THE IMPACT OF THE ECONOMIC UNIT CONCEPT ON THE EQUITY ACCOUNTING METHOD

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ABSTRACT

In December 2007, the Financial Accounting Standards Board (FASB) issued two statements to improve the accounting and reporting of business combinations, FASB Statement 141 *Business Combinations* (Revised 2007) and FASB Statement 160 *Noncontrolling Interests in Consolidated Financial Statements*. The philosophy behind the FASB recommendations is the economic unit concept. Under this concept, the consolidated group is considered to be one economic unit for financial reporting purposes [Moonitz, 1951]. The acquired business is consolidated as a whole regardless of the percentage of controlling ownership of the acquiring company. This approach incorporates the full fair value of the net assets of the subsidiary at the date of acquisition and noncontrolling interests are considered part of owners' equity.

Currently, in practice the most commonly used theory is the parent company concept [Beckman, 1995]. The focus of this concept is that the interest of the acquiring company in its subsidiaries is purely financial. Under this approach, the subsidiaries' net assets include only the acquiring company's share of the difference between the fair market value book value and the full book value at the date of acquisition. Noncontrolling interests are classified between liabilities and owners' equity.

With a piecemeal acquisition, prior noncontrolling investments are adjusted to fair value to form a single block. Unlike the parent company concept, where the fair value is determined at the time of each purchase, the economic unit concept views the date of obtaining control as the key for determining the fair market value of the assets and liabilities acquired.

This paper examines the impact on the equity accounting method of piecemeal acquisitions and use of the economic unit concept. It is important to understand the implications of the two FASB statements on the equity method of accounting since APB 18 states that "…such amount (equity income) reflects adjustments similar to those made in preparing consolidated statements..." (Accounting Principles Board Opinion No. 18, paragraph 6 (b), 1971).