GOODWILL AND IMPAIRMENT

EFRAG Board meeting

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Agenda paper 09-02

EFRAG
European Financial Reporting Advisory Group

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What problems is the IASB considering?

What the IASB has heard?
Information on subsequent performance of an acquisition inadequate
Goodwill impairment losses ‘too late’
Impairment test costly and complex
Reintroduction of amortisation
Challenges identifying and measuring some intangible assets

What is the objective of the project?
Explore whether companies can provide more useful information about business combinations, enabling users to hold management accountable for their acquisition decisions at a reasonable cost

EFRAG contributed to the PIR and to the debate
Discussion Series Paper *Should Goodwill still not be amortised? – Accounting and Disclosure for Goodwill* (July 2014)
Discussion Paper *Goodwill Impairment Test: Can It Be Improved?* (June 2017)

Overview of the IASB considerations

- Amortisation of goodwill vs impairment-only model
- Relief from mandatory annual quantitative impairment test
- Value in use calculation
- Better disclosures about business combinations

AMORTISATION OF GOODWILL VERSUS IMPAIRMENT- ONLY MODEL

Reasons for reconsidering amortisation of goodwill

Reintroduce amortisation of goodwill?

- Not feasible to design impairment test to target acquired goodwill in isolation
- Provide a simple mechanism for reducing acquired goodwill
- Take some pressure off the impairment test
- Hold management to account by including an amortisation charge in the income statement

Arguments for reintroducing amortisation and for reitaing impairment only approach

Amortisation
PIR feedback: too late and too costly
Evidence of high failure rate of acquisitions – concerns over carrying amounts of goodwill
Not feasible to devise a more effective impairment test
Amortisation is a cost-effective mechanism that can hold management to account for its acquisition decisions
Goodwill has a limited useful life
Impairment-only approach mislabels consumptions of goodwill as an impairment loss

Retaining impairment-only approach
Information from impairment is useful
Amortisation provides no useful information and can mislabel some impairment losses as consumption
In spite of “shielding” - impairment test is rigorous and operational
Impairment test assesses whether carrying amounts of acquired goodwill and other assets in CGU are recoverable from cash flows generated jointly
If impairment test operated correctly, acquired goodwill balances are not overstated
It is not possible to estimate how goodwill diminishes over time; an arbitrary amortisation charge is not effective at holding management account
New disclosures to provide better information on subsequent performance

Preliminary views

IASB Staff view
Neither amortisation nor impairment-only is perfect answer
No compelling evidence to justify reintroduction of amortisation

IASB tentative decision
Do not reintroduce amortisation of goodwill (with only a slight majority (8/14))
To present total equity before goodwill in balance sheets.

Discussion Paper
Seek new evidence/views to help IASB move the debate on
Explore stakeholder understanding of ‘too late’ issue and reason for their concern
Discuss whether existing impairment test plus new disclosure sufficiently holds management to account or whether amortisation is necessary.

RELIEF FROM MANDATORY ANNUAL QUANTITATIVE IMPAIRMENT TEST

Relief from mandatory annual impairment test

- **Existing requirements** – mandatory quantitative test for goodwill and some intangible assets
- **Feedback received**
  - Quantitative annual impairment test is costly and complex
  - Recognition of impairment losses not timely and provides limited information
- **Preliminary view** (slight majority)**:** *Revert to an indicator-only approach*
  - Permit relief from mandatory annual quantitative test and only test if there are indicators of possible impairment

Revert to an indicator-only approach

Justification for the indicator-only approach
Existing test assesses whether carrying amount of CGU containing goodwill is recoverable
Shielding limits the effectiveness of the impairment test in targeting goodwill
Frequency of quantitative impairment test should not depend on whether CGUs contain goodwill

Pros
Consistent with impairment test for other assets
Reduces the cost and complexity of current test without any significant information loss
Retaining a mandatory annual quantitative test would not meet a cost-benefit analysis

Cons
Could make impairment test slightly less robust
Could further increase management (and auditors) judgement in impairment testing
Risks loss of good governance mechanism and useful disclosures
Result in some limited loss of information

VALUE IN USE:
POST-TAX INPUTS
FUTURE RESTRUCTURING CASH FLOWS

VIU-Future restructuring and future enhancements

Existing Requirement
When estimating value in use, cash flows from future enhancements excluded
Rationale: test assets in current condition (consistent with IAS 37)

Feedback received by the IASB
Causes cost and complexity
Not consistent with management budget/forecast

IASB Preliminary view
Include cash flows from future enhancements
No threshold for including those cash flows
No additional qualitative disclosures

Discussion: If the restriction is removed
Pro: Reduce cost and complexity Base test on the same unit of account for FV
Con: Risk of unjustifiable optimistic inputs

Value in use -Use of post-tax inputs

Existing Requirement
Pre-tax basis future cash flows and discount rate and disclose the pre-tax discount rate
Rationale: Post tax inputs without specifying the tax attribute could cause double counting of some future tax consequences

Feedback received by the IASB
In practice test is performed on post-tax basis
Pre-tax discount rate not directly observable

IASB Preliminary view
Allow post-tax inputs and discount rates in value in use estimates

Discussion:
Requirement to use post-tax inputs (consistent with other IFRS Standards)
Require entities to use internally consistent assumptions for cash flows and discount rates
Disclosure of post-tax discount rate more useful information

Better disclosures about business combination

Better disclosures for business combinations

Feedback	**IASB preliminary views**
Users want to understand: • Key drivers of the acquisition price • Subsequent performance of the acquisition	Improve disclosure objectives • Evaluate strategic rationale for business combination • Understand key drivers of acquisition price • Evaluate subsequent performance of acquisition
	Add subsequent performance disclosure requirements
Preparers – IFRS 3 disclosures excessive	Targeted disclosure improvements

Better disclosures for business combination

Disclosure at acquisition	Subsequent disclosures
Strategic rationale for the business combination (high level strategy)	Monitoring performance • Amounts of metrics (targets) • If business combination not monitored • If metrics used changed
Key objectives of business combination (detailed targets)	
Metrics management will use to monitor performance	

Intangible assets

Intangibles assets

Problem

Challenges identifying and measuring some intangible assets:

- Cost
- Reliability of fair value

Finding

Mixed views on cost and usefulness of information

Preliminary view

Identifiable intangible assets NOT to be included in goodwill

FASB Invitation to Comment

- *Identifiable Intangible Assets and Subsequent Accounting for Goodwill*

FASB Invitation to Comment (ITC)

- **Issued in July 2019** – comments requested by 7 October 2019.
- **4 main sections**
  - Section 1: Whether to change the subsequent accounting for goodwill;
  - Section 2: Whether to modify the recognition of intangible assets in a business combination;
  - Section 3: Whether to add or change disclosures about goodwill and intangible assets; and
  - Section 4: Comparability and scope.
- **Several approaches to determining the goodwill amortisation period.**

Next Steps

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- Discussion Paper expected to be published by February 2020
- Comment period for Discussion Paper of 180 days

Question for EFRAG Board

Do EFRAG Board have any comment on the project update?

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