Pooling of Interests

What is Pooling of Interests?
- No takeover but a union
- Pooling: owners of separate firms combine for mutual benefit
  - Exchange ownership shares
  - No parent or subsidiary

Controversy with pooling
- Pooling ignores costs of transaction
- Book values remain as if nothing happened
- Pooling: Seller’s cost; Purchase: Buyer’s cost
- Pooling gives:
  - Less information
  - Ignores values exchanged
  - Investors and statement readers can’t tell how much was invested
  - The two methods are difficult to compare
  - Boost in earnings is artificial
  - Combinations are acquisitions, and should be valued at what is given up in exchange
- SFAS 141: all business combinations are done by the purchase method

Criteria for pooling
- Single transaction ➔ exchange of voting stock
- Complete fusion- one had to obtain 90% of other’s stock
- No agreement to reacquire shares
  - Significant assets could not be sold for 2 years
    - Except if duplication existed
- Dissolution
  - Combination costs not capitalized: entire amount expensed

<table>
<thead>
<tr>
<th>Pooling</th>
<th>Purchase</th>
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<tr>
<td>Retain book values</td>
<td>Fair value</td>
</tr>
<tr>
<td>No goodwill</td>
<td>Goodwill: purchase price&gt;FMV of assets</td>
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<tr>
<td>Recognize revenue and expenses</td>
<td>Recognize revenues and expenses that</td>
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<td>Retroactively</td>
<td>accrue after date of acquisition</td>
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<td>Shares based on book value of</td>
<td>Based on fair value of net assets</td>
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<td>Subsidiaries stock and RE</td>
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<td>Combination costs expensed</td>
<td>Costs included in price; stock issue</td>
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<td>reduces paid-in-capital</td>
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Creating a Pooling of Interests

• Issue stock with investment  
  o Equity method: accrue income as earned by other company and adjust for inter-company transactions  
• No cost method, but a book value method  
  o Book value of assets and liabilities of both become book values reported by combined entity  
  o Revenue and expense accounts are combined retroactively as well as prospectively  
• Criteria: 2 broad categories  
  o Single transaction  
    • Obtain 90% of voting stock of the other  
  o Prevent purchases from being disguised as a pooling

Accounting for Pooling of Interests

• No allocations or goodwill (and no amortization expense)  
• Steps in accounting  
  o Book values of assets and liabilities of both companies become book values reported by combined entity  
  o Revenue and expense accounts are combined retroactively and prospectively  
• Reported income is usually higher