## Accounting treatment for the combinations of enterprises

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In the conditions in which the activity on the international markets has rapidly grown and the globalization is a reality of the present economical life, it is noticeable an amplification of combinations of enterprises. A combination of enterprises consists in "the reunion of separate entities in one economical entity by obtaining the control over the net asset and over the activity of one entity by another one" according to IFRS 3 "Enterprises combinations".

IFRS 3 "Combinations of enterprises" replaces IAS 22, by bringing some changes regarding:

a) accounting method-acquisition method;
b) the recognition of acquired identifiable assets, of debts and of possible assumed debts;
c) the assessment of acquired identifiable assets and of debts inclusively those contingent;
d) the accountancy of the commercial fund and of the acquired intangible assets;
e) the treatment on the positive difference between the buyer's interest from the just value of the net identifiable assets acquired through a combination of enterprises and the combination's cost.

The idea that governs SIFRS is that of the accounting treatment at the date of purchase.

### The method of purchase

The method of purchase refers to the combination of enterprises from the perspective of the unit identified in the transaction as acquired, which purchases the net asset and recognizes the acquired assets and the debs, inclusively those contingent assumed and those previously unrecognized by bought society. The contingent debt is defined as being:

A possible obligation because it must be confirmed if has a stipulated obligation which could led to a exit of incorporated resources of economical benefits, or

which does not fulfill the recognition criteria's either because it is improbable of an

A present obligation incorporated resources of economical benefits for the obligation's closing to occur, or because it is not possible to make a sufficiently credible estimation on the obligation's value.

The contingent debts are not recognized contingent asset is a possible asset that appears as a consequence of some previous events and whose identify will be confirmed only by the appearance or non-appearance of some or many insecure events, which can not be totally under the entity's control (for example an indemnification request formulated by an entity but which has an insecure result.

Two modalities regarding combinations of enterprises are acknowledged:

a) net asset acquisition ;
b) The acquisition of participation to the equity capital (one entity gets control over 50% of a subsidiary's ordinary assets with the right to vote).

The method application supposed the respect of the following stages:

1. the establishment of the acquisition's (combination's )cost;
2. the determination of the just value for the acquired entity's assets;
3. The determination of the just value for the debts and for the debts contingent to the acquired entity.

According to the conceptual IASB frame, the just value is defined as being the value at which an asset can be changed or a debt can be stopped by the free will of some parts which are aware of this, inside of transaction concluded in objective conditions. From practice is discovered that the just value's determination implies a high degree of managerial flexibility.

Taking into consideration that the assets and the gainer's debts evaluated at their acquisition cost are combined in financial situations with the acquired entity's assets and debts, evaluated at their just market value on the date of the acquisition, the buyer's balance sheets before and after the acquisition, might not be suitable for comparisons.

4. the establishment of just market value of the acquired entity's net asset as difference between the assets` just market value and the acquired company's debts.

| | | | | |
|---|---|---|---|---|
| the just market value of the net asset belonging to the acquired entity | == | the just market value of the assets belonging to the acquired entity | - | the just market value of the debts and the contingent debts belonging to the acquired entity |

5. The calculation of the commercial fond which appeared from the acquisition based on the relation:

| | | | | |
|---|---|---|---|---|
| commercial fund | = | acquisition cost | - | the just market value of the net asset belonging to the acquired entity |

The commercial fund must be recognized in the balance sheet of the gainer entity. In the professional literature, the commercial fund was and still is one of the most controversial accounting subjects. The commercial fund can not be directly evaluated. Its value is generally determined by the evaluation (based on the evaluator's criteria). As a consequence, the value of the commercial fund is subjectively determined. So, IFRS 3 stipulates that the commercial fund should not undergo amortization, but that it must undergo the depreciation test, while OMFP 1752/2005 regarding accounting regulations consentaneous with the European Union Community's reglementations stipulates the following situations:

- commercial fund usually undergoes amortization in a period of maximum 5 years;
- entities undergo their commercial fund to amortizations systematically over a period above 5 years with the condition that this period should not overpass the economical use period of the asset and that should be presented and explain in explanatory notes.

Example: Society "M" acquired in exchange of 9.000.000 m.u. (monetary units), 90% of the ordinary shares of the society "B" on the 31$^{st}$ January of the accounting period „N". At the moment of acquisition, the share holders equity of the society „N" consisted in:subscribed and paid-in-share capital 6.000.000 m.u., reservs = 3.000.000 m.u., the accounting period result = 1.000.000 m.u. Also as the consequnce of the assets` and debts` evaluation of the society „N" is considered that the net asset evaluated as the just market value is 8.200.000 m.u.

m.u.

| | | |
|---|---|---|
| Acquisition cost | | 9.000.000 |
| Subscribed and paid in share capital<br>Reserves<br>Result | 6.000.000<br>3.000.000<br>1.000.000 | |
| Net asset evaluated at the just market value | 8.200.000 | |
| Quota part that returned to “M” society from the net asset evaluated as the just market value (90% X 8.200.000 m.u.) | | 7.380.000 |
| Positive commercial fund | | 1.620.000 |

The value of the positive commercial fund, calculated in this way, is entered in the consolidated balance sheet of the “M” society at the intangible assets structure, when applying the IFRS 3 and the Accounting Regulations consentaneous with the VI Directive of the European Union Community.

