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Accounting Treatment for Business Combinations: Phase II

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Abstract:

Purpose: *The purpose of the article is to review recent trends as it relates to the USGAAP and IFRS Business Combinations: Phase II.*

Design/Approach: *The researcher utilized a qualitative research method design study and a phenomenological research approach by examining the entity theory and the parent company theory which helps the researcher evaluate the financial statement consolidation under Business Combinations: Phase II.*

Findings: *One of the main findings that two steps exist in the business combinations process. The first step is the acquisition aspect of an entity and the second is the implication of transactional costs. The joint*

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collaboration effort of business combinations brought a higher financial reporting quality measurement and better guidance for accounting provisions (Heffes, 2005). Notably, a group of accounting standards setters known as the FASB, IASB, and International Accounting Standards Committee (IASC) mentioned that business combinations every 10 years was subject to change under the principles-based guidance.

Research Limitations: *The persisting issue when dealing with business combinations is how to recover and determine the right goodwill amount (Giner & Pardo, 2015). The goodwill impairment loss reported on the income statement provides a separate line item that mostly considers a one-time effect only for future performance. This is a relevant fact that engages the classification of the big bath accounting.*

Key Words: *Business Combinations, Entity Theory, Parent Company Theory, Goodwill, Big Bath Accounting, Intangible Assets, Impairment Assets, Translation of Currency, Amortization, Historical Cost, Fair Value*

1. Introduction

Since the 1800s, business organizations have found it attractive to combine their activities into a single entity. Historically, the international joint venture agreement has served as a bridge in accounting for two companies when dealing with business combinations. Business combinations, from an accounting perspective, focus mainly on three aspects: the treatment of accounting business combinations where a company acquires a second company, the segmentation and consolidation of a financial reporting position from a parent to a subsidiary company, and the translation of currency from a subsidiary to a parent company.

For example, as noted by Schroeder, Clark, and Cathey (2014), "Such terms as consolidation, combination, merger and purchase have all been used interchangeably even though they are not all the same, and some are subclassifications of others" (p. 550). In this section, out of the three aspects of business combinations mentioned previously, the first aspect

(i.e., consolidation) will be discussed in more depth. Accounting for multiple entities is not an easy subject of discussion, as it is complex in nature (Schroeder et al., 2014).

2. Review of Literature

Chronological Aspects of Business Combinations

In the classical era, from 1890 to 1904, companies operated under the Sherman Act that primarily consisted in acquiring materials at initial stage and selling the product at the end of the period by bringing vertical integration to the business managerial operations. In the 1920s, World War I ended and the creation of business combinations transaction contributed to the expansion of business operation. WWII ended in 1945 (Wyatt, 1963) and companies strengthened their business operations by diversifying their capital portfolios and investing in new technologies.

Additionally, other factors related to expanding the nature of business combinations included:

- Tax implications. The restructuring of foreign entities by acquiring assets and liabilities in the balance sheet and reorganizing a new line of business.
- Growth and expansion. The intent to acquire a new product by diversifying the same in different markets.
- Financial sustainability. Increase the assets in the balance sheet where the entity could finance additional operations through assets.
- Economies of scale. Created a higher level of competition.
- Profit and gains. Obtain high profitability margin and retire the business operations at an early stage.

The FASB presented two phases of business combinations to the IASB. The first phase was the presentation to both boards by evaluating

intangible assets, SFAS No. 141 and IFRS No. 3. The second phase of business combinations included a set of accounting principles to improve financial reporting performance by adding reliability, relevance, and accuracy into the financial statements (Schroeder et al., 2014).

In 2007, the FASB determined that business combinations should be reported at a fair value. The FASB's fair value definition was promulgated under ASC820 as Schroeder et al., (2014) "the amount for which an asset could be exchanged, or a liability could be settled, in an arm's-length process-should, be used to measure the assets in a business combination" (p. 557). This definition primarily focuses on setting the price of assets and liabilities in the settlement of a business combination. Presently, the definition has been revised and evaluated with new guidelines and can be found within FASB ASC805 (Schroeder et al., 2014).

