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Goodwill and Impairment

Cover Note

Objective

- 1 In preparation of EFRAG's Draft Comment Letter in response to the IASB forthcoming Discussion Paper (expected to be issued in March 2020), the purpose of this session is:
 - (a) to update EFRAG Board members on the outcome of EFRAG TEG's discussion of the IASB's tentative decisions;
 - (b) to receive EFRAG Board direction on eventual additional contents that should be covered in the Draft Comment Letter.
- 2 EFRAG Board will approve the Draft Comment Letter in April 2020.

Background on the IASB project

- 3 The IASB is investigating how companies can provide users of financial statements with better information about business combinations at a reasonable cost. The project responds to concerns reported during the IASB's post-implementation review (PIR) of IFRS 3 *Business Combinations* related to the current annual impairment test.
- 4 Users have indicated that they want to understand the factors that determine the amount a company has paid for an acquired business and whether that acquisition has been successful subsequently.
- 5 In addition, the IASB learned from stakeholders that:
 - (a) goodwill impairment losses are being recognised 'too little too late';
 - (b) the goodwill impairment test is costly and complex;
 - (c) the separate recognition and measurement of some intangible assets is challenging; and
 - (d) some stakeholders would like to see amortisation reintroduced.
- 6 One of the causes of the 'too little too late' goodwill impairment issue is the shielding effect created when acquired goodwill is replaced by internally generated goodwill. Another potential cause is that the impairment test does not directly measure the recoverable amount of the goodwill (but the measurement is based on the recoverable amount of the CGU(s) to which it is allocated).
- 7 In order to address the 'shielding effect', the IASB developed an approach called 'the headroom approach'. However, this approach was considered overly complex and has not been explored further by the IASB.

- 8 The IASB's preliminary view is that it would not be possible to make the impairment test significantly more effective. Accordingly, the IASB has decided to refocus the objectives of the project. Thus, the IASB decided to develop the following project objectives:
- (a) Objective A - 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;
 - (b) Objective B - 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; and
 - (c) Objective C - 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.
- 9 The IASB plans to issue its discussion paper mid-March 2020 with a comment period of 180 days. The IASB will try to develop a set of disclosure requirements that can significantly improve the information provided to users on business combinations.
- 10 In addition to the IASB, the FASB is also considering how to account for goodwill following the initial recognition. In July 2019 the FASB issued an Invitation to Comment (ITC) on *Identifiable Intangible Assets and Subsequent Accounting for Goodwill*. One of the questions asked in this consultation was whether goodwill should be amortised. FASB has received mixed views on this issue.

Agenda Papers

- 11 In addition to this cover note, the following papers have been prepared for the session:
- (a) Agenda paper 08-02 – Questions and tentative responses.
 - (b) Agenda paper 08-03 – Short presentation of EFRAG's past activities and TEG's preliminary views on the IASB tentative decisions.
 - (c) Agenda paper 08-04 – IASB presentation of the project prepared for the April 2020 ASAF meeting.
- 12 **The IASB may issue its discussion paper in the period between this paper being made available for the EFRAG Board meeting and the EFRAG Board meeting on 17 March 2020. Should this be the case, an additional paper will be prepared for the meeting stating the differences between the expected questions as stated in this paper and the questions stated in the discussion paper.**