Question 7 (Impairment only versus Goodwill amortisation)

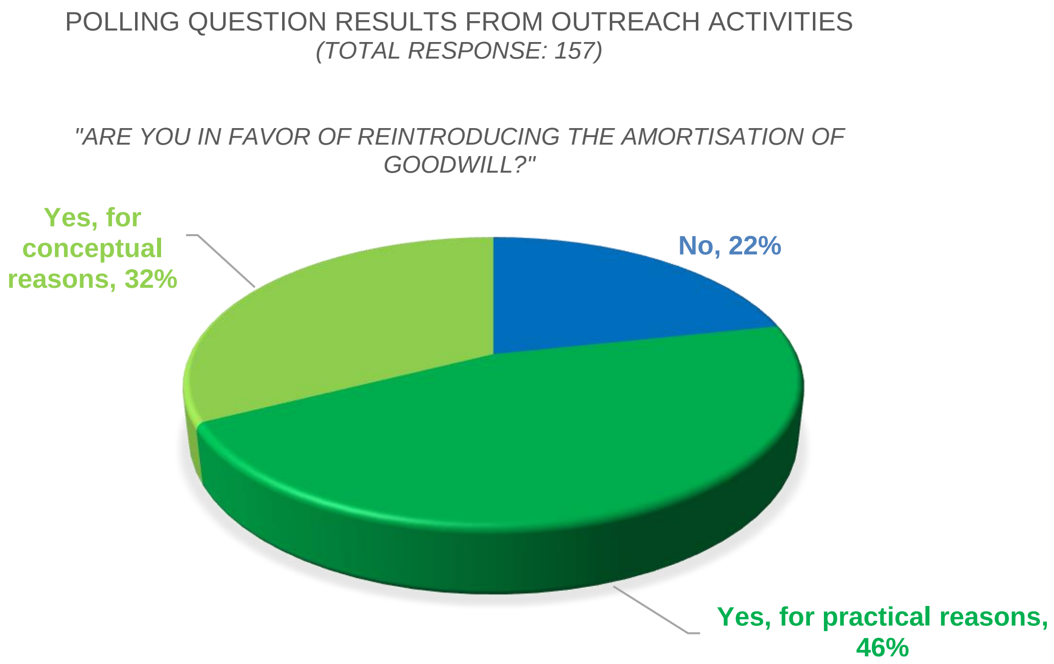
Objective

1 The objective of this paper is to take a position on Q7 (Impairment only versus Goodwill amortisation) by the EFRAG Board members. For Q7 EFRAG did not express a view in the DCL. In Q7 of the DP the IASB's asks whether it should retain the impairment-only model for the subsequent accounting for goodwill or reintroducing amortisation. The IASB acknowledges if they were to reintroduce amortisation, companies would still need to test whether goodwill is impaired.

2 EFRAG TEG recognised the observed shift to amortisation in Europe but was split and therefore preferred to describe the diverging views to EFRAG Board with indications of how EFRAG TEG had voted. Therefore, to inform the EFRAG Board and provide decision making, the appendix of the document lists in detail the feedback received before summarising it, lists the details of TEG discussion.

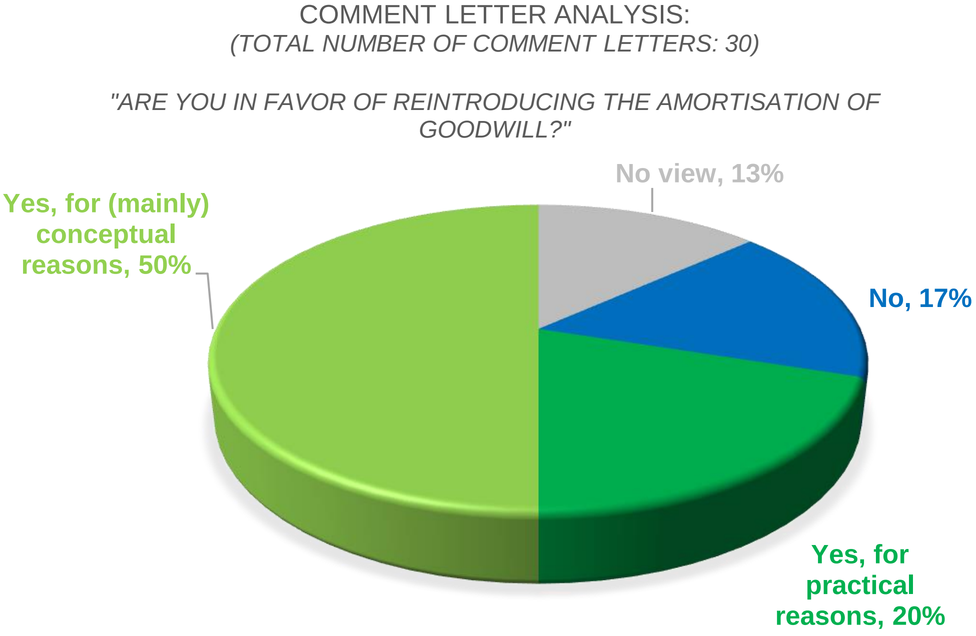
Summary of the Outreach Result

3 Majority of those in Europe that have participated in our outreaches is in favour of the reintroduction of amortisation. Previously, there has been a a slight majority in favour of the impairment only approach for conceptual reasons. From those group a shift can be observed, for an amortisation approach.



