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Evolution of goodwill for entities listed on EU exchanges - Issues Paper

Objective

- 1 During the finalisation of the comment letter ('the FCL') on the *Business Combinations: Disclosures, Impairment and Goodwill* DP some EFRAG Board members were concerned about comments made around increases in reported goodwill. There seemed to be two positions:
 - (a) anecdotal evidence that goodwill balances have been increasing significantly since the introduction of IFRS (which coincided with the abolishment of the amortisation of goodwill); and
 - (b) previous research by EFRAG and others reflecting that goodwill relative to other balances such as total assets, total equity or market capitalisation have not been significantly impacted.
- 2 Therefore, the EFRAG Secretariat updated its previous research. The information presented in the main body of the paper is presented in tabular format in Appendix 3.
- 3 Goodwill, total equity and total assets are developed under a specific accounting regime (IFRS) and are therefore comparable and can be used for tracking relative changes. Market capitalisation is driven by several factors outside accounting requirements and is therefore more volatile compared to total assets and total equity. It is used in this presentation to provide an additional basis for comparison to create a broad and complete picture.

Results from research performed

Sample selection

- 4 The selected sample consists of 1,477 companies listed on exchanges in the European Union. The sample was determined by extracting (from Eikon Refinitiv) those listed entities with total assets exceeding EUR 1 at its 2019 financial year-end, having reported a goodwill balance in any of the seven years under review.

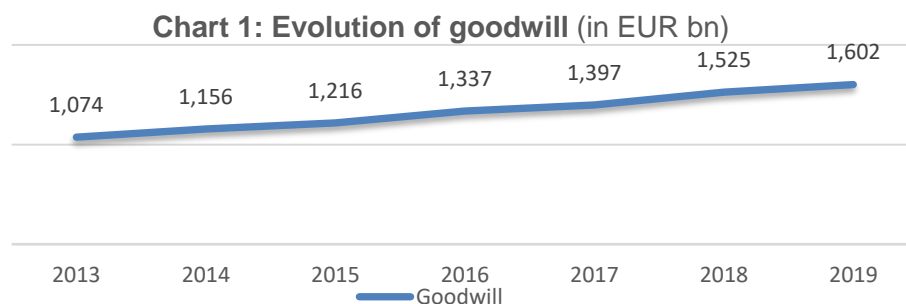
Limitations

- 5 The limitations mentioned in the previous study and summarised in paragraph 19 are also relevant to this part of the paper.
- 6 The EFRAG Secretariat also notes additionally the limited time for the 2021 research and the lack of input and review from other EFRAG sources such as the API, the Academic Panel and EFRAG TEG.
- 7 It is therefore important to note that while due care has been exercised, some data inconsistencies or errors may not have been detected, investigated or amended during the limited time available for this research.

