Questions and tentative responses
Issues Paper

Objective

1 The objective of this paper is to present the issues expected to be included in the IASB's discussion paper and to support the EFRAG Board discussion of the preliminary views of EFRAG TEG on these. The paper lists the issues expected to be covered by the IASB's discussion paper based on the IASB's public discussions on the project. The issues that will be finally covered in the IASB's discussion paper may be different from those presented in this paper.

Objective A - Disclosures

Disclosure requirements

2 The IASB's forthcoming discussion paper (the 'DP') would discuss whether disclosures for business combinations should be improved. The IASB tentatively decided to improve disclosures that would enable investors to assess whether a business combination was a good investment decision and whether, after the acquisition, the acquired business is performing as it was expected at the time of the acquisition. This would include requiring entities to:

(a) disclose information intended to indicate whether the objectives of a business combination are being achieved; and

(b) disclose:

(i) the amount, or range of amounts, of expected synergies;

(ii) any liabilities arising from financing activities and pension obligations assumed; and

(iii) an acquiree's revenue, operating profit or loss before acquisition-related transaction and integration costs, and cash flow from operating activities, after the acquisition date.

(c) disclose the information the chief operating decision maker (as defined by IFRS 8 *Operating Segments*) uses to assess the extent to which the objectives of a business combination are being achieved.

3 EFRAG TEG (also considering inputs by EFRAG User Panel members) support(s) the objectives of the suggested disclosure requirements. EFRAG TEG has, however, some reservations about practical aspects of the requirements. For example, EFRAG TEG questions whether information provided about the amount or range of amounts of synergies will be reliable. It was thus noted that it could be difficult to obtain data and evidences needed to assess whether the objectives of a business combination have been achieved, for example if the acquired business is fully integrated with the existing business or in case of multiple acquisitions. It was noted that some of the information would become increasingly difficult to provide as

time would pass from the acquisition because of the integration of the acquiree Some of the information could be difficult to provide more than two to three years after the acquisition.

Objective B – Improving accounting for goodwill

4 At the meeting of EFRAG TEG and the EFRAG User Panel on 4 March 2020, User Panel members expressed the view that the current impairment-only approach was "broken". Similarly, the feedback received by the IASB has been that impairment losses on goodwill are often recognised too late (see paragraphs 10 - **Error! Reference source not found.**).

5 The IASB's preliminary view is that significantly improving the effectiveness of the impairment test at a reasonable cost is not feasible. The IASB has therefore focused on simplifying the impairment test (see paragraphs 8 - **Error! Reference source not found.** below), without other major changes to the model.

6 Having concluded that the impairment test cannot be significantly improved at a reasonable cost, the IASB has considered whether to reintroduce amortisation of goodwill (an impairment test would still be required, but just when triggered). The IASB's preliminary view is that it should retain the impairment only approach because the IASB does not see compelling evidence that amortisation would significantly improve financial reporting (see paragraphs 15 - 20).

7 Some EFRAG TEG members agree with the IASB's preliminary view that it is not possible to improve the effectiveness of the impairment test, while others consider that the guidance on how goodwill is allocated to cash generating units could be improved (see paragraphs 21 - 24), including new guidance on how to 'track' goodwill related to a business combination when restructurings would take place and/or the segment reporting would change or a business (or part of it) is disposed of.

Use of an indicator only approach for impairment assessment

8 The DP will suggest removing the requirement to test CGU containing goodwill for impairment at least annually. Entities must still assess if there is any indicator of impairment and perform the test (i.e. quantitative calculation of the recoverable amount of the CGU) if such indicator exists. This suggestion is introduced to reduce cost for preparers.

9 EFRAG TEG did not support this simplification to save costs. EFRAG TEG members would support this proposal, but only if goodwill amortisation is introduced (in addition to the indicator only impairment test). On the other hand, some EFRAG TEG members considered that, also in combination with an eventual future requirement to amortise goodwill, the requirement to update the measurement of the recoverable amount at least annually should be maintained, as it provides for the necessary robustness of the test and helps management's stewardship.

Current concerns about impairment test and suggestions for its improvement

10 Since the introduction of the impairment only model, academics have performed research on the approach and EFRAG has had several consultations on the issue. A summary of academic results and EFRAG's past consultations are included in Appendix 1.

11 Academic research and EFRAG's past consultations (and discussions with EFRAG TEG and the EFRAG User Panel) generally show that the impairment only model is not perfect (or applied perfectly). There are problems with the approach (and/or the application), as mentioned above in paragraph 4, including the level of granularity at which the goodwill is currently allocated. However, there is no clear evidence on whether the current approach for the moment is the best of possible approaches,

whether it can be improved or whether it would be beneficial for practical reasons and to "reduce the stress on the model" to reintroduce goodwill amortisations.

12 Following from one of EFRAG's consultation, it can, however, probably be concluded that the impairment approach without amortisation is pro-cyclical. In addition, EFRAG Secretariat observes that the calculation of the recoverable amount of a CGU reflects prevailing market inputs, including the discount rate. Such rate reflects in turn the perceived level of risk of the industry segment to which the CGU belongs, as well as the entity's and CGU's specific perceived level of risk. When an industry segment is experiencing a period of crisis, the increase in discount rate at industry level is a pro-cyclicality factor, as the probability of a recoverable amount lower than the carrying value is higher for all the entities belonging to the industry. The pro-cyclicality is even higher if one considers that a higher perceived risk in a segment is often associated with a projected reduction in its profitability, which in turns result in lower projected cash flows as input of the impairment test.

