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Stellungnahme zum IASB-Diskussionspapier DP/2020/1 *Business Combinations – Disclosures, Goodwill and Impairment*

Die WPK hat am 2. Dezember 2020 gegenüber dem IASB zum Diskussionspapier zu Unternehmenszusammenschlüssen – Angaben, Geschäfts- oder Firmenwert und Wertminderung (DP/2020/1 *Business Combinations – Disclosures, Goodwill and Impairment*) wie nachfolgend wiedergegeben Stellung genommen.

The Wirtschaftsprüferkammer (WPK) is pleased to take this opportunity to comment on the Discussion Paper DP/2020/1 Business Combinations – Disclosures, Goodwill and Impairment.

We welcome the efforts of the IASB to explore whether companies can, at a reasonable cost, provide investors with more useful information about the acquisitions those companies make. By no means is this a small task.

We are particularly pleased that the IASB has analyzed the feedback of the post implementation review of IFRS 3 in detail. The review clearly revealed that investors had mixed views on the impairment-only approach (i.e. non-amortization) of goodwill and that the impairment test is not robust enough.

We would like to limit our comment letter to the crucial question whether the IASB should foresee a reintroduction of amortization of goodwill or whether the current approach should be retained.

Executive Summary:

Since 2004, when IAS 36 was reissued, acquired goodwill is subject to impairment testing at least annually.

We recommend the reintroduction of amortization of goodwill on a straight-line basis over a specified default period (such as 10 years) that would not require justification, and waive the impairment only approach.

Moreover, we recommend that the Board should simplify the goodwill impairment model by eliminating the annual goodwill impairment test and only requiring goodwill to be tested for impairment if there is a triggering event.

Views of the IASB:

In the Discussion Paper the views of the IASB regarding reintroduce amortisation of goodwill are mentioned.

Proponents of **reintroducing amortisation** argue that:

- the impairment test is not working as the Board intended;
- the carrying amounts of goodwill are overstated and, as a result, a company's management is not held to account for its acquisition decisions
- goodwill is a wasting asset with a finite useful life, and amortization would reflect the consumption of goodwill and
- amortisation would reduce the cost of accounting for goodwill.

On the contrary proponents of **retaining the impairment only approach** argue that:

- the impairment-only model provides more useful information than amortisation,
- the impairment test achieves its purpose, if applied well,
- acquired goodwill is not a wasting asset with a finite useful life, nor is it separable from goodwill subsequently generated internally and
- reintroducing amortisation would not save significant cost.

However, these arguments of the proponents of retaining the impairment only approach are **not convincing** because the same arguments were put forward in 2004.

Moreover, the proponents of retaining the impairment only approach do not make any new arguments; they simply claim the opposite of the proponents of reintroducing amortization.

In the IASB staff paper on goodwill amortization (published in June 2019) many valid arguments were listed in favour of goodwill amortization, while only few arguments were listed in favour of the impairment-only approach.¹ On this basis, we would have expected that the IASB would clearly be in favour of reintroducing the goodwill amortization.

ITC issued by FASB:

In this context we would like to highlight the fact that the **Financial Accounting Standards Board (FASB)** has elevated goodwill accounting to the top of its agenda by issuing an “Invitation to Comment (ITC), Identifiable Intangible Assets and Subsequent Accounting for Goodwill” in July 2019.

The Comment Letter Summary on this ITC revealed that respondents had mixed views on the Impairment-only Model such that considerable 47 respondents disagreed with the current impairment-only model whereas only 35 respondents agreed with the current model (8 respondents were neutral on the topic). Those who opposed the impairment-only model frequently noted the **costs of impairment** and the **lack of decision-useful information** that it provides.

Several respondents discussed the significant level of **documentation** required for the impairment test. One preparer noted for example that compliance with the impairment test required more than 600 pages of work papers and more than 2,500 hours to audit a \$1 billion goodwill balance made up of 16 transactions that occurred between 12 and 23 years previously.

With regard to the comments received on the ITC by the FASB and the ongoing discussion within the FASB we are even more surprised that the IASB intends to convey the impression that the impairment-only model must be adhered.

