EFFAS THE EUROPEAN FEDERATION OF FINANCIAL ANALYSTS SOCIETIES

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Contact: Raquel Zaragoza

Re: EFFAS Comment Letter on EFRAG Document regarding the *Goodwill and Impairment* document.

January 11- 2018

Dear Sir/Madam:

EFFAS' Commission on Financial Accounting "FAC", ("Commission", "we") is pleased to share with you the views of European users of financial statements regarding ***Goodwill Impairment Test: can it be improved?*** on which EFRAG is seeking comments from its constituents.

For methodological purposes the document questions have been addressed individually.

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

We believe that companies should provide a qualitative comment and an explanation on the basis of how the goodwill generated is calculated. This calculation plus the net identifiable assets should equate the consideration paid for the acquisition. We think that guidance would be implicit if there is a good explanation of the basis of the acquisition and reconciles with the amount allocated as goodwill. The amount allocated to each CGU would be determined on the basis of the expected cash-flows generated by each of them.

The examples provided in the document should be clearer. There is no explanation on what basis the goodwill amounts allocated to each CGU has been determined nor calculated.

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

Appropriate guidance to report the generated goodwill should be defined before getting into the calculation of the impairment.

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

Users rely on both quantitative and qualitative information when assessing the potential impact of impairment. As noted in *Q1.1*, we think that entities could introduce a qualitative evaluation including the potential impact of exogenous variables as well as of the specific aspects that could affect their CGU.

As noted in paragraph 2.28 those aspects could be reported based on the specific characteristics of an entity. We agree assuming that the "qualitative test" is bases on sound principles.

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

No, specifically.

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

We think that combining *fair value* with *fair value in use* have added complexity, especially as both approaches are not based at all on the same assumptions. We deem that the application of one method will be more reasonable and understandable.

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

For users the disclosure of relevant information is always advisable. In this case the inclusion of restructuring information would be relevant to the extent that the future restructuring will materialize as expected and within a reasonable period of time. We suggest that a group could not include restructuring beyond a three years period. Presenting potential benefits from restructurings in the calculation of the *value in use* should be done on the basis of a solid plan for implementation.

We believe that difficulties arise when entities foresee the inclusion of restructuring processes. However the definition and time frame for implementation and realization is not well defined.

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

Entities and users customarily use a free-market discount rate to calculate WACC and DCF. We will agree with using a post-tax rate for calculation purposes as the relevance of the results will not be affected while being more consistent as the basis for calculation by entities and users.

We think that an entity using pre-tax discount rates should explain the reason for this approach, disclose the basis for its application and the opinion if advisable of valuation experts.

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

One of the fundamental flaws of the current approach is that the impairment test compares the recorded goodwill (due to an acquisition) with the goodwill existing for the CGU at the time of the test. This latter includes goodwill generated internally after the business combination, which under current rules, is not considered as an asset. This was clearly recognised by the IASB Board when IFRS 3 was drafted (see BC 107: *The Board acknowledge that if goodwill is an asset, in some sense it must be true that goodwill acquired in a business combination is being consumed and replaced by internally generated goodwill*).

The impairment test is really the cornerstone of the current approach (see BC 108: *The Board agrees that <u>IF</u> a rigorous and operational impairment test could be devised…)*. We believe that this aggregation of acquired and internally generated goodwill is one the main reasons of the current, and widely recognised, practice of "too little, too late" impairments.

Tracking the internally generated goodwill is thus a good idea. Unfortunately, as goodwill is defined as the part of the valuation that cannot be explained by assets and liabilities, a kind of residual, acquired goodwill and internally generated goodwill are mixed together and it is quite difficult to separate the two components. We thus have serious doubts that it could be possible to track the internally generated goodwill in an objective and operational manner.

In spite of its difficulties the goodwill accretion method could be a reasonable <u>compromise</u> to manage the current problem. This method however should be simple, clearly understandable and avoid adding complexity to the problem. We would suggest that the discount rate is fixed at the beginning of the business combination, so as to avoid having too many moving parts in the complete test, so that it could deliver whatever the accountant wants.

Finally we note that the choice of discount rate is, in fact, choosing an amortization period for the internally generated goodwill. This is inconsistent with the current standard which states that *[the Board] observed that the useful life of acquired goodwill and the pattern in which it diminishes generally are not possible to predict* (BC 107).

Q3.5 Do you have any other suggestions to improve this area of the goodwill impairment test.

Our views to improve this area are stated in the previous comments.

If you would like to further discuss the views expressed in this letter please do not hesitate to contact us.

F. Javier de Frutos

Javier de Frutos
Chairman of the EFFAS FAC,
Commission on Financial Accounting

EFFAS was established in 1962 as an association for nationally-based investment professionals in Europe. Headquartered in Frankfurt am Main, EFFAS comprises 22 member organizations representing more than 16,000 investment professionals. The Commission on Financial Accounting is a standing commission of EFFAS aiming at proposing and commenting on financial issues from an analyst standpoint. FAC members are Javier de Frutos (Chairman, IEAF-Spain), Jacques de Greling (Vice-Chairman- SFAF, France), Rolf Rundfelt (SFF, Sweden), Friedrich Spandl (ÖVFA, Austria), Henning Strom (NFF, Norway), Serge Pattyn (BVFA/ABAF, Belgium), Luca D' Onofrio (AIAF, Italy).