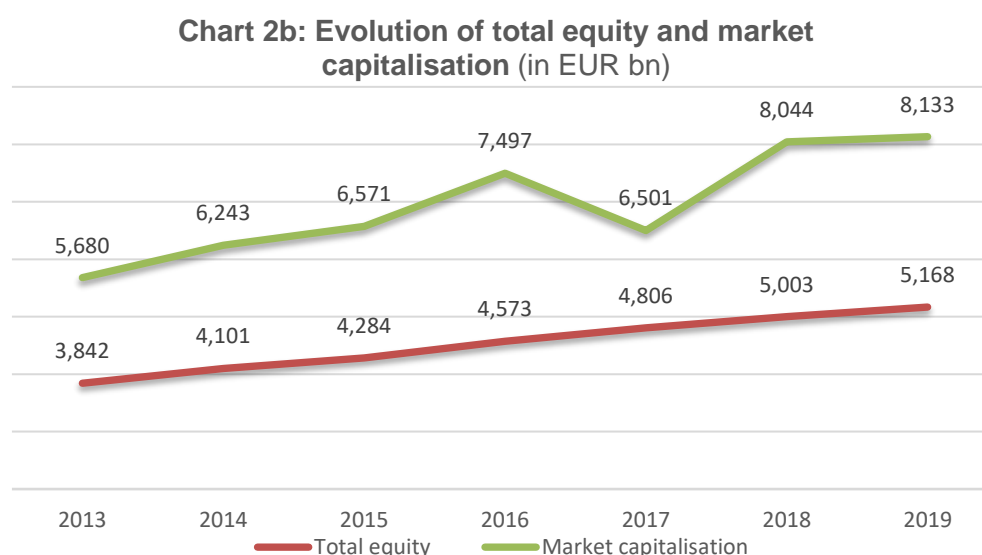
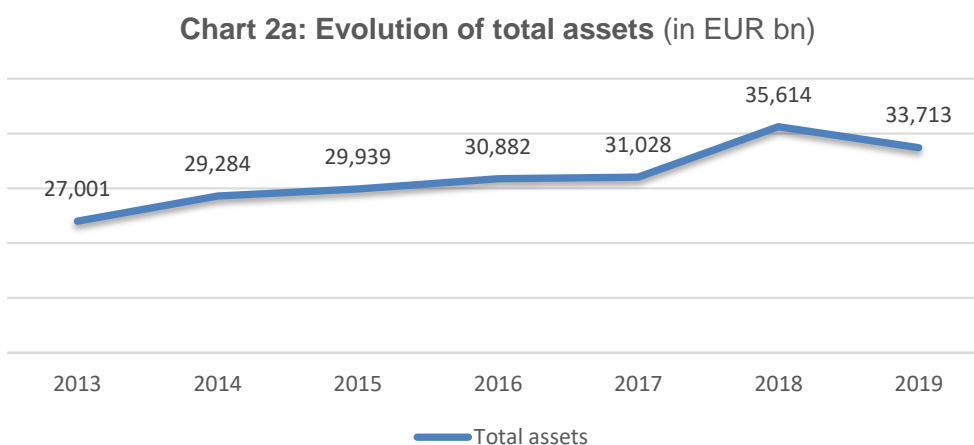
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Reporting in absolute terms

- 8 The amount for Goodwill reported by the entities in the sample has increased since 2013 by EUR 528 billion over this period.



- 9 However, other balances such as total assets, total equity (including non-controlling interests) and market capitalisation have also increased steadily over this period.



- 10 It is important to note that the selection criteria¹ means that new entrants (such as Prosus NV listed in 2019) have been included and therefore some of the growth in

¹ In the time available, this was the only alternative, however, it may be a fruitful area of future research to exclude new entrants. However, in such a case care would have to be taken not to exclude those new entities created as a result of an acquisition as the related goodwill would be important for such research.

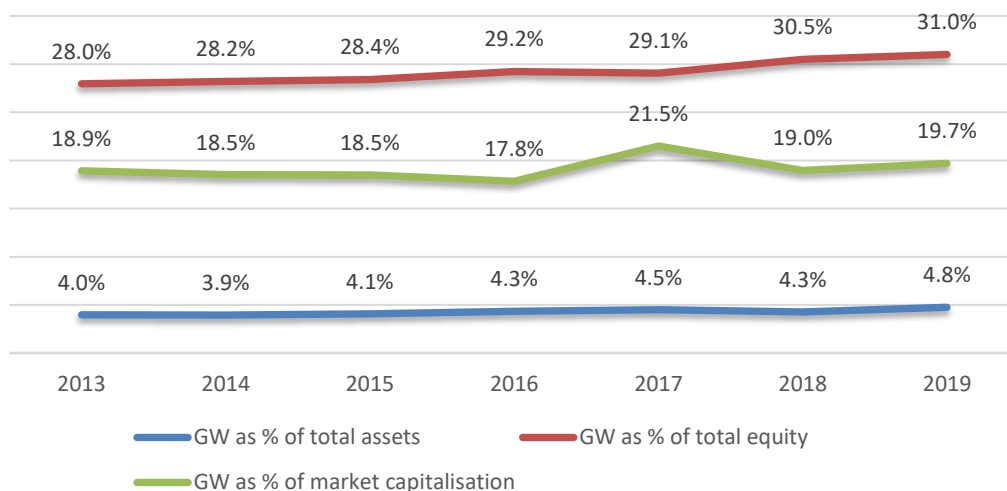
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the absolute numbers is not (only) an increase within the same companies. However, due to the sample selection described in paragraph 4, listed companies who have had total assets over the period but did not have any at the 2019 year-end or had delisted before then have been excluded from the sample.