The recording in the current commercial fund accounting is made by using the formula:

9.000.000 % = 404Suppliers of fixed assets 9.000.000
7.380.000 Identifiable assets
1.620.000 Commercial fund

If we taking in to account the assumption that society “M” acquire tangible assets of society “N” as the cost of acquisition of 7.000.000 m.u., the other elements having the above mentioned values, the negative commercial fund is as follows.

| | | |
|---|---|---|
| Acquisition cost | | 9.000.000 |
| Subscribed and paid in share capital<br>Reserves<br>Result | 6.000.000<br>3.000.000<br>1.000.000 | |
| Net asset evaluated at the just market value | 8.200.000 | |
| Quota part that returned to “M” society from the net asset evaluated as the just market value (90% X 8.200.000 m.u.) | | 7.380.000 |
| Negative commercial fund | | 380.000 |

As a consequence, society “M” obtained an earning because the acquisition was made at a smaller cost then the just market value. According to IFRS 3, the earning is registered in the consolidated profit and loss income account:

Identifiable = % 7.380.000
Assets 404 Suppliers of fixed assets 7.000.000
121 Consolidated profit and 380.000
Losses income

If we take in to consideration the Accounting Regulations consentaneous with the European Directives, the negative commercial fund is registered in the liability account 2075 “Negative commercial fund” and is introduced in the consolidated balance sheet at the “deferred revenue” structure.

6. the counting value assets and debts of the gainer must be combined with the assets and debts of the acquired entity.

7. the net asset of the acquired entity must not be combined with the share holders` equity of the bought company (gainer), because acquired firm ceases to exist after the acquisition.

To illustrate this, we present the following example:

Entity “V” bought entity “N” with 200.000 m.u. It is taken in to account that society “V” pays cash 25.000 m.u. and obtains a new long term loan of 175.000 m.u.

The balance sheet for the entities before the acquisition is the following:

**Before acquisition balance sheet**

| | Society “V” | Society “M” | |
|---|---|---|---|
| | | Identifiable value | Just market value |
| Long-term assets | 250 | 80 | 100 |
| - intangible assets<br>- tangible assets | -<br>250 | -<br>80 | -<br>100 |
| Current assets | 200 | 130 | 140 |
| - stocks<br>- money supply<br>- debts | 120<br>50<br>30 | 100<br>10<br>20 | 110<br>10<br>20 |
| Total assets<br>Long term debts<br>Short term debts | 950<br>100<br>50 | 210<br>60<br>30 | 240<br>60<br>30 |
| Total | 50 | 90 | 90 |
| Paid in company capital<br>Reported profit | 120<br>180 | 25<br>95 | -<br>150 |
| Total equity ownership | 300 | 120 | 150 |

Based on this data, we shall establish: the sold of money supply, commercial fund and we shall create the consolidated balance sheet.

In order to acquire, the gainer society we resort to a long term loan of 175.000 m.u.

The accounting reflection of the acquisition (partially made by 25.000 m.u. money supply and the rest from a long term loan) is registered as follows:

| | | | |
|---|---|---|---|
| 200.000 | = | % | 200.000 |
| Subsidiary Participations | | Money supply | 25.000 |
| | | Long term loans | 175.000 |

a) in a combination of enterprises, by the acquisition method are totalized the two entity’s scolds from the money supplies account and is withdrawn the cash paid as acquisition payment = 50.000+10.000-25.000=35.000 m.u. So, the sold of the money supply account is 35.000 m.u.
b) the commercial fund is the difference between the acquisition cost (paid price) and the just market value of the net asset.

- The just market value
  Of the net asset for the = 240.000 – 90.000 = 150.000 m.u.
  acquired society “N”
- Commercial fund = 200.000 – 150.000 = 50.000 m.u.

c) the registered of the acquisition operations made by the gainer company "V" of the "N" society:

| | | | | |
|---|---|---|---|---|
| subsidiary participation | = | % | | 200.000 |
| | | Cash | | 25.000 |
| | | Long term debts | | 175.000 |

The balance sheet after the acquisition is the following:

**After acquisition balance sheet (acquisition method)**

Thousand m.u.

| | Society "V" | Society "M" | |
|---|---|---|---|
| | | Identifiable value | Just market value |
| Long-term assets | 450 | 80 | 100 |
| - intangible assets | - | - | - |
| - tangible assets | 250 | 80 | 100 |
| Financial assets | 200 | - | - |
| Subsidiary participations | 200 | - | - |
| Current assets | 175 | 130 | 140 |
| - stocks | 120 | 100 | 110 |
| - money supply | 25 | 10 | 10 |
| - debts | 30 | 20 | 20 |
| Total assets | 625 | 210 | 240 |
| Long term debts | 275 | 60 | 60 |
| Short term debts | 50 | 30 | 30 |
| Total debts | 325 | 90 | 90 |
| Paid in company capital | 120 | 25 | - |
| Reported profit | 180 | 95 | 150 |
| Total equity ownership | 300 | 120 | 150 |

In order to create the consolidated balance sheet it must be registered the elimination of the account "subsidiary participations" that is emphasizing of the commercial fund and taking over the assets and debts.

| | | | | |
|---|---|---|---|---|
| 290 | % | = | % | 290 |
| 50 | Commercial fund | | Short term debts | 30 |
| 100 | Tangible assets | | Long term debts | 60 |
| 110 | Stocks | | Subsidiary participations | 200 |
| 10 | Money supply | | | |
| 20 | Debts | | | |

Consolidated balance sheet (acquisition method)

Amounts

| | | |
|---|---|---|
| Long term assets | | 400 |
| - Tangible assets (250+100) | 350 | |
| - Intangible assets | 50 | |
| - Commercial fund | | 50 |
| Current assets | 315 | |
| - Stocks (120+110) | 230 | |
| - Money supply (250+60) | 35 | |
| - Debts (30+20) | | 50 |
| Total assets | | 715 |
| Long term debts (275+60) | 335 | |
| Short term debts (50+30) | | 80 |
| Total debts | | 415 |
| Paid in company capital | | 120 |
| Reported profit | | 180 |
| Total ownership equality | | 300 |

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