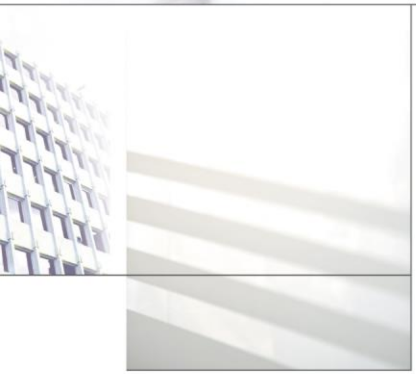
ASAF meeting, September 2017
Agenda paper 5



EFRAG

European Financial Reporting Advisory Group

The ‘goodwill accretion’ approach

Outline

- Background
- Objective of the approach
- Concepts underlying the approach
- How does the approach work?
- More work needed on….

Background

- Feedback to date in Europe indicates:
  - Mixed views on whether goodwill should be amortised;
  - Support for improving the IAS 36 impairment test by making it:
    - More effective
    - Less complex
- In June 2017 EFRAG published a Discussion Paper to gather feedback on some ideas on possible improvements
  - one of these ideas is the 'goodwill accretion' approach
- EFRAG will use feedback on the DP to:
  - further develop the ideas
  - inform EFRAG's input to any future IASB proposals

End of comment period for EFRAG DP:
31 December 2017

Objective

- Impairment of purchased goodwill may be ‘shielded’ in the IAS 36 impairment test as a result of both:
  - Unrecognised pre-acquisition goodwill of CGUs to which the purchased goodwill is allocated (‘first shield’); and
  - Purchased goodwill being replaced/replenished by ‘new’ unrecognised goodwill that is generated after the acquisition (‘second shield’)

Objective (contd.)

- The IASB staff's 'Pre-acquisition Headroom' (PH) approach:
  - aims to mitigate the first shield;
  - does not address the second shield;
  - is a 'static' approach
- The 'goodwill accretion' approach aims to mitigate the second shield in a dynamic manner

EFRAG's DP seeks feedback on the concept and its practical implementation

Underlying concept

- The approach starts from a premise that **purchased** goodwill may be impaired even if the **overall value of** goodwill has been maintained due to replenishment by internally-generated goodwill:
  - but a direct measure of internally-generated goodwill is widely considered to be impractical (e.g. see IAS 36.BC135);
  - if so, a proxy for internally-generated goodwill must be used to address the shielding effect
- The approach is based on a premise that, in order not to be impaired, purchased goodwill must be replenished at least at a rate that is equal to the expected return on the initial investment
  - may also reflect the notion that purchased goodwill is the present value of future excess earnings, and its initial carrying amount includes a discount to be unwound as time passes

Underlying concept (contd.)

- Aims to balance relevance with simplicity and cost-effectiveness, in particular in that it:
  - needs no incremental inputs beyond those used for existing IAS 36 purposes (assuming the accretion rate is the same as used in the impairment test - see slide 11);
  - applies regardless of where the goodwill is initially allocated (pre-existing CGUs or CGUs within the purchased business)

How does it work?

- At each reporting date, the entity determines an amount of goodwill accretion for the period:
  – accretion is calculated by multiplying the opening balance of goodwill by a discount rate
- The accretion is then added to the carrying amount of the CGU or deducted from the recoverable amount, <u>for the purpose of impairment testing:</u>
  – no accounting recognition of the accretion

How does it work? (contd.)

- If no impairment loss is recognised, the balance of accretion is carried forward
- When including the accretion results in an impairment loss, the balance of the accretion is correspondingly reduced
- The entity continues to determine the accretion until the goodwill is fully written off

Illustrative example

	Year 1	Year 2	Year 3
Carrying value of CGU (including Goodwill)	250	230	215
Goodwill	100	100	100-**5**= 95
Rate	6%	7%	5%
Accretion	6	6+7= 13	13-**5**+ (95*5%)= 12.75
Recoverable amount of CGU	258	238	230
Impairment	**no**	230+13-238= **5**	**no**

More work needed on….

- Some of the detailed mechanics
- The selection of the discount rate:
  - Is the discount rate used in the value-in-use calculation the best choice? Is there a more specific expected return on the goodwill?
- Could the goodwill accretion approach be combined with the PH and, if so, how?

Thank you for your attention!

And now …
Questions?
… and answers…

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