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**CL 101**

International Accounting Standards Board
30 Cannon Street, London EC4M 6XH
England

11 April 2003
enj/osj/dor (regu\kor\2003\IASB ED3)

Dear Sirs

**ED 3, Business combinations and proposed changes to IAS 36 and 38**

We welcome the opportunity to provide comments on the Exposure Draft on behalf of the Danish Institute of State Authorised Public Accountants (FSR). We regret, however, that our response has been somewhat delayed due to unforeseen contingences.

FSR's Accounting Standards Committee has reviewed the ED and we summarize our comments below. Our comments have been presented for the Danish Accounting Advisory Panel which represents users and preparers of financial statements. Not all members agree with our opinion. Thus, The Danish Society of Investment Professionals supports the Board's proposal re. non-amortisation and impairment testing of goodwill. The Confederation of Danish Industries proposes that amortisation should be an allowed alternative to the Board's proposal and that the impairment test under IAS 36 should be performed on a "Reporting entity" level in accordance with US GAAP.

**ED 3 Business combinations**

Question 1

(a) Yes, we agree with the Board's proposal.
(b) Yes, we agree with the guidance.

Question 2

Yes, we agree with the Board's proposal.

However, as a consequence of the elimination of the pooling of interests method, it is even more important that the criteria for identifying the acquirer are robust. We are for example concerned about the wording "significantly greater" in paragraph 20(a). This could lead to making enterprises having a choice between which entity should be regarded as the acquired part.

Question 3

No, we do not agree with the proposal. We agree with the example on page 9-13 of the illustrative examples, however, we find that there is contradiction between the wording of section 19 and the example. We cannot see that the legal subsidiary has the power one way or another to govern the legal parent, cf. paragraph 19 (a) – (d).

We find that the identification of the acquirer should be based on a shareholder perspective, i.e. which group of shareholders has ultimately the power to govern the combined enterprise? Therefore, the wording of paragraph 19 should be changed.

Question 4
Yes, we generally agree with the proposal. However, we find that addressing the shareholder perspective in the general criteria, cf. question 3, would clarify the identification of the acquirer. For example, it makes no sense to try to assess whether one entity has the power to govern the other, as there is only one legal entity left. On the other hand, it makes sense to assess which group of shareholders has the power to govern the combined entity.

Question 5
Yes we agree with the Boards proposal.

Question 6
Yes, we agree with the Boards proposal. We find that the recognition criteria in IAS 37 should not necessarily be met, since, opposite to a contingent liability occurring in the ordinary course of business, the enterprise *assumes* the contingent liability by purchasing the acquired enterprise.

However, we find it necessary to underline the requirement that the contingent liability can actually be measured reliably. We believe that normally this would only be the case in situations where the parties one way or another have negotiated a discount for assuming the liability.

We understand that the Board intends to address the issue of contingent assets acquired in a business combination in phase II of the business combination project. We propose that the Board considers whether the issue could be dealt with in the final standard.

Question 7
Yes we agree with the Boards proposal.

Question 8
No, we do agree with the Boards proposal for the following reasons:

- We find that normally goodwill will not have an indefinite life.
- The approach allows in fact capitalisation of internally generated goodwill since, as time goes, the originally purchased goodwill will probably disappear.
- The approach will imply that enterprises with different growth strategies but with the same actual growth rate may report different financial performance. This would be the case if one enterprise grows internally by investing in marketing, branding etc. while the other enterprise grows through acquisition of other enterprises. The first enterprise would report large operating expenses in relation to achieving the growth, while the other enterprise would report no expenses.

We are aware that goodwill amortisation – at least from a theoretical viewpoint – leads to arbitrary results. However, we find that the impairment test as required by IAS 36 could result in even more arbitrary results. We see a risk that in comparable situations, a reported impairment loss could differ significantly between entities or not even be recognised in certain entities.

Further, yearly impairment testing is an onerous process.

Question 9
Yes, we agree with the Boards proposal. However, we find that in certain situations, the allocation of the cost price in accordance with the guidance in appendix B15 could lead to overestimation of negative goodwill. This could for example occur, if the enterprise's assets consisted of assets of a specialised nature, typically assets used in the production. Valuing them at depreciated replacement cost, cf. subparagraph (f), could lead to a value far exceeding the value in use of these assets and therefore in fact the price which would be paid by an independent third party.

Question 10
Yes we agree with the Boards proposal. We find that the rule in the existing IAS 22 is illogical, since the adjustment-period will depend on whether the acquisition date was by incidence at the beginning of the year or at the end of the year.

***Other comments on ED 3, Business combinations***

*Business combinations achieved in steps*

We have noticed that the guidance regarding treatment of the difference between the accumulated cost of acquisition and the accumulated values of goodwill, assets and liabilities at the respective acquisition dates has been clarified in section 58. However, we find that the issue regarding value adjustments to equity-instruments subsequent to the acquisition but prior to the business combination should be addressed. This would be the case with fair value adjustments under IAS 39.103 and recognition of income under the equity-method, cf. IAS 28. In other words: should these value adjustments be reversed through the income statement? Or should this only be the case if value adjustments are recognized in the income statement, cf. IAS 103.b(i) and IAS 28.

