MERGER ACCOUTING FOR COMPANIES

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Summary: *Companies, especially nowadays, are characterized through great mobility, fast circulation of capital, occurring in their chase for profit. In this context, companies look for alliances, economical and political assistance. These objectives can materialize through merging of companies. The merger can be internal (between Romanian companies) or transboundary, which includes foreign companies. In order to correctly reflect these events, the merger operations must be regulated and must respect national and international regulations. One important request concerning the merger operations is that the accounting values of the assets, debts and ownership equity must be brought to the present financial value.*

Keywords: *merger, division, net assets, fair market value, acquired company, acquiring company.*

JEL Classification: *M41*

1. Introduction and context

This article aims to provide new insights into the merger accounting for companies. In today's globalization context, many companies search for solutions to extend, develop or survive. In many cases, a viable variant is merging. The objective of the research is to analyze and highlight in accounting the operations that happen when two companies merge together. In order to handle correctly these events, it is necessary to bring the companies' balance sheet to their real, market value, meaning the companies' assets and debts must be brought to their current value.

This work is a result of scientific research, based on the analysis of literature and legal regulations regarding the merger, division and liquidation of the enterprises.

2. The merger of companies

In a general sense, a **merger** represents the fusion of distinct entities into a new one. Merger is the operation through which 2 or more companies decide to form a new trading company. The merger can be internal (only between Romanian companies) or transboundary, which includes also foreign companies. The merger can have multiple objectives:

a) Consolidating the position on the market by eliminating competition;
b) Survival of a company which is in a difficult situation;
c) Obtaining superior economic performances;
d) Absorbing a main supplier.

As a result of the merger, the following things will happen:

- ✓ The acquired company will cease to exit;
- ✓ All the assets, debts and ownership equity will be transferred to the acquiring company;
- ✓ The shareholders (associates) from the acquired company become shareholders (associates) in the acquiring company.

On an international level, the merger and division operations are regulated by the IFRS 3 *Business Combinations* (International Financial Reporting Standards). According to IFRS, the **combination of companies** means that an entity buys the ownership equity of another entity and all the net assets of a company that form together one or multiple companies. The combination can be done by issuing shares, through cash transfer, cash equivalent or other assets, or through a combination of these methods. The transaction could lead to the formation of a new entity which would control the combined entities or the net assets transferred to one or multiple entities that take part in the combination.

According to article 28 section (1) of the accounting law, each trading company has to make yearly financial statements on occasion of their merger, division or liquidation, in accordance with the law.

The merger operation can have two forms:

a) one or multiple companies are dissolved without being liquidated and they transfer all their assets to another company, in exchange for some shares given to the shareholders of the acquired company from the acquiring company;

b) multiple companies are dissolved without being liquidated, and transfer all their assets to another company which they constitute, in exchange for some shares given to their shareholders at the newly constituted company.

Thus, the merger of the two trading companies can be done by **2 methods**:

a) Merger by **absorption** of one or multiple trading companies by another trading company;
b) Merger by **consolidation** of one or multiple trading companies, in order to make a new trading company.

The merger project, signed by the representatives of the participant companies, is registered at the trade register office, where each company is recorded, together with a declaration of the company that ceases to exist as a result of the merger or the division.

The delegate judge appoints one or several experts, natural person or legal entity, to examine the merger or division project and to send a written report to the shareholders.

With at least one month prior to the extraordinary general assembly, which will decide upon the merger or division project, the administration of the companies that take part in the merger or division, will release the following documents to associates or shareholders:

a) The merger project;
b) The administrators' report;
c) The yearly financial statements and management reports for the last 3 financial years of the societies that take part in the merger;
d) The report of the auditors or of the financial auditor;
e) The records containing all contracts over 10,000 lei each that are still ongoing, and also their distribution in case of the company's division.

Shareholders or associates can obtain, upon request and for free, copies of the documents mentioned above, or excerpt from them. Three months after the merger project is published and a general assembly of each company will decide upon the merger.

The stages in case of a merger through absorption are the following:

1) Inventory and evaluation of elements of assets and liabilities from the merging companies.
2) Drawing up the financial statements before the merger, by the companies that are about to merge. Based on the statements made before the merger, the net asset value is determined (NAV):

NAV = Total Assets – Total Liabilities

3) A global evaluation of the companies to establish a net contribution. Multiple evaluation methods can be used: the net asset method, the stock method, the result-based method (profitability value, yield value), the cash-flow based method, mixed methods.
4) Determining the asset exchange rate (of the shares) to cover the capital of the absorbed companies. In this stage, there are two operations to be done:

a) Determining the share accounting value for the merging companies, by reporting the net contribution to the number of issued shares;
b) Establishing the shares' exchange report, by reporting the accounting value of one share of the acquired trading company to the accounting value of one share from the acquiring company, this report being verified and approved by experts.

