

This paper provides the technical advice from EFRAG TEG to the EFRAG Board, following EFRAG TEG's public discussion. The paper does not represent the official views of EFRAG or any individual member of the EFRAG Board. This paper is made available to enable the public to follow the EFRAG's due process. Tentative decisions are reported in EFRAG Update. EFRAG positions as approved by the EFRAG Board are published as comment letters, discussion or position papers or in any other form considered appropriate in the circumstances.

Goodwill and Impairment – Draft comment letter

Cover Note

Objective

- 1 The objective of this session is to discuss and to approve the EFRAG draft comment letter ('DCL') in response to the IASB Discussion Paper *2020/1 Business Combinations—Disclosures, Goodwill and Impairment* issued on 19 March 2020 (the 'DP').
- 2 The EFRAG Board discussed in its 21 April 2020 Webcast meeting the drafted version of the DCL recommended by the EFRAG TEG. Due to the time-constraints the EFRAG Board discussed questions 2-5 and questions 6, 11 and 14. The EFRAG Board tentatively agreed with EFRAG TEG's direction taken in questions 6, 11 and 14. However the EFRAG Board made comments to questions 2-5. These comments to questions 2-5 have been discussed with EFRAG TEG in its 6 May 2020 Webcast meeting. The EFRAG Secretariat has adjusted the DCL according to the comments received by the EFRAG Board.
- 3 At this meeting, the EFRAG Board will discuss the remaining questions of the DCL. After the discussion the EFRAG Board will be asked to approve the DCL.

Background on the DCL

- 4 The IASB published the [DP](#) on 19 March 2020.
- 5 Before the issuance of the DP, EFRAG Secretariat obtained by the EFRAG Board the Board's directions to be followed when preparing the draft EFRAG position in the DCL. Those directions were pre-agreed with EFRAG TEG and were built on the basis of the publicly available contents of the IASB tentative decisions at that date.
- 6 **EFRAG TEG** discussed in the webcast meeting on **26 March** an extracted draft comment letter that included the drafting proposed by EFRAG Secretariat for questions 2 to 10 of the DP. During the meeting only questions 2 to 6 were covered. EFRAG TEG members were invited to provide their written input on the questions that were included in the initial version of the DCL but were not discussed at the meeting due to time constraints (Questions 7 to 10).
- 7 With reference to the disclosure proposals (Questions 2 to 5) EFRAG TEG's comments and proposed wording changes agreed during the 26 March Webcast meeting were further considered in a discussion with **EFRAG User Panel**, at its **1 April 2020** Webcast meeting. User Panel members provided also input to the initial drafting by the EFRAG Secretariat of Question 12 (separation of Intangible assets). A short summary of the 1 April 2020 User Panel Meeting (as background purposes) is provided as Appendix II of this cover note.
- 8 **EFRAG TEG** members discussed in its **6-8 April 2020 Webcast meeting** the amended version of EFRAG's DCL according with the input received from them in

its 26 March TEG Webcast meeting and with the feedback provided by User Panel members in its 1 April Webcast meeting. EFRAG TEG proposed some drafting changes and recommended the DCL to its approval by the EFRAG Board.

- 9 **The EFRAG Board** discussed in its **21 April 2020 Webcast meeting** the version of the DCL recommended by the EFRAG TEG. Due to the time-constraints the EFRAG Board discussed question 2-5 and questions 6, 11 and 14. The EFRAG Board tentatively agreed with EFRAG TEG's direction taken in questions 6, 11 and 14. However, the EFRAG Board made the following comments to question 2-5:
- (a) They noted that the DCL recommended by TEG was supportive of the IASB's proposal. Some members expressed caution in providing this support, as they considered that the proposed disclosure would be based on management expectations and have substantially a non-GAAP nature. They indicated concerns, including whether it is practical and appropriate to require non-GAAP information in the financial statements.
 - (b) They suggested to include a question to constituents on whether the proposed information should be included in the notes to the financial statements or in the management commentary. This would provide more emphasis as well to the issue of auditability and practicability of these information.
 - (c) Pending the consultation on the DCL, they suggested to adopt a neutral approach to IASB's proposals, softening the support expressed in the drafted wording, but at the same time showing openness to the proposed requirements.
 - (d) Finally, they considered that a possible proposal of narrative information about the reasons and performance of an investment realised through an acquisition would be of value not only for the investments done for external growth, but also for internal investments.
- 10 The EFRAG Secretariat considered above EFRAG Board's comments regarding questions 2 – 5 and discussed them with **EFRAG TEG** in its **6 May 2020 Webcast meeting**.
- 11 EFRAG TEG generally agreed with asking constituents views whether the proposed information (including non-GAAP metrics) should be included in the notes to the financial statements or in the management commentary. They supported such question and recommended to extent the arguments and balance the arguments both in favour of including the information in the management commentary or in the financial statements. For including the information in the financial statements, the following arguments were provided:
- (a) Disclosing such information in the financial statements could provide more reliable information as the information would be audited and as the requirements in relation to management commentary are different. In some jurisdictions/countries the management commentary would not be required.
 - (b) The acquisition is accounted for within the financial statements. Therefore, the supporting information to the acquisition should be as well within the financial statements. According to the IFRS Conceptual Framework one of the objectives of financial reporting is assess management's stewardship. The disclosure supports to assess stewardship and therefore this information should be provided in the financial statement.
 - (c) Partly the requested new information is a follow up of information already required according to IFRS 3.
 - (d) It is not unusual that disclosures represent non-GAAP measures. There are other disclosures and information currently provided in the financial statements that could be non-GAAP measures (as for example the information

