Federation of European Accountants
Fédération des Experts comptables Européens

CL04

Ms. Françoise Flores
TEG Chair
EFRAG
Square de Meeûs 35
B-1000 BRUXELLES

E-mail: commentletters@efrag.org

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Ref.: ACC/AKI/HBL/PPA/SRO

Dear Ms. Flores,

Re: FEE comments on EFRAG's, ASBJ's and OIC's discussion paper – "Should Goodwill Still Not Be Amortised? – Accounting and Disclosure for Goodwill"

FEE (the Federation of European Accountants, www.fee.be) is pleased to provide you below with its comments on the EFRAG's, ASBJ's and OIC's discussion paper – "Should Goodwill Still Not Be Amortised? – Accounting and Disclosure for Goodwill" ("Paper" or "DP").

FEE welcomes the initiative of the EFRAG, ASBJ and OIC for stimulating the discussion on the treatment of Goodwill. Following the discussions triggered from the IASB's post Implementation Review of IFRS 3 – Business Combinations, it is clear that the impairment-only approach for accounting for goodwill raises questions.

In its response to the IASB's request for information, FEE noted the shortcomings of the impairment only approach, including the practical concerns in the performance of the impairment test, the significance of the judgements involved and the perception that impairment losses are sometimes recognised too late.

Nevertheless, at this stage, FEE is not expressing a position on whether or not a change in approach is necessary. Our Member Bodies have different experiences in their respective jurisdictions relating to the practical application of annual impairment reviews as opposed to amortisation. Some FEE Members Bodies support the requirement for annual impairment-only reviews contained in the Standard, albeit as the "least-worst" option. Others favour amortisation of goodwill over its limited useful life combined with regular impairment testing. Hence, FEE believes that it is necessary that further research be performed on the comparative merits of both the impairment only and amortisation approaches.

FEE agrees with the DP that the accounting for goodwill is interlinked to the impairment model. In its response to the IASB re the PIR of IFRS 3, FEE called for improvements to the impairment model of IAS 36 – Impairment of Assets. In this context, FEE noted that the IASB needed to consider enhancing the guidance in IAS 36, especially in the areas that the DP raises (i.e. identification of the cash generating units, discount rate and disclosures).

Furthermore, FEE agrees with the DP that a change in the accounting treatment of goodwill would have an impact on the initial recognition of intangible assets in a business combination and on the subsequent treatment of intangible assets with indefinite useful economic life.

Please refer to the appendix for our responses to the specific questions asked in the DP.

For further information on this letter, please contact Pantelis Pavlou, Project Manager from the FEE Team on +32(0)2 285 40 74 or via e-mail at pantelis.pavlou@fee.be.

Yours sincerely,

André Kilesse
President

Olivier Boutellis-Taft
Chief Executive

Question 1: Do you agree that there should be a requirement to recognise goodwill as an asset and amortise it over subsequent periods? If so, do you support amortisation because:

a) goodwill existing at acquisition date is consumed and replaced with internally generated goodwill over time, thus it should be allocated to subsequent periods as part of the cost of acquiring an entity;
b) an impairment-only model is not sufficiently reliable due to the large use of assumptions in the impairment test (future cash flows, terminal growth rate and discount rate); or
c) amortisation of goodwill, in addition to the impairment test, achieves an appropriate cost-benefit balance.

Recognise goodwill as an asset

(1) FEE agrees that goodwill meets the definition of an asset and it should be recognised in the statement of financial position. The fact that IFRS 3 explains that goodwill is calculated using a top-down approach and, accordingly, is a residual amount does not mean that goodwill is not an asset. Indeed goodwill appears to meet the definition of an asset in that it is a “resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity”. Goodwill is an intrinsic component of the investment made in the subsidiary. By controlling the investment as a whole, the parent entity controls the goodwill that forms part of the investment. Further, goodwill represents an amount that the entity has paid for and expects to recover from synergies between the acquired business and the existing activities. Therefore, FEE disagrees with the immediate writing off of goodwill in profit or loss, in other comprehensive income or directly to equity.

