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**FEE SURVEY ON
BUSINESS COMBINATIONS**

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1. INTRODUCTION, OVERVIEW AND COUNTRIES STUDIED

1.1 Introduction

The purpose of this report is to give an overview of methods of accounting for business combinations have been used in the consolidated financial statements of major European companies in 1999 and 2000 in order to be able to contribute to the discussion on accounting methods for business combinations. A limited review of the country's legislation and national standards has been conducted in order to provide insight into the possible methods of accounting for business combinations in a certain country. The report also provides an overview of goodwill treatments. It is not intended to provide a complete picture of each country's current situation concerning business combinations nor to describe in detail the specific national requirements or regulations.

This chapter gives an overview of business combinations and accounting methods, then an outline of the survey of practice, then some conclusions. Chapter 2 examines national regulations and chapter 3 reports on the survey.

The scope of this report is limited to consolidated financial statements. It does not cover those business combinations where the new subsidiaries are not consolidated but are accounted for by the equity method, for example because they are dissimilar.

The study deals with the accounting for business combination:

- under national requirements, as well as
- under IAS and US-GAAP, where national law allows for the application of IAS or US-GAAP instead of national accounting standards.

This study does not cover asset deals or accounting for legal mergers in the financial statements of individual companies; it covers consolidated statements. It also does not study transactions under common control.

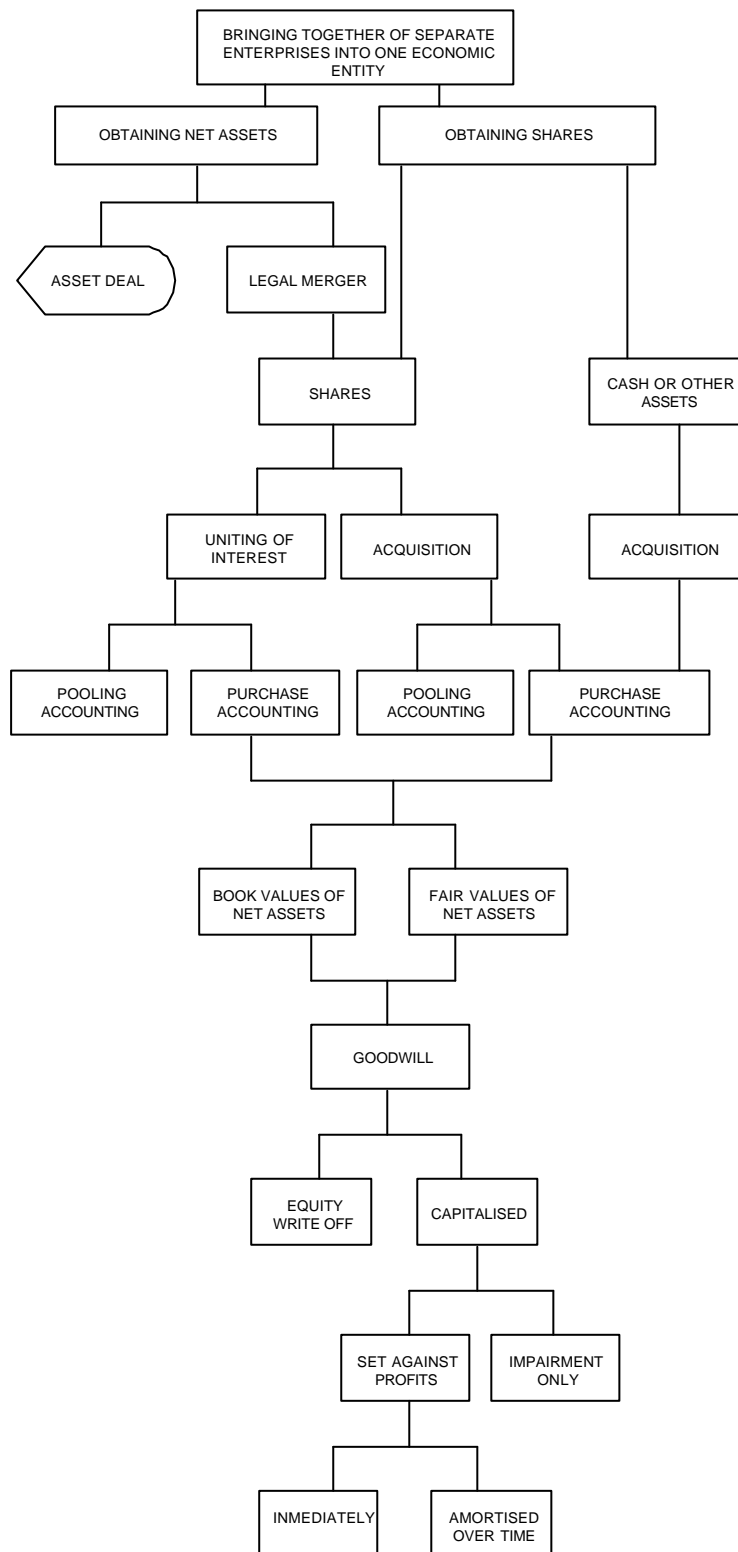
1.2 Overview of combinations

In our study, we use the IAS 22 definition of a business combination as the bringing together of separate enterprises into one economic entity as a result of one enterprise uniting with or obtaining control over the net assets and operations of another enterprise.

Business combinations can be examined by splitting the subject up into six elements:

- What is being obtained: shares (in entities) or other assets?
- What is the consideration: by transferring shares (contribution in kind or legal merger), cash, or other assets?
- What is the substance of the transaction: an acquisition or a uniting?
- How is it accounted for: by purchase, pooling or fresh start?
- How is any goodwill calculated?
- How is goodwill treated?

Figure 1 outlines this six-stage analysis as found in regulations and practice.



1. What is being obtained?

2. What is the consideration?

3. What is the substance of the transaction?

4. How is the transaction accounted for?

5. How is any goodwill calculated?

6. How is positive goodwill treated?

Figure 1. An overview of combinations in practice

What is being obtained?

Stage 1 is to identify what is being obtained. This report concentrates on obtaining the control by one legal entity over another legal entity, which is the normal procedure for large business combinations. The report does not consider the purchase by a legal entity of the net assets from another entity.

There are various ways of obtaining control (see Figure 1, Stage 1). One way is in exchange for shares or cash. Another way is through a legal merger. The definition of the term “legal merger” is provided by law in most of the EU countries surveyed. This is usually directly derived from the Third Company Law Directive, both for merger by acquisition and merger by formation of a new company.

Article 3 of the Third Company Law Directive defines “merger by acquisition” and Article 4 defines “merger by the formation of a new company”.

Article 3

1. *For the purposes of this Directive, “merger by acquisition” shall mean the operation whereby one or more companies are wound up without going into liquidation and transfer to another all their assets and liabilities in exchange for the issue to the shareholders of the company or companies being acquired of shares in the acquiring company and a cash payment, if any, not exceeding 10% of the nominal value of the shares so issued or, where they have no nominal value, of their accounting par value.*
2. *A Member State’s laws may provide that by acquisition may also be effected where one or more of the companies being acquired are in liquidation, provided that this option is restricted to companies which have not yet begun to distribute their assets to their shareholders.*

Article 4

1. *For the purposes of this Directive, “merger by the formation of a new company” shall mean the operation whereby several companies are wound up without going into liquidation and transfer to a company that they set up all their assets and liabilities in exchange for the issue to their shareholders of shares in the new company and a cash payment, if any, not exceeding 10% of the nominal value of the shares so issued or, where they have no nominal value, of their accounting par value.*
2. *A Member State’s laws may provide that merger by the formation of a new company may also be effected where one or more of the companies which are ceasing to exist are in liquidation, provided that this option is restricted to companies which have not yet begun to distribute their assets to their shareholders.*

The main characteristics of legal mergers are the following:

- prior existence of at least two companies;
- legal transfer of all assets and liabilities of one or more of them;
- dissolution of one or all the previous companies without liquidation;
- the company after merger is the company which was not wound up or is the newly established company.

What is the consideration?

Stage 2 is to identify the consideration. At its simplest, this involves the payment of cash to acquire shares. However, often part or all of the consideration involved is the transfer of shares.

What is the substance of the transaction?

Stage 3 of the analysis is to identify whether the substance of the transaction is a uniting of interests or an acquisition. This issue needs to be separated from the issue of how to account for the combination (see Stage 4). According to IAS 22, an acquisition is a business combination in which one of the enterprises, the acquirer, obtains control over the net assets and operations of another enterprise, the acquiree, in exchange for the transfer of assets, incurrence of a liability or issue of equity. A uniting of interests is a combination in which one of the shareholders of the combining enterprises combine control over the whole, or effectively the whole, of the net assets and operations to achieve a continuing mutual sharing in the risks and benefits attaching to the combined entity such that neither party can be identified as an acquirer.

If one party has paid out cash, it could be argued that it is obviously an acquirer. If only shares are used, then it may still be possible to identify an acquirer, although the substance may be that two parties have joined on an equal basis and none of them can be identified as the acquirer. It is generally thought that unitings are rare.

How is the transaction accounted for?

For Stage 4, the first point to note is that transactions are in practice not always accounted for in accordance with their substance. There are several accounting methods which could be applied when dealing with a business combination. They can be divided broadly into three classes of methods of accounting:

1. The purchase method (also known as purchase accounting)
2. The pooling-of-interest method (also known as merger accounting or pooling accounting).
3. New entity method (also known as the fresh start method).

