THE ACCOUNTING REFLECTION OF MERGER OPERATIONS – THE GLOBAL EVALUATION METHOD

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Abstract
Depending on the manner in which the evaluation of companies involved in merger operations is carried out, two methods are employed for the accounting reflection of merger operations: the net asset method and the global evaluation method. This article presents the characteristics of using the global evaluation method for the accounting reflection of merger operations.

Keywords
merger; global evaluation; reorganisation; accounting methods

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In the case of employing the global evaluation method for establishing the value of the companies involved in reorganisation activities through merger, the values corresponding to the balance sheet items are determined by authorised assessors by means of an assessment (evaluation) report drawn up for this particular purpose.

The balance sheet items of *the absorbed company/companies that cease to exist* are taken over by the *absorbing company/the company that benefits from merger contribution* at a value that results from the evaluation, as it is recorded in the books of account of the absorbed company and as specified in the *delivery-receipt protocol*.

The values of the companies involved in the merger will lie at the basis for determining the exchange ratio, such values being determined by the evaluation called for by this operation.

As far as the accounting aspects are concerned, the following rules shall be observed:

- The differences arising from the evaluation required by the merger operation in the case of the *absorbed/acquired company* are recognized in the books of account of the *absorbing/ acquiring company/the newly created company* on the basis of the items/elements to which they correspond, and the possible unchargeable (unallocated) difference of certain balance sheet items represents *goodwill*. The differences arising from the evaluation of the absorbed/acquired company shall be recorded in the balance sheet drawn up by the acquiring company after the recording of the merger operations;
- The differences arising from the evaluation required by the merger operation in the case of the *acquiring company* are not recorded in its books of account. The values resulting from the evaluation of the acquiring company on the occasion of the merger are used only for determining the exchange ratio[1];

[1] OMPF no. 1802, 29 December 2014, for the approval of Accounting Regulations concerning annual individual financial statements and annual consolidated financial statements, published in the Official Gazette of Romania, no. 963/ 30 December 2014, pos. 101 and OMPF no. 897/2015 for the approval of methodological norms concerning the reflection in accounting of the main operations of merger, partition

- in the case of *the acquired company/companies that cease to exist* (the case of merger through consolidation), the differences arising from the evaluation on the occasion of the merger are recognized in accounting records as elements of gain or loss[2], as follows:
    - o if the value of the net contribution is higher than the accounting net asset, the positive difference represents the profit/gain;
    - o b) if the value of the net contribution is lower than the value of the accounting net asset, the negative difference is known as loss.

The recognition in the books of account of *the acquired company/companies that cease to exist* of the (negative or positive) difference arising from the global evaluation on the occasion of the merger is performed by means of the following accounts: 7583, *"Revenue from the sale of assets and other capital operations"* and 6583 "*Expenditure concerning the disposal of assets and other capital operations"*, at the date when the merger operation generates effects.

From a practical viewpoint, in the case of employing the global evaluation method, each company involved in the merger draws up a balance sheet off the ledger which also includes the adjustments resulting from the evaluation carried out by authorised evaluators.

The purpose of these off-ledger balance sheets is that of presenting the situation of items such as assets, liabilities, and equities of the merging companies, with the aim of determining the exchange ratio, which is necessary for establishing the number of shares issued by the acquiring company in order to remunerate the shareholders/associates of the acquiring company for the merger contribution.

For the drawing up of off-ledger balance sheets (statements) that are necessary for determining the exchange ratio, the following rules shall be observed*:

- **in the case of acquiring companies**, the value differences emerging from the evaluation of the balance sheet items are recorded in the category of/next to the elements to which they belong, while the value differences that do not correspond to certain identifiable elements/items are recorded as "*Goodwill*" in correspondence, in both cases, by means of account no. 1068 as "*Other reserves*". If the evaluation of the companies reveals a decrease that cannot be covered by means of "other reserves", this decrease will be covered by the result of the financial period.
- **in the case of acquired companies**, the differences arising from the evaluation are included next to the balance sheet items to which they belong, and the amounts that do not correspond to some identifiable items are mentioned in account no. 207 "*Goodwill*", in both cases, by means of the "*Profit and loss*" account.

