EFRAG
35 Square de Meeûs
B-1000 Brussels

11 January 2018

Dear Sir or Madam,

Re: Discussion Paper Goodwill Impairment Test: Can it be improved?

BusinessEurope is pleased to take the opportunity to respond to the Discussion Paper - *The Goodwill Impairment Test: Can it be improved?* (the DP).

This is a question upon which there is a wide diversity of views but the accounting requirements of which can significantly affect companies' results and the administrative burden placed on them.

The DP contains a number of very interesting suggestions and provides much material for discussion. The detailed responses to the questions asked are included in the Appendix, but we draw your attention to the following points:

- Although the DP is intended to provide suggestions for ways of simplifying the accounting and disclosures for goodwill, we think that overall the effect achieved will be the opposite, that is, several of the suggestions will lead to increased complexity and burden;
- The proposed accretion approach will, we expect, begin to trigger repeated annual impairments. This being the case, one might wonder whether the amortisation of goodwill would be a simpler approach.
- Some of the proposed disclosures will be very onerous to produce and should be required only if they can be demonstrated to be essential for users.
- The "Step-zero" approach may be of real benefit to some entities, but may not be suitable for others. It should be provided as an optional alternative to the annual test rather than be the only approach allowed.

If you require any more information on any of the subjects dealt with in this letter, please do not hesitate to contact us.

Yours sincerely,

Erik Berggren
Senior Adviser
Legal Affairs Department

APPENDIX

QUESTION 1 - HOW AN ENTITY SHOULD ALLOCATE GOODWILL

In paragraphs 2.3 to 2.22 of Chapter 2 EFRAG discusses additional guidance on the allocation of goodwill to CGU and disclosures on the break-down of goodwill by cash-generating unit.

Q1.1 Do you agree with the additional guidance on how an entity should allocate goodwill?

We think that the two allocation methods proposed in paragraphs 2.9-2.10 and 2.11-2.12 of the DP are acceptable methods. However, these will not provide the most relevant allocation in all cases and should therefore not become imposed alternatives. These could helpfully become part of the illustrative, non-mandatory guidance accompanying IAS 36, thus allowing management of the entity the possibility of using its judgment to arrive at the most appropriate approach for its particular circumstances.

The "allocation ceiling" should not be introduced independently of other aspects of the modifications proposed since it would certainly be burden. It should be included as part of a package only if it is decided that the isolation of internally-generated goodwill is worthwhile. As discussed later, we are not convinced that this is the case.

The proposed additional disclosures would certainly present an additional burden on the entity because of the complexity of tracking on an individual basis the goodwill-related elements of successive acquisitions, reorganisations and impairments. This would include the allocation of an impairment charge to each tranche of goodwill, an exercise which is not currently required and would be complex to manage. Such a requirement should be contemplated only after extensive detailed consultation with users and entities using concrete examples. Users must be able to explain convincingly why this information is useful and how they use it in order to avoid the risk of imposing onerous tasks on entities for information which may be of an anecdotal nature for users. We are aware of sophisticated users who ignore the accounting for goodwill altogether and use their own approach for assessing acquisitions and mergers.

Q1.2 Do you have any other suggestions to improve this area of the goodwill impairment test?

No.

QUESTION 2 - WHEN AN ENTITY SHOULD DETERMINE THE RECOVERABLE AMOUNT

In paragraphs 2.23 to 2.37 of Chapter 2, EFRAG discusses the introduction of a 'Step Zero' to the impairment test.

Q2.1 Do you agree with the introduction of an initial qualitative assessment?

By “initial qualitative assessment”, we understand this to mean an annual assessment based on qualitative indicators such as that already included in paragraph 99(c) of IAS 36 and complemented by the list in paragraphs 2.28-2.30 of the DP – the “Step-Zero” approach. We think that for some of our members this would represent a real simplification and would therefore be welcome. For others, the impairment test for goodwill is, and will remain, complex, and they are of the view that it is better to perform it systematically on an annual basis in order to maintain the necessary methodology, process and experience of carrying out the test.

We therefore think that the Step-Zero approach should be introduced on an optional basis, allowing entities to avoid carrying out a superfluous full impairment test in appropriate circumstances. In view of the existing requirements of IAS 36 referred to above, this would not represent a fundamental change in principles from the current standard, but would provide additional guidance, thus making the relief more widely available.

Q2.2 Do you have any other suggestions to improve this area of the goodwill impairment test?

Although we agree that transparency is often a good thing, the requirement for the disclosure about how the entity reached its conclusion on the Step-Zero test and on which factors it based its conclusion could become a burden if a great deal of detail is required. As with all disclosures, we do not agree with the idea that disclosure should provide users with enough information to allow them to recreate calculations or “second-guess” management decisions. This can become counter-productive. Careful drafting of the requirements would be necessary.

