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## **Goodwill and Impairment Cover Note**

### **Objective**

- 1 The objectives of this session are:
  - (a) to complete the discussion on the IASB tentative decisions collecting EFRAG TEG members' preliminary views on the IASB proposals with reference to the disclosure and presentation in the statement of financial position (agenda paper 08-02);
  - (b) discuss the direction and key messages on the IASB's tentative decisions in preparation of the EFRAG DCL (agenda paper 08-03);
  - (c) to update TEG on recently issued documents on goodwill impairment and amortisation (agenda papers 08-04 and 08-05);
  - (d) to discuss the areas of a possible impact assessment to be run in parallel to the consultation on the DCL (section "*Possible approach for an impact assessment*" of this cover note); and
  - (e) to inform about the proposed timetable for the preparation of EFRAG DCL, including the discussion at EFRAG TEG and EFRAG Board (*Proposed Timetable* section of this cover note).

### **Background on the IASB Project**

- 2 The IASB plans to issue a discussion paper on how to account for goodwill subsequent to the initial recognition at the end of February with a comment period of 180 days. 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, such as:
  - (a) goodwill impairment being recognised 'too little too late';
  - (b) 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.
- 3 In addition, the IASB learned from stakeholders that companies provide inadequate information on the subsequent performance of businesses they acquire.
- 4 During the course of the project, the IASB has 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.

- 5 One of the causes of the delayed recognition of goodwill impairment is the shielding effect created by internally generated goodwill (i.e. incremental cash flows internally generated gradually at CGU level after the acquisition and that replaces the cash flows embedded in the synergies paid to the vendor and allocated to acquired 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 has not been explored further by the IASB.
- 6 Accordingly, after concluding that it would not be possible to make the impairment test significantly more effective, the IASB 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.
- 7 Regarding Objective B, the IASB's DP likely will discuss the indicator-only approach (to require an entity to perform a quantitative impairment test of goodwill only when there are indicators of possible impairment). However, the following approaches were previously discussed:
  - (a) to perform a quantitative impairment test of goodwill in the first year after a business combination; and in subsequent years perform the quantitative impairment test only when there are indicators of possible impairment;
  - (b) to perform a quantitative impairment test of goodwill at least annually (and more frequently whenever there are indicators of possible impairment) for the first few years after a business combination; and in subsequent years perform a quantitative impairment test only when there are indicators of possible impairment; and
  - (c) to perform a quantitative test of goodwill less frequently than annually; and in the intervening periods perform a quantitative impairment test only when there are indicators of possible impairment.

#### **EFRAG discussions**

- 8 During the November 2019 EFRAG TEG meeting, members discussed the IASB tentative decisions on Objectives B and C but did not discuss specifically the Objective A.
- 9 A summary of past EFRAG discussions was provided for the [December Board meeting](#).
- 10 The IASB's views on the project objectives, together with the recommendations of the IASB staff was provided as [background](#) for the November 2019 EFRAG TEG meeting.
- 11 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*. A [short summary](#) was provided as background for the November 2019 EFRAG TEG meeting. Some of the comments received by the FASB in response to the ItC from the big audit firms and some other respondents are included in the appendix to Paper 08-04 for this meeting.

### **Possible approach for an impact assessment**

- 12 The debate about how to account for goodwill —particularly whether it should be amortised or not — has taken place for many years, and in EFRAG’s past consultations, constituents have presented split views. In order to make further progress, it is therefore important that EFRAG, in its internal discussions, and in the input it collects, focuses on the rationales for the various views. That is, what additional evidences do exist and how they would demonstrate that the resulting information is relevant, reliable, etc. and the change would meet cost/benefit threshold and the public good criterion. In this regard it will also useful for EFRAG to understand any broader (e.g. financial stability and level-playing field) implication of a requirement to amortise goodwill. Input that could be useful for this understanding could cover:
- (a) How important is convergence with the FASB (and if it is important why, and how the importance of convergence should be weighed against reliability, relevance, understandability and cost/benefits)?
  - (b) Would amortisation of goodwill affect financial stability (e.g. would lower goodwill balances affect financial stability, would amortisation (combined with an indicator-only approach for goodwill impairment) result in less robust internal controls as annual quantifications of impairment would not be requested anymore) and economic growth (e.g. the level of mergers and acquisitions)?
- 13 To understand the impact, EFRAG could, for example:
- (a) Consult academic research. When preparing Paper 08-04 for this session, the EFRAG Secretariat did reach out to the EFRAG Academic Network to learn about research in the area. While the EFRAG Secretariat did receive many references to useful literature on goodwill (which are summarised in Paper 08-04), not many references were provided for studies on the economic impacts on goodwill accounting.
  - (b) Conduct targeted outreach with M&A professionals.
  - (c) Compare the level of M&A activity in jurisdictions that require amortisation of goodwill with jurisdictions that do not.
- 14 In addition to the questions that the IASB will ask in the DP, the allocation of goodwill to cash generating units could be requested.