The accounting reflection of merger operations in the case of the global evaluation method involves aspects that are specific to the two types of mergers, through absorption and through consolidation, as presented further below.

A. The accounting reflection of merger through absorption operations

According to pos. 101 in the *Accounting Regulations concerning annual individual financial statements and annual consolidated financial statements* approved by

and liquidation of companies as well as of withdrawal or exclusion of certain associates from companies, published in the Official Gazette of Romania, no.711 bis as of 22.09.2015, pos.20 a.

[2] OMPF no. 897/2015 for the approval of methodological norms concerning the reflection in accounting of the main operations of merger, partition and liquidation of companies as well as of withdrawal or exclusion of certain associates from companies, published in the Official Gazette of Romania, no.711 bis as of 22.09.2015, pos.20 b.

* **Note:** These accounting norms (rules) are available only for statements (balance sheets) off the ledger/off-balance necessary for determining the exchange ratio.

OMPF 1802/2014, the differences arising from the evaluation on the occasion of companies' reorganisation through merger are not recorded in their books of account. These differences are used only for the determination of the exchange ratio. For this purpose, the balance sheets that lie at the basis of determining the exchange ratio are drawn up off-ledger, as we have shown above.

In compliance with OMPF no. 897/2015 for the approval of the Methodological norms concerning the reflection in accounting of the main operations of merger, partition and liquidation of companies as well as of withdrawal or exclusion of certain associates from companies, the accounting treatment of differences arising from the evaluation called for by the merger is the following:

- the differences arising from the evaluation of the acquiring/absorbing firm are not recorded in the company's accounting;
- the differences arising from the evaluation of the acquired/absorbed company shall be treated differently in accounting, as follows:

a) *in the books of account of the acquiring company*, the differences shall be recognized as added values or minus values arising from the merger, on the basis of the balance sheet items to which that correspond or by means of the "*goodwill*" in the case of unallocated differences;

b) *in the books of account of the acquired company*, the differences shall be recognized as profits or losses resulting from the merger, by means of the revenue and expenditure accounts.

In the following section, we will present the accounting entries and the necessary explanations for a proper understanding of the accounting treatment of the merger operations in the case of employing the global evaluation method.

I. Accounting recordings in the case of the absorbed company:

1. The recording of the accounts receivable regarding the value of items such as the assets transferred on the occasion of the merger:

1400	461 *"Various debtors"*	=	7583 *"Revenue from the sale of assets and other capital operations"*	1400

Explanations: - the sum corresponding to the amount/account receivable, i.e. to the revenue regarding the transferred assets, will include both the accounting value of the assets of the absorbed company and the differences resulting from the evaluation on the occasion of the merger, recorded in the category of asset items to which they correspond or globally by means of account 207 "*Goodwill*" – in the case of unallocated positive or negative differences. Mention should be made that these *differences are recorded only off the ledger/off-balance, in the balance sheet drawn up after the evaluation of the material items, which is necessary for establishing the value of the merger contribution and of the exchange ratio.*

2. The recording of the removal from accounts of balance items such as transferred assets:

"Allowance for depreciation"	=	*"Depreciable assets accounts"*	with the value of the depreciation recorded by the

			time of the merger

6583 *“Expenses concerning the disposal of assets and other capital operations”*	=	% *“Balance asset accounts” (with net or gross accounting value)*

Explanations: - account **6583** “*Expenses concerning the disposal of assets and other capital operations”* shall record the net or gross accounting value that corresponds to items such as the transferred assets, as they were recorded in the books of account of the absorbed company and as it was agreed upon by means of the merger project. If the assets are disposed of at their gross value, then the corresponding adjustments will also be transferred.