4 The comment letters received were analysed with regard to the reasons are given in preference for the different approaches. 70% was in favour of reintroducing

amortisation of which 20% of respondents expressed clearly to be in favour of the reintroduction of amortisation for practical reasons.



5 Respondents experience over the last years shows that impairments are recognised sometimes too little and too late (shielding and management over-optimism are hard to avoid) and that goodwill balances on the balance sheet are rising and reach sometimes the level of equity, or beyond. These facts have moved, for practical reasons, the majority of the respondents in favour of reintroducing amortisation. Respondents refer to:

(a) Amortisation represents a more pragmatic, cost-effective and standardised convention for the subsequent accounting for goodwill. Amortisation would mitigate the effects of shielding and management over-optimism and likely reduce the magnitude of any necessary impairments and could therefore take significant pressure off the impairment test itself.

(b) If goodwill amortisation were to be reintroduced, some of the current issues of identifying separately intangible assets could be solved by allowing some intangible assets acquired in a business combination to be subsumed in goodwill. In that regard it is noted that the identification of intangible assets acquired in a business combination was introduced as a consequence of the introduction of the impairment-only approach. In addition, amortisation would be more consistent with the accounting requirements for most other non-current assets and amortisation would allow entities to convey information (e.g. the useful life) of the components of goodwill.

(c) Scepticism that the existing impairment-only approach should remain unchanged and that improvements to disclosures (although very important) could suffice, because these alone cannot address the existing shortcomings, acknowledged by the DP itself. In addition, the existing impairment-only model is not sufficiently enforceable and auditable.

(d) The conceptual design of the impairment test has prevented excessive impairment losses during the COVID-19 pandemic. The conceptual design allows assumptions leading to optimistic terminal values which prevent an impairment loss even in economic downturns.

(e) It would be prudent to prevent the (observable) constant rise in goodwill.

6 Conceptual arguments exist for both approaches. They are listed in the DP in detail and as well in the appendix to this document. The main new arguments received during the outreach relate to the practical observations; level of judgement, concerns about opportunistic behaviour, the observed growth of immaterial assets acquired in business combinations in relation to total equity and the question about cost and benefit of yearly impairment testing.

EFRAG TEG Discussion in relation to a potential change – Recommendations to the EFRAG Board

7 EFRAG TEG members mentioned that a change in accounting for goodwill needs to be well justified. While some respondents in our outreaches express a clear need for a change some other of those in favour of reintroduction of amortisation also agree to let the IASB initially try to improve the impairment test.

8 To reflect the majority in Europe and to respect the concerns when changing an established accounting process the board could vote for the *Option 1 – Improve impairment testing, if not possible at reasonable cost – go for amortisation* and not for *Option 2 – Go for amortisation*.

9 Another approach could be to report the observed shift in Europe to the IASB without communicating a specific preference. This should be accompanied with expressing the identified shortcoming of the impairment testing and with proposals to mitigate those to let the IASB explore what the potential solutions are: To improve impairment testing and potentially if there is no satisfying solution at reasonable cost from those proposals to consider the reintroduction of amortisation. The consequences and cost of such reintroduction of the amortisation should be further explored. That includes aspects like useful life, amortisation method and transitional provisions. During the outreach it was mentioned that companies would be able to estimate a useful life for goodwill based on the information at acquisition date. Such estimation should be capped.

10 A majority of the TEG members were recommending to accompany the amortisation method by the impairment test. Impairments might be triggered for different reasons. Therefore, impairment testing remains relevant. Thus, it should be expressed that improvements to the impairment testing are relevant and necessary.

Questions to EFRAG Board members

1 What option do EFRAG Board members prefer to choose in response to Question 7 of the IASB DP on the subsequent accounting for goodwill and the possible reintroduction of amortisation?

2 Does EFRAG Board agree with the comments in relation to useful life if amortisation is reintroduced (estimation with a cap)?

3 Does EFRAG Board consider that EFRAG should propose the IASB any transitional requirements or leave this for the phase of the project as that was not specifically addressed during outreach?

4 Does EFRAG Board consider that other comments should be reflected in EFRAG's comment letter?

Appendix 1 – Detailed overview to the Feedback received and the TEG Discussion

IASB DP

5 Because of issues identified in a Post-implementation Review (PIR) of IFRS 3 the IASB research project considers the following topics identified: testing goodwill for impairment—effectiveness and cost and whether to reintroduce amortisation of goodwill. The IASB's objective is to decide whether it has compelling evidence that changes to IFRS Standards are necessary and would justify the cost of change.

6 Having concluded that the approach in IAS 36 *Impairment of Assets* for testing goodwill for impairment cannot be significantly improved at a reasonable cost, the IASB considered whether to develop a proposal to reintroduce amortisation of goodwill. Amortisation could take some pressure off the impairment test and/or provide a simple mechanism that targets the acquired goodwill directly. The PIR of IFRS 3 showed that impairment losses are not recognised on a timely basis and the impairment-only approach has a limited information value.

7 At the time of issuing the DP, there were different views on whether there is a sufficient reason to change. Different IASB members place different weight on different arguments (See par. 3.88 of the IASB DP). **A small majority (8 out of 14 Board members)** reached a preliminary view that the IASB should retain the impairment-only model. The IASB accepts that both accounting models for goodwill—an impairment-only model and an amortisation plus impairment model—have limitations: No impairment test has been identified that can test goodwill directly, and for amortisation it is difficult to estimate the useful life of goodwill and the pattern in which its value diminishes.