As noted above, the substance of a combination needs to be thought of separately from the method of accounting for it. In practice, the method chosen does not always correspond with the substance of the combination. This is allowed in some regulations. In IAS 22:

- a business combination which is an acquisition should be accounted for by the use of the purchase method (para 17);
- a uniting of interests should be accounted for by the use of the pooling of interests method (para 77).

Acquisition accounting

Under acquisition accounting, the identifiable assets and liabilities of the companies acquired should be included in the acquirer's consolidated balance sheet at their fair value at the date of acquisition. The results and cash flows of the acquired companies should be brought into the group accounts only from the date of acquisition. The figures for the previous period for the reporting entity should not be adjusted. The difference between the fair value of the net identifiable assets acquired and the fair value of the purchase consideration is goodwill, positive or negative.

Pooling accounting (pooling of interests)

With pooling accounting the carrying values of the assets and liabilities of the parties to the combination are not required to be adjusted to fair value on consolidation, although appropriate adjustments should be made to achieve uniformity of accounting policies in the combining entities.

The results and cash flows of all the combining entities should be brought into the financial statements of the combined entity from the beginning of the financial year in which the combination occurred, adjusted so as to achieve uniformity of accounting policies. The corresponding figures should be restated by including the results for all the combining entities for the previous period and their balance sheets for the previous balance sheet date, adjusted as necessary to achieve uniformity of accounting policies.

The difference, if any, between the nominal value of the shares issued plus the fair value of any other consideration given, and the nominal value of the shares received in exchange should be shown as a movement on other reserves in the consolidated financial statements. Any existing balance on the share premium account or capital redemption reserve of the new subsidiary undertaking should be brought in by being shown as a movement on other reserves. These movements should be shown in the reconciliation of movements in shareholders' funds.

The purchase method and the pooling of interest method are allowed by the Seventh Directive, although pooling is a Member State option in Article 20.1. In many countries, this option is specifically allowed. In principle, if the option is not included in the law of a Member State, then pooling is not allowed. For example, there is no mention of the option in the Dutch law. However the explanatory notes to the Dutch law implementing the Seventh Directive reveals that the Dutch Government interpret this article as only referring to a specific UK-situation. The general opinion in the Netherlands is that neither the law (nor the Seventh Directive) give any guidance on the accounting method to be used in acquisitions or mergers. So all methods are presumed to be allowed as long as they are generally acceptable. In several other countries (e.g. Belgium and Denmark) the issue is also not specifically addressed in law but the method is nevertheless thought to be allowed. In other countries, it is clearer that the method is not allowed.^a

As noted above, under IAS 22 the method applied to account for a business combination depends on the economic substance of the combination. Accordingly, when no acquirer can be identified, the pooling method should be used.

In some countries accounting principles allow business combinations that are in substance acquisitions to be accounted for by applying pooling accounting and, contrarily, business combinations which are in substance unitings of interest by applying the purchase method. Figure 1 shows this at Stage 4.

The G4+1 has made some recommendations for achieving convergence in the methods used to account for business combinations. In its position paper, the G4+1 investigates whether a single method of accounting for business combinations is preferable to two (or even more) methods; which method should be applied to all business combinations if a single method of accounting is in fact preferable; and which methods should be applied to which combinations if more than one accounting method is preferable.

^a Source: FEE study "Seventh Directive options and their Implementation" (1993)

After investigating these questions the group recommended that the purchase method of accounting should be applied to all business combinations. The pooling method should not be used for any business combinations. For certain combinations, it might be appropriate to use the fresh start method. The proposal to eliminate pooling was taken up in the USA in 2001 with SFAS 141.

The fresh start method is not common in the requirements or practice of EU countries. The method involves incorporating the net assets all the combining parties at fair values.

How is any goodwill calculated?

Stage 5 of the analysis concerns the calculation of goodwill. This can either be made by reference to the book values or to the fair values of the acquired net assets. IAS 22 requires fair value. In the case of the Seventh Directive (Article 19), fair value is allowed but so is book value. However, in the latter case, the Directive requires the consolidation differences to be allocated to the net assets up to their fair values. These two methods are called the fair value method and the book value method. However, in some countries (e.g., Hungary), it is possible to leave the net assets at book values.

How is goodwill treated?

Stage 6 covers the subsequent treatment of any goodwill arising. Usually, this goodwill is positive. Under the Seventh Directive, such goodwill can be capitalised or immediately written off against reserves. The latter is not allowed by IAS 22. Depending on the set of regulations, capitalised goodwill is sometimes amortised over useful life (sometimes limited to, for example, 20 years). Some national rules allow indeterminate life, no amortisation, but impairment tests. Negative goodwill occurs less frequently. The rules are complex, and noted later.

1.3. Countries studied

The survey on business combinations was conducted using the 1999 and 2000 consolidated financial statements of major European companies. The business combinations were selected by each member of the FEE Accounting Working Party for his or her own country. Consequently, the sample has no statistical validity but contains examples thought to be indicative of major combinations in the country concerned. Not all countries had major business combinations which could be involved in the study. For these countries only the limited survey on national regulations has been included.

Consequently, this report covers all EU countries (except Greece) and seven other European countries. However, for six of these 21 countries, only regulations rather than practices were studied. The description of national regulations (in chapter 2) relates to those in force in August 2001, although in a few cases subsequent changes to regulations are noted. Table 1 shows the countries studied in this report.

Table 1. Countries studied

	<i>Business combinations and regulations</i>	<i>Only regulations</i>
Austria	X	
Belgium		X
Czech Republic		X
Denmark	X	
Finland	X	
France	X	
Germany	X	
Hungary	X	
Ireland	X	
Italy	X	
Luxembourg	X	
Netherlands	X	
Norway	X	
Poland		X
Portugal	X	
Romania		X
Slovenia		X
Spain	X	
Sweden	X	
Switzerland	X	
United Kingdom	X	

2. NATIONAL LEGISLATION AND NATIONAL STANDARDS

2.1 Use of IAS / US GAAP

In 1998, G7 Finance Ministers and Central Bank Governors committed themselves to endeavour to ensure that private sector institutions in their countries comply with internationally agreed principles, standards and codes of best practice. They called on all countries which participate in global capital markets similarly to commit to comply with these internationally agreed codes and standards.

Many countries already endorse International Accounting Standards as their own either without amendment or else with minor additions or deletions. Furthermore, important developments are taking place in the European Union, where the European Commission is progressing proposals that will require all listed companies in the European Union to prepare their consolidated financial statements using International Accounting Standards. Already, both inside and outside the EU, many leading companies have stated that they prepare their financial reports in accordance with International Accounting Standards.

Thus, in several European countries, companies are allowed to apply IAS or US GAAP by their National Legislation and Standards. This includes Austria, Germany and Finland. Also, in the Czech Republic, the amendment of the Act on Accounting has been approved. This Act allows companies to prepare the consolidated financial statements in accordance with IAS or other internationally accepted accounting principles instead of the national regulations. It should be applied for the purposes of the consolidated financial statements related to the accounting period beginning on or after 1 January 2002.

In Denmark, France, Italy and the Netherlands, laws to this effect have been enacted but not put into effect by 2001.

2.2 Regulations on accounting methods

Austria

The preparation of consolidated financial statements in Austria is regulated by the Commercial Code (§§ 250 - 262 HGB). There are no other specific legislations referring to business combinations except those regulations of the Commercial Code. There are no national standards. The only method allowed in Austria to account for a business combination is the purchase method. The pooling of interest method was not transferred into Austrian law. The purchase method consists of two types: 1. The book value method ("Buchwertmethode") and 2. The limited revaluation method ("Neubewertungsmethode"). The main difference between the two methods lies in the accounting treatment for the minority interest.

By the way of the book value method the capital and reserves (equity of the subsidiary) shall be set up with the amount corresponding to the book value of the assets, untaxed reserves, accruals, liabilities, and prepaid expenses and deferred charges to be included in the consolidated financial statements. A resulting difference shall be added to or subtracted from the valuation bases of the assets and debts to be shown in the consolidated financial statements of the respective subsidiaries, in so far as their fair value is higher or lower than the book value. The minority interest is not revalued.

Using the revaluation method the capital and reserves (equity of the subsidiary) shall be set up with the amount corresponding to the fair value of the assets, untaxed reserves, accruals, liabilities, and prepaid expenses and deferred charges to be included in the consolidated financial statements and which is to be attributed to these at the point of the time of the acquisition of shares or of the first inclusion of the subsidiary or of the first time at which the company became a subsidiary. When valuing with this fair values, the proportionate capital and reserves may not be set up with an amount which exceeds the parent undertaking's acquisition cost for the shares in the included subsidiary. The minority interest is also valued at fair values.

The method applied shall be stated in the notes to the consolidated financial statements.

Belgium

In Belgium, the law on consolidated financial statements Royal Decree 6 March 1990 regulates business combinations. The methods described in the Seventh Directive are allowed to account for a business combination.

Czech Republic

There is only one method to account for a business combination allowed in Czech Republic. This method should be described as the purchase method. The difference with the normal purchase method is that the identifiable assets and liabilities are not measured at fair values but the carrying amounts are used both for the acquirer's interest and the minority's proportion.

Denmark

Under the law, which was in effect until December 31, 2001 only the purchase method was regulated. The pooling of interest method was in practice allowed if the substance of the transaction was a uniting of interests.

On 22 May 2001 the Danish Parliament approved a new Annual Accounts Act that comes into force on 1 January 2002. The new law has been compiled with the possibility to prepare consolidated accounts in accordance with IAS, when it is in compliance with the 4th and 7th directives and in general gives a true and fair view. The new law introduces to a large extent the same fundamental accounting principles and requirements concerning recognition and measurement as in IAS. However, the provisions of the law are not so detailed as IAS 22. In the new Danish law, there is a separate section with provisions in the new law referring to business combinations. These provisions are, in general, in compliance with IAS 22.