Consolidation and Financial Reporting

The ultimate goal of consolidating the financial statements between a parent company and a subsidiary company is to have one set of reports. The parent company, throughout the consolidation process, has interest over a subsidiary company. The criteria for consolidating financial statements were written under Accounting Research Bulletin No. 51. The conditions and requirements of financial statement consolidation are illustrated as follows:

- The parent company should have majority voting rights with the acquisition and 51% of ownership.
- The parent company exercises majority control over a subsidiary company.
- If the subsidiaries are to be sold in the near future, they should not be included in the parent company's consolidation financial process.
- The parent and subsidiary companies should operate as one singular economic unit of business.

- In the fiscal year, the parent and subsidiary companies should consolidate the year end reports within 93 days of each other.

Accounting Research Bulleting No. 51 promotes two important provisions. The first provision is the orientation of the balance sheet where cannot be owned by the company or owe itself by eliminating assets and offsetting other liabilities. The second provision is the orientation of the income statement where the company cannot generate profits by selling to itself (Schroeder et al., 2014).

In 1991, the FASB defined control, as indicated by Schroeder et al. (2014), as "the power of one entity to direct or cause the direction of the management and operating and financing policies of another entity" (p. 558). In the same year, the FASB established policies and procedures of ownership when consolidating financial statements between a parent and subsidiary company. By late 2000, the FASB modified the exposure draft (ED) that was issued in 1991 and included four steps as a requirement:

1. The company affiliating its operational activities with a subsidiary should have applied SFAS No. 140 supported by FASB ASC860.
2. The limitation of power over one entity.
3. The benefit of permitting future investments with the ability to change the entity's power.
4. An entity evaluating financial activities in terms of time, nature, and volume should meet requirement number 3 mentioned above.

In May of 2008, the FASB and IASB began a collaborative effort to publish a joint discussion memorandum by aligning and improving financial reporting under the two standards. Therefore, it can be concluded that the ED reaffirmed that if a parent company has significant influence over a subsidiary, that constitutes absolute control (Schroeder et al., 2014).

Financial Reporting Theories

The two prominent financial reporting theories that exist under financial statement consolidation are entity theory and parent company. The main purpose of an *entity theory* is to provide relevant financial information to shareholders, and entities are required to report 100% of their assets and liabilities when a new company is acquired. Also, the net income reported in the income statement should meet the disclosure financial requirements under SFAS No. 160. On the other hand, the *parent company theory* mandates that the parent company disclose and report financial information to stockholders. Prior to the issuance of SFAS No. 160, the company had to compute assets in the balance sheet at historical cost and also under a fair value measurement. Therefore, the parent company theory was formulated under the proprietary theory where the net worth of equities section in the balance sheet can be viewed as assets – liabilities = proprietorship and the concern is the supportive foundation of the two theories (Schroeder et al., 2014).

In 2001, business combinations phase II became part of the IASB's agenda. The business combinations accounting treatment had experienced a significant divergence since its formation. Notably, a group of accounting standards setters known as the FASB, IASB, and International Accounting Standards Committee (IASC) mentioned that business combinations every 10 years was subject to change under the principles-based guidance. Once the IASB was established, the FASB completed SFAS No. 141, Business Combinations, with the intent of removing the pooling of interest method by replacing the amortization method of goodwill for impairment test. Major companies in the European Union (EU) and Australian markets requested that the IASB adopt in accounting books the treatment of accounting for goodwill under IFRS by placing entities reporting under USGAAP at a disadvantage (IASB, 2008).

The IASB split the project of business combinations into phases. The first phase of the project indicated the importance of consolidating the pooling of interests and goodwill by replacing IAS22 Business

Combinations. The second phase had a broader view and interpretation of business combinations. The IASB began to test the accounting aspects of the two phases by finding a parallel completion of tasks assigned. During the development of phase II, the IASB supported the FASB. The joint accounting business combinations project helped align the similarities and differences between IFRS3 and SFAS 141 by establishing a new accounting acquisition treatment method (IASB, 2008).

The IASB, during the course of completing phase I under business combinations, recommended that entities entering in a new joint venture business agreement should acquired assets and liabilities at the beginning; by either increasing the level of assets or reducing the amount of liabilities reported in the balance sheet.