13 The IASB has in the past tried to improve the impairment test by exploring the so-called headroom approach. The approach was rejected by the IASB because it was considered too complex (some valuation professionals, however, consider the approach should be reconsidered). EFRAG has also considered in a past consultation an 'accretion approach', which was rejected by constituents. Some suggests that the model could be improved by additional guidance on how goodwill is allocated to cash generating units (including how it is reallocated). However, there are also mixed views on this approach (see paragraphs 21 - 26 below).

14 In order to collect preliminary inputs to this EFRAG Board discussion, EFRAG TEG members were invited to provide their views on how to change the model (for both impairment and amortisation), assuming a hypothetical scenario where the model had to be changed. The EFRAG Secretariat considers appropriate first for EFRAG Board to provide directions if EFRAG Comment Letter should cover the discussion on whether goodwill should be amortised (see below).

New arguments for and against goodwill amortisation

15 The DP will ask whether there are any new arguments for and/or against goodwill amortisation since 2004, when the impairment only approach was introduced.

16 The EFRAG Board decided at its December 2019 meeting that it should discuss whether it should reopen the discussion on whether or not goodwill should be amortised. If it would reopen the discussion, it should also consider what aspects (including what aspects of the European public good criterion) it would consider when forming a view on whether goodwill should be amortised.

17 A majority of EFRAG TEG members have previously stated that if the discussion would be reopened, they would favour goodwill amortisation being introduced. The arguments for different views of EFRAG TEG members are provided in Appendix 2.

18 Recent input received by EFRAG Secretariat from selected outreaches with valuation experts has confirmed that a different accounting approach may indeed impact decision makers' behaviour. In particular, potential buyers that are not required to amortise goodwill subsequently to an acquisition may be willing to offer a higher price in a competitive deal, compared to those that have to recognise costs in the profit or loss in the subsequent periods (due to amortisation). In order to further substantiate this argument, EFRAG Secretariat is currently conducting selected outreaches with M&A professionals and decision makers. We expect that such input will be available in time for the EFRAG Board discussion in April.

19 During the consultation on the EFRAG Draft Comment Letter, EFRAG Secretariat proposes to perform additional outreach. EFRAG TEG has suggested asking preparers with recent acquisitions for what they were paying and if the acquired goodwill or parts of it would be a wasting asset. For example:

(a) What criteria and factors would they apply to determine whether an asset would be a wasting asset?

(b) How would they determine the amortisation period and amortisation pattern?

20 It was also suggested to ask whether goodwill is currently amortised for internal decision-making purposes and how goodwill amortisation would be considered in management performance measures. Would it be added back, would it be considered as useful information and could changing the accounting requirements affect how goodwill would be considered for internal decision making.

Allocation of goodwill to the cash-generating units

21 The DP will not discuss how goodwill is allocated to the cash-generating units. However, EFRAG TEG has considered whether this is a result of inadequate allocation of goodwill to the cash-generating units ('CGUs') (either at too high level or due to its constant reallocation to the most profitable CGU). EFRAG TEG members have, however, presented different views on whether the guidance on how to allocate goodwill to CGU's should be amended.

22 The current guidance in IAS 36 states that each unit or group of units to which goodwill is allocated shall:

(a) Represent the lowest level within the entity at which the goodwill is monitored for internal management purposes; and

(b) Not be larger than an operating segment as defined by paragraph 5 of IFRS 8 Operating Segments before aggregation.

23 Some companies argue that they do not monitor goodwill at CGU level and test goodwill therefore at segment level, which means goodwill can be reallocated by changing the structure of the segment reporting without any change in the structure of the underlying cash inflows.

24 Some EFRAG TEG members have argued that it is difficult to find a better alternative than what is currently required. Other EFRAG TEG members have considered that the guidance could be clarified to ensure that goodwill would be allocated to the lowest level possible. In fact, the current guidance only provides for a upper granularity limit (i.e. a CGU cannot be broader than a segment) but not also for a lower granularity limit (e.g. to be appropriately defined in strict coordination with the initial managerial assessment of the expected benefits of a business combination at acquisition, including entity's specific disclosure on the initial and ongoing monitoring and internal steering process). In this regard it is also noted that changes in how an entity defines its segments for the purpose of segment reporting can result in reallocations of goodwill although there are no changes to the cash generating units to which the synergies relate.

25 EFRAG TEG has suggested to ask preparers how and why goodwill is reallocated in case of a business reorganisation. Is there a change in cash generating units or is there only a change in segment structure?

26 Based on this discussion in relation to the allocation of goodwill and to the standard requirements in relation to disposals and to reorganisations (both follow the relative fair value concept) some EFRAG TEG members see potential for improving the effectiveness of the impairment test and to address some of the concerns discussed. The relative fair value concept might lead to a situation that the goodwill related to an underperforming acquired business remains in case of a disposal with the reporting entity or in case of a reorganisation with the performing part of the entity. Understanding the economic rationale of acquired goodwill and improved tracking according to the underlying economic benefits could improve the effectiveness of the triggers considered to require impairment testing. However, EFRAG TEG has noted that the guidance is insufficient and could result in no

amount of goodwill being allocated to a divested business that is performing poorly and accordingly is not worth much. Also, the guidance could result in goodwill being related to cost savings of bringing two business together being (partly) maintained in the financial statements after one of the businesses have been sold off.

