

Mr. Jean-Paul Gauzès
President of the EFRAG Board
EFRAG
Square de Meeûs 35
B-1000 BRUXELLES
Belgium

Submitted online

Brussels, 20 December 2017

Subject: EFRAG Discussion Paper: Goodwill Impairment Test: Can it be improved?

Dear Mr. Gauzès,

Accountancy Europe (<https://www.accountancyeurope.eu>) is pleased to provide you below with its comments on the EFRAG Discussion Paper (DP): Goodwill Impairment Test: Can it be improved?

We welcome EFRAG's DP which stimulates the debate on the goodwill impairment test. We also appreciate EFRAG's aim to influence future standard-setting developments by engaging with European constituents and providing timely and effective input to early phases of the IASB's related work.

In the years since implementation of the International Accounting Standard (IAS) 36, it has become apparent that there are significant issues arising from the practical application of impairment tests. Based on the feedback that the IASB received from the *Post-Implementation Review of IFRS 3 Business Combinations (2015)*¹, the impairment approach has been criticised because of the significance of judgements involved in the performance of the impairment test and of the perception that impairment losses are sometimes recognised too late. Many entities also think that the impairment test is complex and expensive. There is therefore a need for:

- more guidance to apply the impairment model and
- consideration for an improvement of the model itself.

We appreciate that EFRAG is proactive in this area.

According to paragraph 80 of IAS 36, each unit or group of units to which goodwill is allocated shall:

(a) represent the lowest level within the entity at which goodwill is monitored for internal management purposes; and

¹ <http://www.ifrs.org/-/media/project/pir-ifs-3/published-documents/pir-ifs-3-report-feedback-statement.pdf>

(b) not be larger than an operating segment as defined by IFRS 8 *Operating Segments*.

IAS 36 leaves room for interpretation and we do observe, that in practice, many preparers tend to test the goodwill at an operating segment level. This allows them to benefit from a “natural shield” which delays the recognition of an impairment. Accountancy Europe recommends that this specific aspect is further investigated.

To ensure that the potential amendments to the impairment test will tackle the issue of “too little too late” and the concerns identified in page 12 of the DP in the areas of:

- how an entity should allocate goodwill to cash generating units (CGUs);
- when an entity should allocate goodwill to CGUs; and
- how an entity should determine the recoverable amount,

EFRAG should set priorities in meeting the objectives considered on page 11 of the DP. There are cases where it will be difficult to improve the effectiveness or reduce the complexity of the impairment test and achieve a better balance between costs and benefits all at once. We believe that the primary objective should be to improve the quality and usefulness of information provided to the primary users.

How an entity should allocate goodwill to CGUs

Additional guidance on allocation

We welcome EFRAG’s efforts to give some direction and discipline on how an entity should allocate goodwill. We recognise that this is a difficult area to provide guidance applicable to all entities. Addressing this issue would primarily impact subsequent impairment tests. We agree with EFRAG that dealing with this issue would increase the relevance of the notes in the financial statements as the primary users could have a better view of the benefits expected from the acquired business.

We see the merit of the first example which seems broadly aligned with the methodology applied by valuers when performing a goodwill allocation. As other approaches might also be appropriate or provide more relevant outcome, we recommend that it is not restricted to this one.

However, we do not see the merits of the second example to allow the allocation of goodwill based on where the net identifiable assets of the acquired entity are allocated. The allocation of goodwill would be arbitrary, and it would not allow to link the purchased goodwill with the business which will benefit from the acquisition.

Adding information on composition of goodwill

We are skeptical on the usefulness and practicality of the information relating to the composition of goodwill. While this might be useful on the day of acquisition, over time this would become overly complex and meaningless, especially after a group restructuring or subsequent acquisitions. We therefore invite EFRAG to consider the costs versus benefits of proposing this requirement and to ensure consistency of the approach with the Better communication project.

When an entity should determine the recoverable amount

The ‘Step Zero’

Accountancy Europe appreciate EFRAG's efforts to suggest an approach aiming at reducing costs. However, Accountancy Europe has some reservations on this proposal:

- a. The annual impairment test is considered to be good governance.
- b. Preparers currently have processes in place which ensures the quality of data.