8 Stakeholders have always had strongly held and divergent views on whether goodwill should be required to be amortised. The DP includes a detailed list of the arguments for one or the other approaches (see par. 3.55-3.98 of the IASB DP). Simply repeating the well-known arguments for these views is unlikely to move the debate forward; therefore, the IASB would welcome feedback that provides new practical or conceptual arguments, together with evidence for these arguments and suggestions identifying arguments which should be given more weight and why (Question 7 of the DP is presented in Appendix 1 to this paper). In addition, the approach to determine the useful life of goodwill may affect whether some stakeholders support the reintroduction of amortisation or not.

9 The IASB is also interested in whether stakeholders' views depend on other components of the package of the Board's preliminary views as discussed in paragraphs IN50–IN53 of the DP.

10 Goodwill is a residual. It comprises various components. It is easy to find examples proving that goodwill consists of wasting or non-wasting components. This make it difficult to conclude on one conceptual treatment. Different accounting treatments could be applied to each component. For example, amortisation may be more appropriate for some components than for others, or it may be appropriate to write-off some components immediately. If companies identified more separate components, it might improve the possibility to allocate different components to cash-generating units in a more meaningful way. The IASB rejected this approach

because: it would increase the complexity and subjectivity and the different components of goodwill could probably not be measured reliably (see par. 3.105-3.106 of the IASB DP).

Question 7 of the DP

11 Paragraphs 3.86–3.94 of the DP summarise the reasons for the IASB's preliminary view that it should not reintroduce amortisation of goodwill and instead should retain the impairment-only model for the subsequent accounting for goodwill.

(1) *Do you agree that the IASB should not reintroduce amortisation of goodwill? Why or why not? (If the IASB were to reintroduce amortisation, companies would still need to test whether goodwill is impaired.)*

(2) *Has your view on amortisation of goodwill changed since 2004? What new evidence or arguments have emerged since 2004 to make you change your view, or to confirm the view you already had?*

(3) *Would reintroducing amortisation resolve the main reasons for the concerns that companies do not recognise impairment losses on goodwill on a timely basis (see Question 6(c))? Why or why not?*

(4) *Do you view acquired goodwill as distinct from goodwill subsequently generated internally in the same cash-generating units? Why or why not?*

(5) *If amortisation were to be reintroduced, do you think companies would adjust or create new management performance measures to add back the amortisation expense? (Management performance measures are defined in the Exposure Draft General Presentation and Disclosures.) Why or why not? Under the impairment-only model, are companies adding back impairment losses in their management performance measures? Why or why not?*

(6) *If you favour reintroducing amortisation of goodwill, how should the useful life of goodwill and its amortisation pattern be determined? In your view how would this contribute to making the information more useful to investors?*

WHERE WE ARE IN STANDARD-SETTING PROCESS

12 In the context of a PIR, the IASB will propose changing IFRS requirements only if it has enough information to conclude that a changing the Standard is necessary. The IASB will also need to decide that the benefits of such a change would outweigh the costs and disruption that would be caused by changing the requirements.

13 The current consultation is the first step in a possible change of the standard. The next step would be an ED followed by a final amendment of the standard.

EFRAG DCL

14 EFRAG observed that conceptual merits and limits can be found in both the approaches. Paragraphs 155 to 164 of EFRAG DCL did not express a position or preference but have been included in the draft comment letter to provide

constituents with a basis for their answers, complementing the arguments already included in the IASB DP.

15 In its DCL EFRAG did not form a view on whether amortisation of goodwill should be reintroduced, in combination with an impairment requirement, or whether no major changes to the current accounting for goodwill were justified. EFRAG was seeking views from constituents regarding new evidence, new arguments or new assessment on the existing evidence to support a change. The question was addressed what goodwill (or some of the parts) consists of (wasting asset(s) or nonwasting asset(s) or an accounting construct that it is not useful to have recognised in the statement of financial position).

16 EFRAG also questioned if reporting the age of goodwill would be considered useful.

FEEDBACK OBTAINED IN EFRAG CONSULTATION (Outreach events, surveys and interviews**)**

17 The results of surveys and outreach events conducted show the gradual shift versus amortisation approach mainly not for conceptual but for practical considerations. Out of the group that is conceptually in favour of the impairment only approach more and more are shifting to the amortisation approach for practical reasons. It should be noted that no direct question about reintroduction of amortisation was asked in the surveys. In the survey for preparers it was mainly addressed what goodwill consists of. Some of the preparers expressed their view on reintroduction of amortisation vs. impairment-only in the interviews supporting the survey or being given instead of filling out the survey.

18 Preparers surveys show that preparers have mixed feedback about the composition of goodwill. In particular, 31.0% considered it as a wasting asset and 27.6% considered it as a non-wasting asset. However, the 41.4% of respondents considered that it is only partially wasting, and it would depend on specific circumstances. Furthermore, the 56.7% believed the goodwill is a real economic asset, while the remainder considered it as an accounting construct.