Objective C – Improving the calculation of value in use

Value in use calculation

Future enhancements in the estimation of future cash flows in the calculation of value in use

27 Currently, IAS 36 Impairment of Assets states that when calculating the value in use for the impairment test, future cash flows shall be estimated for the asset in its current condition. Estimates of future cash flows shall accordingly not include estimated future cash inflows or outflows that are expected to arise from improving or enhancing the asset's performance.

28 In accordance with a suggestion previously made by EFRAG, the DP is expected to suggest allowing the inclusion of future enhancements in the estimation of future cash flows in the calculation of value in use. Based on EFRAG's previous position, the tentative view expressed in EFRAG's draft comment letter will support the proposal. The proposal could eliminate an inconsistency in IAS 36 in the sense that it would capture within the value in use the cash flows that will arise from any existing potential to restructure or enhance an existing asset (or CGU) rather than ignoring this potential and align with the way restructuring cash flows are considered when determining fair value.

29 However, as this proposal could increase the use of unjustifiable optimistic inputs and therefore create a potential for earnings management, it would be necessary to develop further guidance on when to include restructuring cash flows in the calculation.

Use of pre-tax inputs and pre-tax discount rate to calculate value in use

30 Currently IAS 36 requires the discount rate and the future cash flows to be determined on a pre-tax basis when calculating value in use for the impairment test.

31 In accordance with a suggestion previously made by EFRAG, the DP is expected to suggest removing the explicit requirement to use pre-tax inputs and pre-tax discount rate to calculate value in use. It has previously been EFRAG's position that this proposal would reduce the cost of the goodwill impairment test; provide more useful information; and make the test more understandable. In addition, using post-tax discount rate and post-tax inputs would be more consistent with other IFRS Standards.

32 However, EFRAG recommends that the IASB develops further guidance to avoid double counting of tax cash flows in estimates of value in use, where the tax cash flows included in the measurement of deferred tax assets or deferred tax liabilities are also included in the recoverable amount of an asset.

Other topics to be considered

Total equity before goodwill subtotal

33 The DP is expected to suggest that a subtotal of total equity before goodwill should be presented in the statement of financial position.

34 EFRAG TEG (including input of EFRAG User Panel members) consider(s) that such a subtotal will be more harmful than beneficial. Presenting the subtotal would create confusion as to whether goodwill is an asset or not. If goodwill is presented separately in the statement of financial position, it would be possible for every user

to calculate total equity before goodwill, if the user would find that useful, without creating confusion about whether goodwill is an asset or not.

Conversion with FASB decisions

35 IFRS 3 Business Combinations was a joint project with the FASB and resulted in requirements that were similar, but not identical, in many respects. In July 2019, the FASB issued an Invitation to Comment (ItC) on how the subsequent accounting for goodwill and certain intangibles could be simplified, while still providing decision-useful information to users. The comment deadline was 7 October 2019. Views were mixed on e.g. whether goodwill should be amortised or not.

36 EFRAG TEG has not yet considered its position on this issue. From limited consultations with valuation experts the EFRAG Secretariat has learned that some (but not all) valuation experts consider convergence on this issue with the FASB important as different requirements on how to account for goodwill after the initial recognition could result in an unlevel playing field[1].

37 In addition, the EFRAG Secretariat has heard both the arguments that:

(a) Entities reporting under accounting requirements that would require goodwill to be amortised (in addition to being subject to an impairment test) would have a disadvantage compared to entities reporting under accounting requirements that would require an impairment only approach. As illustrated above, the argument provided is that the statement of performance of entities reporting under an impairment only approach would not be affected by the price paid for the acquired entity (unless there would be an impairment).

(b) Entities reporting under accounting that would require goodwill to be amortised (in addition to being subject to an impairment test) would have an advantage compared to entities reporting under accounting requirements that would require an impairment only approach. The argument provided is that when goodwill is amortised, the likelihood of an impairment loss decreases. While amortisation cost reported in financial statements are considered as "normal" costs, impairment losses are considered as a sign that the management has purchased a business at a too high price (i.e. the management has failed). Entities reporting under an amortisation (plus impairment approach) would therefore be able to offer a higher price for another business and are therefore more likely to win a bidding war with entities reporting under an impairment only approach.

38 The EFRAG Secretariat is unsure whether it is necessarily good for the economy if entities can offer higher consideration for businesses they acquire. It may lead to entities overpaying when acquiring another business.

39 The EFRAG Secretariat has distributed a short questionnaire on the impact on goodwill amortisations / goodwill impairments on M&A activities to M&A professionals. However, the EFRAG Board will have to make any necessary assessment on whether an effect would be good or bad for economic growth and financial stability.

Identifying intangible assets

40 The DP is expected to ask whether some identifiable intangible assets could be subsumed in goodwill instead of being recognised separately. A similar question

[1] In response to the FASB's ItC, the big four accounting firms had different views of the importance of convergence. PwC thought that it was of "paramount importance", KPMG thought it was "preferable on major projects", Deloitte "encourage the Board [FASB] to keep global convergence in mind when deciding which path to pursue". EY did not explicitly mention convergence with IFRS, but mentioned that "comparability among all PBEs [public business entities] reporting under US GAAP is most important".

was included in the FASB's ItC (see paragraph 35 above). The DP will propose that no changes are made.