### **Proposed timetable**

- 15 The table below illustrates the proposed estimated timetable for the project considering that the IASB’s DP is expected by the end of February 2020. Tentatively, the EFRAG Secretariat estimates to issue EFRAG’s draft comment letter (‘DCL’) at the end of April (to be approved by EFRAG Board at its 21 April meeting) and to issue EFRAG’s final comment letter (‘FCL’) at the beginning of September (to be approved by EFRAG Board at its 10 September meeting).

Goodwill and Impairment – Cover Note

<b>EFRAG WG</b>	<b>Jan-20</b>	<b>Mar-20</b>	<b>Apr-20</b>	<b>Sep-20</b>
EFRAG TEG	<u>29-30 January</u> To obtain directions and key messages for the DCL and to discuss an early impact assessment	<u>4 March</u> To circulate the DP and to obtain first views on unexpected topics/issues (oral communication) <u>9 March</u> Written consultation on any views/wording needed to complete the DCL for the 17 March Board discussion. <u>26 March</u> To recommend DCL and to discuss User Panel views.	<u>16 April</u> Only if needed: to recommend DCL	<u>2-3 September</u> To discuss and to recommend FCL
EFRAG Board		<u>17 March</u> To discuss the preliminary first views expressed by EFRAG TEG and to obtain views on the DCL <u>30 -31 March</u> Webcast meeting – to discuss DCL and User Panel and EFRAG TEG views	<u>21 April</u> To approve DCL	<u>10 September</u> To discuss and to approve FCL
EFRAG User Panel		<u>4 March</u> To discuss the DP and to test early impact assessment questionnaire		
EFRAG FIWG	<u>22 January</u> To discuss the IASB's preliminary views			
EFRAG CFSS		<u>26 March</u> To discuss the DP and to test early impact assessment questionnaire		

**Question for EFRAG TEG**

- 16 Do you agree on the opportunity to complement the consultation in EFRAG DCL with an impact study? Please explain.
- 17 Do you agree with the areas of impact assessment and with the approach described in the section “*Possible approach for an impact assessment*” above?
- 18 Do you have any comment on the proposed timeline for issuing EFRAG’s DCL and EFRAG’s FCL?
- 19 Do you have any comments on the evidence collected (agenda papers 08-04 and 08-05)?
- 20 Are EFRAG TEG members aware of additional evidence that would be useful for its discussion on the IASB’s forthcoming discussion paper?
- 21 The IASB’s forthcoming discussion paper may not include a direct question on whether goodwill should be amortised. However, the EFRAG Board considers providing a view on this. In this regard, the EFRAG Board will consider which aspects of alternative approaches<sup>1</sup> it will assess and compare (e.g. conceptual arguments, cost/benefit consideration, convergence with US GAAP, public good (including financial stability and economic growth)).
- (a) How important does EFRAG TEG consider convergence with US GAAP on the subsequent accounting for goodwill is?
- (b) Does EFRAG TEG have other suggestions to provide to the EFRAG Board (e.g. on what aspects it should consider evidence that can affect the public good assessment (including financial stability and effect on economic activity/growth – (see paragraphs 12 - 13 above))?

**Agenda Papers**

- 22 In addition to this cover note, agenda papers for this session are:
- (a) Agenda paper 08-02 – Issues paper *Disclosure requirements and presentation of equity before goodwill*;
- (b) Agenda paper 08-03 – Issues paper *Key messages for EFRAG DCL*;
- (c) Agenda paper 08-04 – Issues paper *Goodwill – status of the debate*; and
- (d) Agenda paper 08-05 – Issues paper *Goodwill – previous findings*.

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<sup>1</sup> See agenda papers 08-03, 08-04 and 08-05 for arguments against and in favour of goodwill amortisation.