In 2004, the IASB decided to incorporate the updated memorandum of understanding that was issued under IFRS3. At this point, the principles-based standard was highly likely accepted than rules-based standard and consistent with the results of a study conducted by Han and He (2013). Also, the guidance for accounting of mergers and acquisitions was not established as of yet. As a result, IAS22 considered the business combinations consolidation financial process by reshaping the original structure of IFRS3. The FASB and IASB agreed to have equivalent accounting standards by providing more opportunities under business combinations phase II by excluding all possible limitations (IASB, 2008).

Business Combinations Road Map Guidance

Figure 1 illustrates the equivalence of treating the revised IFRS3 as compared to US SFAS141(R). Also, a subsequent accounting method was amended by the IASB IAS27 as related to US SFAS160. The FASB and IASB accomplished a milestone by finding a singular reporting path when dealing with the alignment of financial statements as a result of mergers and acquisitions.

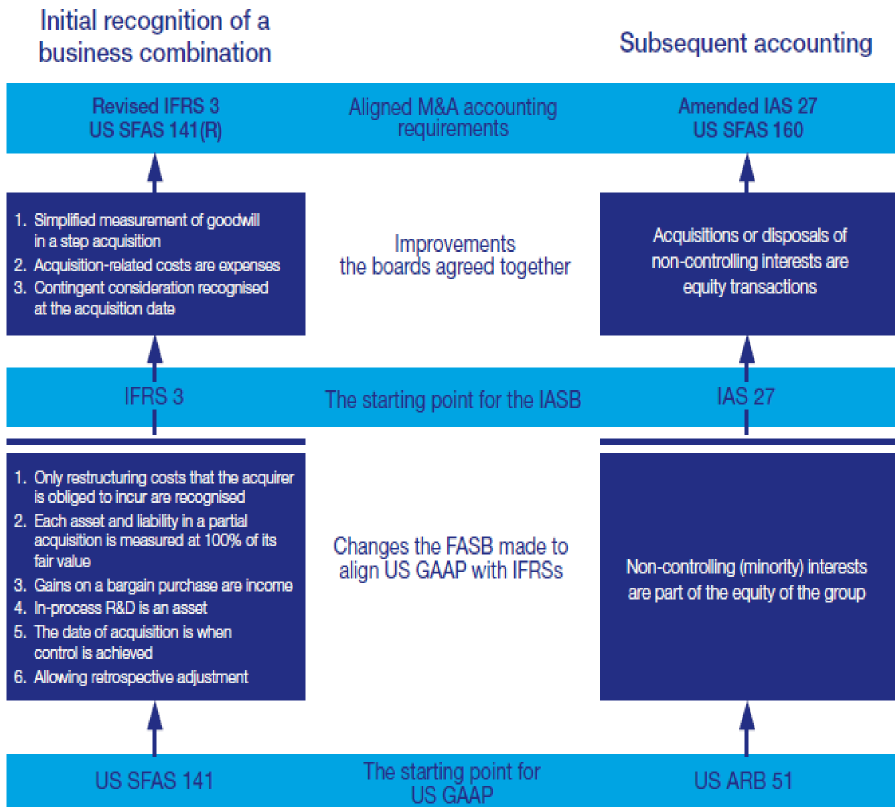

Figure 1. Why the business combinations project will lead to improved financial reporting. Source: IFRS website, p. 5.

In spite of the continuing development of business combinations phase II *Noncontrolling Interests in Consolidated Financial Statements*, the FASB issued SFAS 141(R) and SFAS 160, which are the equivalents to IFRS3 and IAS27. The main purpose under SFAS 141(R) was to promote the fair value method by establishing a new fundamental analysis for purchase accounting requirements. SFAS 141(R) eliminated the inclusion of transaction costs when an entity was acquiring new assets and liabilities in the accounting books and mandated the immediate recognition of gains. SFAS 160 changed the financial reporting

perspective for noncontrolling interest. The noncontrolling interest was classified as shareholders' equity in the balance sheet by leaving income and comprehensive income as a total consolidated amount in the income statement (Henry, Holzmann, & Ya-wen, 2008).