41 EFRAG TEG has not discussed this issue in relation to the DP. However, in relation to EFRAG's research project on better information on intangibles, comments have been provided by EFRAG TEG members. Following these comments, support could be provided for a suggestion to subsume some identifiable intangible assets acquired as part of a business combination in goodwill. Identifying intangible assets acquired in a business combination is not costless for preparers and some of these intangible assets tend to be ignored (at least by some) users particularly if the measurement is perceived to be too subjective. The point has also been made that recognising intangibles acquired in a business combination while not recognising most internally generated intangible assets, reduces comparability between entities that have grown organically and entities that have grown by acquisitions. For some intangibles acquired in a business combination, the measurement at fair value would be as unreliable as measuring internally generated intangible assets at fair value. Accordingly, in addition to recognising additional internally generated intangible assets, not recognising separately some intangible assets acquired in a business combination could help improving the comparability between entities growing organically and entities growing by means of acquisitions.

42 EFRAG TEG will have to further discuss its view on this issue.

Questions for the EFRAG Board

43 Do EFRAG Board members agree with the EFRAG TEG preliminary views on the disclosure requirements included in the paragraph 3 above?

44 Do EFRAG Board members agree with the EFRAG TEG preliminary views on the indicator-only approach illustrated in the paragraph **Error! Reference source not found.** above?

45 Do EFRAG Board members have any comments on improving accounting for goodwill (paragraphs 24 - 29)?

46 Would the EFRAG Board like to reopen the discussion on goodwill amortisation? If so, what factors will it consider when assessing whether goodwill should be amortised or not?

47 Would the EFRAG Board need further information in order to be able to make the assessment noted in paragraph 39 as to whether it is good for economic growth and financial stability if entities think they can offer a higher price in a bidding war for a business?

48 Does the EFRAG Board have any other comments to the questions expected in the DP and the responses following from the preliminary discussions of EFRAG TEG?

Appendix 1 Academic studies and previous EFRAG consultations

1 This appendix summarises results of academic studies on goodwill accounting and EFRAG's previous consultations on the issue.

Academic studies

2 Members of the EFRAG Academic Panel and members of the EFRAG Academic Network have identified some relevant academic studies and literature reviews related to goodwill accounting. In addition, a member of the academic panel prepared for the October 2019 meeting of the Academic Panel a short literature review on goodwill amortisation versus goodwill impairment. This literature[2] provides some evidence that:

(a) A high proportion of the cost of acquisitions are allocated to goodwill, despite the IFRS (or, for the studies conducted on US data, the US GAAP) rules for the recognition of acquired intangible assets. 48.9% for 632 transactions by European companies using IFRS between 2005 and 2008, but larger for some industries. (US 2010[3], US 2011, EU 2010, EU 2011). Some studies find that the proportion of the cost of acquisitions that companies allocate to goodwill is correlated with the 'bonus intensity' of the CEO's remuneration. (US 2011, EU 2012). One study finds that when the likelihood of future impairments is low a higher portion of the costs of acquisition is allocated to goodwill. Other studies indicate that the age of the CEO and bonuses affect the amount allocated to goodwill (US 2011, 2017). One study indicates that companies that have a greater tendency to identify intangible assets also are companies with more relevant financial statements overall. However, the relevance for the financial statement user does not increase by separating intangible assets from goodwill (Swe 2012).

(b) Most companies allocate goodwill on the level of their segment reporting format (i.e. to the highest level allowed under IAS 36 Impairment of Assets), and goodwill often appears (based on studies on entities voluntary disclosures or surveys) to be concentrated in only relatively few CGUs. (EU 2007, EU 2009, EU 2011, US 2011).

(c) Generally, investors consider that goodwill is linked to future economic benefits (/ goodwill is an asset) (US 1995, US 1996, US 2000, International 1993, International 1996, EU 2009, US 2008, UK 2009, US 2011, US 2012, 2014). There is also evidence that lenders believe goodwill is informative and provides an efficient means of limiting agency costs (US 2008). A study, however, shows that recognising goodwill does not force better acquisition decisions (UK 2016). Another study indicates that 'older goodwill' does not have information content (Aus 2006).

(d) Goodwill charges have decreased markedly after the introduction of the impairment-only approach (resulting in goodwill constituting a higher proportion of total assets) (AUS 2010, SWE 2011, US 2017). Some studies have showed that impairment loss reporting is less strongly/not only associated with economic factors and more strongly associated with "big bath" accounting, income smoothing or other non-economic factors such as the tenure of the CEO or analyst coverage (US 1988, US 1992, US 1996, US 2004, Swe 2011, UK 2011, EU 2009, US 2012, US 2017, 2019). Some studies have thus showed that entities are more likely to impair goodwill when earnings are unexpectedly high or unexpectedly low. In addition, some studies

[2] The literature summarised is listed in the section 'References' at the end of this section.
[3] The references indicate the jurisdictions from which data was collected and the year of the publication of the study – which can be several years after the period from which data was collected.

show that companies are less likely to write off goodwill if they face binding debt covenants (US 2012). The setting of the growth-rate is often used to avoid or reduce goodwill impairment (2015). However, not all studies have confirmed that goodwill impairments are used opportunistically (EU 2013). Evidence has thus also been found that US firms record impairments (generally – not specifically goodwill impairments) in a timely fashion to disclose private information in order to show their commitment to a conditionally conservative reporting strategy (US 2018).

