Goodwill and Impairment
Key messages for EFRAG DCL

Objective

1 The objective of this agenda paper is the discuss the direction and the key messages for EFRAG Draft Comment Letter on the IASB's project *Goodwill and Impairment* (the DCL).

Introduction

2 To facilitate the discussion, the EFRAG Secretariat proposes a number of key messages to be included in the DCL. These key messages have been based on the feedback received from EFRAG TEG and EFRAG TEG Working Groups (a summary of past EFRAG discussion was provided for the December Board meeting)

3 The EFRAG Secretariat is planning to present to EFRAG TEG a Draft Comment Letter (DCL) in March 2020 for a recommendation to the EFRAG Board. The timing of EFRAG DCL is crucial so that the EFRAG Secretariat can have a basis to start as soon as possible. In the December discussion, EFRAG TEG members expressed mixed views on the IASB's tentative decision regarding the indicator-only approach for goodwill impairment testing. Many EFRAG TEG members supported an indicator approach if it would be combined with amortisation. For the switch to an indicator only approach and for the reintroduction of amortisation, three views are presented in order to understand TEG members' orientations.

4 Considering the feedback received from EFRAG TEG and other EFRAG working groups, the EFRAG Secretariat suggests the following key messages:

General comments

5 **EFRAG welcomes the IASB's Discussion Paper on Goodwill and Impairment test**. 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

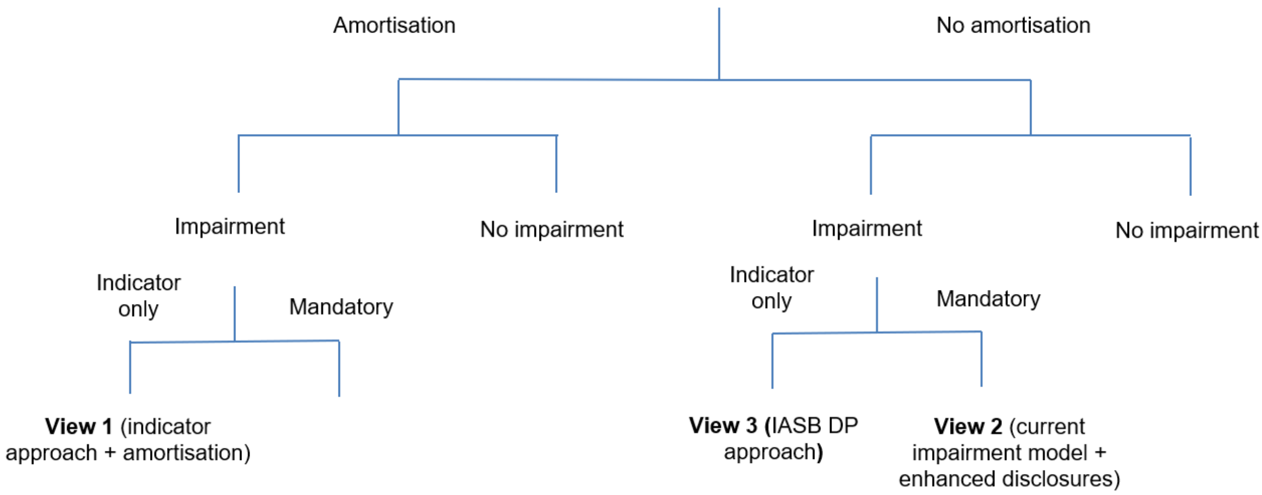
(d) some stakeholders would like to see amortisation reintroduced.

Approaches to amortisation and/or impairment

6 The figure below illustrates the possible alternatives when considering amortisation and impairment (with or without an indicator-only approach). It is the impression of

the EFRAG Secretariat that the majority of EFRAG TEG members have supported an approach under which goodwill would be amortised and subject to an impairment test only when there is an indication of an impairment (in the figure: ‘Amortisation’, ‘Impairment’, ‘Indicator only’). Other views have, however, also been expressed these views have favoured the approach named ‘View 2’ in the illustration. Other combinations of amortisation and impairment than those ‘View 1’ and ‘View 2’ are possible, but it is the impression of the EFRAG Secretariat that those alternatives have not received broad support from TEG members in the past.

