Valuation of assets and receivables and documentation of transfer in merging company 1/43/21

During its lifetime a company often has to adapt to new circumstances arising from its internal changes or external changes such as legislative amendments. The first thing that comes to mind when hearing the word “reorganisation” is change, something different, something being transformed, rebuilt, or improved. And that makes sense because a reorganisation means substantial changes in the company that are commonly undertaken to simplify or change the group structure, to expand its business, or, conversely, to split off lines of business.

Types of reorganisation

The process of reorganisation can be thought of as a corporate transformation. This may involve private limited companies (SIA), public limited companies (AS), and partnerships. There are several types of reorganisation.

Mergers and acquisitions:

- Merger – two or more merging companies transfer all of their property to a newly formed company.
- Acquisition – a company transfers all of its property to another acquiring company.
- Cross-border merger – a merger of two or more companies, at least one of which is registered in Latvia and the others incorporated under the national laws of EU member states.

Divisions:

- Split-up – a company transfers all of its property to two or more acquiring companies and ceases to exist without going into liquidation.
- Split-off – a company transfers some of its property to one or more acquiring companies and continues in existence.
- Transformation – one type of company is changed into another type of company. The transforming company passes all of its rights and obligations to the acquiring company and ceases to exist without going into liquidation.

This article explores accounting aspects in a company being reorganised by merger.

Valuing the assets and receivables and documenting the transfer in the merging company

A key stage of the reorganisation process is notifying creditors. Once the general meeting of shareholders has resolved to reorganise, each of the companies concerned has 15 days to notify their creditors in writing and to publish a notice to creditors in the official gazette “Latvijas Vestnesis.”

Although a reorganisation involves liabilities and obligations passing to the acquiring company under the Commerce Act, for practical reasons companies often choose to re-sign their agreements separately (e.g. agreements with creditors, debtors, existing employees, entities to which the company has made loans or towards which there are some other liabilities obtained in the merging company). Novating an agreement allows the parties to document their existing relationship at the time of novation. This may be important in employment contracts in order to state, for instance, the number of vacation days unclaimed by the date of transfer, or the length of service, thereby giving the employees a sense of security about the reorganisation not adversely affecting their employment with the company.

An important step is re-registering the employees and preparing a file on each of them. From the date set as an employee’s last working day in the merging company, the employer must report the following codes to the State Revenue Service via the Electronic Declaration System (EDS):

- Code 23 for employees
- Code 23 for pregnant women

The acquiring company should report the employees at its end of EDS with the following codes from the next day:

- Code 11 for employees
- Codes 11 and 40 for pregnant women

The effective date of the reorganisation is important for accounting purposes because that is the date for computing the current monthly salary, accrued vacation days for transfer to the acquiring company, and the average daily or hourly earnings.

The closing stage of the reorganisation involves a process that is similar to preparing the annual report. We need to check all account balances, assess each account, and look out for inaccuracies or errors.

The following inventories should be drawn up for accounting purposes:

- Fixed assets and intangibles
- Derecognition of any obsolete and worn-out fixed assets
- Inventory and valuation of debtors and accuracy of the actual balance
- Shareholders’ equity
- Cash and cash equivalents
- Inventory and valuation of creditors and accuracy of the actual balance

Once all accounts have been inventoried and checked, we can start preparing the closing financial statement, which is essentially similar to the annual report. This statement will list all the property, receivables and payables the merging company will pass to the acquiring company from the next day after the reorganisation takes effect. All the documents and data handed over to the acquiring company must be supported by statements of delivery and acceptance.