(e) Entities located in countries with stronger enforcement structures are more likely to report impairment losses than entities domiciled in countries with weaker structure (EU 2009). One study suggests that when a country's enforcement regime is relatively week, private monitoring through institutional investors can substitute for public enforcement (US 2018).

(f) Credits to goodwill are not only resulting from impairments but are also due to disposals. One study has found that disposals account for 20 percent of all credits to goodwill and decreases in goodwill by means of disposals were correlated with goodwill impairments and poor performance of entities (UK 2018).

(g) The value relevance of goodwill has increased after the introduction of the impairment-only approach (US 2007, AUS 2008, Portugal 2010, UK 2010, EU 2010, US 2011). However, in many studies the alternative to the impairment-only approach was not just an amortisation model, but an amortisation model and a pooling-of-interest accounting model.

(h) Goodwill impairment announcements generally seems to provide new information to investors (US 2002, US 2006, US 2011, US 2012, EU 2012, 2016) (however, there are some studies that do not show this effect (SWE 2014)). The reaction depends on the level of legal protection (stronger reaction when legal protection is low - i.e. investors account for higher management discretion and management incentives) (EU 2012). However, in some studies, the short-term effect on the entity's market price seems to be modest. Although goodwill impairments provide new information, analyst earnings forecasts for firms that report goodwill impairment are less accurate and more dispersed than those for matched control firms (2015). Some studies also show that goodwill impairments are associated with lower future operating cash flows, lower sales growth and lower growth in operating income (US 2009, US 2011, 2016). However, there is also a study that shows that impairments are weakly associated with increases in earnings and cash flows in the next two years (US 2012).

(i) Goodwill impairment lag behind the economic impairment of goodwill (US 2008, US 2017) and are often too small. Investors anticipate the economic losses one to two years before the impairment announcements. A recent study (US 2017) finds evidence that after the implementation of the impairment-only approach in the US (and the elimination of periodic amortisation, along with the difficulty in verifying the fair value of goodwill) goodwill impairments have become relatively less timely. US entities may recognise impairments before European entities (EU US 2016). This could be due to the characteristics of the capital markets and different requirements for the impairment review. There is both evidence that the time lag is only present in low enforcement countries (2018) and that it also exists in high enforcement countries (US 2012, US 2016, AUS 2016).

(j) Overpricing of acquisitions is a root cause of impairments, although, as one study points out, stating that overpricing is a root cause of impairments may sound like ex post rationalisation as academic studies would have to determine this by means of proxies (US 2012). Overpricing tend, according to some studies, to be more frequent when the acquisition is paid for the acquirer's stocks. There is also some evidence that when the firm's stocks are overpriced, there is a strong and positive association with the intensity of corporate acquisitions and the growth of accounting goodwill (US 2011, US 2011). Other papers, however, do not find a relationship between the payment method and overpricing (EU 2005).

(k) When goodwill should be amortised under US GAAP over up to 40 years, the average amortisation period was around 30 years (US 1992, US 1993, US 2000, US 2003). The determined useful life might not always have reflected goodwill's economic useful life but might have been influenced by capital-markets related, contracting or political motives. For example, evidence has been found that entities with accounting-based bonus plans and high leverage tended to have longer amortisation periods than other entities (US 1993). One study has found that amortisation periods of 20 – 40 years results in amortisation expenses that are smaller than the decline in economic value perceived by investors (US AUS 1996).

(l) It is unclear whether goodwill amortisations are value relevant. According to some studies performed on US data it is (US 1996, US AUS UK 1996). However, one study shows that this is only the case for the part of goodwill that is not related to going concern and synergy components (2000). One explanation for this could be that these components are non-wasting assets. Another reason could be that the amortisation does not adequately reflect the depletion of economic value. Some studies have shown that goodwill amortisations are not relevant (2001, 2001, EU 2007, UK 2013) or less relevant than goodwill impairments. Some studies have considered whether amortisation or impairment better reflect the underlying economic attributes of goodwill. One study shows that impairment does by comparing the association between goodwill accounting charges against income and firms' economic investment opportunities (2011).

(m) Disclosures are (or at least, have been (as recent data may indicate that compliance levels are steadily increasing (Spain 2019)) incomplete, uninformative, erroneous or of limited use because they are difficult to compare. Non-compliance with disclosure requirements tend to be related to managerial and firm-level incentives and to the strength of national enforcement systems and country culture (EU 2018). The differences in the level of disclosures may have effects on information asymmetry, dispersion of analysts' forecast, analysts' forecast accuracy and the cost of capital. (EU 2008, US 2009, EU 2011, EU 2012, EU 2013, Fra 2015, EU 2017, Ital 2018, 2019).

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Previous consultations of EFRAG

3 Previous studies and discussion papers performed by EFRAG in relation to goodwill include:

(a) Goodwill impairment and amortisation – questionnaire issued in 2012. The study was performed in cooperation with the OIC. The results of this questionnaire showed:

(i) Respondents had different views on what goodwill normally consists of.

(ii) Some of the respondents did not use the information on goodwill presented in financial statements whereas others did. Some of the respondents that did not use the information thought that it was too uncertain (unclear what goodwill consisted of or the calculation was considered unverifiable) or did simply not find the information useful for their projections. Other respondents used the reported goodwill or the disclosures when assessing risks, future cash flows and stewardship.

(iii) Respondents, using the goodwill information, used the goodwill figure differently in their analysis depending on what they thought goodwill included.

(iv) Respondents were split in their views on whether the amount of goodwill recognised in the balance sheet or the changes in the amount recognised provided the most relevant information.