An ED was released by the FASB and IASB related directly to the completion of businesses combinations phase II. The ED explains in depth the mechanics of business combinations phase II and noncontrolling interest. The former director of the FASB, Stefanie Tamulis, mentioned that new adjustments were made to find consistency with IASB and FASB financial reporting. For example, two steps exist in the business combinations process. The first step is the acquisition aspect of an entity and the second is the implication of transactional costs. The joint collaboration effort of business combinations brought a higher financial reporting quality measurement and better guidance for accounting provisions (Heffes, 2005).

The application of the purchase method under business combinations was developed about 30 years ago. The purpose of the purchase method was to bring reliability, relevance, and accuracy to financial statements. Business combinations include four steps:

- The first step: the acquiring business has to eliminate inconsistencies in the balance sheet
- The second step: identify assets and liabilities at the beginning of the process and prevent contingency losses
- The third step: evaluate the net assets or equity interests when a company is reporting business combinations followed by the purchase method
- The fourth step: create one singular accounting financial language that promotes high quality financial reporting

In 2011, the FASB, after intense political battle and financial debate, issued SFAS 141, *Business Combinations*, and SFAS 142, *Goodwill and Other Intangible Assets*. The main objective of these two standards was

to eliminate the pooling interest method and conduct annual tests for impairment rather than amortizing goodwill. The FASB and IASB agreed that business combination goodwill items should be amortized at the acquisition day, otherwise the impairment should be tested. The IASB presented a proposal to the FASB recommending to write off in-process research and development (R&D) when testing impairment assets in the balance sheet. Therefore, the FASB and IASB share common grounds for the fair value measurement (Gornik-Tomaszewski, & McCarthy, 2003).

Accounting Treatment for Goodwill Reporting

SFAS 142 helped establish a new financial path by providing managers with economic choices and illustrating the important accounting choices within the firm. Wahlen, Baginski, and Bradshaw (2015) defined *goodwill* as "a residual and effectively represents all intangibles that are not specifically identifiable" (p. 601). An entity has the ability to establish a method to assess the value of individual assets by operating unit and covering three topics under SFAS 142: (a) specify the treatment for all intangibles in the business combination, (b) indicate the circumstances for intangible assets during the acquisition, and (c) the treatment for intangible assets. The new rule of intangible assets shows that goodwill should be amortized over its useful life. Furthermore, it can be determined that there is an existing relationship between future cash flow and goodwill impairment by creating a greater use of the company's economic value. For instance, the parent company should be able to assign its goodwill to a non-controlling interest. Therefore, the main objective of management is to estimate the fair value by each reporting unit as a whole and embrace the importance of a joint project between the FASB and IASB.

The company should follow SFAS 142 because it changed the evaluation perspective of treating goodwill in the accounting industry. For more than 40 years, goodwill was treated as an asset as well as amortized. SFAS 142 eliminated the goodwill amortization requirement and opened the gateway to evaluating goodwill as impaired by moving

undiscounted cash from a company's financial analysis to a fair value benchmark. However, the accounting treatment for goodwill under SFAS 142 has long-term economic implications. For example, SFAS 142 highlights two critical criteria when a company is reporting goodwill: (a) provide a definition to the reporting units, and (b) how much goodwill should be assigned to each reporting unit. For instance, the two criteria provide an opportunity for managers in the company to conceptualize the existence of goodwill and the amount of goodwill that should be recorded as impairment. Therefore, SFAS 142 helped establish a new financial path by providing managers with economic choices and illustrating the important accounting choices within the firm (Beatty & Weber, 2005).

The financial reporting disclosure information expressed under SFAS 142 provides the firm with future ability to achieve economic objectives. The company, under SFAS 142, has the ability to capture financial stability and regain its earning power. Capital allocation is another avenue that serves as an intrinsic value in the marketplace. Furthermore, the company, for control purposes, can compare the actual goodwill and at the same time analyze its deviation. For instance, the goodwill amortization and other charges are critically analyzed by their retrospective functionality and not the prospective function. For example, SFAS 142 provides a degree of flexibility in determining the fair value in the discounted cash flow calculation. Another example that the company should take under consideration is to test impairment assets at least annually. On the contrary, researchers suggest that like any other assets, goodwill will not be replaced by the company (Morin, 2000). The reinvestment of goodwill cannot be derived from the goodwill amortization. However, noncash charges should be eliminated from the goodwill analysis. The goodwill impairment loss reported on the income statement provides a separate line item that mostly considers a one-time effect only for future performance. This is a relevant fact that engages the classification of the big bath accounting. Schroeder et al. (2014) defined big bath accounting as "Taking a bath. The one-time overstatement of restructuring charges to reduces assets, which reduces future expenses. The expectation is that the one-time loss is discounted

in the marketplace by analysts and investors, who will focus on future earnings" (p. 172). The impairment is a result of overpayments or unrealistic expectations expressed in the acquisition method. The acquired goodwill is difficult to measure and understand the accounting transition event of the same (Ding, Richard, & Stolowy, 2008).

