



To: Mr Jean-Paul Gauzes
EFRAG Board President
EFRAG
Square de Meeûs 35 – 1000 Brussels

From: Insurance Europe

Date: 21 December 2017

Reference: ECO-FRG-17-143

Subject: EFRAG's Discussion Paper "Goodwill impairment test: Can it be improved?"

Dear Mr Gauzès,

Insurance Europe welcomes the opportunity to comment on the EFRAG's Discussion Paper "Goodwill impairment test: Can it be improved?", issued by EFRAG on the 29 June 2017 for public comments.

Significant concerns have been raised on the existing accounting regime for goodwill purchased in a business combination, i.e. impairment only approach, during the recent IASB's Post Implementation Review on IFRS 3 Business Combinations. Consequently, the IASB decided to approach these concerns. Specifically, the IASB aims to find out whether existing accounting regime should be maintained and improved or whether the re-introduction of the mandatory amortization of goodwill should be proposed to the IFRS constituency as a next step. Insurance Europe appreciates the considerable efforts of EFRAG to stimulate the discussion on different approaches for goodwill accounting at European level with all interested stakeholders.

The European insurance industry takes a particular interest in the ongoing debates at the level of the IASB and EFRAG on the future of goodwill accounting in IFRS. Insurance Europe agrees that the current goodwill accounting treatment under IFRS needs a revision. However, **Insurance Europe has concerns that the pre-acquisition headroom approach currently explored by the IASB and the goodwill accretion approach proposed in the EFRAG Discussion Paper will introduce additional complexity and operational cost without clearly demonstrating benefits.**

These concerns also arise in relation to a number of other specific aspects of the EFRAG's paper, eg the additional calculation steps or introducing additional disclosure requirements (e.g. reconciliation of the total goodwill allocated to each CGU and tracking of goodwill by individual acquisition, paragraphs 2.18-2.20); the suggested removal of one of the methods to calculate the recoverable amount (Question Q3.1); and the introduction of a (optional) "Step Zero" (Question Q2.1).

We urge EFRAG to revisit the direction of the research work on the goodwill accounting issue and to focus more on ways which really simplify the goodwill accounting practice in a significant manner and contribute to cost reduction at preparers and users side.

To support this, Insurance Europe suggests to **consider creating an EFRAG Goodwill Accounting Working Group (GAWG)** to utilize current existing practical expertise of European accounting practitioners in this respect.

Finally, Insurance Europe has the view that the general underlying controversy on the right approach for **goodwill accounting needs a pragmatic solution**, i.e. a compromise approach that is pragmatic from an operational perspective and yet retains much of the relevant conceptual underpinning. This **might take the form of allowing for an accounting policy choice**, i.e. allowing amortization and impairment only as optional approaches for the reporting entity to choose between at the reporting entity level, with appropriate disclosure.



The rationale for our suggested approach is set out in detail in our position paper ([ECO-FRG-16-137](#)) which we have put in annex for your convenience.

Please do not hesitate to contact us if you would like to discuss our comments in more detail.

Yours sincerely

A handwritten signature in blue ink, appearing to read "Olav", with a long horizontal flourish extending to the right.

Olav Jones,
Deputy Director General & Director ECOFIN

Insurance Europe's views on IFRS accounting for goodwill: A need for an amortisation option

Our reference:	ECO-FRG-16-137	Date:	14 December 2016
Referring to:			
Related documents:			
Contact person:	Olav Jones	E-mail:	Jones@insuranceeurope.eu
Pages:	3	Transparency Register ID no.:	33213703459-54

Background

Significant concerns have been raised, especially by large number of preparers, on the existing accounting regime for goodwill purchased in a business combination, i.e. impairment only approach, during the recent Post-Implementation Review on IFRS 3 Business Combinations. Consequently, the International Accounting Standards Board (IASB) decided to approach these concerns and to explore this important issue. Specifically, the IASB aims to find out whether the existing accounting regime should be maintained and improved, or whether the re-introduction of the mandatory amortisation of goodwill should be proposed to the IFRS constituency as a next step.

Summary

The European insurance industry takes a particular interest in the ongoing debates at the level of the IASB and at the level of European Financial Reporting Advisory Group (EFRAG) on the future of goodwill accounting in IFRS. As set out below, Insurance Europe's members differ in their views. Some would like the IASB to maintain the current impairment only approach, with improvements to impairment testing. Others would like the IASB to abolish the current impairment only approach as soon as possible and to re-introduce the linear amortisation.

As proponents of the respective approaches cannot be convinced to agree on one alternative, it is reasonable to look at both. Insurance Europe recommends to the IASB to explore a compromise that is pragmatic and yet retains much of the relevant conceptual underpinning. This might take the form of allowing for an **accounting policy choice**, i.e. allowing amortisation and impairment only as optional approaches for the reporting entity to choose between, with appropriate disclosure, including of the rationale for the accounting policy choice.

A further post-implementation review could then be undertaken after a sufficient period of time to take account of new evidence on the operation of the two approaches and their acceptability to users, to inform further improvements in dealing with this complex area of accounting.

Insurance Europe views on IFRS goodwill accounting

The European insurance industry has identified two diverse views with regard to the assessment of the current IFRS accounting treatment required by the IASB for the goodwill purchased in a business combination. They are summarised in the following.