Subsequent accounting treatment of goodwill

(2) Our Member Bodies have different experiences in their respective jurisdictions relating to the practical application of annual impairment reviews as opposed to amortisation. Some FEE Members Bodies support the requirement for annual impairment-only reviews contained in the Standard, albeit as the “least-worst” option. Others favour amortisation of goodwill over its limited useful life combined with regular impairment testing.

(3) Supporters of the impairment-only approach note that this method is the purest from a conceptual viewpoint. On the other hand, supporters of an approach that combines amortisation of the acquired goodwill over its limited useful life with regular impairment testing believe that acquired goodwill is an asset with a limited useful life and it should be amortised on a systematic basis over this life. They do not view the problem of determining the useful life as being a compelling conceptual argument against the amortisation of goodwill, as this problem also applies to other intangible assets with a finite life.

(4) Supporters of the amortisation method accept the need for regular impairment reviews but believe that amortisation reduces the pressure on the impairment review process and thereby facilitates reliable measurement.

(5) We believe that the reason that goodwill does not require impairment is that it passes from acquired to internally-generated over the course of time, such that the asset that "passes" the impairment test is no longer the one initially recognised. This is inconsistent with the prohibition from recognising internally generated goodwill. However, this ceases to be an issue when the asset is amortised as the useful life of goodwill, in most cases, would be sufficiently short that the goodwill would not change from acquired goodwill to internally generated goodwill.

(6) There are also problems with the amortisation approach, particularly related to the relevance of what could be seen as arbitrary annual charges to the financial statements.

(7) Due to valid arguments raised for and against both approaches, FEE believes that this important matter warrants further consideration by other constituents and the IASB. We are also in agreement with the Paper that the discussion re the accounting treatment of goodwill is directly related to the need of an improvement in the impairment model (please refer to our response to Question 3).

(8) In addition, this discussion is an opportunity to review the requirement to separately recognise intangible assets from goodwill and the treatment for intangible assets with indefinite useful economic life (please refer to our response to Question 5).

Question 2: Assuming that there was a requirement to amortise goodwill, do you think that the IASB should:

a) indicate what the amortisation period should be?
b) indicate a maximum amortisation period?
c) provide guidance on how entities should assess the amortisation period (for instance, by referring to the expected payback period or the useful life of the primary asset)?
d) allow entities to elect the amortisation period that they consider appropriate?

(9) FEE agrees that the determination of the amortisation period is a key question and that the subjectivity involved in the determination of that period is a key argument of those who oppose the amortisation of goodwill. FEE does not agree that the issue of the subjectivity of the estimation should be addressed by establishing a set amortisation period that would need to be used to every business combination in every industry.

(10) In addition, in FEE's opinion, establishing a maximum period for the amortisation of goodwill in an accounting standard is difficult to justify at a conceptual level. Each business combination is different and, therefore, establishing a maximum useful economic life for goodwill will not reflect the economic substance due to differences in business models and industries. For example, the useful life of goodwill arising on acquisition of an internet based high-tech entity is likely to be significantly shorter than the estimated life of goodwill arising on acquisition of a well-established manufacturing entity. Therefore it would be extremely difficult for a standard setter, like the IASB, to set a maximum number for the useful economic life at a level that would be relevant in all circumstances.

(11) FEE also disagrees with the use of the estimated payback period as the method to determine the useful economic life of goodwill. The payback period is a basic investment appraisal technique which only accounts for the nominal return of the initial cost to the investors. Especially in environments with extreme (de)inflation rates, the use of the payback period will result in a longer/shorter useful economic life compared to the useful economic life that would be derived using other valuation methods that account for the time value of money (which provide more relevant and reliable information).

(12) From a conceptual point of view FEE believes that the IASB should develop some principles that entities might use to identify the useful economic life of goodwill and the amortisation method that best reflect the consumption of the economic benefits embodied in acquired goodwill.

(13) The estimated useful life and the amortisation method identified as most relevant would be reviewed when necessary and any changes should be within the scope of *IAS 8 – Accounting Policies, Accounting Estimates and Errors* as changes in accounting estimates.

