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Dear Jean-Paul,

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

On behalf of the Accounting Standards Committee of Germany (ASCG) I am writing to comment on EFRAG's Discussion Paper *Goodwill Impairment Test: Can it be improved?* (herein referred to as the 'DP').

We appreciate the opportunity to respond to the DP and provide our detailed response to EFRAG's questions to constituents, grouped by the sections of the DP, in the appendix of this letter.

Please note, that our answers are based on the stipulation that only potential amendments to the existing requirements for the goodwill impairment test are within the scope of the DP. The overriding question concerning the best possible accounting for goodwill is not addressed in our response. Therefore, it remains to be discussed whether more fundamental changes are needed, e.g. regarding the advantages and disadvantages of reintroducing annual amortisation and a related transition guidance or regarding the identification and measurement of intangible assets in a business combination.

If you would like to discuss our comments further, please do not hesitate to contact Peter Zimniok (zimniok@drsc.de) or me.

Yours sincerely,

Andreas Barckow

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Appendix – Answers to EFRAG’s questions to constituents

QUESTION 1 - HOW AN ENTITY SHOULD ALLOCATE GOODWILL

Q1.1

Do you agree with the additional guidance on how an entity should allocate goodwill? Do you have any other concerns related to the description of the disclosure problem beyond those identified by EFRAG?

Q1.2

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

With regards to how an entity should allocate goodwill acquired in a business combination to CGUs, we believe that the pivotal criterion for determining an appropriate allocation is the identification of what the respective goodwill actually represents and which expected ‘benefits’ constitute the goodwill in each instance.

Principally, goodwill is ‘just’ a residual. In practice, however, a lot of different facts and circumstances lead to the recognition of goodwill. Therefore, different allocation methods may be conceivable and reasonable in any given situation. Hence, determining the appropriate allocation method will naturally remain judgemental.

Only in the rare circumstance that an entity can reliably determine the nature of the respective goodwill, it will be able to answer the question of how to appropriately allocate the given goodwill to its CGUs. This is why we are critical of prescribing universally applicable allocation methods. We recommend EFRAG to further analyse the viability of outlining possible appropriate allocation methods, based on different underlying economics of the goodwill.

Regarding EFRAG’s proposed allocation methods, we think that allocation method 1 (paragraphs 2.9 and 2.10) represents a theoretically reasonable method, which is also used regularly in practice. In our view, allocation method 2 (paragraphs 2.11 and 2.12) represents a possible approach, which in the extreme example (100% of assets to be integrated in CGU A, with additional synergies arising in CGU B) would lead to a result (allocation of 100% of goodwill to CGU A) that seems to violate the basic principle of allocating goodwill to each of the CGUs that is expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units or groups of units (IAS 36.80).

As regards EFRAG’s suggestion of adding information on the composition of goodwill, namely a requirement to disclose a reconciliation of the total goodwill allocated to each CGU, we understand the intention of this proposal but doubt its practical feasibility.

The traceability of each individual (partial) goodwill (per CGU) from each business combination cannot be achieved in practice, since business combinations are usually aimed at integrating the acquired business. The better this integration succeeds, the less can individual developments, especially impairments, be assigned to ‘its origin’, i.e. which specific acquisition underperformed and therefore caused the impairment. This is complicated further in cases of internal reallocations



and/or if a (group of) CGUs contains goodwills resulting from multiple business combinations.

Even though we support EFRAG's intention of providing a clearer picture of the changes in the allocation and the historical origin of goodwill, so that users would be better equipped to assess the recoverability of goodwill, we are afraid that the additional information EFRAG is suggesting cannot be provided in practice. Particularly not by those entities for which this information would be most desirable, namely entities that regularly engage in business combinations. Therefore, we do not support requiring such disclosures.

QUESTION 2 - WHEN AN ENTITY SHOULD DETERMINE THE RECOVERABLE AMOUNT

Q2.1

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

Q2.2

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

We acknowledge that the current requirements in IAS 36 for the determination of the recoverable amount of a CGU to which goodwill has been allocated are complex and time-consuming. Therefore, we understand the intention to reduce this complexity, especially when the likelihood of impairment is remote.