The Danish Institute of Chartered Accountants (FSR) has issued a draft accounting standard on Business Combinations (U19). Compliance with the accounting standards are only required for companies listed on the Copenhagen Stock Exchange. The draft standard is based on IAS 22. It is proposed that the new standard should be applicable for financial statements covering periods on or after 1st January 2002,

Under the new law and accounting standards, two methods of accounting for business combinations are allowed in Denmark. These two methods are the purchase and the pooling of interest method. The way in which the methods should be used depends on the type of business combination. The purchase method should be applied to a business combination which is an acquisition, where one of the combining enterprises obtains control over the other combining

enterprise, thereby enabling an acquirer to be identified. The use of the purchase method in connection with the acquisition of an enterprise being should be similarly to the purchase of other assets.

The starting point is that a business combination is an acquisition. In exceptional cases, it may not be possible to identify an acquirer. Instead of a dominant party emerging, the shareholders of the combining enterprises join in a substantially equal arrangement to share control over the whole, or effectively the whole, of their net assets and operations. Such a business combination must be accounted for as a uniting of interests using the pooling of interests method.

Finland

Legislation referring to business combinations is stated in the Finnish Accounting Act (Chapter 6). There are no national standards on accounting for a business combination. More than one method is allowed to account for a business combination. One of the method which is allowed is the purchase method, which is stated in the Finnish accounting act (chapter 6, article 8). The pooling of interest method is also allowed (chapter 6, article 9).

In Finland, the choice of accounting method depends upon whether the substantial majority of the voting common shares of the combining are exchanged. The choice of accounting method also requires that the subsidiary and the parent undertaking are not materially different in size or line of business.

France

The purchase method is the normal way to account for in France a business combination. It has been thoroughly redefined by the règlement 99-02 of the Comité de la Règlementation Comptable, which is in force at the latest for the years opened on 1 January 2000 and after. The purchase method in France is now very close to IAS 22.

The pooling of interests method is defined in France in paragraph 215 of the règlement CRC 99-02 which is in force since 1 January 2000. This method can be applied in France to business combinations for which the two following conditions are met:

- the acquiring company acquires an interest of 90% or more in the acquired company;
- the consideration consists of shares of the acquiring company or of a subsidiary of this company; consideration other than shares cannot exceed 10% of the consideration in shares.

This method is optional and the acquisition method remains the normal method even for an acquisition which qualifies for the pooling of interests method. The pooling of interests method does not apply specifically to business combinations which are "uniting of interests" as referred to in IAS 22; this kind of business combination is not defined in France.

Within two years of the acquisition date, an acquisition accounted for under the pooling of interests method should be restated retrospectively under purchase accounting in case of transaction with the vendor resulting in consideration other than shares exceeding 10% of the shares or when the percent held in the acquired company falls under 90%.

A method similar to fresh-start method is applied in France in cases where existing companies would be acquired by a newly formed holding company. In this case, the assets of the acquired

companies would be consolidated at their fair values by the holding company as of the acquisition date.

The fresh-start method would also be applied through a full revaluation process which is allowed for the preparation of consolidated accounts.

Germany

In Germany, accounting requirements distinguish between the accounting for asset deals, business combinations in form of a legal merger and the accounting for other business combinations like share deals resulting in a parent-subsiary relationship:

The preparation of consolidated financial statements is regulated by § 290 to § 315 HGB and - for large companies without limited liability - by the Publizitätsgesetz. These rules apply only to share deals. For asset deals specific regulations exist for individual accounts (§ 242 to § 289 HGB). Accounting for business combinations treated as a legal merger is regulated under the Transformation Act (Umwandlungsgesetz).

There is more than one method allowed in Germany to account for a business combination in the form of a share deal. According to § 301 HGB two variants of the purchase method are permitted: The book value method (Buchwertmethode) and the limited revaluation method (Neubewertungsmethode). Both methods are based on the concept that for the first time consolidation of a company it is assumed that a bunch of assets and liabilities were acquired. The interest is replaced by individual assets and liabilities. Consequently both variants of the purchase method require the application of current values for the assets and liabilities, but limited to the cost of acquisition of the shares. The main difference between the two methods consists in the accounting for minority interests. When applying the book value method the hidden reserves and liabilities are only presented corresponding to the proportion of the equity acquired. With the limited revaluation method the hidden reserves and liabilities of the minority interests increase or decrease the difference due to consolidation.

According to § 302 HGB the pooling of interest method may only be applied if the following conditions (derived from the Seventh Directive) are fulfilled:

- ninety percent of the subsidiary's subscribed capital belongs to the parent enterprise;
- the shareholders of the acquired enterprise receive as the main consideration for their shares not cash but shares in the parent enterprise or another consolidated subsidiary instead;
- any cash payment to these shareholders does not exceed 10 per cent of the nominal value of the shares.

The subsidiary's assets and liabilities are included in the group accounts at their book value. The difference between the book values and the consideration given is taken directly to equity.

Some business combinations may take the form of a legal merger. The accounting for legal mergers is regulated in the Transformation Act (Umwandlungsgesetz). The Accounting and Auditing Board of the Institut der Wirtschaftsprüfer (IDW) has issued the pronouncement HFA 2/1997 "Zweifelsfragen der Rechnungslegung bei Verschmelzungen". This pronouncement provides guidance how to account for in a legal merger.

According to § 24 UmwG a free choice of two methods exist:

- the purchase method requires to allocate the cost of the acquisition to the assets and liabilities acquired (up to their fair value) with any remainder being considered goodwill. The goodwill has to be amortised over 4 years at a rate of at least a quarter each year or over the useful life. Alternatively, the goodwill can be taken to the profit and loss account immediately;
- the bookvalue method requires to value assets and liabilities at the bookvalue of the combined enterprise. Any difference between the bookvalues and the consideration given has to be recognised in the profit and loss account.

The German Accounting Standards Committee (GASB) has issued the German Accounting Standard No. 4 “Acquisition accounting in consolidated financial statements” in which some of the options to account for business combinations are closed. Based on the concept stipulated in § 342 HGB the GASB is not allowed to qualify certain choices provided by the law as not acceptable. To the extent that a legally permissible alternative treatment with respect to the application of consolidation accounting principles is exercised in a consolidated financial statement in contravention of GAS No. 4 this does not justify a reservation of the auditor on the consolidated financial statements with respect to the propriety of the consolidated accounting.

Hungary

The preparation of consolidated financial statements in Hungary is regulated by the Accounting Act. The Company Act regulates the legal merger. The only method allowed in Hungary to account for a business combination is the purchase method. The pooling of interest method is not allowed. The purchase method consists of two types: 1. The book value method and 2. The revaluation method. It is optional which is used. The revaluation method can be done either by revaluing each asset to fair value or to establish the value by income generating method. If the latter is used the difference of the total of the individual assets and the value of the enterprise is goodwill which is to be accounted by the assets.

Using the revaluation method the capital and reserves shall be set up with the amount corresponding to the fair value of the assets, untaxed reserves, accruals, liabilities, and prepaid expenses and deferred charges

Ireland

Ireland has a number of national standards on accounting for a business combination. These standards are FRS 6 ‘Acquisitions and Mergers’, FRS 7 ‘Fair values in acquisition accounting’ and FRS 10 ‘Goodwill’.

In Ireland, it is allowed to use acquisition accounting (purchase method) and merger/pooling accounting (pooling of interest method) to account for a business combination. These methods are stated in the national legislation and national standards of Ireland. Merger accounting can only be used when some criteria are met. Specific criteria are set out in the standards and the law for the use of merger accounting. All other combinations not meeting these criteria must be accounted for using the acquisition method.

In Ireland, the choice of accounting method is influenced by the fair value of one enterprise compared to that of the other enterprise. Furthermore, the choice of accounting method also depends on whether the shareholders of each enterprise maintain substantially the same voting rights and interest in the combined entity.

When a business combination is like a group reconstruction, one can use merger accounting notwithstanding that the criteria in the accounting standards are not met in full.

Italy

In Italy there is no specific legislation on accounting for business combinations, but new legislation on this issue has been decided and will be applicable shortly. The civil rules relating to contribution in kind, mergers and acquisitions have been interpreted in order to find suitable accounting methods. Authors, Court decisions and, relating to the stock exchange, the national stock exchange commission (CONSOB) have recommended some applicable accounting methods.

No national standard on accounting for business combinations exists at the moment in Italy.

There are two methods of accounting for business combinations used in Italy; the purchase method and the pooling of interest method. The purchase method is commonly applied for the accounting of a contribution in kind consisting of a business (acquisition of net assets by issue of shares). Relating to legal mergers and division of operations the purchase methods is normally applied when differences arise between the accounting value of shares owned by a company and the values of assets and liabilities of the controlled company involved in the business combination.

Some auditors and CONSOB are recommending the purchase method in all combinations that can be considered acquisitions. The pooling of interest method is commonly applied for the accounting of legal mergers in which assets and liabilities of two companies, that will extinguish, are transferred to a new company.

Luxembourg

In Luxembourg, Section XVI of the Companies Law, which is closely derived from the provisions of the Seventh Directive, refers to business combinations. The purchase method, the pooling of interest method and the fresh-start method are allowed in the legislation. The choice of accounting method generally reflects the legal form of the business combination. Companies applying IAS may use criteria under IAS 22.