Economic Association Event Decline in Sales and Profits

A one-time charge associated with an economic event will have a negative impact on the financial structure because it can reduce the amount of assets and will flow through the income statement by lowering stockholder equity. This effect will be reported in the financial press. Goodwill may be subject to allegations because of the acquisition of overpayment position in the market. Furthermore, if the goodwill allegations are proven to be untrue, management will be reluctant to accept the charges. On the other hand, a new management team in the company may attribute charges to poor decisions made by their predecessors by reducing the possibility of future goodwill to be impaired. For example, rule APB No. 17 indicates that the amortized life of goodwill is a period of 40 years. Therefore, the new rule of intangible assets shows that goodwill should be amortized over its useful life (Zang, 2008).

Decline in Sales and Net Income: Effects on Statement of Cash Flow

The FASB, after adopting SFAS 142, noted future cash flow can be predicted at a better economic future position. SFAS 142 allows for managerial discretion and enables the company to have a significant economic impact on the financial statements. The adoption of SFAS 142 has been quite challenging for manipulators of the statement of cash flow to misrepresent the economic life of the same. SFAS 142 provides contingent road map guidance for the statement of cash flow. Therefore, it can be determined that there is an existing relationship between future cash flow and goodwill impairment by creating greater use of the company's economic value (Lee, 2011).

Economic Event and Accounting Disclosure

In 2001, publicly traded companies in the United States were required to implement the new standard mentioned previously in the literature review. During the first 6 months of the adoption of SFAS 142, companies assessed goodwill impairment balances and at the same time reported transitional goodwill impairment losses. The impairment of goodwill is reported as income from continuing operations. Therefore, after the adoption of SFAS 142, the FASB gave companies reporting economic benefit a new transition period by allowing them to report the real economic value of the goodwill impairment and at the same time meeting the expectations of accounting principles (Huefner & Largay, 2004).

Huefner and Largay (2004) determined that companies that adopted the accounting method under SFAS 142 included GE, Kraft, and AOL Time Warner, and the economic event under SFAS 142 illustrated two major accounting changes:

1. Amortization of *all* goodwill ceased, regardless of when it originated. Goodwill is now carried as an asset without reduction for periodic amortization.
2. Companies are to assess goodwill for impairment at least annually. If goodwill is impaired, its carrying amount is reduced and an impairment loss is recognized. (p. 30)

Announcement Made to the Public

The effect of goodwill should be recognized by the parent companies, because the parent companies should be able to share full disclosure value under SFAS 141(R). The full disclosure value under SFAS 141(R) demonstrates some exceptions under goodwill reporting. The standard known as SFAS 141(R) requires other methods of evaluation. Furthermore, the areas parent companies should consider are as follows:

(a) assets held for sale, (b) deferred tax assets and liabilities, (c) operating leases, and (d) employee benefit plans. As a result, parent companies should be able to evaluate the purchase price under SFAS 141(R) because the amount of goodwill should be allocated as controlling and non-controlling interests. The parent company should be able to assign its goodwill as attributed to non-controlling interest (Brenner, Brenner, & Jeancola, 2008).

With respect to the goodwill recognition treatment from a parent company's perspective, the IASB offers a consistent approach. The importance in this process is to provide attribution to the parent company's recognition value. This is also a consistent method with the IASB. It can be argued that goodwill can only be determined by the arm's-length transaction, which requires a parent company to identify the fair market value for the identifiable net assets in the balance sheet. For example, other supporters of goodwill indicate that a parent company's recording goodwill at fair value is characterized as an irrelevant and unreliable method. As a result, understanding the accounting transaction event from a parent company's point of view can be a challenge. As another example, if the parent company records $30 above the fair market value as an identifiable assets, the full recording value of goodwill of $40 should be consolidated by the entity. Therefore, the joint project between the FASB and IASB proposed that the non-controlling interest (NCI) should be subject to impairment testing (Rebecca & Smith, 2007).

