Goodwill and Impairment Test
Cover Note

Objective

1 The objective of this session is to seek preliminary views from EFRAG TEG on the IASB's tentative decisions on the IASB's Research project on Goodwill and Impairment (the project). The IASB's tentative decisions on the following topics will be discussed in this session:

(a) exploring whether to simplify the quantitative impairment test and whether amortisation of goodwill should be reintroduced (*agenda paper 10-02*);

(b) improving value in use calculation *(agenda paper 10-03)*; and

(c) better disclosures for business combinations *(agenda paper 10-04).*

Background and next steps

2 The project responds to concerns reported during the IASB's post-implementation review (PIR) of IFRS 3 *Business Combinations*. During the course of the project, the IASB considered a number of ways to address the 'too little too late' goodwill impairment issue, and how it could improve the disclosures for business combinations.

3 Some argue that one of the causes of the delayed recognition of goodwill impairment is the shielding effect created by internally generated goodwill and other factors. Another potential cause is that the impairment test does not directly measure the recoverable amount of the goodwill. In order to address the 'shielding effect', the IASB developed the headroom approach; however, the approach was considered overly complex and not explored further by the IASB.

4 Subsequently, the IASB decided to develop the following project objectives:

(a) Objective A - Exploring whether to simplify the accounting for goodwill by permitting an indicator-only approach to determine when an impairment test is required; and/or reintroducing amortisation of goodwill;

(b) Objective B - Exploring whether to improve the calculation of value in use by permitting cash flow projections to include future restructurings and future enhancements to an asset; and the use of post-tax inputs in the calculation of value in use; and

(c) Objective C - Identifying disclosures to enable investors to assess management's rationale for the business combination; and whether the subsequent performance of the acquired business, or combined business, meets expectations set at the acquisition date.

5 At its meeting in June 2019, the IASB reached preliminary views on the project objectives mentioned above. Appendix 1 provides a summary of the IASB staff recommendations and the IASB's preliminary views on these recommendations.

6 At its meeting in July 2019, the IASB staff asked for permission to begin the balloting process for a discussion paper. The IASB's discussion paper is expected by February 2020 with a proposed comment period of 180 days.

7 In July 2019 the FASB issued an Invitation to Comment (ITC) on *Identifiable Intangible Assets and Subsequent Accounting for Goodwill*. A short summary is provided as background in agenda paper *10-05 –Summary of FASB's Invitation to Comment.*

8 At a joint meeting in July 2019, the IASB and the FASB discussed their projects and considered how to improve the quality of disclosures about business combinations, amortising goodwill as opposed to using an impairment-only model and simplifying the impairment test.

Previous EFRAG discussions

EFRAG TEG-CFSS

9 EFRAG TEG-CFSS discussed various aspects of the project at its meetings in April 2018 and November 2018. The main suggestions made by members can be found in the papers provided for this session.

EFRAG User Panel

10 In July 2019, EFRAG User Panel members received an update on the project. EFRAG User Panel members expressed mixed views on whether or not goodwill should be amortised, and some members supported the indicator-only approach with a strong list of indicators. Members generally supported permitting the use of post-tax inputs, post-tax discount rates and the inclusion of cash flows from future restructuring in the estimates of value in use. They had mixed views on whether more disclosures were necessary.

EFRAG Academic Panel

11 In its meeting in October 2019, EFRAG Academic Panel members discussed how to account for goodwill. They generally supported an approach that combines amortisation and impairment of goodwill. They indicated that the indicator approach could reduce the complexity and could save cost for preparers.

Agenda Papers

12 In addition to this cover note the following papers have been provided for the session:

(a) agenda paper 10-02 – *Issues Paper – Goodwill and impairment test - Quantitative test and amortisation of goodwill – EFRAG TEG 19-11-05;*

(b) agenda paper 10-03 – *Issues Paper – Goodwill and impairment test - Improving value in use calculation – EFRAG TEG 19-11-05;*

(c) agenda paper 10-04 – *Issues Paper – Goodwill and impairment test - Better disclosures for business combination – EFRAG TEG 19-11-05; and*

(d) agenda paper 10-05 –*Summary of FASB's Invitation to Comment – EFRAG TEG 19-11-05 (Background purposes).*

Appendix 1: IASB staff's recommendations and IASB's tentative decisions

Introduction

13 The following table summarises the IASB staff's recommendation for the IASB's preliminary views to include in the DP against the overall aims of the project objectives. Also, it includes the IASB indicative decisions made in its June 2019 meeting.

Idea being explored	**IASB staff's recommendation**	**Aims achieved**	**Aims hindered**	**IASB's indicative decision**
Reintroduction of amortisation.	Retain an impairment-only model and not reintroduce amortisation of goodwill.	• Better information from impairment test retained. • Purpose of impairment test clarified for stakeholders. • Avoids disruption when there is, at best, a marginal case for change.	• Was not possible to amend the impairment test to target acquired goodwill in isolation. • Consumption may be mislabelled as impairment loss.	A close majority of the IASB members (8/14) agreed to retain impairment-only approach. However, they agreed to explore in the discussion paper both approaches providing arguments in favour and against.
Relief from the mandatory annual impairment test.	Remove the requirement for a mandatory annual quantitative test of goodwill and some intangible assets.	• Reduces the costs associated with the impairment test (performing test/providing disclosures).	• Change in frequency of performing test should result in only limited reduction in robustness of test. • Loss of disclosures generated by goodwill impairment tests.	IASB agreed moving to an indictor-only approach requiring impairment testing of goodwill only when there are indicators of possible impairment.

Idea being explored	**IASB staff's recommendation**	**Aims achieved**	**Aims hindered**	**IASB's indicative decision**
Removing restrictions on cash flow projection used in calculating VIU.	Permit the inclusion of cash flows from future restructurings or future enhancements in estimates of VIU.	• Reduces cost and complexity of performing test. • Improves effectiveness as cash flow forecasts used are not just produced for financial reporting purposes.	Might impact robustness of test by permitting inclusion of unjustifiably optimistic cash flows.	IASB agreed to allow the inclusion of cash flows from future restructurings or future enhancements in the calculation of VIU.
Removing requirement to use pre-tax inputs in calculating VIU.	Permit the use of post-tax inputs and a post-tax discount rate to estimate VIU.	• Permits disclosure of post-tax discount rates, which are likely to be more useful information. • Makes test more understandable.	None identified by the IASB staff.	IASB agreed to remove the explicit requirement to use pre-tax inputs to estimate VIU.
Better disclosures for a business combination.	Require disclosures of subsequent performance of the acquired business, and targeted improvements to existing requirements.	• Provides better information for users. • Addresses feedback from PIR of IFRS 3 that users need information on subsequent performance of acquired business.	• Additional costs for preparers. • Additional costs limited by use of chief operating decision maker threshold and removing pro forma information requirement, but less information provided as a consequence. • Further deletions could offset the additional costs.	IASB supported the disclosures recommended by the IASB staff.