(v) Most respondents using the goodwill information, did not treat goodwill acquired in a cash-settled business combination differently from goodwill acquired in a business combination settled by an exchange of shares.

(vi) Some respondents using the goodwill information treated the goodwill figure differently from information about other intangible assets.

- amortise goodwill (and review it for impairment);
- require additional disclosures;
- expense goodwill on acquisition;
- immediate offset of goodwill against equity;
- account for goodwill similarly to other intangible assets;
- permit recognition of internally generated intangible assets and;
- calculating goodwill as the difference between the book value of equity and the (long-term) market value of equity.

(vii) Some respondents thought the accounting information on the impairment of goodwill was useful, for example, it provided information on key planning assumptions for each CGU. Others noted that users had expected impairment losses before they were recognised in the financial statements, and the information was therefore considered of limited use.

(viii) Most respondents reflected possible future impairment losses on goodwill in their analyses.

(ix) Most respondents did not usually foresee an impairment loss to be recognised after a change in the management.

(x) Some respondents thought that under the current requirements, internally generated goodwill is recognised and that this is inconsistent with IAS 38.

(xi) Some respondents thought there would be conceptual reasons for adopting the same approach for goodwill as for other intangible assets.

(xii) Different views were presented for and against reversing goodwill impairment losses.

(xiii) The questionnaire considered the effects of goodwill impairments in time of financial crises. Different views were presented in relation to effects of goodwill impairments through the economic cycle. Some thought that effect on the macro economy should not be considered when developing accounting standards. Some thought that the impairment requirements were pro cyclical as:

- no amortisation would lead to higher prices for entities;
- impairment losses were usually recognised very late when business perspectives were already poor.

(xiv) Most respondents who thought that goodwill impairment losses were pro cyclical thought that amortisation could reduce the effect.

(xv) Respondents had different views on whether the costs of performing the impairment test were significant and proportionate to the importance of the information. Some thought that it was costly and that the information was not particularly useful as:

- it was too subjective;
- acquired goodwill turned into going concern goodwill/internally generated goodwill;
- it was not related to the operational performance and frequent impairment losses would just create noise when assessing performance;
- the supporting information in the notes was incomplete;
- it could result in unbeneficial behaviour of the management of an entity.

(xvi) Some thought the costs could be reduced by:

- allowing/requiring amortisation of goodwill;
- limiting impairment test to when there would be an indication of impairment;
- reducing the frequency of the impairment test;
- only requiring impairment test when the book value of equity compared with the market capitalisation of the company would exceed a given threshold;
- introducing a less prescriptive approach;
- introducing a more standardised approach;
- clarifying the requirements.

(xvii) Some respondents suggested the information could be made more useful by:

- disclosing total acquired and internally generated goodwill;
- decomposing changes in value in use;
- apply a hypothetical value for 'internal goodwill'.

(xviii) Some respondents did not think the requirements should be changed as the information was valuable for users.

(b) EFRAG, OIC and ASBJ Discussion Paper (the 'DP') Should Goodwill still not be amortised? – Accounting and Disclosure for Goodwill issued in 2014. This DP concluded that reintroduction of goodwill amortisation would be appropriate, because it reasonably reflects the consumption of the economic resource acquired in the business combination over time, and can be applied in a way that achieves an adequate level of verifiability and reliability. In addition, the DP concluded that further improvement should also be considered in the area of disclosure requirements.

Most respondents agreed with the main conclusion of the DP that the impairment-only model for acquired goodwill did not provide the most appropriate solution for subsequent measurement of goodwill. These respondents agreed with the preliminary views of the DP that amortisation of goodwill should be reintroduced, but also pointed out that there are areas for improvement in the impairment testing. In commenting on this matter, they referred to various reasons including the fact that amortisation would reasonably reflect the consumption of the economic resources acquired in the business combination and allocate the costs of acquired goodwill to the periods it was consumed. Nonetheless, these respondents provided mixed views on whether the IASB should indicate a maximum amortisation period. Some respondents acknowledged the subjectivity and high level of judgement in determining the useful life of goodwill. However, they believed that the level of subjectivity and judgement was not higher than that in the impairment test. In general, respondents who supported the amortisation of goodwill considered that the IASB should develop guidance to help preparers determining the useful life of the acquired goodwill. In contrast, a minority of respondents, mostly users, were supportive of the current impairment-only approach. These respondents explained that the amortisation model was fairly meaningless and it would not be beneficial to users of financial statements. Improvements to the guidance and disclosures in IAS 36 Impairment of Assets Many respondents considered that the impairment-only approach was a challenge in practice and that there was room to improve the guidance in IAS 36. These respondents identified a number of difficulties related to the current approach and provided some suggestions on what should be improved. When questioned about whether there was a need to improve disclosure requirements on impairment tests, respondents provided mixed views. Some considered that there was room for improvement, while others did not. Nonetheless, respondents emphasised that any additional disclosure requirements should be considered in the context of overall amount of disclosure requirements, which are already considered extensive. In addition, many respondents highlighted that the relevance of impairment testing for goodwill, and consequently the need for improved guidance and disclosures, would significantly decrease if the IASB reintroduced amortisation.

Many respondents considered that, if the IASB reintroduced amortisation of acquired goodwill, it should require the same for virtually all intangible assets (including those with indefinite useful lives). They also suggested that the IASB reconsider the requirement to recognise separately intangible assets in business combinations, especially when the IASB decides to reintroduce the requirement regarding amortisation of acquired goodwill.