5) Determining the number of shares to be emitted in order to remunerate the net contribution at the merger. In this stage the following operations happen:

a) Determining the number of shares that must be emitted by the acquiring company, either by reporting to the ownership equity (net accounting asset) of the acquired company to the accounting value of one share from the acquiring trading company, or by multiplying the number of shares of from the acquired company with the exchange ratio;
b) Increasing the social capital of the acquiring trading company by multiplying the number of shares that must be emitted by this company with the nominal value of a share emitted by the same company;
c) Calculating the merger bonus, as a difference between the shares' accounting value and their nominal value.

6) Highlighting in the companies' accounting the operations that occur due to the merger.

An extremely sensitive problem is the one referring to the evaluation of the company's value: should it be evaluated at the historical value (based on the accounting value), the present value (based on the fair market value) or a future value (based on the utility value)? I believe that the fair market value is the best option, because the historical value shows the value of assets and liabilities from the past that might not be brought to a present value,

and the utility value is based on a possible prognosis of the cash flow, which is not a certainty, but only a probability.

3) Case study regarding the highlighting of operations related to the merger

In addition to the theoretical part, I present a model of a highlight of operations regarding the merger of two companies: the company X, the acquiring company which has positive ownership equity, while the company Y, acquired, has negative ownership equity.

Steps:

A) Inventory and evaluation of the assets and debts of the two companies

At the company X, the revaluation of fixed assets (constructions) is done, their fair market value being 817,000 lei, while their net accounting value is 806,250 lei, having a plus of 11,250 lei. As a result, the revaluation difference is registered:

212	=	105	11,250
Constructions		Reserves from revaluation	

B) The assets and liabilities situation, according to the two balance sheets, is the following:

Balance sheet of the company "X" (acquiring)

Name of the element	No. Row	Balance
A. FIXED ASSETS		
Intangible fixed assets (ct. 203)	1	5,500
Tangible fixed assets (ct. 212)	2	817,500
Financial fixed assets (ct. 263)	3	4,500
FIXED ASSETS-TOTAL (rows 1+2+3)	**4**	**827,500**
B. CURRENT ASSETS		
Stocks (ct. 371)	5	220,400
Receivables (ct. 411)	6	361,900
Short term investments	7	
Cash and bank accounts (ct. 5121)	8	68,600
CURRENT ASSETS-TOTAL (rows 5+6+7+8)	**9**	**650,900**
C. PRE-PAID EXPENSES (ct. 471)	10	7,500
D. DEBTS (< 1 year) (ct. 404)	11	720,800
E. NET CURRENT ASSETS/NET CURRENT DEBTS (rows 9+10-11-19)	**12**	**- 67,400**
F. TOTAL ASSETS-CURRENT DEBTS (rows 4+12)	**13**	**760,100**
G. DEBTS (> 1 year) (ct. 162)	14	180,100
H. PROVISIONS (ct. 151)	15	
I. DEFFERED INCOME (rows 17+18+21+22) from which:	**16**	
1. Subventions for investments (ct. 475)	17	
2. Deferred income (ct. 472) total (rows 19+20)	18	5,000
Amounts to be recognized as income in less than 1 year	19	5,000
Amounts to be recognized as income in more than 1 year	20	
3. Deferred income related to the income received through transfer (ct. 478)	21	
4. Negative goodwill (ct. 2075)	22	
J. CAPITAL AND RESERVES		
I. Capital (rows 20+21+22) from which:	**23**	

1. Subscribed and paid capital (ct. 1011) (10,000 shares x 10 lei/share)	24	100,000
2. Subscribed and unpaid capital (ct. 1012)	25	
3. Patrimonial assets of the public corporations (ct. 1015)	26	
4. Patrimony of research and development national (ct. 1018)	27	
II. Share premiums (ct. 104)	28	
III. Revaluation reserves (ct. 105)	29	11.250
IV. Reserves (ct. 106)	30	32,500
Own shares (ct. 109)	31	
Gains related to the ownership equity instruments (ct.141)	32	
Losses related to the ownership equity instruments (ct. 149)	33	
V. Reported profit or loss Balance C (ct. 117)	34	375,000
Balance D (ct. 117)	35	
VI. Profit or loss financial year Balance C (ct. 121)	36	61,250
Balance D (ct. 121)	37	
Profit distribution (ct. 129)	38	
Ownership equity -(rows 23+28+29+30-31+32-33+34-35+36-37-38)	**39**	**580,000**
Public patrimony	40	
CAPITALS - TOTAL (rows 39+40) (rows 13-14-15-17-20-21-22)	**41**	**580,000**