No Convincing arguments to retain the impairment only approach:

We admit that the reintroduction of amortising the goodwill might have severe implications on companies, auditors, investors and enforcers, especially in the year of transition. For this reason, appropriate and well-considered transitional arrangements must be established. Apart from a significant one-time workload in the year when the transitional arrangements have to be performed, we cannot find any convincing arguments that would justify retaining the impairment only approach:

¹ <https://cdn.ifrs.org/-/media/feature/meetings/2019/june/iasb/ap18b-goodwill-and-impairment.pdf> Page 25

- The carrying amount of the global recognized **goodwill has risen continuously** since 2004. This is not sufficiently considered in the Discussion Paper and its effects are not adequately analyzed.
- Leading economic researchers predict severe recessions in the upcoming years. In many cases, goodwill is therefore also viewed as a **hidden time bomb** that has been ticking for a long time and could go off in one case or another due to the Corona crisis.
- In addition, the low interest rate level has led many companies to buy other companies at **inflated purchase prices** and thus further inflated the goodwill of many balance sheets.

We would like to refer to the situation in Germany: in the balance sheets of the 30 largest German companies (DAX 30), the total goodwill in 2019 sums up to over EUR 317 billion (**35 percent of their equity**). This is an increase of more than EUR 140 billion in 10 years (or almost EUR 200 billion since 2005). In some cases, the goodwill exceeds equity.²

In comparison, the impairment is negligible: in 2019, all 30 DAX companies impaired their goodwill by approximately just EUR 5 billion.

In the USA all public companies had USD 5.6 trillion of goodwill on their books in 2018. That amounted to 6% of their total assets and **32 percent of their equity**. S&P 500 companies accounted for USD 3.3 trillion of such goodwill, representing 9 percent of their total assets and **41 percent of their equity**.³

The current Corona crisis makes impairment tests likely more dramatic for all goodwill figures, because the assumed growth rates and expected cash flows of many takeovers in the past, which may have justified the goodwill at the time, are likely to be unsustainable in the future. The current situation is more than explosive. Many corporations have piled up mountains of goodwill after extensive takeover tours, which are now in danger of collapsing.

The effects of the crisis are devastating. Here just two examples:

² <https://www.boerse-online.de/nachrichten/aktien/so-viel-goodwill-steckt-in-den-bilanzen-der-30-dax-konzerne-ein-ueberblick-1029117085>

³ <https://www.cfo.com/accounting-tax/2020/02/fasb-turns-up-the-heat-on-goodwill-impairment-testing/>

As a result of the worsening economic outlook the Banco Santander adjusted their goodwill ascribed to some units and to deferred tax assets totalling up to EUR 12.6 billion resulting in a loss of approx. EUR 11 billion million in the first half of the year 2020.⁴

Due to the COVID 19 pandemic, HeidelbergCement AG comprehensively reviewed the business prospects of all significant local business units of the Group in the second quarter of 2020, considering the expected effects of the COVID 19 pandemic on the business of HeidelbergCement. The audit leads to an impairment of goodwill and tangible fixed assets shown in the consolidated balance sheet totalling around EUR 3.4 billion before tax.⁵

The economic situation in Germany is often seen as extremely challenging. 80 percent of the companies expected falling sales for the full year. 40 percent have serious liquidity problems and every tenth company even believes they are at risk of bankruptcy.⁶

Holistic View is required:

The pros and cons have been largely unchanged over the last decades. However, observations reveal that the current impairment only approach does not work. Instead of an isolated consideration of the pros and cons of an amortisation of goodwill against impairment only model we are convinced that **only a holistic consideration** will lead to an appropriate result. As mentioned in the discussion paper the Board accepts that both accounting models for goodwill – impairment only model and an amortisation model – have limitations. No impairment test has been identified that can test goodwill directly, and for amortisation it is difficult to estimate the useful life of goodwill and the pattern in which it diminishes.

However, we are convinced that the amortisation model would lead to a truer and fairer view than the extant impairment only model or any other model under discussion. Moreover, it would reduce the basis for impairment charges and increase comparability.

The amortisation of goodwill may result in understated carrying amounts of goodwill in the financial statements. Thus, from an auditor's perspective we recognize that the audit risk would become much lower in the amortization model combined with an impairment test as compared with the impairment-only model.

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⁴ <https://www.santander.com/content/dam/santander-com/en/documentos/resultados-trimestrales/2020/2q/rt-2t-2020-informe-financiero-en.pdf>

⁵ <http://mobile.dgap.de/dgap/News/adhoc/heidelbergcement-revaluation-asset-portfolio-heidelbergcement/?companyID=217&newsID=1364471>

⁶ <https://www.wallstreet-online.de/nachricht/12855196-dihk-konjunktur-bricht-stark-befuerchtet>

We hope that our comments are helpful. If you have any questions relating to our comments or if you wish to explore any considerations made in our letter, we should be pleased to discuss such matters further with you.