(c) The quantitative study What do we really know about goodwill and impairment? issued in 2016. The study presented an analysis of a sample of 328 European companies. The data showed that:

(i) From 2005 to 2014 the total amount of goodwill recognised increased from 935 billion euros to 1.341 billion euros, with an increase of 43%;

(ii) A small number of companies account for a large share of the carrying amount of goodwill. The level of concentration has been decreasing slightly over time;

(iii) The goodwill to total assets ratio has remained fairly stable over the years at approximately 3,7%. The ratio is significantly higher when entities in Financials industry are excluded from the total. The ratio excluding Financials decreased gradually from 19,5% in 2009 to 16,6% in 2014;

(iv) The goodwill to net assets (or equity) ratio has been decreasing since 2008, but it was still significant in 2014 (29%);

(v) The amount of impairment losses recognised was at the highest level in 2008 and 2011, years when the performance of the financial markets was negative. On average, impairment losses represented 2,7% of the opening balance of goodwill. Although in 2012 the financial markets were already showing signs of recovery, the level of impairments in 2012 were similar to 2008;

(vi) Impairment losses were significantly concentrated in a small number of companies, particularly in the telecommunications and financials industries;

(vii) Absolute and relative levels of goodwill and impairment losses vary significantly across industries. The carrying amount of goodwill increased for most industries but decreased for telecommunication services. The ratios goodwill over total assets and goodwill over net assets also vary across industries, with telecommunication services and consumer staples being the leaders. The industries with the bigger impairment charges are telecommunication services, financials and materials.

4 The EFRAG Discussion Paper Goodwill Impairment Test: Can It Be Improved? issued in 2017. The suggestions included in the paper and constituents' responses are summaries below.

(a) The paper suggested additional guidance on the allocation of goodwill to CGUs (e.g. allocation based on the pre- and post-acquisition fair value of each CGU (or group of CGUs) that is expected to benefit from the acquisition). Respondents provided mixed views on this suggestion. Some would welcome additional guidance as it would bring more direction and discipline to preparers on how to allocate goodwill. However, others considered that IAS 36 already allowed entities to use its judgement to determine an appropriate method to allocate goodwill to the CGUs and that EFRAG's proposals seem to be a rule-based and driven by anti-abuse concerns. Still, some suggested that the allocation methods proposed in the paper could become part of the illustrative and non-mandatory guidance accompanying IAS 36.

(b) The paper proposed additional disclosure of information on composition of goodwill (i.e. information (in amounts) about which acquisitions the total amount of goodwill is related to). Many respondents did not support additional disclosures as it would be difficult and onerous to track and assess each individual component of goodwill over time.

(c) The paper proposed to introduce a 'Step Zero' in the impairment test (a qualitative assessment of the likelihood of an impairment loss). The majority of the respondents generally welcomed the introduction of the Step Zero as the requirements in IAS 36 for the calculation of the recoverable amount are complex, costly and have to be performed at least annually even if there is no indication of an impairment and the CGU has a significant headroom. Those that disagreed with the Step Zero were mainly concerned that it would not significantly reduce the operational costs while likely delaying the recognition of goodwill impairments.

(d) The paper suggested a single calculation approach: fair value less costs of disposal ('FVLCD') or Value in Use ('VIU'). The majority of the respondents that replied to this question did not support the introduction of a single method for determining the recoverable amount as it would not result in a significant simplification (entities are not currently required to calculate both VIU and fair value less cost of disposal ('FVLCD')) and that both VIU and FVLCD were considered relevant for the calculation of the recoverable amount. Nonetheless, many respondents considered that the VIU was the most appropriate method to calculate the recoverable amount and considered that the VIU should be retained if a single method was to be introduced.

(e) The paper proposed to allow consideration of cash flows from future restructurings when testing for impairment. Most of the respondents supported EFRAG's suggestion as it would take into consideration management's views of the business and simplify the impairment test (it would allow entities to use directly their budgets and forecasts, which are likely to include the impact of future restructurings without making artificial adjustments to remove them). Nonetheless, a number of respondents called for some level of safeguard. For example, future restructurings would have to be approved by management and this should be a requirement.

(f) The paper proposed to allow the use of a post-tax rate when testing for impairment. Almost all respondents supported allowing the use of a post-tax rate since entities often conduct the impairment tests on a post-tax basis with an additional iteration simply to derive a pre-tax discount rate. Therefore, the introduction of a choice would simplify the calculation of the VIU and reduce costs.

(g) Finally, the paper proposed to deduct an accretion amount from the recoverable amount of a CGU for the purpose of the impairment test. The accretion amount would be calculated as the carrying amount of goodwill multiplied by an accretion rate (e.g. the discount rate used for the impairment test). In general, respondents acknowledged that the basic assumption underlying the goodwill accretion approach and its objective. However, the majority of the respondents did not support EFRAG's goodwill accretion approach as it would add complexity and subjectivity to the goodwill impairment model. In addition, respondents argued that if acquired goodwill is an asset that is being consumed and decreasing over time, then the discussion should be focused on the reintroduction of goodwill amortisation, which is a simpler approach. Nonetheless, two users' representative associations considered that the goodwill accretion approach could be a reasonable compromise to solve the issues related to internally generated goodwill and timeliness of impairments.

