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Mr Jean-Paul Gauzes
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13 December 2017

Dear Mr Gauzes,

On behalf of the Austrian Financial Reporting and Auditing Committee (AFRAC), the privately organised standard-setting body for financial reporting and auditing standards in Austria, we appreciate the opportunity to comment on the *EFRAG Discussion Paper Goodwill Impairment Test: Can it be improved?*, issued by the EFRAG in June 2017 (the 'DP').

Principal authors of this comment letter were Otto Altenburger, Günther Hirschböck, Christian Höllerschmid, Erich Kandler, Christina Khinast, Roland Nessmann, Andreas Rauter, Alexander Schiebel, and Alfred Wagenhofer. In order to assure a balanced Austrian view on the DP, the professional background of these authors is diverse.

Our detailed comments and responses to the three questions raised in the DP are set out in the Appendix.

If you would like to discuss our comments further, please do not hesitate to contact us.

Kind regards,

Romuald Bertl,
Chairman

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EFRAG DISCUSSION PAPER GOODWILL IMPAIRMENT TEST: CAN IT BE IMPROVED?

GENERAL REMARKS

AFRAC welcomes and supports the continuing initiatives of EFRAG to improve the accounting for goodwill. This DP focuses on the impairment test of goodwill, which is also an issue of high importance in practice in Austria. We received feedback from preparers that the impairment test of goodwill is complex and costly to perform. This DP includes several suggestions how to reduce this complexity.

We also support further initiatives, particularly regarding possible amortization of goodwill, which may also have a significant effect on the cost of performing annual goodwill impairment tests. While we understand the narrow focus of the DP, we note that some of the issues raised in the DP are closely related to the non-amortization approach of the currently effective IFRS. For example: (i) As the 'one-step' approach is designed for intangibles that are not amortized on a regular basis, the suggestion to change this approach is inherently linked with the general accounting for intangibles with indefinite useful life. (ii) The goodwill accretion suggested in the DP seems to create a periodic adjustment of the carrying amount similar to an amortization. We strongly believe that a reintroduction of goodwill amortization (either mandatory or based on a similar assessment as is required for other intangibles) would significantly reduce concerns as to the annual impairment test.

SPECIFIC REMARKS

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.

Question 1.1

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

Due to the nature of goodwill, there is no undisputable conceptual basis for its allocation to CGUs or groups of CGUs. Therefore, we believe that there should be an allocation basis that works reasonably well and does not depend so heavily on subjective views of management. Therefore, we support more guidance or a specific rule. For example, IAS 36 already includes a rule to allocate an impairment loss to assets in a CGU, which does not allow the exercise of much discretion.

We believe that the two allocation mechanisms suggested in the DP are at least as good as the current requirement in IAS 36, but their costs are likely to be different. Method 1 seems to require the determination of the post-acquisition fair value of the CGUs, which is usually not readily available. Furthermore, it would require the determination of the pre-acquisition fair value, which might be available if the recoverable amount of the CGU was the fair value. Method 2, on the other hand, seems to require the determination of the fair value of the portion of the acquired business to be included in the CGU, which is usually not readily available.

We prefer the second method because – in practice – it appears to be easier or more likely to calculate the fair value of the parts of the acquired business than to make the other calculations required for method 1.

Another possible approach could be to offer entities the choice between these two methods.

We are sympathetic to the idea of considering a headroom constraint, although such a requirement would add once again more complexity. Conceptually, a reason for considering such a constraint is the different accounting for internally generated and acquired goodwill. Amortizing acquired goodwill would sidestep the issue generally.

Question 1.2

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

We agree with the intention to offer more information about the origin of goodwill that is impaired. This could be implemented by improving the disclosures that relate to the impairment of goodwill.

We see no great benefit of a general requirement of a reconciliation of goodwill that is allocated to different CGUs and of a breakdown of changes in the carrying amount of goodwill in each CGU. We believe that for most entities such a table would be sparsely filled in. Moreover, there may be practical problems with reallocations of goodwill, the allocation of a goodwill impairment of a particular CGU to the different goodwill additions from acquisitions, and the like.

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.

Question 2.1

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

We understand that IAS 36.99 already provides practical exceptions from the one-step method. The DP appears to broaden them slightly. We do not object that, if exceptions are limited.

