23 November 2021

IASB Information Request on the subsequent accounting for goodwill

Dear Tim, dear Paolo,

On behalf of the staff of the Accounting Standards Committee of Germany (ASCG) I am writing to reply to your Information Request regarding the subsequent accounting for goodwill. We appreciate the opportunity to comment on the questions raised.

Following the Post-implementation review of IFRS 3 *Business Combinations*, the IASB published its Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment*. The Board discussed summaries of feedback at its meetings in March, April and May 2021.

In July 2021 you provided the IASB with analysis of feedback on the Board's preliminary views on the subsequent accounting for goodwill, including whether to reintroduce amortisation of goodwill. Before making a decision about whether to reintroduce amortisation of goodwill, Board members said they would like more information to help make that decision, in particular about the feasibility of estimating a useful life of goodwill and the effect on historic goodwill balances of transitioning to an amortisation model.

You are in the process of researching and analysing this information and asked for our help and input on particular aspects of these matters (ref. your E-mail of 20 September 2021).

We discussed the issues raised in the Information Request with representatives of the National Offices of the German large five audit firms and the Institute of Public Auditors in Germany (IDW). Particularly, we asked them to provide their observations and experiences regarding the determination of the useful life of goodwill in accordance with German GAAP and their views on the potential transition to an amortisation model under IFRS. We also sounded this feedback with chief accountants of listed companies and German preparer's organisations.

For further details, please refer to our answers to your two set of questions below. If you would like to discuss our comments further, please do not hesitate to contact Peter Zimniok (zimniok@drsc.de).

This document was prepared by the ASCG staff. It is made available to the public so that the proceedings of the communication between the ASCG staff and the IASB staff can be followed. The document does not reflect official positions of the ASCG or its technical committees. Those positions are solely set out in the German Accounting Standards and in ASCG comment letters as approved by the technical committees.

(A) Useful life of goodwill

If the applicable local accounting framework in your jurisdiction requires goodwill to be subsequently amortised, how is the useful life determined and, in particular whether:

(i) a default period is provided in local GAAP (for example: 10 or 20 years) and the reasons for setting a default period and how that default period was determined;

(ii) entities can deviate from a default period based on specific facts and circumstances (rebuttable presumption) and, if so, whether in practice entities tend to rebut that presumption and deviate from the default period, and what evidence is provided to support any deviation;

(iii) useful life is established on the basis of management's best estimate and, if so, whether a list of indicators/factors to be considered is provided (for example: cash flow streams, synergies, payback period), how entities are making these estimates and whether auditors and regulators can, and do, challenge these assumptions.

German Commercial Code and German GAAP provisions

We would like to note, that the provisions of German GAAP differ from the methodology that is implied in the IASB's Information Request, as entities in Germany are regularly expected to determine the useful life of goodwill by themselves, only in exceptional cases a fallback to a default period is permitted. This is different to an approach to regularly use a default period (as a rebuttable presumption) and to deviate from this period only if entities can provide special evidence to support any deviation.

The methodology for the subsequent amortisation of goodwill in German GAAP, as specified in the German Commercial Code (Handelsgesetzbuch, HGB) and German Accounting Standard 23 *Accounting for Subsidiaries in Consolidated Financial Statements* (GAS 23), can be summarised as follows:

- The German Commercial Code deems goodwill to be a finite-lived asset. Therefore, the cost of goodwill shall be amortised.
- The amortisation schedule shall allocate the cost of goodwill over the financial years in which it is expected to be used. Thus, an amortisation schedule that defines both the amortisation method and the useful life shall be prepared as at the date of initial consolidation. If goodwill is allocated to several business lines of the subsidiary, a separate amortisation schedule shall be prepared for each business line.
- Amortisation shall start in the year in which goodwill is recognised. Goodwill shall be written down on a time-proportionate basis if it is acquired during the year.
- As a general principle, goodwill shall be amortised on a straight-line basis. A different amortisation method may only be applied if there is evidence that this method more accurately reflects the pattern of consumption.
- The useful life shall be determined by reference to objectively verifiable criteria. A shorter period shall be used if there are any estimation uncertainties.

- The following factors that may be relevant for estimating the expected (remaining) useful life are specified in GAS 23:

  a) the expected life and development of the acquired entity, including legal or contractual requirements,

  b) the life cycle of the products of the acquired entity,

  c) the effects of expected changes in sales and procurement markets as well as in the economic, legal and political environment affecting the acquired entity,

  d) the level and timing of maintenance expenditures required to realise the expected economic benefits from the acquired entity, and the ability of the entity to finance those expenditures,

  e) the term of material sales and procurement agreements of the acquired entity,

  f) the expected duration of employment of key personnel of the acquired entity,

  g) the expected behaviour of (potential) competitors of the acquired entity, and

  h) the sector and expected trends in that sector.