Accountancy Europe wonders whether a Step Zero approach would not impair the ability of preparers to maintain adequate processes ensuring the quality of data. If it was considered that a qualitative test could reduce the workload for some preparers, it would need to be written sufficiently robustly so that it would not enable preparers to avoid an impairment charge where it would be necessary. Thus, the criteria would have to be clear enough that it would be consistently applied and easily enforced by auditors and regulators.

Moreover, as noted in the EFRAG DP, US GAAP includes the option to perform a first qualitative assessment of the likelihood of impairment. Under US GAAP, the quantitative impairment test is required only if the fair value of a reporting unit is likely to be lower than the carrying amount. Whereas, EFRAG allows entities not to perform an impairment test when the likelihood of impairment is assessed to be remote. The threshold prompting the impairment test under US GAAP is thus different to what EFRAG is proposing.

It is important to explore how the US GAAP guidance is applied and what are the benefits for users and preparers. For instance, according to the 2016 report *Examining the patterns of goodwill impairments in Europe and the US*², US companies recognise impairment losses less frequently based on this option. However, the same study reveals that it is not clear what is the overall effect of this method on timeliness and on the level of impairment. We see value in EFRAG exploring both aspects.

How the entity should determine the recoverable amount

A single calculation approach

We see merit in considering a single calculation approach. We believe that the core principle is that the asset should be tested based on how the entity expects to recover its value. This implies that the starting point would be the assumptions used in the business plan of management. A single measurement approach based on such assumptions could allow a better alignment with the information communicated to the users. To this respect, it is important to understand the primary user's needs and identify which method gives them the best informative value.

A single calculation approach would be a significant change to the fundamental principles of IAS 36. This project should therefore discuss whether such change is needed on all other assets that are under the scope of IAS 36.

VIU and future restructurings

We agree with the inclusion of future restructurings in the calculation of the VIU. We would expect that capacity investments in cash flow projections should also be allowed in the VIU calculation to the extent that they are included in the approved management's business plan.

VIU and discount rates

We concur with EFRAG's view that the recoverable amount should be calculated on a post-tax basis applying post-tax discount rates. Pre-tax discount rates do not exist on the market and can only be calculated iteratively from the post-tax amount solely for compliance with current IAS 36 requirements.

² André, P. Filip, A. and Paugam, L., (2016), *Examining the patterns of goodwill impairments in Europe and the US* [online], Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2867340

Targeting internally generated goodwill

We understand from EFRAG's proposal that the objective of the approach is twofold: translating in the financial statements the economic consumption of the goodwill while taking into account the internally generated goodwill. While we agree with EFRAG's objectives, we do not believe that the proposed approach allows to meet those objectives. The approach presented is based on the application of a discount rate on the opening balance of the goodwill, which in our view does not reflect the creation of internally generated goodwill. Besides, we believe that the implementation would increase significantly the complexity and costs. We recommend that EFRAG continues to explore which model would be appropriate, while also considering the cost / benefit objective.

We also understand that the goodwill accretion was developed as an alternative to re-introducing the amortisation of goodwill. Accountancy Europe has not yet formed an opinion on whether or not a change in the impairment-only approach is necessary and we acknowledge that this is outside the scope of this research project. Nonetheless, this is an important matter that warrants further consideration by EFRAG, other constituents, and the IASB.

For further information on this letter, please contact Eleni Ashioti on +32 (0)2 8933387 or via email at elenia@accountancyeurope.eu from the Accountancy Europe team.

Sincerely,



Olivier Boutellis-Taft
Chief Executive

About Accountancy Europe

Accountancy Europe unites 50 professional organisations from 37 countries that represent close to 1 million professional accountants, auditors, and advisors. They make numbers work for people. Accountancy Europe translates their daily experience to inform the public policy debate in Europe and beyond. Accountancy Europe is in the EU Transparency Register (No 4713568401-18).