Board of Directors and CEO

The Board of Directors and CEO will provide recommendations regarding how to test goodwill impairment in the company and as an additional step to consider treating sales as part of accounting and also how to prevent net income decline. In addition, Huefner and Largay (2004) illustrated two steps in terms of testing goodwill impairment:

Step 1: The company estimates the fair value of the reporting unit (UFV) and compares it with the unit's book value (UBV), which equals the recorded amounts of assets and allocated goodwill less liabilities.

When UFV is greater than UBV, there is no impairment, and the test is complete. When UFV is less than UBV, however, goodwill may be impaired, and the company goes to Step 2. Step 2: The company estimates the implied fair value (GFV) of the reporting unit's goodwill by repeating the process performed at acquisition. This requires subtracting estimated current fair values of the unit's identifiable net assets (INA) from the unit's estimated fair value (UFV), and comparing the difference with the carrying amount of the goodwill (GBV). When GFV is greater than GBV, goodwill is not impaired and there is no write-off. When GFV is less than GBV, however, the company must record an impairment write-off equal to the difference. (p. 32)

Furthermore, the company should follow the information illustrated under SFAS 142 paragraph number 30 to report the operating segment of goodwill. The main objective of management is to estimate the fair value by each reporting unit as a whole (Huefner & Largay, 2004).

Business Combinations: IFRS3

IFRS3, under business combinations, promotes the principles of relevance, reliability, and sustainable financial reporting of an entity. An acquirer should be familiar with the financial principles and requirements illustrated below (IFRS Foundation, 2012):

(a) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree;
(b) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and
(c) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. (p. 1)

The goodwill item under IFRS continues to be a controversial subject of discussion among standard setters. IFRS3 was created with the intent

to promote relevant accounting information by presenting the importance of economics and sustainability. As a result, the IASB has been criticized related to how potential management earnings can be inherited as an impairment test under IFRS3 (Giner & Pardo, 2015).

Goodwill does recognize the future economic benefit of a company's acquisition in the assets and liability section in the balance sheet (see IASB 2004a, IFRS3, para. 52). During this transaction, there is an investment opportunity realization that is not captured by the accounting system. The acquiring company often chooses to use a monopolistic approach by taking advantage of the market imperfections with the ability to generate more profits and overcome market entrance barriers. As prescribed by the Basis for Conclusions to IAS 36:

If a rigorous and operational impairment test could be devised, more useful information would be provided to users of an entity's financial statements under an approach in which goodwill is not amortized, but is tested for impairment annually or more frequently if events or changes in circumstances indicate that the goodwill may be impaired. (IASB 2004c, IAS 36 para. BC131G; p. 24)

In 1986, Spain decided to join the European Union (EU) and its accounting standards had to be changed to principles-based guidelines. By 1990, the accounting plan (i.e., GAP) was restructured and the accounting for goodwill had a lifetime value of 10 years; impairment was recorded as an expense. In the past, goodwill was accounted as impairment only, but due to the new adaptation of principles-based guidelines in the EU's financial market, goodwill has decreased in value. At the end of the 1990s, under business combinations the life expectancy of amortization for goodwill was increased to 20 years. In 2007, a new accounting plan (i.e., GAP) criteria was applied to individual accounts and the computation for amortization impairment was excluded (Giner & Pardo, 2015).

Research studies have shown that goodwill for business combinations can be applicable through a merger and acquisition. The principle

standards known as IFRS3 and IAS22 (e.g., IASB, 2004a; IASC, 1998) are used in the 28 states of the EU because business combinations are required to recognized goodwill acquisition premium and the recording position of an entity net asset reported at a fair market value. For instance, the pooling of interest method rejects the premium, while the purchase method evaluates the goodwill value and company net assets should be consolidated at existing book value. Earnings are important key leading indicators, because they can be used to help assess and evaluate the company's managerial position (Giner & Pardo, 2015).