We think that in some cases there might be a fairly strong correlation between these proposed requirements and the elements one would expect to be discussed in the Management Commentary. There may thus be an opportunity to provide sufficient explanation and the information required by users through cross-referencing to that commentary.

QUESTION 3 - HOW AN ENTITY SHOULD DETERMINE THE RECOVERABLE AMOUNT

In paragraphs 2.38 to 2.78 of Chapter 2, EFRAG discusses how an entity determines the recoverable amount.

In our view, many of the amendments proposed for the Goodwill Impairment Test may be equally valid for the impairment test of individual assets, and consideration will have to be given to this before finalising an approach for goodwill, if only on the grounds of consistency and thoroughness.

Q3.1 Do you agree with having a single method for determining the recoverable amount?

We are not convinced that the limiting of the calculation of the recoverable amount to only one method would result in a significant reduction in the preparer’s burden.

Preparers use their experience to select the method that is the more likely not to result in an impairment and therefore reduce the number of occasions when they have to apply both the Value-in-Use (VIU) and the Fair-Value-less-Costs-of-Disposal (FVLCD) methods.

If only one method were to be retained, we think that this should be the Value-in-Use method as this is an entity-specific approach which, in our view, provides the more relevant and useful set of information about the entity's situation. Furthermore, we think that, in general, a FVLCD for an asset that is sufficiently similar to the Goodwill/CGU under review will not be readily observable, and that preparers will in such cases be forced to revert to a discounted cash-flow approach which is close to the VIU method, except for some elements not currently permitted to be included in the VIU.

Q3.2 Do you agree with the inclusion of future restructurings in the calculation of the value in use?

Given that the price paid for an acquisition may well include an allowance for the cost and effect of future restructuring, it seems appropriate to allow the entity to include the cost and effect of future restructuring in its estimate of the VIU. Inclusion of restructurings that are decided upon subsequently would also provide a VIU which is more relevant. It would be necessary, as stated in the DP, to impose conditions to ensure that the inclusion of such effects is realistic. In addition to the guidance of IAS 38 in this area referred to in the DP, some of the conditions included in IFRS 5 for a disposal may also be helpful as a model.

Q3.3 Do you agree with allowing the use of a post-tax discount rate?

We agree that allowing the entity to choose between the pre- and post-tax discount rate would be a useful simplification. Guidance would have to be provided, of course, to ensure consistency between the discount rate and the cash-flows used.

Q3.4 Do you agree that the impairment test should target internally generated goodwill? Is the goodwill accretion an acceptable way to do so?

We find it difficult to conclude on this issue. On the one hand, the merging of the acquired activity with an existing activity is often one of the major sources of the expected synergies to be achieved. In this context, it seems inappropriate to try to isolate the pre-existing/internally generated goodwill and more consistent to test the whole of the new merged structure for impairment.

On the other hand, if the objective is to identify only the marginal recoverable value created by the acquisition, then in principle internally generated goodwill should be identified and separated out to allow the purchased goodwill to be tested in isolation. However, we wonder whether this is an achievable and realistic objective, since the pre-existing goodwill at the time of the acquisition was measured at an individual point in time, and in all probability, will turn out to be different from the actual flows that would be generated, but will be impossible to monitor on their own.

In the context of the latter, the goodwill accretion approach has merit, and, as suggested in the DP, the use of the discount rate for the accretion would simplify the calculation. However, if the cash flows do not increase as anticipated through the unwinding of the discount, a critical point will be reached and this method will probably result in yearly impairment charges until the goodwill is entirely written off. This raises the question of whether it would not be simpler after all to adopt an amortisation approach to goodwill.

The pre-acquisition headroom approach of the IASB would be another way of isolating the marginal effect of the acquisition which equally has merit. The disadvantage both methods possess is that the goodwill from individual acquisitions and the related impairments would have to be tracked in detail, once again increasing complexity and the consequent burden.

Final comment

Despite its stated purpose not to do so, we think that the DP once again raises the difficult question of whether to amortise goodwill or not. In this respect we reiterate the conclusion of our previous letter in response to the EFRAG Discussion Paper on the amortisation of goodwill:

"On balance, we suggest that the following approach would be reasonable: there should be a rebuttable presumption that acquired goodwill has a finite useful life which the entity can estimate sufficiently reliably. Goodwill should be amortised over this period. Where the entity can demonstrate on a continual basis that goodwill has an indefinite useful life, or that the useful life cannot be estimated reliably, the entity should be required to apply an "impairment-only" approach as at present."

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