of the impairment test or disclosures already required on proforma information in IFRS 3)

- 12 Additionally, EFRAG TEG members agreed to amend the question to constituents in question 2 of the DCL to also ask whether it is feasible to audit the proposed information (on the performance of an acquired business) and to address to preparers whether it is feasible to prepare the disclosures in a way that they can be audited.
- 13 Finally, EFRAG TEG suggested not to include in the response to Question 2 of the DCL that the proposed information would also be useful for other material investments as part of an organic growth (outside of a business combination). EFRAG TEG considered that this would be outside of the scope of an amendment to IFRS 3 *Business combination*. The EFRAG Secretariat notes that the issue could be considered in relation to another project, for example, the project on the management commentary.
- 14 The EFRAG Secretariat has amended the DCL according with the comments made by EFRAG TEG members explained in paragraphs 11 and 12 as drafted in agenda paper 01-02. The EFRAG Secretariat seeks EFRAG Board's view on whether the DCL should be amended according with the EFRAG TEG's comment in paragraph 13.

Questions for EFRAG Board

- 15 Does the EFRAG Board consider that the DCL should be amended according with EFRAG TEG's comment in paragraph 13?
- 16 Does the EFRAG Board have any comment on the proposed EFRAG TEG wording changes explained in paragraphs 11 and 12.
- 17 Does the EFRAG Board have any comment on the proposed wording of the DCL to the cover letter, Questions 1, 7, 8, 9, 10, 12 and 13?
- 18 Does the EFRAG Board approve the draft comment letter as drafted in agenda paper 01-02?
- 19 The IASB asked for comments on the DP by 31 December 2020. The EFRAG Secretariat suggests making any additional time available to its constituents for comment. For that reason, the EFRAG Secretariat proposes fixing a comment period ending on 28 December 2020. Does the EFRAG Board agree with the comment period suggested by EFRAG Secretariat?

Agenda Papers

- 20 In addition to this cover note, the following papers have been provided for this session:
 - (a) Agenda paper 01-02 –EFRAG DCL on the DP (track-changed version);
 - (b) Agenda paper 01-03 –EFRAG DCL on the DP (clean version);
 - (c) Agenda Paper 01-04 - Initial feedback received in response to EFRAG's M&A consultation;
 - (d) Agenda Paper 01-05 Presenting EFRAG DCL on Goodwill - May 2020; and
 - (e) Agenda Paper 01-06 – the DP (Background purposes).

Appendix I: Goodwill allocation level analysis

Introduction

- 21 The EFRAG Secretariat performed an analysis to obtain evidence on the level of goodwill allocation used by the companies in practice with large goodwill balances. The analysis has been prepared with sample selection of 30 European publicly traded companies with largest goodwill balances from Thompson Reuters database
- 22 This analysis was provided for the 21 April 2020 EFRAG Board Meeting in order to discuss EFRAG's response to question 6 of the DCL that was already agreed. The EFRAG Secretariat provides also for this meeting for completion purposes.
- 23 The objective of the analysis performed by EFRAG Secretariat was to obtain the view on the level of goodwill allocation used by the companies in practice with large goodwill balances.