3. Closing revenue and expenditure accounts:

121 *“Profit or loss account”*	=	6583 *“Expenses concerning the disposal of assets and other capital operations”*
7583 *“Revenue from the sale of assets and other capital operations”*	=	121 *“Profit or loss account”*

Explanations: - the balance of account 121 “*Profit or loss*” will record the profit or loss corresponding to the merger, and it represents the difference between the revenues corresponding to the transferred assets (at their evaluated value) and the expenses related to the disposed assets (recorded as their accounting value), and which corresponds to the difference between the value of the net merger contribution and the value of the net accounting asset (of the re-evaluated net asset), or the difference arising from the evaluation of the absorbed company, respectively.

4. The recording of the removal from accounts of items such as debts and adjustments corresponding to transferred asset items when assets were disposed of at their gross value:

% *“Debt accounts”* *“Adjustment accounts”*	=	461 *“Various debtors”*

5. The recording of cancellation of equity items, which correspond to the net merger contribution and the recording of the financial obligation regarding the payment of shareholders/associates:

% *“Equity items”, including account 121 – which records the loss or gain arising from the merger or the difference*	=	456 *“Settlements with shareholders/associates concerning the capital”*

resulting from the evaluation of the absorbed company, respectively		

6. Regulation of accounts 456 *"Settlements with shareholders/associates concerning the capital"* and 461 "*Various debtors*", a recording that corresponds to the redemption of financial obligations to the shareholders/associates of the absorbed company as a result of distributing shares/ social stakes by the absorbing company:

456 *"Settlements with shareholders/ associates concerning the capital"*	=	461 "*Various debtors*"

Alternative option

If we were to choose not to comply with the provisions of pos. 101 from the *Accounting Regulations concerning annual individual financial statements and annual consolidated financial statements* – approved by OMPF no.1802/2014 and, instead, we would record in accounting the differences arising from the evaluation of the absorbed company, the accounting procedure in the case of the absorbed company, with respect to the recording of the merger operations through absorption, in relation to using the global evaluation method, would be as follows:

In the books of account of the absorbed company

1. Recording the value differences (be they positive or negative) arising from the evaluation of the balance sheet items:

a) in the case of differences attributable to the evaluated balance sheet items (usually the tangible assets)

% *"Accounts with balance items such as assets"/ Asset accounts*	=	7583 *"Revenue from the sale of assets and other capital operations"*	for positive differences
6583 *"Expenses concerning the disposal of assets and other capital operations"*	=	% *"Balance asset items"*	for negative differences

b) the case of unallocated differences*:

* *These differences occur when we employ global evaluation methods for the evaluation of the absorbed company (the stock market method, methods based on results etc.), a situation in which the difference between the value of the merger contribution and the value of the net accounting asset (positive or negative) cannot be attributed to certain balance items.*

207.1 *"Positive goodwill"*	=	7583 *"Revenue from the sale of assets and other capital*	for positive differences

		operations"	
6583 *"Expenses concerning the disposal of assets and other capital operations"*	=	*207.5* *"Negative goodwill"*	for negative differences

c) the closing of revenue and expenditure accounts and the recognition of the gain or loss arising from the merger:

7583 *"Revenue from the sale of assets and other capital operations"*	=	121 *"Profit or loss"* (distinct analytic account)	the gain/profit arising from the evaluation brought about by the merger
121 *"Profit or loss"* (distinct analytic account)	=	*6583* *"Expenses concerning the disposal of assets and other capital operations"*	the loss arising from the evaluation called for by the merger

2. Recording the account/amount receivable representing the value of balance items such as transferred assets

461 *"Various debtors"*	=	7583 *"Revenue from the sale of assets and other capital operations"* (with the net/gross evaluated value of transferred assets)*

* We have shown above that in the merger project the companies can make provisions for the taking over of items such as assets, liabilities and equity at a net or gross value, a situation in which the corresponding adjustments and depreciations will be taken over.