Companies providing a high consolidated book value (Ayers, Lefanowicz, & Robinson, 2000) use earnings as a key metric financial reporting to evaluate managerial performance. Evidently the purchased method diminished the return-on-equity (ROE) and mark-to-book (M/B) ratio where the acquisition premium is amortized by preventing goodwill cost. This financial phenomenon is consistent with the results of a study conducted by Hopkins, Houston, and Peters (2000) because it validates the financial impact among stock prices by using the purchase method and amortization acquisition at a premium level. IFRS3 and USGAAP agreed that the pooling of interest method and eliminating amortization for goodwill was the best approach (Cheng, Ferris, Hsieh, & Su, 2005; Giner & Pardo, 2015).

Over a decade, the impairment has been criticized because of a lack of relevance and financial reliability. The IAS36 requires a separate financial schedule when testing impairment and splits the assets that are expected to generate cash flow. As a result, the goodwill schedule cannot be tested individually and revised (IASB, 2004b, IAS36, para. 80). The persisting issue when dealing with business combinations is how to recover and determine the right goodwill amount (Giner & Pardo, 2015).

Anglo-American Accounting Versus Asian Accounting

The major differences that exist between the United States and Japan are in the way in which companies value inventories and securities.

Japanese accounting is quite unique because it is influenced by both the Anglo-American and Germanic traditions. Business combinations have been a major concern for the accounting standards in Japan. Therefore, the major accounting issues in Japan are embracing the adoption of IFRS and the regulations in the market.

Asian Accounting

The accounting tradition in Japan gives preference to the information provided to the public and the amendments mandated by tax authorities. Little research has been conducted by accounting researchers on Edo's work from 1603 to 1867 and Meiji's work from 1868 to 1912, important accounting eras where the world wars were given great importance. In 1990, Kurosawa brought a new aspect to the accounting profession in Japan. In 1934, the first guidelines for accounting were presented in the Japanese market (Noguchi & Boyns, 2012).

Japan: Accounting for Business Combinations

Accounting for business combinations has been a source of concern in Japan due to the unique nature of business. Keiretsu conglomerate groups are a form of business combination in which there are systems of interlocking directorates of related businesses formed to work together. A keiretsu can comprise banks, manufacturers, suppliers, and so on. There are interlocking shareholders who are not necessarily majority owners, but who in effect control the companies in the keiretsu. As Japan's economy has struggled in recent years, the keiretsu has been more open to doing business with other business entities (Radebaugh et al., 2006).

International Accounting Dimension in Japan

Japan has an attractive and interesting international dimension in its market. The majority of Japanese companies prepare an additional set of financial statements in English for foreign companies. Radebaugh et al. (2006) indicated that approximately 30 Japanese companies prepared

their financial statements in accordance with USGAAP. Japanese companies, when traded in the U.S. market, are required to file Form 20 F and follow Japanese GAAP standards. The main reason appears to be that when Japanese corporations were first listed in the United States, there were no Japanese consolidation requirements, and hence it was considered appropriate to adopt USGAAP. As a result, the majority of MNEs respond to international market pressure and comply with the mandatory existing policies and regulations. Since 2007, a study group appointed by Japan's Ministry Finance conducted research that compared Japanese accounting standards to IFRS. In their report, they recommended that the European Commission consider Japanese accounting standards as equivalent to IFRS, as non-European companies listed on the European exchange were required to use (Radebaugh et al., 2006).

Anglo-American Accounting

In the United States, the dominant force of accounting is ruled by the securities markets. For instance, under the Securities Act of 1933 and the Securities Exchange Act of 1934, investors are protected by the government. However, in 1929 when the stock market crashed, the SEC took immediate action by accepting the rules based-guidance of GAAP (Radebaugh et al., 2006).

The United States does not exercise full disclosure requirements over financial statements that have been fully audited. Corporations in the United States are constituted under state law, not by the government. Minimal requirements are exercised over financial statements. In the case of financial statements that have been fully consolidated, the public has access to the financial records. As a result, the SEC at the federal level enforces annual audits of financial statements. For example, the SEC has jurisdiction over companies that are listed in the stock exchange. Therefore, companies that are formed as limited liability companies do not have to follow precisely the SEC regulations (Choi & Meek, 2005).