The details

- 24 To get an overview on which level goodwill is allocated to CGUs for impairment test purposes, EFRAG Secretariat has made a sample selection of 30 European publicly traded companies with largest goodwill balances from Thompson Reuters database.
- 25 The companies selected represent the following split by country:

Country	Number of companies
Belgium	1
France	7
Germany	6
Italy	2
Netherlands	4
Switzerland	4
United Kingdom	6
Grand Total	30

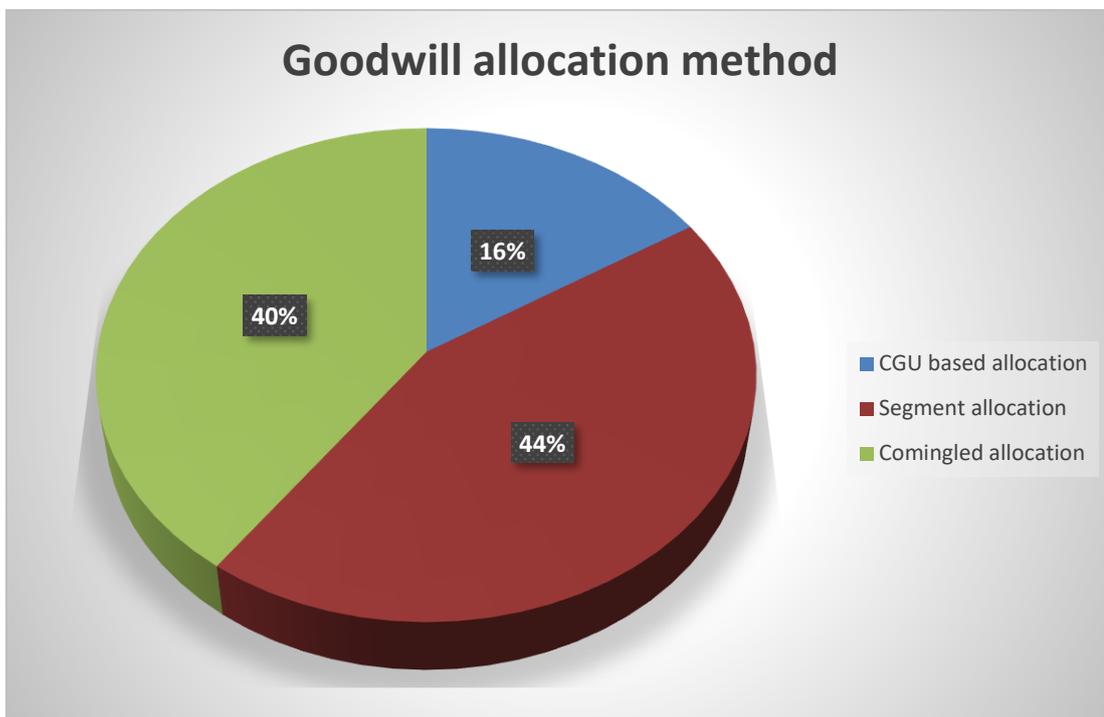
- 26 The total gross goodwill balance for these companies amounts to 762 bln EUR whereas the total equity amounts to 1.180 bln EUR and total assets – to 7.206 bln EUR. The table below presents the breakdown per country:

Country	Total assets	Total equity	Gross g/w balance	Net g/w balance	Percentage of net g/w to total assets	Percentage of net g/w to total equity
Belgium	211.104.214.880	67.548.567.320	114.289.835.140	114.285.374.840	54%	169%
France	732.589.000.000	202.745.000.000	139.679.000.000	113.908.000.000	16%	56%
Germany	1.016.019.000.000	288.623.000.000	168.406.000.000	145.400.000.000	14%	50%
Italy	953.145.000.000	85.744.000.000	37.109.000.000	18.436.000.000	2%	22%
Netherlands	304.613.800.000	33.218.600.000	55.066.500.000	53.064.300.000	17%	160%
Switzerland	353.855.523.332	153.963.525.239	84.712.733.968	73.795.361.354	21%	48%
United Kingdom	3.634.541.217.573	348.084.051.174	163.651.409.984	60.822.499.400	2%	17%
Grand Total	7.205.867.755.785	1.179.926.743.733	762.914.479.092	579.711.535.594	8%	49%

- 27 The analysis shows that also on overall for 30 companies selected net goodwill (after impairment charges) represents almost 50% of total equity, for some countries like for example Belgium and Netherlands net goodwill could be more than 150% of equity of these companies.
- 28 In addition, EFRAG Secretariat has analysed the financial statements of these 30 companies in order to find the information about goodwill allocation level for the goodwill impairment purposes. The result of the analysis showed that for 16% of

companies' goodwill was allocated on CGU level, for 44% - on segment level and for the rest – the allocation was done partly on segment, partly on CGU level.

29 The following graph represents the results:



30 The results show that almost half (44%) of the companies selected allocate goodwill on a segment level which is the maximum level permitted by IAS 36. Only 16% of them perform goodwill allocation at the level lower than a segment. This could be one of the reasons of “too little too late” issue as the larger the CGU is, the more headroom it could potentially contain, which in turn might delay the timely recognition of goodwill impairment.