19 In relation to the debate about whether goodwill should be amortised, the question was raised in the survey if there is any new evidence for a change (please note that 10 out of the 30 preparers in the survey were French). 69.0% considered that there is no new evidence or arguments (or new assessments of existing evidence) that should be taken into account when assessing whether the amortisation should be reintroduced. However, the remaining 31.0% based their response on the following arguments:

(a) The increased state of uncertainty in the markets;

(b) The impairment model does not work in practice and cannot be improved significantly;

(c) The weight of goodwill on total assets in companies' balance sheet has dramatically increased;

(d) In the financial industry goodwill is deducted from solvency capital for regulatory reporting;

(e) Comparability with some accounting standards applying amortization, such as Japanese GAAP.

20 Feedback provided by preparers that were giving an interview instead of filling out a survey (6 preparers) showed a slight majority in favour of goodwill amortisation being reintroduced. Some of the preparers during these and interviews that were given in addition to filling out the survey commented that amortisation would not have any beneficial information for investors and would not eliminate the involvement of management's judgement (i.e. when determining the useful life). However, some others supported it based on practical reasons and on the wasting nature of goodwill. Furthermore, some comments showed that splitting goodwill into components was considered as a grounded technical solution, but it would be considered complex and judgemental. Some of the preparers were still undecided which direction to go.

21 Public Outreach events addressed the question whether amortisation should be reintroduced or the impairment-only approach being retained. The majority of respondents <u>in each event</u> were in favour of reintroduction of amortisation.

(a) 16 October (mixed geographic composition of participants, 42 respondents): 35% would favour reintroduction of the amortisation for conceptual reasons (as goodwill is a at least partially a wasting asset), 48% would favour reintroduction of the amortisation for practical reasons (to reduce carrying amounts of goodwill and pressure on the impairment test), 12% for conceptual reasons prefer an impairment-only approach and 5% considered that there are no new evidences to support a change;

(b) 23 October 2020 (outreach with Denmark, 19 respondents mainly from Denmark): 42% would favour reintroduction of the amortisation for conceptual reasons (as goodwill is a at least partially a wasting asset), 42% would favour reintroduction of the amortisation for practical reasons (to reduce carrying amounts of goodwill and pressure on the impairment test), 16% for conceptual reasons prefer an impairment-only approach;

(c) 2 November and 20 November 2020 (joint outreach event in Germany, 40 participants with different background (mainly preparer, academics, auditors, professional organisations) all that were speaking were in favour of reintroduction of the amortisation mainly for practical reasons;

(d) 9 November 2020 (outreach with Norway, 34 respondents mainly from Norway): 29.4% would favour reintroduction of the amortisation for conceptual reasons (as goodwill is a at least partially a wasting asset), 44% would favour reintroduction of the amortisation for practical reasons (to reduce carrying amounts of goodwill and pressure on the impairment test), 21% for conceptual reasons prefer an impairment-only approach and 6% considered that there are no new evidences to support a change;

(e) 12 November 2020 (User outreach event) it was discussed only between panellists, mixed views were provided. Panellists discussed the usefulness of the recognition and measurement of goodwill to investors. Almost all panellists agreed that in general goodwill will be ignored by investors and all the panellists agreed that goodwill amortisation will be ignored by investors. One panellist suggested to explore the option to enhance the current impairment test further instead of reintroducing the goodwill amortisation;

(f) 24 November 2020 (outreach with Portugal; 66 respondents mainly from Portugal (87%)) – 45% of respondents were in favour of reintroduction of amortisation for practical and 29% - for conceptual reasons. 23% of respondents were in favour of keeping the impairment test for conceptual reasons as it provides more relevant information for the users of financial statements and 3% of respondents considered that there was not enough proofs that a major change was needed to the current accounting;

(g) 25 November 2020 (outreach with Italy, 44 respondents): 63% of the respondents would favour reintroduction of goodwill. However, the panellist participating to the discussion, even if recognising some application issues and limitations, recognised some benefits and the relevance of the information provided by the current impairment framework.

22 In other closed outreach meetings with users, standardsetters, professional organisations or EFRAG working groups mixed views were provided but also with the trend towards amortisation for practical reasons. As the main shortcomings of the impairment test shielding and management overoptimism were discussed. It was partly mentioned as being part of the system but could be used for opportunistic behaviour (e.g. good business was mixed with bad business in order to create a new unit of account that would avoid impairment).

FEEDBACK FROM COMMENT LETTERS RECEIVED

23 A majority of comment letters (18 out of 26; 69%)[1] received have been in favour of reintroduction of amortisation of goodwill. Some of the comment letters urged the IASB to reintroduce amortisation as soon as possible to ensure proper accounting outcome. Only three respondents (11%) were in favour of retaining the current model. One user organisation suggested neither to amortise nor to do impairment testing.[2] Four respondents did not express a view.

24 Some of those respondents in favour of reintroduction of goodwill amortisation referred only to conceptual reasons. The respondents agreed with the IASB conclusion that impairment model was not working as intended and cannot be improved at a reasonable cost. Thus amortisation was considered by others a practical solution. From a conceptual point of view these respondents considered goodwill to be a (partly) wasting asset which should be amortised to reflect its consumption.

