represents not only the parent’s share, but also the noncontrolling interest’s portion. Logically, the noncontrolling interest is now measured to include goodwill as well. It is no longer treated as a liability, but equity. The consolidation is performed on the basis of the fair value of the subsidiary’s net assets, which can in turn be inferred from the parent’s cost of investment. The parent may acquire the subsidiary in multiple stages. As the ownership increases, the accounting method in recognizing the investment income from the subsidiary is required to change from the cost method to the equity method. At that time the gain or loss from the previous investments must be updated and recognized. The computations can become very complicated. After the parent’s ownership has reached a controlling interest, consolidation becomes necessary and goodwill is established. Thereafter, any disposition of parent’s investment in the subsidiary is now treated as an equity transaction, rather than an ordinary sale of stock. As a result, the consolidated financial statements truly reflect a comprehensive “economic unit” of an enterprise. This article is intended to investigate these aspects. The emphasis is placed on the problems of stage acquisition. Examples provide for illustrative purposes.

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LITERATURE REVIEW

The subject of consolidated financial statement is quite old. It did not change much until the last few years. Rees and Janes (2012,) provided the most detailed review of the literature in the past. It started in 1944 under Accounting Research Bulletin (ARB) 24 Chapter 5, paragraphs 6, 8 and 9. At that time, it was concerned with only the purchased goodwill. The asset value solely depends on the price paid and may not be amortized until it has been impaired. In other words, no amortization period was specified.

In 1970 under APB No. 16, paragraphs 18-20, it provided that any goodwill must be amortized over no more than 40 years. In 2001 under FASB No. 141, paragraph 7, it provides that goodwill is not amortized but subject to an impairment test. It means there is no amortization period. Goodwill can go on forever, unless it has been impaired. Lange and Formaro (2014,) offer the most comprehensive review.

Up to this point, goodwill represents only the parent company, but not the noncontrolling interest. In 2009 under FASB No. 141R, paragraph 34, the measurement of goodwill now must include not only the parent but also the noncontrolling interest. PriceWaterhouse provides many examples to show how to determine goodwill in real-world practice. It shows that goodwill is an intangible asset that can bring in profit for the entire enterprise, but cannot be identified. The concept of consolidation is shifted from the parent company theory to the entity theory. In terms of amortization period, it stays at an unlimited life. In other words, goodwill is only subject to the impairment test when circumstance dictates.

In 2011 FASB issued ASU 2011-08. It allows the enterprise to perform a “qualitative test” to determine the likelihood that goodwill has indeed been impaired. In 2012 FASB further issued ASU 2012-02. It now requires the entity to conduct a “quantitative test” in determining whether goodwill has been impaired. Based on the result, the losses can be recognized.

In 2014 FASB further issued ASU 2014-02. It allows the private business entity to use an alternative period of 10 years for the amortization of goodwill. As it stands now, most public held enterprises are not required to amortize goodwill.

In the past decade, it was rather appalling to observe that the goodwill amortization period has been changing from zero to 40 years to zero again and finally to 10 years. It raises the question as to what guiding principle, if any, has the FASB been following. By the same token, it also clearly demonstrates the degree of complexity on the subject of goodwill.

In 2009 the entire subject of consolidation took a turn for the worse. Under FASB No. 141R, it changed the treatment of noncontrolling interest from a liability to equity. Bahnsen.et al (2008), pointed out the wrong treatment in the past. However, it leads to the concept that goodwill must include both the parent and the noncontrolling interest. Consequently, the noncontrolling interest must also include goodwill. Worse yet, if the parent acquired the subsidiary in many different stages, the consolidation process becomes even more complicated. That is where it stands now.

In 2008, Deloitte (2008) pointed out the problem of stage acquisition, stating that “an equity interest previously held in the acquire which qualified as a financial asset under IAS 39 is treated as if it were disposed of and reacquired at fair value on the acquisition date. Accordingly, it is remeasured to its acquisition-date fair value and any resulting gain or loss is recognized in profit or loss.”

It means that the acquirer may not obtain the controlling ownership until more than one stage of acquisition. If so, the value of investment must be remeasured at each acquisition date according to the fair value at that date. This remeasuring process at each stage of acquisition may result in a gain or loss. This amount of gain or loss must be recognized in Income Statement. How to figure out the gain or loss is a highly technical problem.

In 2015, Chartered Education (2015) further elaborated on the complexity of stage acquisition, providing that “Not all business combinations take place in one go. Sometimes a parent can acquire an entity in stages, which we call step acquisition. This takes place when an acquirer holds an existing
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