Nonetheless, we do not support the introduction of a mandatory initial qualitative assessment (the 'step zero'). In our view, the suggested reduction of cost due to less frequent calculations of the recoverable amount is outweighed by a loss of continuity and a slower acquisition of knowledge as to how to perform impairment tests, if preparers only occasionally attend to the quantitative impairment test.

Additionally, we think that the existing practical expedient in paragraph 99 of IAS 36 already provides relief and is indeed used by preparers.

Furthermore, the procedural conditions for performing the quantitative impairment test have usually already been established by the entities. Hence, we question whether - in comparison - performing qualitative assessments and then discussing these judgements and assessments with an auditor would truly constitute relief for entities.

On the other hand, if the introduction of a 'step zero' were to be made optional (and therefore no additional burden for entities), we concede that achieving more convergence with the corresponding option under US GAAP could be an argument for introducing the initial qualitative assessment.



QUESTION 3 - HOW AN ENTITY SHOULD DETERMINE THE RECOVERABLE AMOUNT

Q3.1

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

Q3.2

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

Q3.3

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

Q3.4

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

Q3.5

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

With regards to EFRAG's suggestion of requiring or allowing only a single method for determining the recoverable amount, we think that this would not lead to a significant reduction of complexity, as - per our knowledge and experience - most entities usually apply only one of these measurement methods. In practice, fair value less costs of disposal (FVLCD) is not generally available as an observable price and is then alternatively determined by using a discounted cash flow (DCF) calculation. Value in use (VIU) generally is also determined by using DCF calculations. Therefore, it regularly happens that both measures are based on DCF calculations. Only when the first method results in a recoverable amount that is lower than the carrying amount, entities also apply the second method.

If only one method were to be retained as the measurement of recoverable amount, we think that the following aspects as to which method is preferable should be considered. As EFRAG also notes, each method has its own advantages and disadvantages. FVLCD reflects the assumptions of market participants and implies the intention to sell. We think that only if there is a definite intention to sell, the use of FVLCD as a measurement basis for the impairment of goodwill should be applied. This school of thought adds the benefit of being aligned with the objective of IFRS 5.

When performing an impairment test, however, an entity normally assumes a continuing use and not an immediate sale, as most business combinations are aimed at integrating and continuing the acquired business (going concern assumption). We think that, conceptually, this is better reflected in the VIU, which incorporates the management perspective. Therefore, we think that VIU is a better starting point for determining the recoverable amount and if only one method were to be allowed or required, we would favour VIU.

Nonetheless, we think that the current IAS 36 guidance pertaining to the VIU are too restrictive and should be improved once the VIU should be the measurement basis for goodwill impairment testing. Our observations and recommendations relate particularly to the inclusion of future

restructurings and asset enhancements as well as the use of a post-tax discount rate. We believe that the use of internal budgets and forecasts, which take the dynamic management of the business into consideration, should be foreseen. These budgets and forecasts obviously would have to be reasonable and supportable, i.e. they would have to be reliable for market participants. Therefore, we support EFRAG's suggestion to change the requirements for the VIU measurement, in order to allow the effect of planned future restructurings to be incorporated in the cash flow projections that are used to determine the VIU.

As regards EFRAG's suggestion to allow entities an election between a pre-tax or post-tax calculation, we observed that entities regularly use a post-tax basis with an additional iteration to derive the pre-tax discount rate required by IAS 36 (for disclosure purposes as no observable pre-tax interest rates are available). Therefore, we agree with EFRAG's suggestion to use a post-tax discount rate as an alternative to the pre-tax rate currently mandated.

Regarding EFRAG's suggestion of the goodwill accretion approach, we are not in favour of making this adjustment (the accretion) when testing purchased goodwill in order to eliminate the effect of internally generated goodwill. We think the goodwill accretion approach effectively constitutes an amortisation method, where an impairment results, i.e. goodwill is consumed, if the growth of the recoverable amount of the CGU is less than the assumed internal generation of goodwill in this CGU. If one really believes that the useful life of purchased goodwill is finite and therefore consumed over time, then it would be more appropriate to have a regular annual amortisation instead.