Source: own calculations

Balance sheet of the company "Y" (acquired)

Name of the element	Nr. rd.	Sold
A. FIXED ASSETS		
Intangible fixed assets	1	
Tangible fixed assets (ct. 212)	2	240,000
Financial fixed assets	3	
FIXED ASSETS-TOTAL (rows 1+2+3)	**4**	**240,000**
B. CURRENT ASSETS		
Stocks (ct. 371)	5	86,000
Receivables (ct. 411)	6	134,000
Short term investments	7	
Cash and bank accounts (ct. 5121)	8	2,800
CURRENT ASSETS -TOTAL (rows 5+6+7+8)	**9**	**222,800**
C. PRE-PAID EXPENSES (ct. 471)	10	3,100
D. DEBTS (< 1 year) (ct. 404)	11	359,000
E. NET CURRENT ASSETS/NET CURRENT DEBTS (rows 9+10-11-19)	**12**	**- 137,800**
F. TOTAL ASSETS-CURRENT DEBTS (rows 4+12)	**13**	**102,200**
G. DEBTS (> 1 year) (ct. 162)	14	228,000
H. PROVISIONS (ct. 151)	15	
I. DEFFERED INCOME (rows 17+18+21+22) from which:	**16**	
1. Subventions for investments (ct. 475)	17	
2. Deferred income (ct. 472) total (rows 19+20)	18	4,700

Amounts to be recognized as income in less than 1 year	19	4,700
Amounts to be recognized as income in more than 1 year	20	
3. Deferred income related to the income received through transfer (ct. 478)	21	
4. Negative goodwill (ct. 2075)	22	
J. CAPITAL AND REZERVES		
I. Capital (rows 20+21+22) from which:	**23**	
1. Subscribed and paid capital (ct. 1012)(8,000 shares x 5lei/share)	24	40,000
2. Subscribed and unpaid capital (ct. 1011)	25	
3. Patrimonial assets of the public corporations (ct. 1015)	26	
4. Patrimony of research and development national (ct. 1018)	27	
II. Share premiums (ct. 104)	28	
III. Revaluation reserves (ct. 105)	29	
IV. Reserves (ct. 106)	30	12,000
Own shares (ct. 109)	31	
Gains related to the ownership equity instruments (ct.141)	32	
Losses related to the ownership equity instruments (ct. 149)	33	
V. Reported profit or loss Balance C (ct. 117)	34	
Balance D (ct. 117)	35	115,700
VI. Profit or loss financial year Balance C (ct. 121)	36	
Balance D (ct. 121)	37	62,100
Profit distribution (ct. 129)	38	
Ownership equity - (rows 23+28+29+30-31+32-33+34-35+36-37-38)	**39**	**- 125,800**
Public patrimony	40	
CAPITALS - TOTAL (rows 39+40) (rows 13-14-15-17-20-21-22)	**41**	**- 125,800**

Source: own calculations

C) Global evaluation of the 2 companies:

Company X

Net asset = Total assets – Total debts = Ownership equity = 827,500 + 650,900 + 7,500 – 720,800 – 180,100 – 5,000 = 580,000 lei

Net contribution = Net asset = 580,000 lei

Company Y

The global value of the company "Y" after the revaluation registers a 18,500 lei increase vis-à-vis the net asset.

Net asset = Total assets – Total debts = Ownership equity = 240,000 + 222,800 + 3,100 – 359,000 – 228,000 – 4,700 = - 125,800 lei

Net contribution = Net asset + value from revaluation = - 125,800 + 18,500 = 107,300 lei

D) Determination of the shares' exchange report, in order to cover the contribution of the acquired company:

In this case, the acquiring company "X" will take over elements of assets and liabilities of the acquired company "Y" without the equity issue, the last one having after the evaluation a negative contribution of 107,300 lei.

E) Highlighting the merger operations in the accounting of the 2 companies:

Merger accounting for the acquired company "Y"

a) highlighting the value of the transferred assets (465,900 + 18,500):

461	=	7583	484,400
Various debtors	Income from selling the assets and other capital-related operations		

b) subtracting from the assets the transferred elements of assets:

6583	=	%	465,900
Expenses related to the given		212	240,000

assets and other capital-related operations   Constructions
371   86.000
Merchandises
411   134,000
Clients
471   3,100
Prepaid expenses
5121   2,800
Bank accounts in lei

c) closing the income and expenses account:

121 = 6583   465,900
Profit or loss   Expenses related to the given assets and other capital-related operations