Question 3: The DP suggests the need for improved guidance in a number of areas in IAS 36. Do you think that the IASB should improve and/or provide additional guidance in relation to:

a) the methods to determine the recoverable amount of the goodwill;
b) the application of the value-in-use method;
c) the identification of cash-generating units and allocation of goodwill to each unit; and
d) the choice of the discount rate.

If not, please indicate why. Please state any specific suggestions for improvements if you have.

Methods to determine the recoverable amount

(14) IAS 36 defines the recoverable amount as being the higher of the FVLCTS and the VIU of the asset (or cash generated unit). The standard, however, takes into account neither the intention of management nor the business model of the entity. In FEE's opinion, the management intentions and the entity's business model can have a significant impact on the estimation of the recoverable amount.

The application of Value in use

(15) Even though IAS 36 imposes the use of the discounted cash flows valuation technique to determine value-in-use (VIU), FEE believes that, in some instances, other valuation methods can be used either to determine or corroborate the VIU.

(16) Accordingly, FEE suggests that IASB should consider allowing management to use the valuation techniques that best reflect the VIU of each CGU, depending on the industry in which the CGUs operate. In some instances, most of the VIU comes from the Terminal Value (TV), which is usually calculated using extrapolation of the time-horizon free cash flows (for example manufacturing factories, oil rings and other mineral resources etc.). In these cases, other valuation methods can be used, such as the Gordon Growth Model.

(17) Other valuation techniques like EVA®, or comparable entities [multiples technique], may also be appropriate in certain circumstances.

Identification of cash generating units, allocation of goodwill to each unit, foreign currencies

(18) Allocating goodwill to CGUs is a key requirement of IAS 36; however, the Standard only provides minimum guidance for identifying the CGUs. Further guidance on the issue may be worthwhile.

(19) FEE notes that concerns were raised in the DP with respect to whether goodwill is allocated to a sufficiently low level under IAS 36. At this time it may be premature to recommend that goodwill must necessarily be allocated at the smallest CGU level. However, FEE agrees that the allocation level is one of the issues that warrant further investigation.

Choice of the discount rate

(20) FEE agrees that the requirement to use a pre-income tax discount rate is an area of practical difficulties for which solutions should be investigated by the IASB.

Question 4: The DP suggests a number of possible new disclosures about impairment testing for goodwill. Do you think that the IASB should consider improving requirements to:

a) assist users in understanding the robustness of the modelling and the entity's current assumptions;
b) provide confirmation of the 'reasonableness' of the entity's past assumptions; and
c) assist users in predicting future impairment.

(21) FEE believes that users are better placed to assess the usefulness of the information disclosed. Further, FEE believes that potential improvements to the disclosure requirements in IAS 36 should be addressed in the context of the IASB Disclosure Initiative.

Question 5: IAS 38 requires that intangible assets with indefinite useful lives are not amortised but tested for impairment at least annually. Assuming that there was a requirement to amortise the goodwill, do you think that the same requirement should be extended to other intangible assets with indefinite useful lives? In addition, assuming that there was a requirement to amortise goodwill, do you think that the current requirements of identifying intangible assets separately from goodwill should be reconsidered? If so, how?

Assets with indefinite useful economic life

(22) FEE agrees that some intangible assets may have indefinite useful economic life, in particular, brand names.

(23) From a conceptual point of view, some argue that the impairment-only approach is the best way to measure these intangible assets. Others believe that if goodwill is to be amortised, then the same treatment should be applied to intangible assets with indefinite useful economic life.

(24) Hence, like for goodwill, the issue of whether or not there should be intangible asset with indefinite useful economic life warrants further consideration. This should include whether or not the same approach is necessary for goodwill and indefinite-life intangible assets. Indeed, there may be factors to consider that would justify a different approach. One of these factors may be the availability of valuation techniques for intangible assets that may address the short-comings of an impairment-only approach.

Intangible assets to be separately recognised from goodwill

(25) FEE agrees with the DP that should the IASB decide to review the accounting model for goodwill, it should take the opportunity to review the requirements in IFRS 3 for recognising intangible assets separately from goodwill.