Netherlands

In the Netherlands, the law is silent about the accounting methods that can be used in business combinations. However the “Richtlijnen voor de Jaarverslaggeving” (the Guidelines on Annual Accounts) from “de Raad voor de Jaarverslaggeving” (the Council on Annual Reporting) gives standards that are based on IAS.

These standards allow purchase accounting as well as merger accounting (pooling of interest). Normally for a business combination the purchase method has to be used. Only if the business combination is a uniting of interests is the pooling method allowed. A uniting of interests exists if the shareholders of the parties involved get the control over the whole or nearly the whole of the equity and of the whole or nearly the whole of the operations of the united entities. The distribution of the risks and rewards of the new entity over the parties should be such that none of the involved parties can be recognized as an acquirer. In the Guidelines there are some conditions mentioned that normally have to be met to conclude to an uniting of interests. To the

conditions that have to be met belong the fact that the transaction is in substance an exchange of shares and has the intention for a long term sharing of risks and rewards.

Using the pooling of interest method (merger accounting) the company has to include the assets and liabilities as well as the income and expenses of the uniting entities as if there was one entity during the year of the merger. Differences between the value of the net assets contributed to the new entity and the shares obtained have to be accounted for under reserves. It is allowed to harmonize the accounting principles used by the entities. The differences with prior valuations have to be accounted for as a change of accounting principles.

Norway

The Norwegian Accounting Act regulates the accounting treatment of business combinations. Additional regulation is found in national standards. These standards are the preliminary Norwegian Accounting Standard regarding consolidated accounts and group formation, the preliminary Norwegian Accounting Standard regarding legal mergers and the preliminary Norwegian Accounting Standard regarding legal demergers.

In Norway, two methods of accounting for business combinations are allowed. These methods are: the purchase method and the pooling of interest method. These methods are stated in the national legislation and standards. The choice of accounting method depends on the substance of the transaction. If the transaction is an acquisition, the purchase method has to be used. When the transaction in rare circumstances is in substance merger of equals, the pooling of interest method has to be used. The pooling of interest method also has to be used in connection with reorganisations with unaltered ownership. Two types of such reorganisations exist; mergers between companies under common control and mergers between companies with identical ownership.

Poland

The Polish regulations require business combinations to be accounted for using the purchase method or the pooling of interest method. The Accounting Act specifies some detailed conditions, which need to be met in order to be able to use the pooling of interest method, basically these mean that the method can only be used when no acquirer can be identified.

Accounting for business combinations using the purchase method requires valuing of assets and liabilities of the controlled company at their fair value. Valuing at book value is used while accounting for business combinations using the pooling of interest method.

In Poland, accounting for business combinations is regulated by the Act of 9th November 2001 on amending the Accounting Act. Regulations on accounting for business combinations are a subject of the new chapter of the Accounting Act (Chapter 4a: Business Combinations). These regulations are based on IAS. The amended Accounting Act will be in force from 1 January 2002.

Portugal

In Portugal, there is the Decree-Law n. 238/91 July, 3 (Approving the rules for consolidated Accounts) and there is a standard that was released by the national standard body (Comissão de Normalização Contabilística). This standard is called "Accounting treatment of Business

Combinations” while there is another one called “Accounting Concept of Goodwill”. There are, also, other standards that refer indirectly to these issues.

In Portugal it is possible to use the pooling of interest method and the purchase method. These methods are applied according to specific conditions. The purchase method is applied under the basis that all acquisitions must be measured by fair value. The pooling of interest method has exceptional application and can only be adopted if some requirements are met, but in practice most of all companies follow this accounting treatment because of the advantages in the taxation system, namely article 62 of the Tax Law.

To use the pooling of interest method, none of the companies can be identified as the purchaser, the basis of the transaction has to be the acquisition of shares by issue of shares and the total of assets and liabilities has to be aggregated in the new entity, besides other. The shareholders of each enterprise maintain substantially the same voting rights and interest in the combined entity.

Romania

Romania has some legislation referring to business combinations other than the obligation to draw up a consolidated financial statement. An example of a law is The Law nb. 31/1990 regarding commercial societies, chapter II “Merger and division of societies” of Title VI “Dissolution of merger and division of commercial societies”.

According to the legislation and national standards of Romania, two methods of accounting for business combinations are allowed. These methods are the purchase method and the pooling of interest method. The purchase method needs to be used when it is an acquisition (or a merger by absorption) and the pooling of interest method needs to be used when it is a uniting of interest (or a merger by reunion).

In Romania, the choice of accounting method depends upon if a business combination is a achieved by means of a legal merger or not. If the fair value of one enterprise is not significantly different from that of the other enterprise, it can influence the choice of accounting method in Romania.

Slovenia

In Slovenia, Accounting Standards and the Law on Commercial Companies refer to business combinations. Each Slovenian Accounting Standard has a special part dealing with consolidation. Moreover, as stated in the introduction to the Slovenian Accounting Standards, in the areas where there is no Standard, assistance should be found in the relevant IAS. Legal transfer of assets and change in the legal form are mechanisms for achieving business combination. The purchase method and pooling of interest method are allowed in the standards. The purchase method is used when the substantial majority of the voting common shares of the combining entities are exchanged. The pooling of interest method is used when the shareholders of each enterprise maintain substantially the same voting rights and interest in the combined entity.

New Accounting Standards, which are in accordance with IAS, are expected to come into force on 1st January 2002.

Spain

In Spain, there is no accounting standard covering business combination. Only a draft was issued, by the Accounting and Auditing Institute (ICAC), in 1993. The comments that follow are based on practice, that only in some cases are justified and described in the financial statements. In practice, the acquirer makes a choice between the acquisition method and the pooling of interest method, although a minority of the mergers use a mixture of them.

The lack of a rule means that the disclosure of the characteristics of the combination are not included in the first financial statements issued after the acquisition date. One of the points omitted is the consideration given to the seller, as well as the fair value of the assets and liabilities acquired.

In the case of a merger involving firms that already belong to the same group or in the case of associates, there is reluctance to use fair values for the assets and liabilities acquired. In such a case, the incorporation of the elements of the acquiree is usually made using book values. The difference between the consideration given by the acquirer and the net assets incorporated is deducted against retained profits of the acquirer.

Sweden

The Annual Accounts Acts implements the requirements on business combinations in Swedish law. The Company's Act includes requirements for legal mergers.

The Swedish Financial Accounting Standards Council (Redovisningsrådet) has issued an accounting standard on Business Combinations, RR1:00. This standard has recently been revised to accommodate the changes in IAS 22 (revised 1998). The standard requires the identifiable assets and liabilities to be recognised at their fair value as of the date of acquisition. The standard allows, as in IAS 22 and SIC 9, the use of the pooling of interest method in the exceptional case that no acquirer can be identified.

Switzerland

There is no legislation in Switzerland referring to business combinations other than the obligation to draw up a consolidated financial statement. However, Art. 748 and 749 of the Swiss Code of Obligations (Swiss limited companies law) treat, in general terms, mergers or regrouping of companies.

There are accounting standards on accounting for a business combination. These standards are the Financial Reporting Standards in Switzerland (Swiss GAAP FER), formerly referred to as the Swiss accounting and reporting recommendations (ARR).

The purchase method is stated in the national standards of Switzerland. The pooling of interest method is also allowed but not specifically treated in the national standards or in any compulsory regulation. This method is only treated in technical literature.

The choice of accounting method depends on which standards (Swiss GAAP FER, IAS or US GAAP) are applied by the company for its financial statements. However, since about two thirds of the listed companies in Switzerland prepare consolidated financial statements in accordance with IAS the accounting for business combinations of the majority of public companies follow the methods as required under in IAS.

United Kingdom

In the UK, merger and acquisition accounting are both permitted. These methods are stated in the national legislation and national standards. FRS 6 sets out the circumstances in which acquisition accounting and merger accounting are to be used. FRS 7 sets out the principles of accounting using the acquisition method. In addition, FRS 10, goodwill and intangible assets sets out the principles of accounting for goodwill and intangible assets.

In the UK, merger accounting is only permitted by the Companies Act if the relevant shares in the undertaking acquired were acquired in return for the issue of equity shares by the parent or its subsidiaries, and the fair value of any other consideration did not exceed 10% of the nominal value of the equity shares issued. One of the five criteria set out in FRS 6 is that the consideration received by the equity shareholders of each party to the combination in respect of their equity shareholdings should comprise primarily equity shares in the combined entity. Any non-equity consideration (e.g. cash, other assets, loan stock and preference shares) should represent an immaterial proportion of the fair value of the consideration received by the equity shareholders of each party to the combination. FRS 6 also allows the use of merger accounting for certain group reconstructions.

Summary

Table 2 summarises the position with respect to the legality of the pooling method in the national legislation (apart from any use of IAS or other rules instead of national rules).

Table 2. Are poolings allowed under some circumstances?

	<i>Yes</i>	<i>No</i>
Austria		✓
Belgium	✓	
Czech Republic		✓
Denmark	✓	
Finland	✓	
France	✓	
Germany	✓	
Hungary		✓
Ireland	✓	
Italy	✓	
Luxembourg	✓	
Netherlands	✓	
Norway	✓	
Poland	✓	
Portugal	✓	
Romania	✓	
Slovenia	✓	
Spain	✓	
Sweden	✓	
Switzerland	✓	
United Kingdom	✓	

2.3 Goodwill

2.3.1 Positive goodwill

Austria

In Austria goodwill arising from the capital consolidation (differential amount arising from the netting) has to be recognised as an asset. This item and material change from the previous year shall be discussed in the notes (§ 254(3) HGB). § 261(1) HGB provides three possibilities for treatment of this difference.