The only governmental independent regulatory agency acting as a regulator in the U.S. financial market is the SEC, because the government does not have full authority over the SEC. In 1973, the FASB was established and had issued 150 Statements of Financial Accounting Standards (SFASs) up to the month of December 2003. The FASB goes through a lengthy process due to procedures before issuing an SFAS. In developing its work agenda, it listens to individuals, professional firms, courts of law, companies, and government agencies. For example, the financial statements consolidated in U.S. territory are governed by GAAP. As a result, the most voluminous set of accounting standards is the USGAAP as compared to other accounting standards around the world. For this specific reason, the SEC and FASB have decided to move away from rules-based to principles-based standards (Choi & Meek, 2005).

The SEC recently issued a comment for a proposal to accept financial statements prepared in accordance with IFRS, not considering the full consolidation of the financial statements under USGAAP. Different accounting criteria exist between USGAAP and IFRS. The SEC affirmed that IFRS are more investor oriented than are USGAAP. The SEC is presently facing different challenges from USGAAP and IFRS because both standards promote financial quality. Therefore, the SEC indicated that a commission is necessary in the convergence process from USGAAP to IFRS to settle the similarities and differences that exist between the two standards (Jamal et al., 2008).

Anglo-American Accounting Business Combinations

With respect to accounting business combinations, the FASB issued two standards, SFAS 141(R), *Business Combinations* and SFAS 160, *Non-Controlling Interest in Consolidated Financial Statements*. The new valuation of business combinations promotes the asset section, the liabilities are to be computed at fair value, and the contingency of the financial statements is feasible. For instance, SFAS 160 brings a new financial path for non-controlling interests and how they are presented in

the balance sheet and attributed in the income statement as comprehensive income (Henry et al., 2008).

The statement of SFAS 141(R) brought significant changes to the market by treating the purchase method of accounting under business combinations. The new business combinations financial reporting requires further guidance from the research and development interpretation. The research and development should be treated as an asset, not as an expense. Therefore, the company assigns an indefinite value of the intangible assets identified as research and development (IFRS Foundation, 2012).

3. Applying the Acquisition Method

A business combination should provide appropriate disclosure requirements and measurements in the acquisition application method under one common financial ground. For example, IFRS provide direct guidelines in recognition of these principles as follows (IFRS Foundation, 2012):

(a) Leases and insurance contracts are required to be classified on the basis of the contractual terms and other factors at the inception of the contract (or when the terms have changed) rather than on the basis of the factors that exist at the acquisition date.

(b) Only those contingent liabilities assumed in a business combination that are a present obligation and can be measured reliably are recognized.

(c) Some assets and liabilities are required to be recognized or measured in accordance with other IFRSs, rather than at fair value. The assets and liabilities affected are those falling within the scope of IAS 12 Income Taxes, IAS 19 Employee Benefits, IFRS 2 Share-based Payment and IFRS 5 Non-current Assets Held for Sale and Discontinued Operations.

(d) There are special requirements for measuring a reacquired right.

(e) Indemnification assets are recognized and measured on a basis that is consistent with the item that is subject to the indemnification, even if that measure is not fair value. (p. 2)

4. Conclusion

In conclusion, it can be determined that since the 1800s, business organizations have found it attractive to combine their activities into a single entity. The FASB and IASB share common grounds for the fair value measurement. For more than 40 years, goodwill was treated as an asset as well as amortized. Business combinations, from an accounting perspective, focus mainly on three aspects: the treatment of accounting business combinations where a company acquires a second company, the segmentation and consolidation of a financial reporting position from a parent to a subsidiary company, and the translation of currency from a subsidiary to a parent company. Therefore, the SEC indicated that a commission is necessary in the convergence process from USGAAP to IFRS to settle the similarities and differences that exist between the two standards (Jamal et al., 2008).

5. Recommendation for Future Studies

The author of this article suggests that the following aspects should be considered for future studies when studying the business combinations phase II under FASB vs. IASB:

1. Companies should increase the effort of embracing sustainability issues in the income statement, balance sheet and statement of cash flows.

2. The FASB and IASB should develop a section devoted to the consolidation of intangible assets.

3. Examine the relationship between USGAAP and IFRS in the accounting treatment for both intangible assets and impairments.

4. The psychological financial effect of brand value and business combinations.

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