Based on the example in the Draft Illustrative Examples, the conclusion could be reached that the reversal should be recognised directly in equity.

We propose that an equity reconciliation for the parent company is added to the example (revaluation of land +600, share of profits, +1,200, reversal of fair value adjustment = -700).

*Adjustments after the initial accounting is complete*

We find that examples illustrating the difference between non-adjusting changes to the initial accounting and errors, for which adjustments should be made, would be valuable, since in practice it may be difficult to distinguish between these two situations.

Further, we find that in such situations fraud would not be a representative example of a reason for an error, cf. the last section of paragraph 47.

*In-process research and development*

We find it necessary to have further guidance on when to recognise separately in-process research and development in an acquisition. It seems confusing that the example listing in the Illustrative Examples does not directly address this issue.

*Reverse acquisitions*

We find it confusing that the example includes a "control premium" from the shareholders of the legal subsidiary to the shareholders of the legal parent company. Had the exchange been based on the fair values (12 per share for A and 40 per share for B), the owner of the legal subsidiary would have owned 66 2/3% of the combined entity, namely 2,400/ (2,400+1,200) and not 60%.

**IAS 36, Impairment of assets**

Question 1

We find that there should be consistency between the date of impairment-testing of goodwill and of other assets. We question whether it is really necessary to address the issue of at what point of time of the year the impairment-test should be performed. Management would have the responsibility that the estimates were reasonable at the balance sheet date, and we find this fact sufficient to ensure that if material changes have taken place since the last impairment test was performed, the estimates would be updated to reflect these changes.

Question 2 – intangible assets with an indefinite useful life

Yes we agree with the Boards proposal since the nature of such assets is different from the nature of goodwill.

Question 3

(a) Yes, we agree with the elements listed in paragraph 25a. We agree that entities should have the choice between adjusting the cash flow or the interest rate to reflect uncertainty, because the choice would be case by case based.
(b) We agree with the Boards proposal. However, we find that the requirement to take into effect the Management's ability to forecast cash flows is a rather theoretical requirement, unless the requirement is supported by examples. These examples should illustrate that if for example cash flows have been overestimated in the past, adjustment should be made to reflect the risk that the cash flows will be lower than expected.
(c) Yes, we find the guidance appropriate.

Question 4

(a) Yes, we agree with the Boards proposal.
(b) Yes, we agree with the Boards proposal.
(c) Yes, we agree with the Boards proposal.

Question 5

(a) Yes, we agree with the Boards proposal.

With the view of reducing the risk of capitalising internally generated goodwill, we find it necessary to perform the impairment test at the lowest possible level.

(b) No, we do not agree with the Boards proposal since it would imply that goodwill had to be tested for impairment on a yearly basis. We do not find it necessary to test on a yearly basis if goodwill is amortised, cf. our answer to question 8 of ED 3. Instead goodwill should be tested for impairment based on the rule applying for other assets, cf. paragraph 9.
(c) No, we do not agree with the Boards proposal. We find that the ongoing "purchase price allocation" would be very burdensome for the enterprises. Further we find that the risk of not recognising an impairment loss of goodwill is considerably less under the amortisation model proposed by us, cf. our answer to question 8 to ED 3. We therefore propose to keep the model in the present IAS 36, i.e. an impairment loss would be measured on the basis of each CGU as a whole.

Question 6
Yes, we agree with the Boards proposal.

Question 7
Yes we agree that extensive disclosure is required in an area with such a high degree of subjectivity. However we have some concern about the total extent of disclosure required by the standard and other standards.

**IAS 38 Intangible assets**

Question 1
Yes, we agree with the Boards proposal.

Question 2
Yes we agree with the Boards proposal.
However, we find that further guidance is required with respect of deciding whether an intangible asset must be recognised separate, i.e. in fact has a fair value. It is confusing that paragraph 29 seems to assume that a fair value of an intangible asset can always be assessed. How should this for example be applied to in-process R & D?

Question 3
We agree that there should not be a rebuttable presumption that the useful life of intangible assets does not exceed 20 years. However, we find that the useful life should always be finite, cf. question 5.

Question 4
Yes we agree with the Boards proposal.

Question 5
No, we do not agree with the Boards proposal. For the reasons mentioned in our comments to question 8 to ED 3 we find that intangible assets should always be amortised. I.e. we find that intangible assets could normally not be expected to have indefinite lives and that the approach in fact allows capitalisation of internally generated intangible assets prohibited from capitalisation under the draft IAS 38.55.

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If you have questions to the above, please do not hesitate to contact us.

Yours sincerely

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| Eskild Nørregaard Jakobsen<br>Chairman of FSR's Accounting<br>Standards Committee | Ole Steen Jørgensen<br>Head of Department |