7583 = 121   484,400
Income from selling the assets and other capital-related operations   Profit or loss

d) transfer of the liabilities:

% = 461   591,700
162   Various debtors   228,000
Long term bank loans
404   359,000
Fixed assets providers
472   4,700
Deferred income

% = 456   70,500
1012   Settlements with the shareholders   40,000
Subscribed and paid capital
106   12,000
Reserves
121   18,500
Profit or loss

456 = %   177,800
Settlements with the shareholders   121   62,100
Profit or loss
117   115,700
Reported result

e) adjustments of the accounts 456 and 461:

461 = 456   107,300
Various debtors   Settlements with the shareholders

Merger accounting for the company “X” – acquiring

The accounting records are the following:

a) registration of the net contribution:

117 = 456   107,300
Reported result   Settlements with the shareholders

b) processing the asset elements of the company “Y” – acquired

% = 456   484,400
207   Settlements with the shareholders   18,500
Goodwill
212   240,000
Constructions
371   86,000
Merchandises
411   134,000
Clients
471   3,100

Prepaid expenses

5121			2,800
Bank accounts in lei			

c) taking over of the liability elements of the company "Y" – acquired:

456	=	%	591,700
Settlements with the shareholders		162	228,000
		Long term bank loans	
		404	359,000
		Fixed assets providers	
		472	4,700
		Deferred income	

BALANCE SHEET OF THE COMPANY "X" AFTER THE MERGER

Name of the element	NO. rows	Balance
A. FIXED ASSETS		
Intangible fixed assets (5,500 + 18,500)	1	24,000
Tangible fixed assets	2	1,057,500
Financial fixed assets	3	4,500
FIXED ASSETS-TOTAL (rows 1+2+3)	**4**	**1,086,000**
B. CURRENT ASSETS		
Stocks	5	306,400
Receivables	6	495,900
Short term investments	7	
Cash and bank accounts	8	71,400
CURRENT ASSETS -TOTAL (rows 5+6+7+8)	**9**	**873,700**
C. PRE-PAID EXPENSES (ct. 471)	10	10,600
D. DEBTS (< 1 year) (ct. 404)	11	1,079,800
E. NET CURRENT ASSETS/NET CURRENT DEBTS (rows 9+10-11-19)	**12**	**- 205,200**
F. TOTAL ASSETS-CURRENT DEBTS (rows 4+12)	**13**	**880,800**
G. DEBTS (> 1 year) (ct. 162)	14	408,100
H. PROVISIONS (ct. 151)	15	
I. DEFFERED INCOME (rows 17+18+21+22) from which:	**16**	
1. Subventions for investments (ct. 475)	17	
2. Deferred income (ct. 472) total (rows 19+20)	18	9,700
Amounts to be recognized as income in less than 1 year (5,000 + 4,700)	19	9,700
Amounts to be recognized as income in more than 1 year	20	
3. Deferred income related to the income received through transfer (ct. 478)	21	
4. Negative goodwill (ct. 2075)	22	
J. CAPITAL AND REZERVES		
I. Capital (rows 20+21+22) from which:	**23**	
1. Subscribed and paid capital (ct. 1011) (10,000 shares x 10 lei/share)	24	100,000
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3. Patrimonial assets of the public corporations (ct. 1015)	26	
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III. Revaluation reserves (ct. 105)	29	11,250

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Gains related to the ownership equity instruments (ct.141)	32	
Losses related to the ownership equity instruments (ct. 149)	33	
V. Reported profit or loss Balance C (ct. 117) (375,000 – 107,300)	34	267,700
Balance D (ct. 117)	35	
VI. Profit or loss financial year Balance C (ct. 121)	36	61,250
Balance D (ct. 121)	37	
Profit distribution (ct. 129)	38	
Ownership equity - (rows 23+28+29+30-31+32-33+34-35+36-37-38)	**39**	**472,700**
Public patrimony	40	
CAPITALS - TOTAL (rows 39+40) (rows 13-14-15-17-20-21-22)	**41**	**472,700**

Source: own calculations

4. Conclusions

The merger processes plays an important role in the actual development of the economy, both at a national and international level, and it is the accounting's duty to highlight these transactions.

As a result of the merger, the shareholders of the acquired company do not lose their legal rights, as they have the same rights as the acquiring company. They can hope for better performances and implicitly to recover their investments. But they can also expect failure. No one guarantees economic success after a merger. It is important to respect the rights of all the shareholders, and to carry out all the operations in a transparent manner and according to the legal regulations.

Although the fair market value is a circumstantial price, which depends upon internal and external factors, it is the closest one to the economic reality and it reflects most faithfully a transaction happening at a certain time.

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