7 The following paragraphs further explain the rationale for the different views.



View 1 An amortisation plus impairment, indicator-only approach

8 **EFRAG would support the IASB tentative decision to switch to an indicator only approach if it would be combined with amortisation** (on the grounds that amortisation would likely reduce the need for impairment) with a robust list of indicators. However, EFRAG highlights that this approach results in less useful information for users, as they would lose information on stewardship and capital employed and would not significantly reduce the robustness of the test. EFRAG highlights that a robust list of impairment indicators needs to be provided in this case to ensure that the quantitative impairment test works as expected.

9 EFRAG considers that indicator only approach in isolation (i.e. without amortisation) would relax even more the reliance of users on the results of the impairment test, could accentuate ‘too little too late’ issue and could result in a further loss of information on governance and management stewardship of capital employed.

10 EFRAG considers that the combined approach would address the deficiencies inherent in the current impairment test. In addition, the need for improved impairment guidance and disclosures could be reduced.

11 This approach would also address the concern of the increasing levels of goodwill on the balance sheets with levels sometimes reaching the levels of equity.

12 EFRAG notes that if users do not like the amortisation expense reported in financial statements, these expenses can easily be removed for doing their estimations.

13 In addition, EFRAG supports to apply the same relief as for goodwill for intangible assets with indefinite useful lives and for intangible assets not yet available for use. EFRAG agrees that this approach would:

(a) remove the difference in frequency of impairment tests between identifiable and unidentifiable intangible assets (including goodwill);

(b) reduce scope for accounting arbitrage when different impairment models applied to goodwill and other types of intangible assets; and

(c) ensure the consistent accounting treatment between intangible assets not yet available for use and tangible fixed assets under development (no mandatory impairment test for both categories).

14 EFRAG also indicates the above approach would result in cost-savings for preparers and in a uniform impairment model in IAS 36.

15 (Under View 1, whether or not additional disclosures should be provided is considered separately).

View 2 – Current approach plus better disclosures

16 **EFRAG considers that no changes to current impairment model should be made and the additional disclosures about subsequent performance of the acquisition tentatively proposed by the IASB would be sufficient to address users' concerns.**

17 EFRAG notes that amending again the accounting standards would not be warranted from conceptual perspective and no clear evidence exists proving that the current impairment model is broken.

18 **EFRAG supports the IASB tentative decisions requiring entities to provide the improved disclosure information helping users understand the subsequent performance of acquired business.**

19 However, EFRAG expresses concerns that some of the information required in the proposed disclosures could be confidential as it would expose commercially sensitive details, such as expected synergies, etc.

20 EFRAG also highlights the practical difficulties of providing the quantitative information after the acquisition date in cases where the acquired business was fully integrated with the existing business and if the initial performance targets against which the acquisition was assessed were to change.

21 EFRAG agrees with the IASB tentative decision that the information on subsequent performance should be based on the level on which CODM monitors the subsequent performance of the acquired business and not on the materiality concept.

22 EFRAG agrees that this approach would result in disclosing all significant or strategic business combinations and that it would establish an appropriate level of disclosure that balances users' needs with practical considerations for preparers.

23 However, EFRAG highlights a need for more information on how management monitors the acquisitions and whether CODM is an appropriate monitoring level before making a final decision.

24 EFRAG also supports the IASB tentative decision not to replace paragraph B64(q)(ii) of IFRS 3 that requires disclosure of the revenue and profit or loss of the combined entity for the current reporting period as though the acquisition date for all business combinations that occurred during the year had been as of the beginning of the annual reporting period. EFRAG agrees on the grounds that this information was already required by IFRS 3 and taking into account that paragraph B64(q) also permits an entity not to disclose this information if it is impracticable.

25 Lastly, EFRAG considers that the IASB should further develop the disclosure requirements in IAS 36 to require entities to disclose estimated projections that normally are not approved in budgets (such year 4, year 5) but are included in doing impairment test.