1. Views of those members who would like the IASB to maintain the current impairment only approach, with improvements to impairment testing:

- The existing impairment only approach (i.e. the prohibition of systematic amortisation over a pre-determined period) has been introduced in 2004 because the IASB decided that it is not possible to predict either the useful life of acquired goodwill or an amortisation pattern, unlike other intangible assets and tangible assets. This makes any year's amortisation charge at best completely arbitrary, and likewise also the remaining balance sheet value.
- There is no significant evidence that it has become more possible than in 2004 to predict either goodwill's useful life or its amortisation pattern, nor that users of financial statements now (in contrast to 2004) regard a completely arbitrary amortisation charge or balance sheet value as providing useful information.
- It is not clear that all goodwill is consumed over time and replaced by internally generated. Some at least is likely to be sustained by rationalisation and future investment.
- In any case, goodwill does not lose value in the same way as other assets. Instead it does so because of individual events and these are better reflected as impairment charges, e.g.
 - changes in the business environment, for which impairment charges better reflect the economic reality; and/or and
 - failures of management, for which impairment charges better reflect the stewardship/ accountability objective of financial reporting.
- Both these kinds of signaling to capital markets participants have substantial micro-and macro-economic benefits.
- Good impairment testing is necessary for both the impairment-only and the amortisation approaches. It needs to be as effective as possible and reduce any incidence of 'too little/too late'. It should not be weakened through some form of simplification in the case of the amortisation approach. Instead, the IASB considers that improvements to impairment testing are possible, and investors have supported the IASB in principle in this respect.
- If it is possible to simplify impairment testing as well as make it more effective, that would be welcomed in reducing compliance costs for preparers, auditors, investors, regulators and other users.
- Preparers, auditors and users have got used to the existing treatment of goodwill, and any changes to this are likely to be costly. Hence changes should be avoided unless they are clearly supported by cost/benefit analysis - which does not appear to have been carried out so far.
- The form and content of IFRS-based accounts is governed by the EU Regulation on IFRS, not the EU Accounting Directive.
- It is not helpful in a debate on the merits of one accounting approach or another to refer to any political motivation on the part of the IASB's decision-makers, especially so many years ago and in a quite different context. If that test were applied throughout IFRS, who knows what decision would remain.

2. Views of those members who request the IASB to abolish the current impairment only approach as soon as possible and to re-introduce the linear amortisation:

- While the internally generated goodwill is rightly not recognised in IFRS financial statements, the purchased goodwill is treated as a recognisable intangible asset and measured subsequently via the impairment only approach. However, the existing prohibition of the scheduled amortisation of the purchased goodwill is highly problematic as it has significant negative consequences. In particular, the current impairment only approach is not working properly as it results in too little and too late impairment recognition. The reason is that the design of the impairment only approach requires an implicit recognition of internally generated goodwill which leads to continued replacement of goodwill acquired by the goodwill internally generated (i.e. contrary to the existing explicit prohibition of its recognition).
- Reporting entities growing organically are systematically put in disadvantage and the accounting treatment incentivises merger and acquisition activities. The latter result in significantly growing amounts of goodwill recognised in balance sheets. The impact of 'too little and too late' phenomenon might in consequence lead to significant pro-cyclical effects contradicting the political goal of stable economic growth. [The negative effect of "too little and too late" is not explicitly observable in the recent empirical study of EFRAG as it has been based on average numbers.]
- Therefore, the removal of the impairment only approach is not only necessary for conceptual reasons as noted above. It would also significantly reduce the compliance costs for reporting entities, efforts of statutory auditors and of enforcement authorities. The linear amortisation of goodwill is a pragmatic, transparent and cost-effective solution which contributes to more robustness of balance sheets at micro basis and financial stability at macro level.
- The impairment only approach is also assessed as not being in line with the revised European Accounting Directive 2013/34/EU of 26 June 2013. The Directive requires that the goodwill shall be written off over no more than 10 years if its useful life cannot be reliably estimated.
- Consequently, IFRS also should ensure that the goodwill purchased in a business combination is written off within a maximum predefined period of years on a linear basis, accompanied by a simplified annual impairment test based on predefined triggering events.
- The determination of useful life of goodwill is not more complex than for any other tangible or intangible asset. As a pragmatic default solution the IASB might set a predetermined maximum for it if the useful life cannot be reliably estimated in particular circumstances.
- The introduction of impairment only approach was rather politically motivated after the FASB's preceding decision in 2001 (in conjunction with the abolishment of the pooling-of-interest method) than caused by the conceptual problems with the application of amortisation approach.
- The increasing concern of those opposing the impairment only approach is that the IASB might rather intend to generally corroborate the current impairment only approach instead of allowing for a switch to linear amortisation as a more appropriate, pragmatic and cost-effective alternative for preparers.

Insurance Europe is the European insurance and reinsurance federation. Through its 34 member bodies — the national insurance associations — Insurance Europe represents all types of insurance and reinsurance undertakings, eg pan-European companies, monoliners, mutuals and SMEs. Insurance Europe, which is based in Brussels, represents undertakings that account for around 95% of total European premium income. Insurance makes a major contribution to Europe's economic growth and development. European insurers generate premium income of €1 200bn, directly employ over 975 000 people and invest nearly €9 800bn in the economy.