Relative metrics

- 11 As all the items have been reported at an increasing value over the period, other metrics tracking relative changes in goodwill were investigated and the results are as follows:

Chart 3: Goodwill relative to other variables



- 12 While these results do not reflect a steady increase throughout (for example goodwill/total assets in 2014 and goodwill/market capitalisation in 2016 and 2017), it appears that the relative size of goodwill from 2013 to 2019 has steadily grown.

Top 25 Goodwill reporters

- 13 The EFRAG Secretariat also considered the 25 entities with the highest reported goodwill balances as at their 2019 financial year-end as a proxy for the potential impact of size. The results of the absolute numbers are as follows:

Chart 4a: Top 25 - Evolution of goodwill, total equity and market capitalisation (in EUR bn)

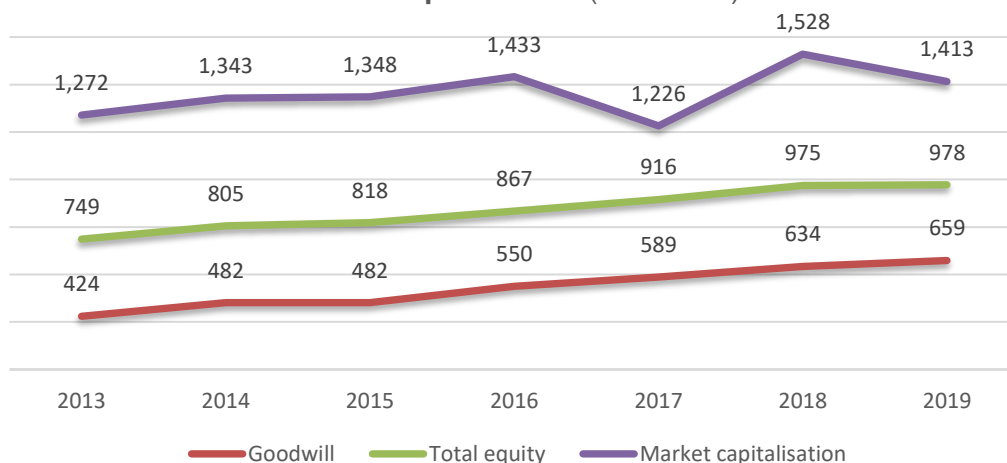
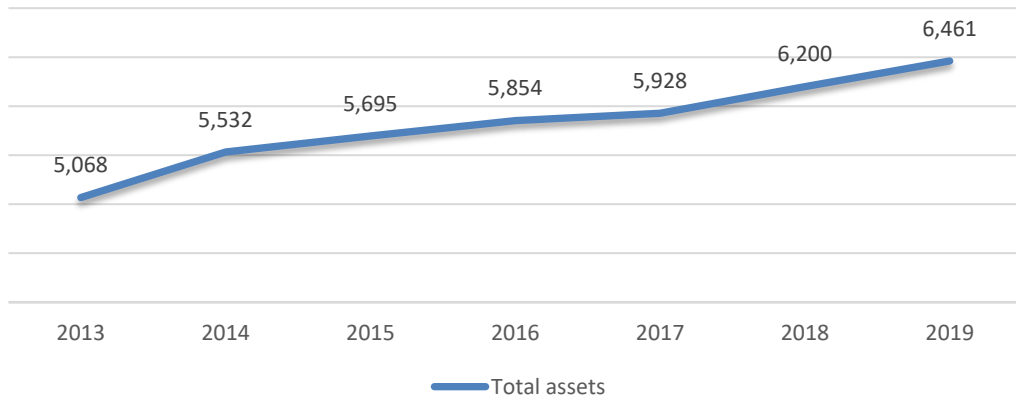
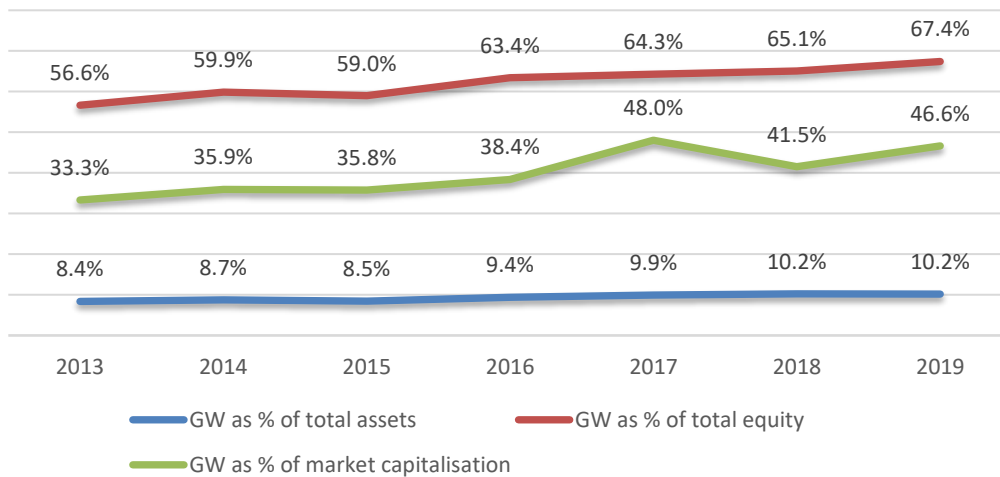