View 3 – IASB DP approach

26 **EFRAG agrees with the IASB's suggestion to remove the requirement to carry out an annual quantitative impairment test when no indicator of impairment exists for goodwill**. In addition, EFRAG supports to apply the same relief as for

goodwill for intangible assets with indefinite useful lives and for intangible assets not yet available for use. EFRAG agrees that this approach would:

(a) remove the difference in frequency of impairment tests between identifiable and unidentifiable intangible assets (including goodwill);

(b) reduce scope for accounting arbitrage when different impairment models applied to goodwill and other types of intangible assets; and

(c) ensure the consistent accounting treatment between intangible assets not yet available for use and tangible fixed assets under development (no mandatory impairment test for both categories).

27 EFRAG also indicates this view would result in cost-savings for preparers and in a uniform impairment model in IAS 36.

28 EFRAG acknowledges that the current impairment model under IAS 36 is not perfect and that impairment losses are generally recognised too late at a too low amount. Similar to the IASB, EFRAG has considered manners to improve the impairment test. These attempts have, however, shown to result in a too complex impairment test. Although the impairment test is not perfect, it is, at the moment, the best alternative. In that regard, EFRAG notes that academic research does generally not find any support for arguments that amortisation of goodwill would result in more useful information. Some argue that amortisation of goodwill would be less costly. EFRAG would, however, note that an amortisation only approach (i.e. an approach under which goodwill would be amortised, but never tested for impairment) would result in goodwill being accounted for differently from other assets. EFRAG would not support such an approach. In the view of EFRAG, amortisation of goodwill should be accompanied by impairment. It is therefore the assessment of EFRAG that amortisation of goodwill would not eliminate the costs of performing impairment tests although impairment may occur less frequently when goodwill is amortised.

29 (Under View 3, whether or not additional disclosures should be provided is considered separately).

Question for EFRAG TEG

30 Which view does EFRAG TEG members support?

31 If EFRAG TEG supports View 3, does it think that although generally an impairment test would only be performed when there is an indication of impairment, an impairment test should be performed within a given number of years (e.g. at least every three years)?

32 What are the arguments for that view in terms of: relevance, reliability, comparability, understandability, cost/benefits and public good (including economic growth and financial stability)?

Value in use calculation

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

33 **EFRAG supports to allow the inclusion of future enhancements in the estimation of future cash flows in the calculation of value in use.** This 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.

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

35 EFRAG considers that a pre-tax discount rate could be hard to understand and that it does not provide useful information because this rate is not observable and is generally not used for valuation purposes. The current value of an asset is regarded and understood as a post-tax measure which is more directly observable.

Question for EFRAG TEG

36 Does EFRAG TEG agree with the key messages on future enhancements in the estimation of future cash flows in the calculation of value in use suggested above?

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

37 **EFRAG supports the IASB tentative decision to remove the explicit requirement to use pre-tax inputs and pre-tax discount rate to calculate value in use.** EFRAG considers 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.

38 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.

Question for EFRAG TEG

39 Does EFRAG TEG agree with the key messages to remove the explicit requirement to use pre-tax inputs and pre-tax discount rate to calculate value in use suggested above?

Other topics to be considered

Total equity before goodwill subtotal

40 **EFRAG supports the proposal to present in the statement of financial position a subtotal of total equity before goodwill**. In EFRAG's view this proposal could increase the prominence of acquired goodwill carrying amounts, given the nature of goodwill and the inevitable limitations of the impairment test. In addition, this could be a further response to the 'too late' feedback, with a limited impact on costs.

Question for EFRAG TEG

41 Does EFRAG TEG agree with key message suggested above?

Allocation of goodwill to the cash-generating units

42 EFRAG notes that impairment losses are often late and inadequate as 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 is of view that the manner in which goodwill in practice is allocated to the CGUs reduces the robustness of the impairment test. Therefore, **EFRAG suggests that the IASB considers introducing the additional guidance on the allocation of**

goodwill to CGUs together with disclosures on the break-down of goodwill by CGU.

43 EFRAG acknowledges that acquired goodwill could be shielded from impairment by unrecognised headroom of the legacy business that becomes part of the tested unit past acquisition and recommends that the current guidance on the allocation of goodwill to (group of) CGUs should be further developed.

Question for EFRAG TEG

44 Does EFRAG TEG agree with key messages suggested above?

Conversion with FASB decisions

45 Finally, **EFRAG considers that providing useful information to users is more important than the convergence in the decisions with the FASB**.

Questions for EFRAG TEG

46 Does EFRAG TEG agree with key messages suggested above?