Appendix 2

EFRAG TEG members' preliminary views on goodwill amortisation

1 EFRAG TEG members have discussed what solution they would support in the case a change to the goodwill impairment and amortisation approach would be considered necessary. EFRAG TEG members did not support the approach suggested by the IASB under which goodwill would not be amortised and only tested for impairment when there is an indication of an impairment.

(a) The majority of (but not all) EFRAG TEG members supported an amortisation plus indicator-only impairment approach. That is an approach under which goodwill would be amortised and tested for impairment if there is an indication of impairment.

(b) Some (a minority of) EFRAG TEG members supported maintaining the annual impairment test and introducing requirements regarding amortisation.

(i) Some of these EFRAG TEG members thought that it should be considered what goodwill in a particular case would consist of. If it was a wasting asset (or parts of it would consist of wasting assets), it (those parts) should be subject to amortisation while it (or the parts) should not be amortised if it (they) would have an indefinite life (similar to other assets under IAS 38 *Intangible Assets*).

(ii) The other some EFRAG TEG members who supported maintaining the annual impairment test, and introducing amortisation thought that goodwill should always be amortised.

(c) Some (a minority of) EFRAG TEG members did not support changing the current requirements (impairment only approach).

2 The following arguments in favour of (a) the amortisation plus indicator-only impairment approach were provided by EFRAG TEG:

(a) Although there are academic studies that show that goodwill impairments are not used opportunistically, most academic studies show that they are. Goodwill impairments e.g. seem to take place when there is a change in the management. Accordingly, goodwill impairment information is currently not particularly useful.

(b) Although the impairment only approach might in theory be the right model, the current impairment only model does not work. Amortising goodwill would therefore be preferable from a practical perspective.

(c) Goodwill is payment for future profits. The costs should therefore be allocated to the periods in which the additional profits will incur[4].

(d) Goodwill is a wasting asset. Sometimes it is argued that e.g. a market share would be perpetual, however, it would generally be necessary to maintain this position, and accordingly to bear costs of doing so. The market share is accordingly not perpetual.

(e) Goodwill consists of many elements. Many of these elements would not be assets. The goodwill figure is therefore a 'plug'. The purpose of recognising goodwill is that it is helpful for assessing stewardship (i.e. to assess whether the management had paid too much for the acquired business). In the first few

[4] An EFRAG TEG member who thought that in some cases goodwill could be a wasting asset and should be amortised in these cases, added that when goodwill would then be amortised, it should be regarded as a genuine cost, and thus not added back in e.g. EPS calculations for compensation plans.

years after an acquisition, the goodwill figure would be useful for that. However, as time passes, acquired goodwill would be replaced by internally generated goodwill. After the first few years, the goodwill figure is therefore not useful. It is therefore better to have it removed from the statement of financial position by amortising it.

(f) The fact that it could be difficult to determine the amortisation period is not a good excuse for not amortising goodwill. It is also difficult to determine the amortisation period for many types of tangible assets, and still these are subject to depreciation.

(g) Most academic studies show that the goodwill figure has become more relevant after the impairment only approach has been introduced. However, this could be explained by the fact that the impairment test after the introduction of the impairment only approach had become more rigorous and the impairment information thus became more relevant. It was not because the amortisation made information less relevant5.

(h) Amortising goodwill would enhance comparability between entities growing organically and entities growing by means of acquisition (in both cases the cost of goodwill would be included in the statement of profit or loss).

(i) For assessing managements' stewardship, it is preferable that the costs of a business combination, including the cost of goodwill, is recognised in profit or loss (which would often not happen under the impairment only approach).

3 Members supporting accounting for goodwill similarly to other intangibles under IAS 38 (the view presented in paragraph 1(b)(i) above), noted that under the current regime goodwill impairment losses are interpreted by analysts as representing an investment failure. However, if goodwill is a payment for excess future profits for a limited time period, goodwill would naturally diminish over time. In order not to give the impression that the investment was a failure, it would be more informative to present the decline in the value as amortisation expense, and hence to amortise goodwill. However, when goodwill would not be a wasting asset, it should be subject to the impairment test only. An argument provided for keeping the impairment test was that after the current impairment model had been introduced, impairment losses had become more relevant.

4 Members supporting a mandatory annual impairment test and amortisation of (all) goodwill noted that goodwill is a plug and consisted of different items, some of which might have a finite life (but considering what elements it consists of would be complex). The impairment only approach accordingly did not work appropriately, and amortising goodwill would take the pressure off the annual impairment test.

5 Members that did not support changing the current requirements noted that:

(a) It was unnecessary to do unless there would be specific arguments demonstrating that the current accounting is flawed.

(b) Introducing amortisation would not result in (significantly) less impairment as the risk of impairment is highest in the first years after an acquisition in which the amortisation has little impact.

(c) Introducing amortisation would have a significant effect on financial statements.

(d) Issues identified with the impairment model (i.e. the shielding effect) are caused by internally generated intangibles not being recognised.

[5] The EFRAG TEG member who provided this argument thus also believed that the requirement of a yearly impairment test should be kept.

(e) Although goodwill may consist of elements that are wasting assets, goodwill in itself is not a wasting asset.

6 At its July 2019 meeting, EFRAG User Panel members expressed different views on whether goodwill should be amortised and whether the impairment test could be carried out only when there is an indication of an impairment. Similar statements were received during the joint meeting with TEG in March 2020. However, the users said that the system is broken and even if amortisation is not reintroduced changes is the guidance/application of the impairment-approach are necessary.