Shareholder Letters: Accounting Themes

Purchase vs. pooling for acquisitions

Berkshire letters: 1999, 2000

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What the Letter Says

> *“Managements usually detest purchase accounting because it almost always requires that a “goodwill” account be established and subsequently written off.”*
>
> Warren E. Buffett, 1999 letter

- Key letters: 1999, 2000
- Course fit: ACC250 — · ACC531 — · Difficulty: Advanced

Step 1: Same Deal, Two Methods (before 2001)

EX. Pay $500 for a company; book value of its net assets $300; fair value $380.

	Purchase	Pooling
Net assets recorded at	Fair value $380	Book value $300
Goodwill	$120	$0

Step 2: The Effect on Later Earnings

- Before 2002, goodwill was **amortized** (up to 40 years).

Each year	Purchase	Pooling
Goodwill amortization	$3	$0

- Purchase method → lower reported earnings every year; pooling → none.

Step 3: Today

- SFAS 141 (2001) banned pooling: only the **acquisition (purchase) method** is allowed.
- SFAS 142 (2001) ended goodwill amortization; goodwill is tested for impairment instead.

Back to the Letter

- Buffett (1999): managers “detest purchase accounting” because it creates goodwill that is written off.
- The economics of the deal are the same under both methods; only the accounting differs.

Questions

1. Which method must U.S. companies use today to record an acquisition?

   A. The acquisition (purchase) method: assets and liabilities at fair value, the excess as goodwill

   B. Pooling of interests

   C. Either method, at management's choice

   D. No entry until the target is sold

2. Why did many managers prefer pooling?

   A. It recorded assets at fair value

   B. No goodwill was created, so there was no later charge against earnings

   C. It required more disclosure

   D. It raised income taxes

Sources

- Warren E. Buffett, 1999 letter (berkshirehathaway.com/letters)
- Warren E. Buffett, 2000 letter (berkshirehathaway.com/letters)
- Reading packet and question sheet for this theme

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