Chart 4b: Top 25 - Evolution of total assets (in EUR bn)



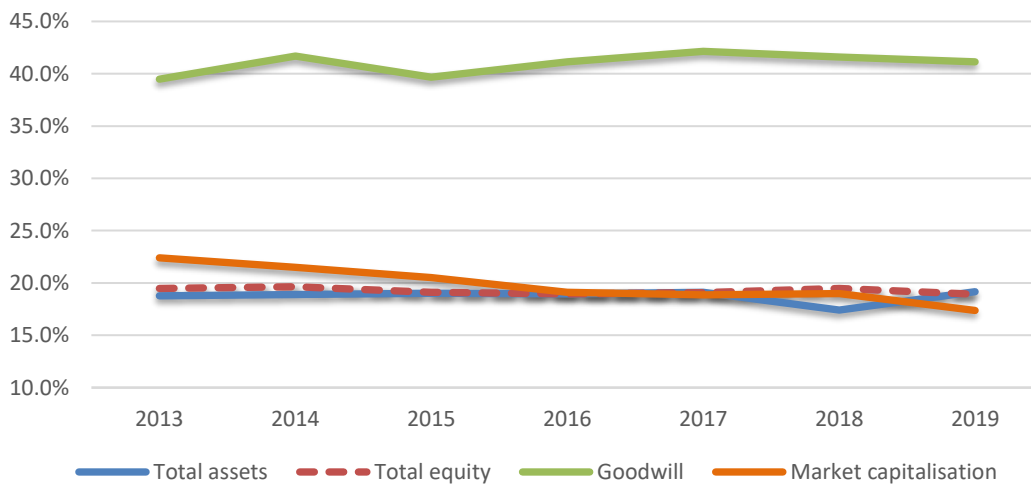
- 14 Similarly to the results from the research on the complete sample, goodwill and other items have increased over the period from 2013 to 2019. Therefore, other metrics tracking relative changes in goodwill were investigated for these entities.

Chart 5: Top 25 - Goodwill relative to other variables



- 15 The amounts reported by the top 25 goodwill reports as a percentage of those reported by the complete sample are as follows:

Chart 6: Top 25 as percentage over total population



- 16 From the above it is clear that the top 25 goodwill reporters have an outsized impact on the results for the whole sample as it accounts for around 40% of the goodwill over the period but between 17%-22% for the other items.