Question 2.2

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

We believe that a move away from the one-step to a two-step approach (with a "step zero") should not be discussed without considering its effect on all intangibles with infinite life. Conceptually, the periodic impairment test was introduced because periodic amortization was abandoned. Therefore, any change in the impairment requirements for goodwill should apply to all intangibles with infinite life. Due to the special nature of goodwill (many argue that goodwill does not satisfy the criteria for an asset) measurement should even be stricter than for other intangibles.

We propose that any additional suggestions should be considered together with a reintroduction of amortization of goodwill.

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.

<u>Question 3.1</u>

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

The VIU considers cash flows from ongoing operations and the proceeds from the disposal of the asset or CGU. Therefore, conceptually the VIU encompasses the FVLCD. The difference is that the FVLCD presumes the immediate sale of the asset, which is generally an inappropriate presumption. Thus, we believe that if a single method for determining the recoverable amount is chosen, it would be the VIU.

<u>Question 3.2</u>

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

We are aware that adjusting budgets and forecasts for future restructurings is an onerous task in practice. Thus, any improvement is welcome.

While we believe that the simple inclusion of future restructurings in the calculation is not in line with the concept of the VIU, the special situation concerning goodwill may justify a broader view for two reasons: on the one hand the special nature of goodwill as an aggregate item, on the other hand the prohibition of reversing an impairment loss.

We hear that in some cases the requirements for including future restructurings in the calculation of the VIU appear to be too strict. There are disadvantages, too, as mentioned in para. 2.54 of the DP. Weighing the different disadvantages is not easy.

We can imagine to allow the inclusion of future restructurings: If a restructuring has zero net present value (NPV), then it would not matter for the determination of the VIU whether the restructuring is included in the cash flows or not. Therefore, we suggest that restructurings should be adjusted only if their NPV significantly differs from zero.

We do not agree with the argument that future restructurings could be included in the VIU because a buyer would incorporate them (if the restructurings are the best way to continue business) (para 2.49 of the DP). The VIU is a value from the perspective of the entity and not from that of a potential seller, and it would conceptually be included in the FVLCD.

<u>Question 3.3</u>

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

We strongly support the suggestion to allow the use of a post-tax calculation of the VIU. From our point of view most entities actually use a post-tax calculation, mainly because pre-tax returns are not observed in markets and must be calculated from the post-tax calculation of the VIU and because entities usually plan post-tax profit or loss.

As stated in Para. 2.62 of the DP, a post-tax and pre-tax calculation should result in the same VIU. Hence, any differences may be due to inaccurate planning of either pre-tax or tax amounts. Therefore, we see no clear advantage of one or the other method.

Question 3.4

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

We agree that the different accounting for acquired and internally generated goodwill is a major concern. From our point of view the most plausible, and easiest, way to address this concern is to reintroduce amortization of goodwill.

We do not support introducing other methods, such as the goodwill accretion in the DP, that essentially attempt to achieve something similar to amortization, although under a different heading and by adding complexity. For accretion this heading is an exogenous assumption of the rate of creation of internally generated goodwill. Actually, this results in a value resulting from indirectly discounting the acquired goodwill, which is compared to the recoverable amount of the CGU that includes the goodwill. We do not believe that this is a sensible approach to tackle the underlying issue, the distinction between acquired and internally generated goodwill.

We note that the headroom approach (para. 2.13-15 of the DP) is another attempt to achieve the objective, again with little conceptual basis.

Question 3.5

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

As mentioned earlier, we believe that reintroducing the amortization of goodwill is the most useful, and most obvious way to deal with the issue. Amortization reduces the carrying amount of goodwill on a regular basis, so that even without impairment the carrying amount declines to zero after several years, thus, being converging to internally generated goodwill. The amortization approach for goodwill could be made mandatory or, alternatively, an entity's decision similar to the general requirements for intangibles according to IAS 38.88 and following.

In that case, the impairment test could be performed in two stages, i.e., the search for indicators and the impairment test if an indicator is identified. This procedure is in line with the DP's suggestions.

We also note that amortization of goodwill is required in the IFRS for SMEs and in the Accounting Directive, thus, the reintroduction of amortization aligns goodwill accounting under IFRS with these requirements.