- If, in exceptional cases, the expected useful life of goodwill cannot be estimated reliably, the German Commercial Code requires goodwill to be amortised over a period of ten years. (The German Commercial Code does not include specific considerations for setting this default fallback period but follows the maximum period as set out in Directive 2013/34/EU for such cases). Additionally, GAS 23 points out that estimation uncertainties that regularly affect the determination of the useful life of goodwill do not justify the use of this standardised useful life.
- The remaining useful life of goodwill shall be reviewed at each reporting date if there is evidence of change in the original assumptions regarding the factors contributing to goodwill and that the useful life could therefore have been reduced or prolonged.

Observations and local GAAP experiences: Feedback received from our constituency

We received the general feedback that the provisions of German GAAP represent a well-established methodology and that the criteria set out in GAS 23 are well suited to estimating the useful life of goodwill in a comprehensible and also verifiable manner.

In practice, these criteria are used in both annual and consolidated financial statements prepared in accordance with German GAAP, mostly resulting in an estimated useful life of 5 to 15 years.

Due to the nature of goodwill, there remains a certain degree of judgement and discretion, which is the case for every estimate of useful life for other intangible or even tangible assets. This means that if better information is obtained and the original useful life estimate turns out to be too short or too long, it is adjusted according to the general criteria. This, however, is not seen as an argument to forego the estimation of a useful life.

Estimating the useful life of goodwill generally involves a judgemental decision on the part of the preparers. We were told that this judgement is subject to additional scrutiny by auditors, if the useful life of goodwill exceeds 20 years.

We also were told about a certain interest in avoiding deviations from either the German tax requirements (amortisation over 15 years) or the amortisation in higher-level consolidated financial statements (if these contain a scheduled amortisation of goodwill).

Furthermore, the majority of the feedback we received, stated that amortising goodwill over the default period of 10 years, as specified in the German Commercial Code, is only used in a few cases. This also portends that the useful life can be estimated by entities reasonably and reliably using the criteria of GAS 23.

(B) Transition to an amortisation model

If the IASB decides to reintroduce goodwill amortisation and transition to an amortisation model requires adjusting historical goodwill balances, what are the potential effects of writing-off significant amounts of historic goodwill on transition and amortising the remaining historic goodwill balances, in terms of:

(i) financial position, financial loan covenants, distributable reserves and dividend distribution, capital maintenance and other similar measures;

(ii) capital markets and economic development, and whether entities would run the risk of failing to meet any market regulations (for example, listing requirements);

(iii) tax implications and whether the amortisation charge would be tax deductible; and

(iv) any other local jurisdictional requirements that might be relevant.

Please explain the basis on which you have prepared your response. For example, if you conducted your own outreach, please tell us the type of stakeholders that responded.

Views received on transitioning to an amortisation model under IFRS

With regard to the possible effects of a transition to an amortisation model on existing/historical goodwill balances, the feedback we received points to the high amount of goodwill of German companies applying IFRS, which in some cases exceeds the equity of the reporting entity. The (re-)introduction of an amortisation model, would therefore be challenging for the companies concerned. Should a retrospective application of amortisation or a subsequent offsetting of existing goodwill balances be required, significant burdens on equity and/or earnings are to be expected for most companies.

In view of the significance of the goodwill in terms of external perception and capital market communication, the effects could only be partially mitigated by corresponding explanations in the notes and separate disclosure in the balance sheet and statement of comprehensive income.

If there are (contractual) agreements linked to the amount of group equity (e.g. debt covenants, compensation agreements), the negative effects on group equity resulting from the amortisation could lead to consequences from these agreements or make it necessary to amend these agreements.

Income tax implications are not expected, as taxable profits are based on financial statements in accordance with the German Commercial Code and/or separate tax accounting provisions.

However, this is only true for the group's companies based in Germany and may be different for foreign subsidiaries.

Although profit distributions are legally based on statutory financial statements of the (parent) company under German GAAP, it is worth noting that dividend policies are often based on consolidated financial statements under IFRS.

Regardless of the expected challenges for inorganically growing companies, we got the message from audit firms, that it would send a wrong signal if the replacement of the impairment-only model were to fail just because there is supposedly no solution for the goodwill balances that are widely considered to be too high.

In this context we would like to note that in recent years, many companies have adjusted their external and internal corporate reporting structure due to new business strategies, having consequences on the definition of cash-generating units and causing goodwill (re-)allocations. Similar consequences arise from changes in business activities due to mergers & acquisitions, spin-offs, etc. As a result, goodwill may be difficult to be traced back to individual business combinations.

As a simple satisfying solution is likely to be difficult to find, the IASB should discuss transitional provisions for the reintroduction of amortisation of goodwill at a very early stage and 'test' them with the companies most affected, e.g. by conducting further outreaches.

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