1. The difference is to be amortized annually over a period not exceeding five years.
2. The differential amount may also be netted openly with any capital or profit reserve.
3. The amortization of this amount may also be distributed regularly over the financial years in which it will be foreseeably used, in so far as this amount corresponds to goodwill acquired.

Goodwill arising from legal merger when applying the current values to assets and liabilities has to be recognized as an asset as well. This amount has to be amortized over useful life. For tax purposes goodwill must be amortized over 15 years, this depreciation is often used also for accounting purposes.

Belgium

In Belgium, the amortisation of positive goodwill is carried out over a maximum of five years, except if it is justified in the notes. Capitalisation of goodwill with amortisation is the only method allowed for accounting for purchased positive/negative goodwill.

Czech Republic

In the Czech Republic there were two allowed treatments related to positive goodwill in 1999 and 2000. Goodwill is considered the difference between the acquisition costs and the related share on the net book value of subsidiary's identifiable assets and liabilities as at the date of the first consolidation. The first treatment is to recognize the positive goodwill arising from the first consolidation as the extraordinary expense immediately. The other allowed treatment is that the above difference is recognized as an asset that should be written off using the straight-line method over 5 years (20% of the difference per year). The recent legislation developments occurred in the Czech Republic are mentioned in section 2.1.

Denmark

In Denmark, there are two allowed treatments for positive goodwill. One is that it is immediately written off to equity at the date of the acquisition. The other treatment which is allowed is capitalisation of goodwill with amortisation. Amortisation should not exceed 20 years, except in exceptional circumstances. Provisions concerning positive goodwill are written into the new law (in effect from 2002). These provisions are in general in compliance with IAS 22.

Finland

In article 8 of Chapter 6 of the Finnish accounting Act are some regulations concerning positive goodwill made. It is compulsory to capitalize purchased goodwill. The goodwill shall be written off within a maximum period of five years according to a predetermined plan or over its useful economic life if it exceeds five years. However the write off period may not exceed 20 years.

France

All accounting regulation in France on goodwill are contained in the legislation and the règlement 99-02 which is compulsory. Goodwill is capitalized and amortised over its useful life. No requirement exists as regard the amortisation period and the method of amortisation. The general practice is the straight-line method. For listed companies, the Commission des Opérations de Bourse is reluctant to accept an amortisation period exceeding 20 years and will not accept a period above 40 years. In France, companies are allowed to identify as separate intangible asset items that would normally be part of the goodwill according to IAS 22. This option is often used as these items, such as market shares or brands, need not be amortised.

Before this pooling of interests method was made possible in France, i.e. before 1 January 2000, the "Commission des Opérations de Bourse" (COB) accepted that the goodwill on consolidation could be deducted against equity providing the acquisition was paid in shares of the acquiring company, whatever the interest acquired. This option is no longer available to French companies.

Germany

In Germany the calculation and treatment of positive goodwill arising from the consolidation of business combinations in form of a share deal is dealt with in §301 para. 3 and §309 para. 1 HGB. For goodwill arising from the first consolidation in the consolidated financial statements § 309 para. 1 HGB provides a free choice between three possibilities:

1. the goodwill may be amortised over the four years following the first consolidation, at a rate of at least a quarter each year;
2. the goodwill may be amortised over its economic life. The law does not prescribe a maximum period;
3. the goodwill may be set off against the reserves, so that it does not affect the profit and loss account.

For amortisation GAS 4 provides the following: "Goodwill should be amortised on a systematic basis over its estimated useful life. An amortisation period in excess of 20 years may only be used in justified cases. Goodwill should be amortised using the straight-line method unless another method more appropriately reflects the way in which the goodwill's value is depleted. Any changes to the systematic basis originally selected must be justified". According to GAS 4, a direct set-off against group reserves does not comply with this standard (GAS 4 para. 28). Similarly this Standard does not permit goodwill to be set off against group reserves on an instalment basis nor for it to be partially amortised against income and partially set off against group reserves (GAS 4 para. 29).

A goodwill arising from a legal merger when applying the purchase method to measure the acquired assets and liabilities has also to be recognised as an asset unless it is recognised as

expense immediately. The goodwill has to be amortised over four years or the useful life but may not be offset against reserves. The book value method (Buchwertverknüpfungsmethode) does not give rise to goodwill as any positive difference has to be recognised in the profit and loss account immediately.

Hungary

In Hungary there is regulation concerning positive goodwill within the national legislation. Positive goodwill is defined as the difference between the price and net asset value. It has to be capitalized as an asset and depreciated over 5 years, or more (up to 15 years) with explanation in the notes.

Ireland

In Ireland, positive goodwill should be recognised as an asset. It should be amortised unless certain evidence of its durability is present. If a useful life in excess of 20 years is used, it must be subject to an annual impairment test. If there is no amortisation the true and fair override must be used to address the conflict with the law.

Italy

In Italy, with regard to consolidated financial statements, the accounting rules applicable to the positive or negative difference between the cost of acquisition of shares and the fair values of the identifiable assets and liabilities of controlled companies are provided by the legislative decree 127/91 art. 33.

Art. 33 allows, but does not require the off-set between the positive consolidation difference not referring to real future economic benefits (goodwill) with the negative consolidation differences recognized in the consolidated equity as consolidation reserve, so that some differences may arise between IAS 22 and national accounting standards and rules.

According to the Italian accounting standard doc. 17 the positive consolidation difference can be written-off against the negative consolidation differences recognized in the consolidated equity only when it is not a goodwill because it does not reflect future economic benefits. In this latter case the positive consolidation difference can be written-off against the consolidation equity reserve or debited to consolidated profit and loss account. IAS 22, on the contrary, allows only the recognition of an impairment loss under conditions of IAS 36.

The accounting treatment of purchased goodwill raised in an acquisition of net assets or in a legal merger and of the positive consolidation difference (not written-off against the negative consolidation differences recognized in the consolidated equity) requires the recognition of an intangible asset with subsequent depreciation within a period of 5 years. The depreciation period can be longer than 5 years if the specific reasons are disclosed in the financial statements (disclosures). According to Italian accounting standard doc. 24 "Intangible assets" the depreciation period should not exceed 20 years. Civil rules require the authorisation of the board of statutory auditors for the recognition of purchased goodwill as an asset.

Luxembourg

In Luxembourg, positive goodwill follows the Seventh Directive, with no limit on useful life. Writing off to equity and capitalisation of goodwill are methods of accounting allowed for purchased goodwill.

Netherlands

In the Netherlands the law states that goodwill can either be capitalized and amortised over the useful life (however if the period of depreciation is more than 5 years the reason has to be disclosed together with the period used.) or amortised at once or directly written off against reserves. Recently the Council on Annual Reporting issued a standard (becoming effective from 1 January 2001 on) that forbids writing off goodwill against reserves. The goodwill has to be capitalized and amortized over the useful life. This period will normally be no longer than 20 years. If a period of more than 20 years has been used an impairment test on a yearly base is obligatory. Government prepares a law that will endorse this standard.

Norway

In Norway, positive goodwill should be recognised as an asset, and should be amortised on a systematic basis over its useful life. There is a presumption that the useful life of goodwill will not exceed 20 years from initial recognition, and in disclosures the reason for choosing an estimated useful life beyond 5 years should be stated. The amortisation for each period should be recognised as an expense. The general valuation rules for fixed assets apply to goodwill, which also include the rules of impairment. The write-down must be reversed by the extent to which the basis for the write-down is no longer present.

Poland

In Poland, goodwill, i.e. surplus of the business combination price over the fair value of net assets of the controlled company, is shown in the assets of the company which owns the assets of the combined companies, or of the new company created as a result of combination. Goodwill is amortised in the period of time no longer than 5 years. In some justified cases this period of time can be extended up to 20 years and the information about it, together with the justification, needs to be included in the notes to accounts. Amortisation is calculated using the straight-line method and is included in other operating costs.

Portugal

In Portugal the Decree Law n.o 238/91 July,2 (Approving the rules for Consolidated Accounts) contains some regulations concerning positive goodwill. There is also:

DC 1- Accounting Treatment of Business combinations sets out some regulations concerning positive goodwill.

Goodwill should be amortised on a systematic basis over 5 years unless there is a rebuttable presumption that the useful life of goodwill is higher, but it must not exceed twenty years.

Romania

Purchased goodwill arising on consolidation should be amortised systematically over its useful life, up to a maximum of 20 years. The notes should explain the period chosen and the reason for it.

Slovenia

In Slovenia, positive goodwill is regulated in the Law on Commercial Companies and in the Slovenian Accounting Standards 2 (Intangible Fixed Assets). Goodwill should be amortised within a period of five years.

Spain

In Spain, the accounting treatment of positive goodwill, according to the general accounting standards, is that it must be charged against profit in a maximum period of 20 years from the date of the acquisition, in a systematic way.

Sweden

In Sweden, the Annual Accounts Act and Redovisningsrådet recommendation RR1:00 regulate positive goodwill. Capitalisation of goodwill with amortisation is the only method of accounting allowed. The law has a rebuttable presumption of the period of amortisation of 5 years, the standard 20 years as in IAS 22.

Until 1st January 2002, the accounting standards prescribed an absolute maximum of 20 years.

Switzerland

In Switzerland, there are not any regulations concerning positive goodwill within the national legislation, but there are some regulations within the national standards of Switzerland.