Results from previous research

General

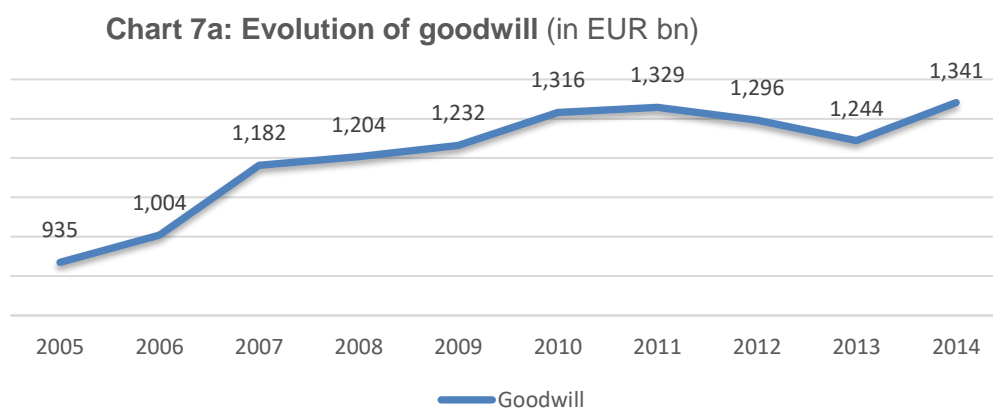
- 17 In September 2016, EFRAG published a research report [‘What do we really know about goodwill and impairment’](#). The objective of the study was to facilitate the debate related to the accounting for goodwill by providing evidence on how goodwill and goodwill impairment have evolved over time².
- 18 The study presents a quantitative analysis of a sample of European companies from 2005 to 2014. This sample was derived from the S&P Europe 350 Index, including companies from 16 European countries, including the EEA. EFRAG made some adjustments to the data, such as removing some companies for which data were missing in some years or a sub-group was already included at the parent company level. The final sample includes 328 companies, with a market capitalisation of approximately EUR 6 trillion.

Limitations

- 19 The limitations to this type of quantitative study are as follows:
- (a) The sample is not statistically representative of all European listed entities;
 - (b) The study is based on a relative short time frame of past data which may not be a reliable indicator of future developments;
 - (c) The study is based on the data included in the commercial database, which have not been systematically verified with the financial statements;
 - (d) The level of concentration means that averages may have a limited relevance. To overcome this limitation, the study includes measures of relative standing such as percentile ranking and classes; and
 - (e) In the study we refer to financial and economic factors. However, there may be other important factors that may influence the data trends. Thus, we encourage to use caution when inferring causation between different data.

Evolution of goodwill

- 20 The graph below illustrates the evolution of goodwill from 2005 to 2014. The changes in goodwill include new acquisitions, disposals, impairment losses and foreign currency translation effects.



² The original study analyses both the evolution of the goodwill amount and the impairment on the goodwill. This paper only refers to the analysis in respect of goodwill.

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- 21 From 2005 to 2011, the total amount of goodwill progressively increased by 43%. From 2012 to 2013 there was a decrease of 4% due to the combined effect of significant amounts of impairments and a decrease in additions to goodwill.
- 22 In 2014 the total amount of goodwill reached its highest level, amounting to EUR 1.341 billion. This increase was related to significant additions of goodwill combined with lower amounts of impairments (35 companies account for 80% of the additions).
- 23 The following charts presents the trend in total equity, market capitalisation and total assets. The market capitalisation fluctuated widely from 2005 to 2014, with sharp decreases in 2008 (41%) and 2011 (11%). While goodwill also fluctuated from 2005 to 2014, it showed a different trend and a lower level of volatility. In particular, decreases on the total amount of goodwill only occurred in 2012 and 2013, when financial markets were already showing signs of recovery.

Chart 7b: Evolution of total equity and market capitalisation
(in EUR bn)