25 The amortisation would also provide a mechanism to eliminate increasing goodwill balances from the balance sheet, that, as some argue, do not reflect the incremental value of the acquired business a couple of years after acquisition. Amortisation would help to avoid the volatility in profit or loss caused by impairment charges.[3]

26 Feedback received suggested that management could estimate the useful life based on a goodwill consumption pattern or the payback period of the investment and the amortisation pattern - on the basis of the realisation of the expected synergies. The rebuttable presumption of 10 years amortisation period in line with EU Accounting Directive can be used, if the useful life cannot be reliably estimated

[1] four respondents referred to a majority within the decision making body. One respondent was requesting an accounting policy choice.

In addition three out of four comment letter received after the TEG meeting are in favour of reintroduction of amortisation of goodwill. So the total would be 21 out of 30; 70%.

[2] Mixed views in the organisation.

[3] The strong growth in goodwill balances is documented in EFRAG's quantitative study What do we really know about goodwill and impairments? (2016).

in particular circumstances. Straight-line amortisation could be used as a pragmatic, transparent and cost-effective solution.

27 The four respondents not expressing a view acknowledged that both approaches had their advantages and disadvantages and absence of the new compelling evidence to support one of them.

28 Three respondents, were in favour of keeping the existing impairment model on the grounds that the impairment test was the only conceptually correct model, that problems lied within its application and that it provided relevant and useful information to users and investors. These respondents also noted that no new arguments were provided to justify a change. In their view the impairment model worked as intended and no significant facts or circumstances were identified that would lead to reconsider the conceptual arguments.

29 There was also a proposal of accounting policy choice between amortisation and impairment model and the views against such a choice as negatively impacting comparability between the entities. One organisation where the majority favoured reintroduction of amortisation suggested treating goodwill like other intangible assets. That means determining whether there is a finite useful life (amortisation) or an infinite one (impairment-only).

30 A majority in one user organisation expressed the view not to be in favour of goodwill amortisation as that would not provide meaningful information. On the other hand they did not regard testing goodwill for impairment as either robust or desirable. Some of the organisations participants favour a broader annual test of the market value of an acquisition, with goodwill being lowered if necessary. One of member of this user organisation views goodwill as a heterogeneous mixture and that each element should be treated differently: expected synergies should be amortised.

SUMMARY OF FEEDBACK RECEIVED

Generally

31 The during the outreach period observed shift versus amortisation approach for practical reasons was confirmed by the comment letters received. The group of impairment-only supporters is becoming clearly smaller. Former impairment-only supporters are changing their opinion for practical reasons and starting to consider amortisation as a pragmatic option to address the issues identified with the impairment test. There is a visible change of opinion in Europe shifting towards the amortisation.

32 There are many of the opinion that conceptually the impairment only model is the right approach. The following arguments are provided by the proponents of impairment only approach:

(a) Goodwill is neither a wasting asset with a finite useful life nor an accounting construct but, on the contrary, a genuine “asset representing the future economic benefits arising from the assets acquired in a business combination that are not individually identified and separately recognised” (IFRS 3). It is therefore not possible to predict either the useful life of acquired goodwill or an amortisation pattern, unlike other intangible and tangible assets, and this makes any amortisation charge at best completely arbitrary, and likewise also the remaining balance sheet value.

(b) Goodwill is part of the acquisition price paid and is therefore an indicator for the value of the future free operating cash flows (at least seen through the eyes of the acquirer). Goodwill is an asset, is part of "invested capital" and determines thus whether a reporting entity is profitable or not.

(c) Amortisation would result in the statement of profit or loss (and reported EPS) being less useful for predicting future profitability. This is because, for a period of time, both the cost of acquiring the goodwill in the form of amortisation expenses and the cost of maintaining the acquired goodwill (which cannot be capitalised) will affect profit or loss.

(d) The assumptions used in calculating goodwill amortisation (for example the useful life) are not particularly verifiable, and therefore, some could argue that the goodwill impairment test is more verifiable.

(e) Amortisation would not properly reflect the costs related to the benefits generated in an acquired business, particularly not if the useful life of goodwill is indefinite. The impairment approach would be useful to provide information about whether the management has paid too much when acquiring an entity or whether the acquisition meets the expectation.

(f) If goodwill is considered an accounting convention, goodwill amortisation would equally not represent any economic factors. It would therefore not be useful to include goodwill amortisation in the statement of profit or loss.

(g) 'Too little too late' is not an issue pervasive enough to trigger a change in the accounting for goodwill and there is no evidence at this stage to conclude that the test fails to provide timely information.

(h) Management judgements and estimates provide useful information to users about how an entity's management views its business and how it thinks business will unfold—this should not be conflated with management's bias and overoptimism.

(i) If goodwill is reduced in value by arbitrary amortisation over time, the value of an impairment charge will only partially reflect the impairment event itself. This conveys less relevant information to the investors, and it provides a poorer basis for management to be accountable.

(j) The argument that amortisation provides useful information about the consumption of goodwill depends on the presumption that entities would not apply a default amortisation period, even when the maximum life is rebuttable. However, previous experience suggests that many entities did use the rebuttable presumption of a maximum life as a default period.

(k) Preparers, auditors and users have got used to the existing treatment of goodwill, and any changes to this are likely to be costly. No cost-benefit analysis of the switch to amortisation has been carried out.

(l) The implications and cost of the reintroduction of amortisation may be so important that the threshold to make that accounting change would be very high. Practical arguments supporting amortisation are unlikely, alone, to exceed that threshold.