The method of writing off to equity of the purchased goodwill is only allowed for the first consolidation. When this method of accounting for goodwill is used specific disclosure is required. In the notes, a disclosure of equity, assets and profits has to be made assuming that the goodwill is capitalised and amortised. The method of writing off to net income is not recommended by the Financial Reporting Standards in Switzerland (Swiss GAAP FER). Swiss GAAP FER recommends the method of capitalisation of the purchased goodwill with amortisation. The depreciation rate of the goodwill has to correspond to economic criteria and has to be clearly indicated in the notes to the accounts. The amortisation period should not exceed 5 years unless a longer period up to a maximum of 20 years is justified. The method of capitalisation of goodwill with no amortisation is not allowed in Switzerland.

United Kingdom

The Companies Act 1985 in the UK permits only purchased goodwill to be capitalised. Furthermore it prescribes the balance sheet presentation and requires goodwill treated as an asset to be amortised systematically.

FRS 10 requires purchased positive goodwill to be capitalised. It should then generally be amortised over 20 years or less. A longer or indefinite life can be substituted if the durability of the acquired business can be demonstrated (and justifies estimating that the useful economic life will exceed 20 years) and if the goodwill is capable of continued measurement. In such a case, the annual impairment reviews are required.

Summary

Table 3 summarises the rules relating to the treatment of positive goodwill.

Table 3. Goodwill treatments under national rules (in 1999/2000)

	Write off to equity allowed	Amortisation period	
		Rebuttable limits	Absolute limits
Austria	✓	-	None
Belgium		5	None
Czech Republic	✓ ^a	-	5
Denmark	✓	5	None
Finland		5	20
France	✓ ^b	(20) ^c	None (40) ^c
Germany	✓	20	None
Hungary		5	15
Ireland		20	None
Italy	✓ ^d	5	None (20) ^e
Luxembourg	✓	-	None
Netherlands	✓	5	None
Norway		5 (20)	None
Poland		5	20
Portugal		5	20
Romania		-	20
Slovenia		-	5
Spain		-	20
Sweden		5	20
Switzerland	✓	20	None
United Kingdom		20	None

^a Against net income.

^b Before 1st January 2000.

^c COB is reluctant to accept a period exceeding 20 years and will not accept a period above 40 years.

^d Under certain circumstances; see text above.

^e According to Italian accounting standard doc. 24 "Intangible assets" the depreciation period should not exceed 20 years.

2.3.2 Negative goodwill

Austria

In Austria there is a regulation concerning the treatment of consolidation differences to be shown on the liabilities side (§ 261(2) HGB). This negative goodwill may be reserved in a manner affecting operating income in so far as: 1. An unfavourable development of the future results of the undertaking expected at the time of acquisition of the shares or the initial consolidation of the annual financial statements of the affiliated undertakings has materialized or expenses expected at this timepoint are to be taken into account. 2. This negative goodwill may also be set up in the reserves if it is established on the balance sheet date that it corresponds to a realized gain.

Belgium

In Belgium, negative goodwill is treated as part of the equity and can never be taken into profit except to compensate future losses.

Czech Republic

In the Czech Republic there were two allowed treatments related to negative goodwill in 1999 and 2000. Goodwill is considered the difference between the acquisition costs and the related share on the net book value of subsidiary's identifiable assets and liabilities as at the date of the first consolidation. The first treatment is to recognize the negative goodwill arising from the first consolidation as the extraordinary income immediately. The other allowed treatment is that the above difference is recognized as an equity item (the negative consolidation difference) that should be released to the profit and loss account on the regular basis over 5 years (20% of the difference per year). The recent legislation developments occurred in the Czech Republic are mentioned in chapter 2.1.

Denmark

Under the law, which was in effect until December 31st, 2001, two treatments of negative goodwill were allowed. If negative goodwill related to expected future losses and expenses it should be recognized as a provision and taken to income when the future losses and expenses are recognized in the income statement. In other cases negative goodwill should be recognized on equity.

In the new law, effective from January 1st, 2002, there are general rules on how to treat negative goodwill that are in substance in compliance with IAS 22. In the draft accounting standard (U19) there are detailed rules concerning negative goodwill that are in compliance with IAS 22.

Finland

In the Finnish accounting are some regulations concerning negative goodwill made in chapter 6, article 8. The proportion of the negative goodwill which cannot be allocated, shall be recorded as income in the consolidated profit and loss account at the time when the corresponding

expenditure or losses are recognized as an expense in the subsidiary's profit and loss account or when it is matched by realised income.

France

All accounting regulation in France on goodwill are contained in the legislation and the règlement 99-02 which is compulsory. The value adjustments attributed to assets when allocating the acquisition cost should not result in identifiable net assets at fair value above the acquisition cost. The French regulations do not indicate how to reallocate the excess. In case where a remaining negative goodwill exists, it should be amortised to income. The amortisation period and the amortisation method are not specified.

Germany

In Germany, accounting for goodwill is dealt with in § 301 para. 3 and § 309 para. 2 HGB.

A negative consolidation difference in the consolidated financial statements can arise if the interest at the time of the first consolidation is less than the parent company's share of the book value of the subsidiary's net assets at that time. Such a negative difference must be included in the consolidated financial statements as a difference arising from capital consolidation (§ 301 para. 3 HGB). The difference may be released to the profit and loss account only if:

- expected losses actually occur or if certain expenditure has to be charged; or
- it becomes clear at the balance sheet date that the negative difference corresponds to a realised profit (§ 309 para. 2 HGB).

The German Accounting Standard No. 4 clarifies, that negative goodwill should be presented separately in the balance sheet. Where a negative goodwill relates to future expenses or losses, relating to the acquisition, it should be released to income in subsequent years as and when these future expenses or losses are incurred (para. 40).

In case of legal mergers, the book value method (Buchwertverknüpfungsmethode) does not give rise to goodwill as any positive or negative difference has to be recognised in the profit and loss account immediately.

Hungary

In Hungary there are regulations concerning negative goodwill in the national legislation. It is accounted for as deferred income and has to be written off against income in 5 years, or more. If more than 5 years it is necessary to explain in the notes.

Ireland

In Ireland, negative goodwill should be presented alongside positive goodwill and FRS 10 expects the figure for negative goodwill to be recognised in the profit and loss accounts for subsequent periods, but does not specify a heading within the profit and loss account. Negative goodwill up to the amount of the fair value of the non-monetary assets acquired should be recognised in the periods in which those assets are recovered, whether through depreciation or

disposal. Any negative goodwill in excess of the fair value of the non-monetary assets acquired should be recognised in the periods expected to benefit.

Italy

In Italy, there are regulations concerning negative goodwill in the national legislation. With regard to consolidated financial statements the accounting rules applicable to the positive or negative difference between the cost of acquisition and the fair values of the identifiable assets and liabilities of controlled companies are provided by the legislative decree 127/91 art 33.

The negative difference between the cost of acquisition and the fair values of identifiable assets and liabilities related to estimated future losses is recognised as a provision that will be recognised as an income on a systematic basis over a period related to future losses. Remaining amounts are written off against non-monetary fixed assets. Then any negative difference related not to future losses but to a discount for the acquirer has to be recognised as part of consolidated equity in the consolidation process. This is in contrast with IAS 22.

Luxembourg

There are no regulations concerning negative goodwill in Luxembourg.

Netherlands

In the Netherlands, law states that if the net asset value based on fair value is less than the purchase price a revaluation reserve has to be formed under equity. This revaluation reserve is a legal reserve that cannot be distributed to the shareholders. In the explanatory notes to the law the minister stated that only in rare cases the purchase price can be lower as the fair value of the assets and liabilities acquired. He indicates that one should question the valuation of assets used in operations that give rise to losses. Also one should consider the building of provisions to restructure the operations. The Council on Annual Reporting however, in her standards follows the IAS in building a provision and taking an amount on a yearly base to the profit and loss account.

Norway

In Norway, there are no regulations concerning negative goodwill in the national legislation. The regulations concerning negative goodwill in the preliminary Norwegian Accounting Standard regarding consolidated accounts and group formation are nearly the same as the regulations in IAS 22 concerning negative goodwill arising on acquisition. There is one (small) difference: IAS 22 paragraph 62 a) states that the negative goodwill not exceeding the fair values of acquired identifiable non-monetary assets should be recognised as income on a systematic basis over the remaining weighted average useful life. The Norwegian Standard states that the amount should be recognised as a deduction of expenses on a systematic basis over the remaining weighted average useful life.

The methods of accounting for purchased negative goodwill, which are allowed in Norway, are nearly the same as which are stated in the IAS 22.

Poland

In Poland, negative goodwill (up to the amounts not exceeding fair value of fixed assets acquired, excluding long-term financial assets listed on regulated markets) is included in provisions and amortised over the weighted average of useful economic lives of acquired assets. Negative goodwill in the amount exceeding fair value of fixed assets, excluding long-term financial assets listed on regulated markets, is included in the income at the date of combination.

Negative goodwill is written off to other operating income up to the amount in which it related to reliably estimated future losses and costs established by the controlling company at the business combination date. The writing off is done in this accounting period in which losses and costs influence the financial result.

Portugal

In Portugal, in the Decree – Law n.o 238/91 July, 2 (Approving the rules for consolidated accounts) there are some regulations concerning negative goodwill. In the DC 1 – Accounting Treatment of Business Combinations - are also some regulations made concerning negative goodwill in Portugal. The amount of negative goodwill is recognised as equity and further recognised as income on a systematic basis over 5 years unless the remaining weighted average useful life of the identifiable acquired depreciable/amortisable assets is higher but not exceed twenty years from initial recognition.

Romania

In Romania there are no regulations concerning negative goodwill in the national legislation or standards.