Appendix II– Summary of EFRAG User Panel Discussion

Description

- 31 On 1 April 2020 EFRAG User Panel (EFRAG UP) discussed the IASB DP 2020/1 *Business Combinations— Disclosures, Goodwill and Impairment* issued on 19 March 2020 (the 'DP'). The discussion was limited to the questions on improving disclosures on acquisitions (Section 2 of the DP) and on whether to allow some identifiable assets acquired in a business combination to be included in goodwill.

Summary of the discussion

Question 2 (Section 2 – Improving disclosures about acquisitions) - to add new disclosure requirements about the subsequent performance of an acquisition.

- 32 The members of EFRAG UP generally welcomed the IASB decision to require additional disclosure requirements about the subsequent performance of the acquisition as this information was currently missing in the financial statements. They considered the IASB decision as a step forward.
- 33 However, members also expressed concerns as to the usefulness and reliability of the information to be provided.
- 34 Some members considered that additional disclosures will not help users if the solution to remove goodwill from balance sheet by amortising or impairing it will not be found. Currently in some industries one can find goodwill balances of 20 years old. In addition, these disclosures will be costly and onerous which contradicts with the IASB objective to reduce costs and complexity for preparers.
- 35 Regarding the **level of monitoring by the CODM**, the EFRAG UP members provided the following views:
- (a) not necessary to set the level, if the acquisition is monitored at a lower level it could also be very useful;
 - (b) the concerns about the objectivity of the information provided, as the independency of CODM, who usually decides on an acquisition is questionable.
- 36 Regarding the **duration of a monitoring of an acquisition**, EFRAG UP members expressed the following views:
- (a) Two years period was considered too short. If an entity is acquired in the middle of the year, it might become one financial year of disclosures. The period of three-four years was considered more reasonable;
 - (b) If goodwill amortisation would be required, it would be amortised over a longer than two years period, therefore it is not reasonable to accept such a short period of management monitoring; and
 - (c) Several UP members questioned why management should stop monitoring a major acquisition and even considered that if monitoring stops, the goodwill should be impaired.
- 37 Regarding **commercial sensitivity of information** to be provided, one EFRAG UP member noted that the most useful information is commercially sensitive and therefore doubted the usefulness of new disclosure requirements.
- 38 Regarding **forward-looking information**, members commented that progress and success of an acquisition is monitored against business plans, budgets and other forward-looking management information which is only used internally and might not consider all the circumstances.

Question 3 (Section 2 - Improving disclosures about acquisitions) - to add disclosure objectives about the benefits expected from an acquisition and how an acquisition meets management objectives.

- 39 The EFRAG UP members expressed concerns about the independency of CODM and hence the objectivity of the information provided about meeting the objectives set-up by CODM itself, as well as forward-looking nature of the information used for internal purposes as discussed above.

Question 4 (Section 2 - Improving disclosures about acquisitions) – Synergies

- 40 The EFRAG UP members highlighted that information about the synergise was an important point and that NPV of expected synergies is calculated for every acquisition.
- 41 However, they expressed concerns about the assumptions used to calculate the synergies, such as timing horizon (it is often assumed that they would last forever) or not including other important information, such as loss of market share for example. It was also noted that the share price of an entity could fall despite the forecasted synergies.
- 42 Members also noted that synergies are not defined as an accounting term and are thus subject for interpretation.

Question 5 (Section 2 - Improving disclosures about acquisitions) – Pro-forma information

- 43 The EFRAG UP did not have comments on this question.

Question 12 (Section 5 – Intangible Assets) - not to develop a proposal to allow some intangible assets to be included in goodwill.

- 44 The majority of EFRAG UP members have agreed with this proposal on the grounds that otherwise many conceptual and practical points would be needed to address and it would delay the progress of this DP. Members also noted that this question would be more relevant if the amortisation of goodwill or some of its components would be reintroduced.
- 45 However they pointed out the difference in accounting treatment between acquired and internally generated intangible assets and that solution to resolve this mismatch would be useful.

Goodwill amortisation vs impairment

- 46 Several EFRAG UP members expressed their support towards revised goodwill amortisation approach. In their opinion:
- (a) it would resolve (part of) the issue with too little too late;
 - (b) goodwill is an investment which should be recovered over a specific period of time and therefore amortised;
 - (c) sending money outside a company is a cost and should be reflected in profit or loss;
 - (d) the same approach as for PPE should be adopted;
 - (e) if the system (impairment test) is not working, one cannot disregard it as it represents already a new evidence by itself.

One EFRAG UP member favoured goodwill impairment as in his opinion goodwill amortisation charges are disregarded for management compensation purposes, might result in double counting of expenses and goodwill (or at least some of its components) organically replaced and therefore results in infinite useful life.