

Business acquisitions

Finance



Business Acquisitions Accounting Methods GAAP (Generally Accepted Accounting Principle) acknowledges several accounting methods for an investing corporation. This can be Fair-value method or Equity method. In addition to these two, is the Consolidation formula for the reporting stands (Sevin, S., Schroeder, R., 2005). All the three methods are great in their application which is majorly determined by the control which Big Co. will have on the three companies it has ownership. The best method which will suit Big Co. in handling its accounting systems will be the Equity method as far as its relationship with Small Co is concerned. This is primarily because the Big Co. only has a noticeable control of the Small Co. (3000share of the 10000 share is a considerable control). For the case of Little Co., Big Co. has a fairly small control which amounts to about one percent of the issued (i. e. owns 1000 shares of the 10000 shares) stock. For this reason, Fair value accounting formula will be employed in treating the accounts work that relates the two companies. Considering the case in Tiny Co., Big Co. has total control on this company and hence the method of consolidation of the accounts will be used. The relationship between Big Co. and Tiny Co. will be viewed as one business. The three methods will be applied as has been outlined mainly because of the voting control Big Co. has on each of them.

Journal Entries The ownership which Big Co. has on Little Co. of about 1%, the accounting will be guided entirely by fair value method. This is reflected right away from the journal entries which are the original books of accounts where transactions are recorded as they occur. The journal entries describing the transactions between Big Co. and Small Co. will be directed by the stipulations of equity method. All these transactions are as outlined below in the following tables. Transaction between Big Co. and Little Co Date

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Description Debit Credit N/A Common stock (investment A/C – Little Co.) \$ 115, 000 Ownership in Little Co. (Big Co. Cash A/C) \$ 115, 000 N/A Income A/C (Dividends paid by Little Co. to Big Co.) \$ 200 Cash A/C (of Big Co.) \$ 200

Transaction between Big Co. and Small Co Date Description Debit Credit N/A Common stock (Investment A/C - Small Co.) \$ 300, 000 Cash A/C (of Big Co.) \$300, 000 N/A Inventory A/C (including markup) \$ 115, 000 Payments A/C (To cater for inventory) \$ 95, 000 Creditor A/C (pending Inventory payment to Small Co. \$ 20, 000 N/A Dividends A/C (33. 33% of Small Co.'s Income) \$ 150, 000 Debtor (unpaid dividends from Small Co.) A/C \$ 150, 000

These entries have fully accounted for the double entry system and assumptions have also been made. Firstly, it is assumed that for the transaction between Big Co. and Small Co., all dividends, which have not been paid, will be paid in full without any profits ploughed back. If that was the case, then according to the Equity method, the equity of Big Co. would have increased. The total equity of Small is assumed to be the issued 10, 000 as this gives 33. 33% ownership of Small Co. by Big Co.

Memorandum of Acquisition Businesses at some point do see the need to purchase other existing companies. This is mostly inline as to reduce risks as buying an existing business is really cheaper and less risky (Deloitte, 2009). Additionally, this increases the worth of the share of the buying company. For the same reasons, Big Co. wants to formally acquire Tiny Co. In this process, there are number of methods to use in acquiring Tiny Co. Other factors to consider also are the changes that have occurred in the acquisition of businesses. The way goodwill and financial statement presentations are affected and possible elimination that may occur between Big Co. and Tiny Co. is part and parcel of what this memorandum clarifies. In the acquisition standards, any business

combination is precisely treated as an acquisition. This position has been taken so that the accounting work can be simplified. This is indeed a break from the previous version which was referred to as purchase accounting. For this case the acquisition accounting will provide guidelines in acquiring Tiny Co. All the Financial statements will follow the criteria provided by the acquisition accounting as the acquisition was facilitated by the cash purchase of the Tiny stock. Tiny company has been purchased in full and hence its elimination is eminent. This though now depends solely on the decision of the Big Co. management. The elimination in this matter refers to change in controlling powers and management of Tiny Co. will fall under directives of the management from Big Co. Tiny company had an established goodwill which is its intangible asset. The pooling risks together method did not acknowledge goodwill but under the revised purchase model, all the assets are recognized irrespective of whether they are tangible or intangible (Dunse, N. A, Hutchison, N., Goodacre, A. 2004). CFO of Big Co. will have honor the fair value of the good will figure. References Deloitte,(2009). Business Combinations : A guide to IFRS 3. Available from: <http://www.deloitte.com/dtt/article/0,1002,cid%254D63411,00.html> Dunse, N. A, Hutchison, N., Goodacre, A. (2004). Trade-Related Valuations and the Treatment of Goodwill. *Journal of Property Investment & Finance*, 22(3), 236-258 Sevin, S., Schroeder, R. (2005). Earnings Management: Evidence from SFAS No. 142 Reporting. *Management Auditing Journal*, 22 (7), 674-687