33 There is also a large group that sees conceptual merits in amortisation, such as:

(a) Goodwill is (at least partly) a wasting asset and the amortisation would reflect goodwill consumption. It is also a practical solution that targets goodwill directly unlikely to impairment test for cash generating units.

(b) Goodwill does not represent anything 'real' but is an accounting construct. For example, a portion of goodwill may result from the effects of deferred tax liabilities or as a result of some mismatching. It could even be argued that as goodwill is a residual value, it is not really an asset. It is therefore not useful to have goodwill on the statement of financial position and goodwill should therefore be amortised for it to be gradually removed from the statement of financial position.

(c) Amortisation of goodwill could reduce volatility in profit or loss as it reduces the risk of less predictable impairment losses. In addition, amortisation could provide to preparers the opportunity to convey information about the components of goodwill.

(d) The amortisation model would remove the differences between companies growing organically and by acquisition and therefore would improve the comparability.

(5) The amortisation would provide a simple mechanism to eliminate increasing goodwill balances from the balance sheet. The results of recent studies[4] and research suggest that the impairment-only model does not reflect the economic life of goodwill, that in some cases the implicit lifetime of goodwill reaches 100 years and more, that the value relevance of goodwill rapidly decreases with age and that impairment-only model provides a potential for earnings management.

(6) The impairment-only approach reinforces the pro-cyclicality of net income. It is normal that the average profitability is higher in economic upturns than in downturns. When goodwill is expensed only through impairments, the losses tend to accumulate in economic downturns and this effect will exacerbate the normal cyclicality. With amortisation, the accounting charges would be more evenly distributed over upturns and downturns.

(7) The measurement of recoverable amount is often highly sensitive to unverifiable assumptions about the terminal growth rate. Amortisation would relax this concern, slightly improving the level of verifiability (for example some could argue that it is easy to verify whether the goodwill amortisation is calculated correctly).

34 However, the experience over the last years shows that impairments are recognised sometimes too little and too late (shielding and management over-optimism are hard to avoid) and that goodwill balances on the balance sheet are rising and reach sometimes the level of equity, or beyond. These facts make some of the members of the first group consider practical reasons for reintroduction of amortisation, such as:

(a) The amortisation represents a more pragmatic, cost-effective and standardised convention for the subsequent accounting for goodwill. Amortisation would mitigate the effects of shielding and management over-optimism and likely reduce the magnitude of any necessary impairments and could therefore take significant pressure off the impairment test itself.

(b) If goodwill amortisation were to be reintroduced, some of the current issues on identifying separately intangible assets could be solved by allowing some intangible assets acquired in a business combination to be subsumed in goodwill. In that regard it is noted that the identification of intangible assets acquired in a business combination was introduced as a consequence of the introduction of the impairment-only approach. In addition, amortisation would be more consistent with the accounting requirements for most other non-

[4] Patloch-Kofler and Roider (2020), ASBJ and HKICPA Staff paper (ASAF meeting, April 2020, AP 1A); Bugeja and Gallery (2006), Ojala et al (2007)

current assets and amortisation would allow entities to convey information (e.g. the useful life) of the components of goodwill.

(c) Scepticism that the existing impairment-only approach should remain unchanged and that improvements to disclosures (although very important) could suffice has been mentioned, because these alone cannot address the existing shortcomings, acknowledged by the DP itself. In addition, the existing impairment-only model is not sufficiently enforceable and auditable.

(d) The conceptual design of the impairment test has prevented excessive impairment losses during the COVID-19 pandemic. The conceptual design allows assumptions leading to optimistic terminal values which prevent an impairment loss even in economic downturns.

35 It should be noted that the results of the polling questions during the outreaches described in paragraph 21 showed the strong preference for amortisation be it for conceptual or for practical reasons.

36 EFRAG notes some other minor views which range from goodwill never impair and should always remain on the balance sheet to goodwill should be written-off directly through equity after an acquisition. There are also some views in-between: goodwill has an information value for the first three-five years after an acquisition, after that it could be written-off through OCI. However, these views are not supported by the majority of respondents.

Views of users

37 The views of users are a bit more split on this topic, with several being in favour of reintroduction of amortisation and some – for maintaining the impairment test and few proposing a different way by not recognising amortisation nor performing an impairment test. For example, according to a survey performed by the Austrian standard setter, 68% of Austrian analysts and investors stated to prefer goodwill amortisation over the current impairment-only approach. Swedish users also lean towards amortisation model. The Spanish and the French user organisation and one European User organisation were in favour of the reintroduction of amortisation. The Belgium user organisation is in favour of retaining the impairment only model. One international user organisation provided mixed views with a majority proposing not to reintroduce amortisation and not to do impairment testing (as not reliable).

38 The users which are in favour of reintroduction of amortisation would only consider it if it will be accompanied by the impairment test.

39 In general there are doubts from the users that impairment testing is working properly as intended. Goodwill is not tested directly (or even indirectly), instead carrying value of CGU is tested. It needs to dealt with shielding and management overoptimism.

Views of the financial services sector

40 The feedback received from the financial services sector indicates that majority would support the reintroduction of amortisation on both practical and conceptual reasons. One respondent suggested that an accounting policy choice between impairment and amortisation model accompanied by disclosures could be a solution.

41 It should be noted that goodwill is already deducted from CET1 and Solvency capital, and therefore its accounting treatment does not have an impact on regulatory capital requirements of financial institutions.