Slovenia

In Slovenia, negative goodwill is regulated in the Slovenian Accounting Standards 10 (Long-term Provisions). Negative goodwill should be recognised in revenues over a period of five years.

Spain

In Spain, the accounting treatment of negative goodwill, according to the general accounting standards, is that it needs to be classified, at the date of acquisition, either as a provision (liability) or as deferred income (to be deducted from the book value of the assets).

Sweden

In Sweden, the Annual Accounts Act and Redovisningsrådet recommendation RR1:00 regulate negative goodwill. In case losses can be identified, negative goodwill is accounted for as a provision that should be released as the adverse condition/losses occur. Otherwise the carrying value of non-monetary assets is decreased. From 1st January 2002 the rules as in IAS 22 apply.

Switzerland

There are no regulations concerning negative goodwill within the national legislation in Switzerland. Financial Reporting Standards in Switzerland (Swiss GAAP FER) define that the notes to the consolidated accounts have to indicate how positive and negative goodwill has been treated in the consolidated accounts.

United Kingdom

The UK Companies Act specifies that if negative goodwill arises it should be treated as a negative consolidation adjustment. FRS 10 changed the treatment of negative goodwill. It is no longer disclosed as a direct credit to reserves. Instead, it is shown separately with the assets on the balance sheet, immediately below the goodwill heading, followed by a subtotal showing the net amount of positive and negative goodwill.

FRS 10 expects the figure for negative goodwill to be recognised in the profit and loss accounts for subsequent periods, but does not specify a heading within the profit and loss account. Negative goodwill up to the amount of the fair value of the non-monetary assets acquired should be recognised in the periods in which those assets are recovered, whether through depreciation or disposal. Any negative goodwill in excess of the fair value of the non-monetary assets acquired should be recognised in the periods expected to benefit.

3. SURVEY OF FINANCIAL STATEMENTS

3.1. Introduction

Section 1.3 introduced our survey. Table 4 shows the sets of rules used by the companies surveyed.

Table 4. Generally Accepted Accounting Principles used in the financial statements

<i>Company</i>	<i>Acquired Company / Merging Companies</i>	<i>National GAAP</i>	<i>IAS</i>	<i>US GAAP</i>
Austria (1999)				
Adcon	Stamptronic		X	
Wienerberger	General Shale Products		X	
Brain Force	MMI Consulting		X	
Austria (2000)				
VA Tech	Sulzer		X	
Adcon	Smart Telecom Solutions		X	
Wienerberger	Scherokee Sanford Group		X	
BWT	Christ Group		X	
Denmark (2000)				
Group4 Falck	Falck – Group 4 Securitas	X		
Navision- Damgaard	Navision Software – Damgaard	X		
Finland (1999)				
Metso Corporation	Valmet - Rauma	X		
Huhtamaki's van Leer	Van Leer	X		
TietoEnator	Tieto – Enator	X		
Finland (2000)				
UPM- Kymmene	Repap Enterprises.	X		
StoraEnso	Consolidated Paper		X	
France (1999)				
TotalFina	Total (Fr) – PetroFina	X		
TotalFinaElf	TotalFina – Elf Aquitaine	X		
Sanofi Synthelabo	Sanofi – Synthelabo	X		
Aventis	Rhône Poulenc – Hoechst	X		
Carrefour	Carrefour – Promodes	X		
BNP Paribas	BNP – Paribas	X		
France (2000)				
Vinci	Vinci - GTM	X		
Germany (1999)				
Deutsche Bank	Bankers Trust		X	
Germany (2000)				
Degussa	Degussa Hüls – SKW Trotsberg			X
RWE	VEW		X	
E.On	VEBA –VIAG			X
Hypovereinsbank	Bank Austria		X	

<i>Company</i>	<i>Acquired Company / Merging Companies</i>	<i>National GAAP</i>	<i>IAS</i>	<i>US GAAP</i>
Ireland (1999)				
Ardagh	Rockware Glass	X		
Irish Life & Permanent	Irish Life plc – Irish Permanent plc	X		
CRH	Ibstock building products – Finnsementti/Lohja Rudus	X		
Ireland (2000)				
Qualceram Shires	Shires plc	X		
Jurys Doyle Hotel Group	Doyle Hotel Group	X		
Italy (1999)				
Snia	Caffaro – Sorin Biomedica	X		
Italy (2000)				
Compart (now Montedison)	Calcemento	X		
Compart (now Montedison)	Montedison	X		
Olivetti	Tecnost	X		
Luxembourg (2000)				
RTL Group	CLT-UFA – Pearson Television		X	
Clearstream international	Cedel – Deutsche Börse Clearing		X	
Netherlands (1999)				
Royal Vopak	Royal van Ommeren – Royal Pakhoed	X		
AEGON	Transamerica corporation	X		
VNU	Nielsen Media Research	X		
Netherlands (2000)				
Ahold	US Foodservice	X		
Norway (1999)				
Alphatron	Kitron	X		
SPCS-Gruppen	PC Systemer Norge – PC Systems	X		
Norske Skogindustrier	A/S Union	X		
EDB	Telenor Progamvare	X		
DnB	Postbanken	X		
Storebrand	Finansbank	X		
Roxar	Multi-Fluid – Smedvig Technologies	X		
Norske Hydro	Saga Petroleum	X		
Norway (2000)				
Altinex	Mercur Subsea Products – Well Service Technology	X		
Teco Maritim	Marine Kurer – Stromme	X		
Kitron	Kitron – Sonec	X		
CorrOcean	Safetec Nordic - Robit	X		
Kongsberg Gruppen	Navia	X		
Merkantidata	Avenir and Provida	X		
Fred. Olsen Energy	Navis	X		
Veidekke	Stavdal	X		

<i>Company</i>	<i>Acquired Company / Merging Companies</i>	<i>National GAAP</i>	<i>IAS</i>	<i>US GAAP</i>
Portugal (1999)				
Portugal Telecom	TC Participações – Telesp Celular	X		
Portugal (2000)				
Sonae	Soltróia	X		
Portugal Telecom	Zip.Net	X		
Spain (1999)				
BSCH	Banco Santander – Banco Central Hispano	X		
Logista	Midesa	X		
Altadis	Seita	X		
Repsol	YPF	X		
Spain (2000)				
BBVA	Banco Bilbao Vizcaya – Argentaria	X		
Centros Comerciales Carrefour	PRYCA - Continente	X		
Sweden (1999)				
Cell Consulting Group	New Media Science	X		
SAAB	Celsius	X		
Atlas Copco	Rental Services Corporation	X		
Atle	Martinsson gruppen	X		
Sweden (2000)				
ASSA Abloy	Yale Intruder Security	X		
Tele2	SEC	X		
SE Banken	BfG	X		
Telia	NetCom		X	
Mandator	Cell Network	X		
Nordea	Unidanmark	X		
Switzerland (1999)				
SwissCom	Debitel		X	
Switzerland (2000)				
Adecco	Olsten Corporation			X
Syngenta	Parts of Novartis - AstraZeneca		X	
UBS	PaineWebber Group		X	
UK (1999)				
Corus	Koninklijke Hoogovens	X		
Rolls Royce	Vickers	X		
UK (2000)				
BP Amoco	Arco + Burmah Castrol	X		
Telewest Communications	Flextech	X		
Smiths Industries	Parts of Invensys	X		
CGNU	CGU – Norwich Union	X		
Lloyds TSB	Scottish Widows Fund & Life	X		
Royal Bank of Scotland	National Westminster Bank	X		
Cable & Wireless	Data Co	X		
British American Tobacco	Imperial Tobacco Canada	X		

<i>Company</i>	<i>Acquired Company / Merging Companies</i>	<i>National GAAP</i>	<i>IAS</i>	<i>US GAAP</i>
UK (2000)				
Standard Chartered	Grindlays Bank – Parts of Chase Manhattan Bank	X		
WPP Group	Young & Rubicam	X		
PowerGen	LG&E Energy	X		
Rexam	American National Can Group	X		
Granada Media	Granada Technology Group	X		

3.2. Characteristics of the business combination

Table 5 shows the types of combination found in our survey.

Table 5. Characteristics of the combinations

	<i>The obtaining of shares by issue of shares</i>	<i>The obtaining of shares by transfer of cash only</i>	<i>The obtaining of shares by issue of shares and transfer of cash</i>	<i>Legal merger</i>	<i>Not indicated clearly</i>
Austria	1	4	2	-	-
Denmark	1	-	-	1	-
Finland	2	2	1	-	-
France	7	-	-	-	-
Germany	4	-	-	-	1
Hungary	-	-	-	1	-
Ireland	1	3	1	-	-
Italy	-	-	-	4	-
Luxembourg	2	-	-	-	-
Netherlands	-	1	2	1	-
Norway	1	4	2	9	-
Portugal	2	1	-	-	-
Spain	6	-	-	-	-
Sweden	4	3	3	-	-
Switzerland	1	2	-	-	1
UK	5	8	2	-	-
Total	37	28	13	16	2
Percentage	39	29	13	17	2

3.3 Methods applied

Tables 6 and 7 show the type of accountancy methods applied by our survey companies.

Table 6. Accountancy methods applied by country

	<i>The purchase method</i>	<i>The pooling- of – interest method</i>
Austria	7 ^a	-
Denmark	-	2
Finland	3	2
France	1	6
Germany	4	1
Hungary	1	-
Ireland	4	1
Italy	4	-
Luxembourg	1	1 ^b
Netherlands	3	1
Norway	11	5
Portugal	3	-
Spain	6 ^a	-
Sweden	9	1
Switzerland	4	-
United Kingdom	14	1
Total	75	21

^a For both Austria and Spain, two combinations applied the book value method.

