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Business Combinations

1. Whenever two or more corporations are brought together, or combined, for the purpose of carrying on in a single corporation the previously conducted businesses, the accounting to give effect to the combination will vary depending upon whether there is a continuance of the former ownership or a new ownership.[1] This statement has been prepared (a) for the purpose of differentiating between these two types of corporate combinations, the first of which is designated herein as a *pooling of interests* and the second as a *purchase,* and (b) to indicate the nature of the accounting treatment appropriate to each type.

2. For accounting purposes, the distinction between a pooling of interests and a purchase is to be found in the attendant circumstances rather than in the legal designation as a merger or a consolidation, or legal considerations with respect to availability of net assets for dividends, or provisions of the Internal Revenue Code with respect to income taxes. In a pooling of interests, all or substantially all of the equity interests in predecessor corporations continue, as such, in a surviving corporation[1] which may be one of the predecessor corporations, or in a new one created for the purpose. In a purchase, on the other hand, part or all of the ownership of the acquired corporation is eliminated. A plan or firm intention and understanding to retire capital stock issued to the owners of one or more of the corporate parties, or substantial changes in ownership occurring immediately before or after the combination, would also tend to indicate that the combination is a purchase.

3. Other factors to be taken into consideration in determining whether a purchase or a pooling of interests is involved are the relative size of the constituent companies and the continuity of management or power to control the management. Thus, a purchase may be indicated when one corporate party to a combination is quite minor

[1] When the shares of stock in the surviving corporation that are received by the several owners of one of the predecessor companies are not substantially in proportion to their respective interests in the predecessor company, a new ownership or purchase of such company is presumed to result.

in size in relation to the others, or where the management of one of the corporate parties to the combination is eliminated or its influence upon the management of the surviving corporation is quite small. Other things being equal, the presumption that a pooling of interests is involved would be strengthened if the activities of the businesses to be combined are either similar or complementary. No one of these factors would necessarily be determinative, but their presence or absence would be cumulative in effect.

4. When a combination is deemed to be a purchase the assets purchased should be recorded on the books of the acquiring company at cost, measured in money or the fair value of other consideration given, or at the fair value of the property acquired, whichever is more clearly evident. This is in accordance with the procedure applicable to accounting for purchases of assets.

5. When a combination is deemed to be a pooling of interests, the necessity for a new basis of accountability does not arise. The book values of the assets of the constituent companies, when stated in conformity with generally accepted accounting principles and appropriately adjusted when deemed necessary to place them on a uniform basis, should be carried forward; and retained incomes of the constituent companies may be carried forward. If one party to such a combination had been acquired as a subsidiary by another such party prior to the origin of a plan of combination, the parent's share of the retained income of the subsidiary prior to such acquisition should not be included in the retained income account of the pooled companies.

6. Due to the variety of conditions under which a pooling of interests may be carried out it is not practicable to deal with the accounting presentation except in general terms. A number of problems will arise. For example, the aggregate of stated capital of the surviving corporation in a pooling of interests may be either more than, or less than, the total of the stated capital of the predecessor corporations. In the former event the excess should be deducted first from the aggregate of any other contributed capital (capital surplus), and next from the aggregate of any retained income (earned surplus) of the predecessors; while in the latter event the difference should appear in the balance-sheet of the surviving corporation as other contributed capital (capital surplus), analogous to that created by a reduction in stated capital where no combination is involved.

The statement entitled "Business Combinations" was unanimously adopted by the twenty-one members of the committee. Messrs. Andrews, Paton, and Wellington assented with qualification.

Messrs. Andrews, Paton, and Wellington qualify their assent because they believe Paragraph 5 is misleading in so far as it fails to make clear that any adjustment of asset values or of retained income which would be in conformity with generally accepted accounting principles in the absence of a combination would be equally so if effected in connection with a pooling of interests.

NOTES

1. Accounting Research Bulletins represent the considered opinion of at least two-thirds of the members of the committee on accounting procedure, reached on a formal vote after examination of the subject matter by the committee and the research department. Except in cases in which formal adoption by the Institute membership has been asked and secured, the authority of the bulletins rests upon the general acceptability of opinions so reached. (See Report of Committee on Accounting Procedure to Council, dated September 18, 1939.)

2. Recommendations of the committee are not intended to be retroactive, nor applicable to immaterial items. (See Bulletin No. 1, page 3.)

3. It is recognized also that any general rules may be subject to exception; it is felt, however, that the burden of justifying departure from accepted procedures must be assumed by those who adopt other treatment. (See Bulletin No. 1, page 3.)

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