3. The recording of the removal from accounts of items such as transferred assets:

6583 *"Expenses concerning the disposal of assets and other capital operations"**	=	% *"Balance asset accounts" – including account 207 "Goodwill"* (at gross/net evaluated value)

The sums recorded in accounts 7583 and 6583 (pos. 2 and 3 above) also contain the positive or negative results of the evaluation (operation 1a and 1b), which cancel or invalidate each other, without recognizing the difference arising from the evaluation demanded by the merger.

4. Closing the revenue and expenditure accounts corresponding to the merger operation:

7583 *Revenue from the sale of assets and other capital operations"*	=	121 * *"Profit or loss"*

121 * *"Profit or loss"*	=	*6583* *"Expenses concerning the disposal of assets and other capital operations"*

* ***Note:*** *Following these recordings, the balance of account 121 "Profit or loss" no longer reflects the difference arising from the evaluation called for by the merger, a difference which is recorded in pos. 1.*

5. The recording of the removal from accounts of items such as liabilities, adjustments and depreciation corresponding to transferred assets:

% *"Debt accounts"* *"Adjustment accounts"* *"Depreciation accounts"*	=	461 *"Various debtors"*

6. The recording of the transfer of equity elements and (financial) obligations to the shareholders/associates of the absorbed company regarding the remuneration of the merger contribution:

% *"Equity accounts"* *	=	456 *"Settlements with shareholders/associates concerning the capital"*

* *Equities also comprise the profits or losses arising from the merger, which are reflected in the balance of the "Profit or loss" account, as mentioned in the operation from pos. 1.*

7. Reception of securities for the remuneration of the merger contribution:

109 "*Company's own shares"* *(261 "Shares owned in affiliated companies")*	=	461 *"Various debtors"*

8. Distributing securities to the shareholders/associates of the absorbed company:

456 *"Settlements with shareholders/associates concerning the capital"*	=	109 *" Company's own shares"* *(261 " Shares owned in affiliated companies")*

II. Accounting recordings in the case of the absorbing company:

1. Recording the capital increase and the merger premium:

456 *"Settlements with shareholders/associates concerning the capital"*	=	% 1012 *"Post-issue paid up share capital"* 1042 *"Merger premium"*

2. Recording the taking over of asset items from the absorbed company at the value arising from the evaluation, with differences recognized directly in the category of items to which they correspond or in account 207 "*Goodwill*", in the case of unallocated differences:

% *"Balance asset accounts"* *(including account 207 "Goodwill")*	=	456 *"Settlements with shareholders/associates concerning the capital"*	at the evaluated value recorded in the books of account of the absorbed company

***Note*:** with balances specified in the delivery-receipt protocol.

3. Recording the taking over of balance items such as liabilities, adjustments and depreciations from the absorbed company:

456 *"Settlements with shareholders/associates concerning the capital"*	=	% *"Debt accounts"* *"Adjustment accounts"* *"Depreciation accounts"*

Conclusions

In all the situations in which the value of the net merger contribution differs from the value of the net accounting asset, the method of global evaluation shall be employed as a method for the accounting reflection of merger operations, a method which involves the following accounting guidelines to be complied with by the companies participating in the merger, as follows:

- <u>in the case of the absorbing/acquiring company</u>:
  - the difference between the value of the net merger contribution and the net accounting asset is not recorded in the books of account;
  - the difference between the contribution value and the value of the net accounting asset that corresponds to the absorbed company is recognized in the category of balance sheet items to which they belong or in the "*Goodwill*" account in the case of unidentifiable differences;

- in the case of the absorbed/acquired company:
  - the difference between the merger contribution value and the value of the net accounting asset is recorded as profit or loss arising from the merger, depending on the positive or negative quality of the difference.

For the purpose of recording merger operations in their books of account, accountants shall have to work with the accounting principles that correspond to the accounting regulations applicable in the time frame associated with the operation regarding a company's reorganisation through merger.

References

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