PURCHASE vs. ACQUISITION METHODS OF BUSINESS COMBINATIONS

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ABSTRACT

The fundamental accounting principles remains the same for purchase method and acquisition method, that is, upon business combination, the purchase price is first applied to cover the fair values of the identifiable assets and liabilities, any additional money is accounted for as goodwill. The difference is: purchase method employs a more discretionary purchase-price-allocation approach, while acquisition method employs a more market-driven recognition approach. [1]

The acquisition method is designed to improve the recognition and measurement of the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree. Although there are criticisms about the changes brought by SFAS No.141(R), such as the difficulty of estimating contingencies, controversy about treatment of In-Process Research and Development, and increased complexity of business combination, the revised acquisition method reflects FASB's goal of fair-value accounting. Under acquisition method, business combinations are reflected at full fair value and include non-controlling interests as well as contingencies. These changes are helpful to generate more faithful representation of intangible assets and goodwill, thus make the financial statements more relevant and transparent. Besides, the new requirements are consistent with standards established by IASB and promote the global harmonization.[2]

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[1] Kang Cheng, Another Step Toward Global Convergence, The Journal of Corporate Accounting & Finance September/October 2008, page 35
[2] John A. Simon, Editor's Perspective—New Accounting Standards Require Expertise from Remediation Professionals; Remediation Journal, Volume 19, Issue 1, 19 Dec 2008, page 4

However, fancier goods usually cost more. Will the accounting reporting and auditing costs increase if companies adopt the revised acquisition method? If the costs do increase, will the benefits overweigh the costs? Future research may take a look at this question and provide more reliable advice to the accounting standards board.