^b Treated as the creation of a joint venture, in which assets of both companies are brought in at book values, and differences taken to equity.

Table 7. Accountancy methods applied by company

<i>Company</i>	<i>The purchase method</i>	<i>The pooling- of- interest method</i>
Austria (1999)		
Adcon	X	
Wienerberger	X	
Brain Force	X	
Austria (2000)		
VA Tech	X ^a	
Adcon	X	
Wienerberger	X	
BWT	X ^a	
Denmark (2000)		
Group4 Falck		X
Navision- Damgaard		X
Finland (1999)		
Metso Corporation		X
Huhtamaki's van Leer	X	
TietoEnator		X
Finland (2000)		
UPM- Kymmene	X	
StoraEnso	X	
France (1999)		
TotalFina		X
TotalFinaElf		X
Sanofi Synthelabo	X	
Aventis		X
Carrefour		X
BNP Paribas		X
France (2000)		
Vinci		X
Germany (1999)		
Deutsche Bank	X	
Germany (2000)		
Degussa		X
RWE	X	
E.On	X	
Hypovereinsbank	X	
Hungary (2000)		
KH Bank	X	
Ireland (1999)		
Ardagh	X	
Irish Life & Permanent		X
CRH	X	
Ireland (2000)		
Qualceram Shires	X	
Jurys Doyle Hotel Group	X	

^a Book value method applied

<i>Company</i>	<i>The purchase method</i>	<i>The pooling- of- interest method</i>
Italy (1999)		
Snia	X	
Italy (2000)		
Compart-1 (now Montedison)	X	
Compart-2 (now Montedison)	X	
Olivetti	X	
Luxembourg (2000)		
RTL Group	X	
Clearstream international		X ^b
Netherlands (1999)		
Royal Vopak		X
AEGON	X	
VNU	X	
Netherlands (2000)		
Ahold	X	
Norway (1999)		
Alphatron	X	
SPCS-Gruppen		X
Norske Skogindustrier	X	
EDB	X	
DnB	X	
Storebrand	X	
Roxar		X
Norske Hydro	X	
Norway (2000)		
Altinex		X
Teco Maritim		X
Kitron		X
CorrOcean	X	
Kongsberg Gruppen	X	
Merkantildata	X	
Fred. Olsen Energy	X	
Veidekke	X	
Portugal (1999)		
Portugal Telecom	X	
Portugal (2000)		
Sonae	X	
Portugal Telecom	X	
Spain (1999)		
BSCH	X	
Logista	X ^c	
Altadis	X	
Repsol	X	

^b Treated as the creation of a joint venture, in which assets of both companies are brought in at book values, and differences taken to equity.

^c Assets and liabilities are incorporated at book values, and the differences with the acquisition price are accounted as goodwill.

<i>Company</i>	<i>The purchase method</i>	<i>The pooling- of- interest method</i>
Spain (2000)		
BBVA	X	
Centros Comerciales Carrefour	X ^c	
Sweden (1999)		
Cell Consulting Group	X	
SAAB	X	
Atlas Copco	X	
Atle	X	
Sweden (2000)		
ASSA Abloy	X	
Tele2	X	
SE Banken	X	
Telia	X	
Mandator		X
Nordea	X	
Switzerland (1999)		
SwissCom	X	
Switzerland (2000)		
Adecco	X	
Syngenta	X	
UBS	X	
UK (1999)		
Corus	X	
Rolls Royce	X	
UK (2000)		
BP Amoco	X	
Telewest Communications	X	
Smiths Industries	X	
CGNU		X
Lloyds TSB	X	
Royal Bank of Scotland	X	
Cable & Wireless	X	
British American Tobacco	X	
Standard Chartered	X	
WPP Group	X	
PowerGen	X	
Rexam	X	
Granada Media	X	

3.4 Goodwill

3.4.1. Positive Goodwill

Table 8 shows which companies used which methods for the treatment of goodwill and the depreciable lives adopted.

Table 8. Treatment of goodwill and the depreciable lives of goodwill

<i>Company</i>	<i>Capitalisation</i>	<i>Written off to equity</i>	<i>Amortisation period (years)</i>
Austria (1999)			
Adcon	X		10
Wienerberger	X		20
Brain Force	X		10
Austria (2000)			
VA Tech	X		15-20
Adcon	X		10
Wienerberger	X		20
BWT	X		20
Finland (1999)			
Huhtamaki's van Leer	X		Max. 20
Finland (2000)			
UPM-Kymmene	X		5-20
Stora enso	X		20
France (1999)			
Sanofi Synthelabo		X	
Germany (1999)			
Deutsche Bank	X		15
Germany (2000)			
E.On	X		20
Hypovereinsbank	X		20
RWE	X		Period is not indicated
Ireland (1999)			
Ardagh	X		20
CRH	X		20
Ireland (2000)			
Qualceram Shires	X		Max. 20
Jurys Doyle Hotel Group	X		20
Italy (1999)			
Snia	X	X ^a	Period is not indicated
Italy (2000)			
Compart-1 (now Montedison)	X		Max. 20
Compart-2 (now Montedison)	X		Max. 20
Olivetti	X		Max. 20

^a In the Snia consolidated financial statements, the positive consolidation difference that cannot be attributed to individual assets or liabilities is charged against (off-set) equity reserves. Any positive consolidation difference in excess of these reserves is booked as an asset and amortized on a straight-line-basis. This goodwill is capitalized and amortized on a straight-line-basis.

<i>Company</i>	<i>Capitalisation</i>	<i>Written off to equity</i>	<i>Amortisation period (years)</i>
Luxembourg (2000)			
RTL group	X		20
Netherlands (1999)			
AEGON		X	
VNU	X		Max. 40
Netherlands (2000)			
Ahold		X ^b	
Norway (1999)			
Alphatron	X		10
Norske Skogindustrier	X		20
EDB	X		20
Storebrand	X		20
Norske Hydro	X ^c		-
Norway (2000)			
Merkantildata	X		5-20
CorrOcean	X		5-20
Kongsberg Gruppen	X		20
Veidekke ^d	X		5-12,5
Portugal (1999)			
Portugal Telecom	X		25 ^e
Portugal (2000)			
Sonae	X		20
Portugal Telecom	X		5-6
Spain (1999)			
BSCH	X		20
Logista	X		10
Altadis	X		20
Repsol	X		10
Spain (2000)			
BBVA	X		Max. 10
Centros Comerciales Carrefour	X		20
Sweden (1999)			
Cell Consulting Group	X		20
SAAB	X		20
Atlas Copco	X		40 ^f
Atle	X		Period is not indicated
ASSA ABLOY	X		10-20
Telia	X		20
Tele2	X		5-20
Nordea	X		20

^b Due to a new Guideline of the Council for Annual Reporting, Ahold started to capitalize and amortize goodwill from December 2000. However, it did not relate to the acquisition of US Foodservice.

^c There is no difference between fair value of the assets and the acquisition price.

^d In the notes to the consolidated financial statements, nothing is said about the amortisation period for goodwill arising with this specific business combination

^e Period remaining to the end of concession.

^f The notes detail the effects amortisation in 20 years as required by the accounting standard.

<i>Company</i>	<i>Capitalisation</i>	<i>Written off to equity</i>	<i>Amortisation period (years)</i>
Switzerland (1999)			
SwissCom	X		10
Switzerland (2000)			
Adecco	X		5
Syngenta	X		20
UBS	X		20
UK (1999)			
Corus	X		20
Rolls Royce	X		Max. 20
UK (2000)			
BP Amoco	X		10
Telewest Communications	X		20
Smiths Industries	X		Max. 20
Lloyds TSB	X		No amortisation [§]
Royal Bank of Scotland	X		20
Cable & Wireless	X		Max. 20
British American Tobacco	X		Period is not indicated
Standard Chartered	X		20
WPP Group	X		Max. 20
PowerGen	X		20
Rexam	X		Max. 20
Granada media	X		Period is not indicated

3.4.2 *Negative goodwill*

Negative goodwill arose with the purchase by SE Banken of BfG. The negative goodwill for BfG was treated as a restructuring reserve.

[§] The acquired goodwill is not amortized because of the power of the brand 'Scottish Widows'. Every year an impairment test is done to investigate if the goodwill has the same value.

4. CONCLUSIONS

The following conclusions can be derived from the study:

1. The purchase method is allowed in every country. The pooling of interest method is allowed in most countries under restricted circumstances, but not allowed in Austria, the Czech Republic and Hungary (see Table 2).
2. The business combinations in our survey were achieved by the exchange of shares for shares (39%), by the acquisition of shares for cash (29%) or for a mixture of shares and cash (13%), or by legal merger (17%). In 2% of cases the method was unclear (see Table 5).
3. Of the 96 business combinations examined, a majority was accounted for using the purchase method (75) (see Table 6). The number of poolings was surprisingly large (21). The pooling of interest method is sometimes used even for business combinations which are in economic substance acquisitions, because national law allows it.
4. Most countries required acquired goodwill to be capitalised and amortised. For the period of the survey, nine countries allowed acquired goodwill to be directly written off to equity (see Table 3).
5. One case shows the use of impairment only, which according to the tentative conclusions of IASB will become the required method under IAS in future.
6. There is a wide range of amortisation periods, with no demonstrated relationship to commercial life. An amortisation period of 20 years is common. Notes that contain ranges or wording such as “up to 20 years” are fairly common, but are unhelpful to readers (see Table 8).