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## **Goodwill - Draft Comment Letter Cover Note**

### **Objective**

- 1 The objective of this session is to discuss EFRAG draft comment letter ('DCL') on the IASB's Discussion Paper *2020/1 Business Combinations—Disclosures, Goodwill and Impairment* issued on 19 March 2020 (the 'DP'). The IASB asks for comments on the DP by 15 September 2020.

### **Background**

- 2 The IASB is investigating how companies can provide users of financial statements with better information about business combinations at a reasonable cost. 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.
- 3 Users have indicated that they want to understand the factors that determine the amount a company has paid for an acquired business and whether that acquisition has been successful subsequently.
- 4 In addition, the IASB learned from stakeholders that:
  - (a) goodwill impairment losses are being recognised 'too little too late';
  - (b) the 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.
- 5 One of the causes of the 'too little too late' goodwill impairment issue is the shielding effect created when acquired goodwill is replaced by internally generated goodwill. Another potential cause is that the impairment test does not directly measure the recoverable amount of the goodwill (but the measurement is based on the recoverable amount of the CGU or group of CGU(s) to which it is allocated).
- 6 In order to address the 'shielding effect', the IASB developed an approach called 'the headroom approach'. However, this approach was considered overly complex and has not been explored further by the IASB.
- 7 The IASB's preliminary view is that it would not be possible to make the impairment test significantly more effective. Accordingly, the IASB has 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.
- 8 In its June 2019 meeting the IASB expressed its tentative views on the above project objectives:
- (a) IASB supported requiring disclosures of subsequent performance of the acquired business, and targeted improvements to existing requirements.
  - (b) IASB agreed moving to an indicator-only approach requiring impairment testing of goodwill only when there are indicators of possible impairment.
  - (c) A close majority of the IASB members (8/14) agreed to retain impairment-only approach. However, they agreed to explore in the discussion paper both approaches providing arguments in favour and against.
  - (d) IASB agreed to allow the inclusion of cash flows from future restructurings or future enhancements in the calculation of value in use.
  - (e) IASB agreed to remove the explicit requirement to use pre-tax inputs to estimate value in use.
- 9 EFRAG TEG discussed the IASB tentative decisions in its meeting in January 2019:
- (a) EFRAG TEG members supported the objectives of the suggested disclosure requirements, however they had some reservations about practical aspects of the requirements.
  - (b) EFRAG TEG did not support the indicator-only approach to save costs. A majority of EFRAG TEG members would support this proposal, but only if goodwill amortisation is introduced.
  - (c) A majority of EFRAG TEG members have previously stated that if the discussion about amortisation would be reopened, they would be in favour of reintroducing goodwill amortisation (in combination with an impairment approach – indicator).
  - (d) EFRAG TEG supported to allow the inclusion of cash flows from future restructurings or future enhancements in the calculation of value in use.
  - (e) EFRAG TEG agreed to remove the explicit requirement to use pre-tax inputs to estimate value in use.
- 10 The EFRAG TEG and User Panel members in its March 2020 joint meeting, discussed the tentative views expressed by EFRAG TEG in January 2020. EFRAG User Panel members indicated that the current impairment model was broken among other things due the shielding effect creating the too little and too late issue. Members listed some possible solutions in addition to reintroducing goodwill amortisation (on which different views were expressed, should the issue be reopened) as for example improving the guidance on goodwill allocation to CGUs, reallocating goodwill to another unit of account and on derecognition in case of a disposal.

- 11 EFRAG TEG and EFRAG User Panel members generally agreed that additional disclosures can help assessing whether a business combination was a good investment decision and whether, after the acquisition, the acquired business was performing as expected. However, members highlighted that these disclosures would only be relevant for a short period after the acquisition (e.g. for the three first years). Lastly EFRAG TEG and EFRAG User Panel members considered that the IASB's tentative proposal to include a subtotal of equity before goodwill would not provide any added value.
- 12 EFRAG TEG members in its March 2020 meeting discussed whether, and if so, what additional evidence/information should be collected before EFRAG issues its final comment letter on the IASB's forthcoming discussion paper on goodwill. Members suggested that a proposed questionnaire for preparers should try to focus on understanding the reasons for having amortisation and ask for criteria and factors that preparers would apply to determine whether an asset would be a wasting asset. In addition, they suggested that such questionnaire should include questions relating to feasibility of some disclosures, for example, providing more information on a business combination.
- 13 The EFRAG Board discussed the directions of EFRAG's draft comment letter at its meeting in March 2020.
  - (a) The Board discussed whether EFRAG TEG should form a view on whether goodwill should be amortised. They expect that constituents raise the issue in their comment letters to EFRAG. As such, they consider appropriate that a question is asked to constituents, in particular whether compelling evidence exists to support such a relevant change. Some members observed that on the topic strong views exist but there is no real new evidence that a change is needed. They agreed not to include a tentative position in EFRAG's draft comment letter on whether goodwill should be amortised or not. Instead the draft comment letter should include a question to constituents on their views and additional evidence in support of their views.
  - (b) EFRAG Board members did not have comment with the tentative views expressed by EFRAG TEG on other issues expected to be covered in the IASB's discussion paper and on the additional issues related to the allocation of goodwill to cash generating units that were considered by EFRAG TEG. One member mentioned the opportunity to comment on auditability of the disclosures.
- 14 The IASB published the DP on 19 March 2020. Based on EFRAG TEG's previous discussions the EFRAG Secretariat has drafted a draft comment letter (notes to constituents will be drafted by EFRAG secretariat after this TEG meeting). As the exact wording of the DP was unknown at the time EFRAG TEG had its previous discussions, the drafted comment letter includes sections that have not been agreed by EFRAG TEG.
- 15 The questions for EFRAG TEG are included in the drafted draft comment letter (Agenda Paper 05-02).

**Agenda Papers**

- 16 In addition to this cover note, the following papers have been provided for this session:
- (a) Agenda paper 05-02 – EFRAG DCL on the DP (*As the DP was issued on 19 March 2020, this paper will not be available until a few days before the EFRAG TEG meeting*); and
  - (b) Agenda Paper 05-03 – the DP (Background purposes).