THE EFRAG SECRETARIAT PROPOSAL to EFRAG TEG

42 The EFRAG Secretariat considered the variety of responses received with the arguments in favour and against the reintroduction of amortisation, including the shortcomings of an amortisation method and concluded that, although the amortisation model has an arguably less strong conceptual basis compared to the impairment-only model, it does have significant advantages in terms of simplifications of goodwill accounting, addressing 'too little too late issue', improving comparability between entities growing organically and by acquisition and dampening any procyclical effects of the current accounting model.

43 The reintroduction of amortisation will take pressure away from the impairment test and would allow to simplify and improve it as described in EFRAG's response to Question 6. Many respondents suggested that amortisation of goodwill should be accompanied by either an indicator-only impairment model or by annual quantitative impairment test. Such approach would be consistent with the current accounting for other intangible assets.

44 The EFRAG Secretariat has reservations that an impairment-only model could be significantly improved at a reasonable cost and that proposed new disclosure requirements would be sufficient to address all the identified shortcomings.

45 Feedback received suggested that management could estimate the useful life based on a goodwill consumption pattern or the payback period of the investment and the amortisation pattern – on the expected benefits and synergies (with a cap or rebuttable presumption for a useful life).

46 EFRAG received mixed feedback on whether new MPMs will be created to add back goodwill amortisation expense and on the usefulness of providing the age of goodwill.

47 The EFRAG Secretariat also acknowledges arguments supporting the impairment-only model, such as that goodwill is non-wasting asset and an indicator for the value of the future free operating cash flows and future economic benefits, some of which can have indefinite lives (like access to markets for example). It is part of "invested capital" and determines whether a reporting entity is profitable or not.

48 The impairment test holds management to account, better reflects the economic reality and the stewardship and accountability objective of financial reporting whereas an amortisation charge is an arbitrary value which has no value relevance and will be ignored by investors.

49 It should be noted that the cost of changing the existing model is likely to be high and the cost-benefit analysis of the switch to amortisation should be carried out before making the decision. The transitional arrangements such as retrospective or prospective application should be discussed in depth.

Option 1 – Improve impairment testing, if not possible at reasonable cost – go for amortisation

50 Taking into account the above, EFRAG acknowledges the conceptual and practical arguments for both impairment only model and reintroduction of amortisation and notes that more and more voices are raised in favour of the latter. However, acknowledging the conceptual strength of the impairment model, EFRAG suggests the IASB further explore improvements to the existing impairment test. Should the IASB reach a conclusion that the proposed improvements could not address the identified existing shortcomings of the impairment model at a reasonable cost, EFRAG is of view that the amortisation of goodwill should be reintroduced to mitigate the identified shortcomings detected during the PIR of IFRS 3.

Option 2 – Go for amortisation

51 Taking into account the above, EFRAG acknowledges the conceptual and practical arguments for both impairment only model and reintroduction of amortisation and notes that more and more voices are raised in favour of the latter. EFRAG agrees with the IASB conclusion that the existing impairment test cannot be significantly improved at a reasonable cost and considers that the proposed new disclosure would not be sufficient to address the identified shortcomings. Therefore, EFRAG is of view that the IASB should consider the reintroduction of goodwill amortisation as a transparent and cost-effective solution. The cost of such reintroduction of amortisation should be inquired.

EFRAG TEG DISCUSSION and DECISION on 16 DECEMBER 2020

52 EFRAG TEG members presented mixed views on the issue of subsequent accounting for goodwill with a slight majority in favour of reintroduction of amortisation.

Eight out of fifteen EFRAG TEG members present supported Option 2 to go for reintroduction of amortisation. Members in favour of this option provided the following reasons for their choice:

(a) The combination of amortisation and impairment is the best system addressing the issues of diminishing goodwill balances and reflecting the failed investment;

(b) Goodwill is a wasting asset with its value declining over time which should be reflected;

(c) Non-wasting assets have no support in the academic thinking and research;

(d) The amortisation provides the same treatment as for other tangible and intangible assets;

(e) The amortisation ensures comparability between companies growing organically and by acquisition; and

(f) Practical solution to address the recognised issues with the current impairment test and impossibility to improve it to meet market expectations.

53 Two of the EFRAG TEG members in the minority view (Option 1) in principle favoured Option 2 but supported Option 1 as a first step for political reasons.

54 The two and one other EFRAG TEG members supporting Option 1 provided the following reasons for their choice:

(a) The need to define the impairment test which would work better;

(b) Strategically it is the best option as it presents a neutral position given the variety of views;

(c) The disclosures provided by the current impairment test are useful and have to be kept; and

(d) The impairment test is not working perfectly because of implementation issues, but is conceptually the right solution.

55 One EFRAG TEG member considered that there were good arguments for Option 1 (mainly conceptual) and Option 2 (mainly practical). Improvements to the current impairment testing were necessary from his point of view. He proposed to report openly in the comment letter the current state of the discussion in Europe.

56 Two EFRAG TEG members were against reintroduction of amortisation and in favour of keeping the existing impairment test subject to improvements proposed by EFRAG to address application issues. In those members' view there was no new compelling evidence that the change was necessary again (after changing from amortisation to the impairment only model). One of those members suggested that the IASB should try to improve the impairment test and if this would not be possible, to consider other options.

57 One EFRAG TEG member noted that goodwill loses its relevance for the analysts approximately three to five years after the acquisition. Therefore, the following option could be considered: to perform the impairment test for the first five years after the acquisition and then to write-off goodwill completely through the OCI. This would increase comparability between entities growing organically and by acquisition and give information on a failure of an acquisition (if the test is applied in an appropriate way). This member was not in favour of an approach proposed by a user organisation that goodwill should always stay on the balance sheet in order to permanently reflect the invested capital. And he did not support the reintroduction of amortisation.

58 One observer suggested that the IASB should first consider the proposals for improvements of the impairment test and then, should it not be practicable, the return to amortisation.

59 In case of reintroduction of amortisation several EFRAG TEG members suggested that accompanying the amortisation by full scale impairment test would be the better option than by the indicator-only approach.

60 One EFRAG TEG member preferred that amortisation would be accompanied by the indicator-only approach.

61 In relation to the useful life and amortisation period it was recognised that this was judgemental and a cap would be useful to address such judgement. One EFRAG TEG member suggested that amortisation period should not be longer than 10 years and that transitional requirements should not be discussed at this stage of the project.

62 Given the mixed views of the members EFRAG TEG decided to leave the decision on the Question 7 to the EFRAG Board. EFRAG TEG requested the EFRAG Secretariat to inform the EFRAG Board about the details of the discussions and the arguments heard during the Outreach period.

ALIGNMENT WITH US GAAP

63 Currently IFRSs and US GAAP are aligned in not requiring amortisation. If IFRS would require goodwill amortisation, but US GAAP would not do so, a potential competitive issue could arise due to the different accounting treatment.

(a) From one side, amortisation results in expected recurring costs to be factored indirectly in the price the buyer is willing to pay;

(b) At the same time, the impairment-only approach increases the risk of future impairment losses which may be interpreted as a failure of the acquisition and, thus may result negatively impact on an investment decision.

64 The FASB ran a consultation in July/October 2019 on possible changes on accounting for goodwill and intangible assets, including possible amortisation. The main reason to start the project was the cost/benefit profile of the impairment test and the project primarily aimed to investigate ways to reduce the cost for preparers. The feedback received shows that stakeholders were divided on amortisation

versus impairment-only. For both views, conceptual and practical arguments have been put forward by the respective supporters.

65 The project is currently in the re-deliberation phase, which will result in an Exposure Draft. The latest decisions were taken in July 2020, when the FASB asked the staff to explore adding amortisation to the goodwill impairment model, including the amortisation method and period (systematic/by default or judgemental).

66 The IASB and the FASB had a joint education meeting in November 2020.

(a) The FASB (staff) noted that an amortisation approach would not be based on a strong conceptual view as there is no conclusion whether goodwill is a wasting asset or not. However, at the same time the goodwill amount on the balance sheets of companies is increasing, is aged and the information value of impairment tests becomes significantly lower in the longer term. Additionally, the cost-benefit and current shortcomings of the impairment test are taken into account;

(b) The FASB Board members argued that conceptually, since the company paid for the goodwill, at some point it should be impacting the income statement, as the payment relates to future earnings;

(c) The FASB Board members further noted that the accounting for and presentation of any amortisation expense in the income statement or through other comprehensive income (OCI) still needs to be considered; although the accounting through OCI is not expected to get much support;

(d) The IASB Board members emphasised that amortising based on an arbitrary period will result in expensing the premium paid during an acquisition without holding the management to account for their decisions.

(e) Furthermore, both the IASB and the FASB received feedback from some stakeholders that the amortisation approach would be preferred only if there is convergence between the US GAAP and IFRS Standards.

THE EFRAG SECRETARIAT PROPOSAL to THE EFRAG BOARD

67 Majority of those in Europe that have participated in our outreaches seems to be in favour of the reintroduction of amortisation. EFRAG TEG members mentioned that to justify a change in accounting for goodwill very good reasons are required. While some respondents in our outreaches express a clear need for a change some other of those in favour of reintroduction of amortisation also agree to let the IASB first try to improve the impairment test. To reflect the majority in Europe and to respect the concern not to change easily an established accounting process the board could vote for the **Option 1**.

68 That would address as well the concerns around the effectiveness of impairment testing and that impairment testing remains important to accompany any amortisation model.

69 The prepared FCL includes in detail the feedback received (paragraph 118-154).

70 **Option 2** reflects the majority of the European views. It could be accompanied with the suggestions to the IASB to address the challenges of useful life and amortisation pattern as well as transitional requirements (retrospective versus prospective application). These topics the IASB could address in the next phase of the project.

Other possibilities

71 **Not to express a view**: to describe the feedback received from the outreach events and comment letters, acknowledge the variety of views and merits of each of them

and to state that it is difficult to make a choice. One of the board member expressed in the last meeting that this would be from his point of view not a preferred outcome as the DP already lists extensively and in detail the conceptual arguments for one and the other approach and the IASB investigated potential improvements to the impairment model. Goodwill is not tested directly, the outcome of the PIR shows that it is not working as intended and therefore practical considerations should play a role.

72 The minority approaches should not be considered

(a) To stay with the current impairment test subject to improvements, as there are no compelling evidence for a change (French view);

(b) Not to impair goodwill at all;

(c) To write-off goodwill to equity immediately after the acquisition;

(d) To apply the impairment model for the first five years after the acquisition and to write-off goodwill completely through OCI after.