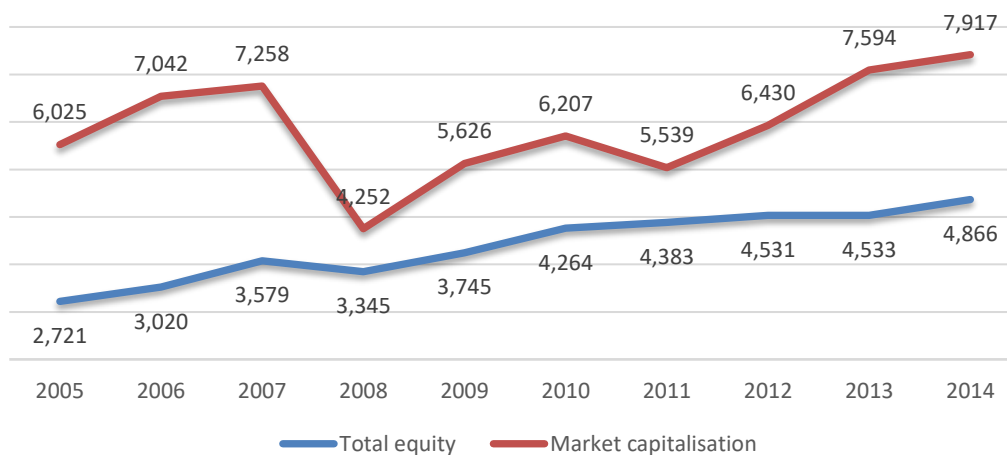
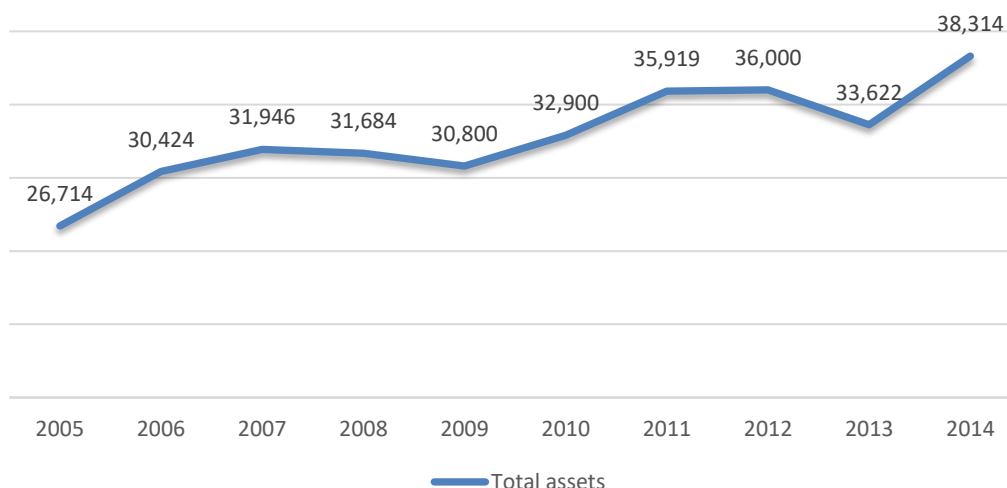


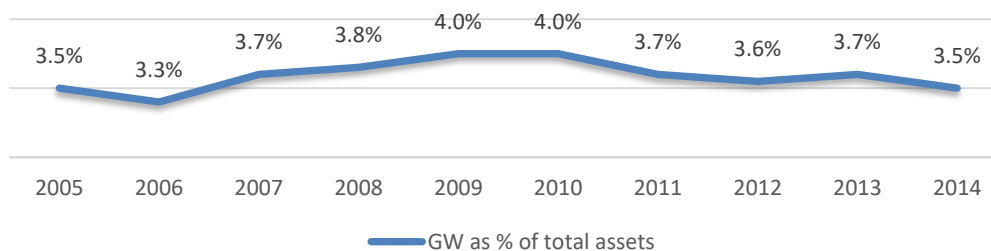
Chart 7c: Evolution of total assets (in EUR bn)



Trend of goodwill as a percentage of total assets

- 24 The chart below shows that the ratio of goodwill to total assets is relatively stable since 2005 for the companies with goodwill in the sample and oscillated around 3,7%.
- 25 Entities in the financial industry have typically very large balance sheets and their ratio averages only 0,9%. If entities in the financial industry are excluded, the ratio becomes significantly higher and fluctuates between 13,5% and 19,5%. The adjusted ratio started to decrease in 2009 and it stabilised at 16,5% in 2014. Although the total amount of goodwill has been increasing over the years, its relative weight has been slightly decreasing from 2009 to 2013.

Chart 8a - Goodwill over total assets

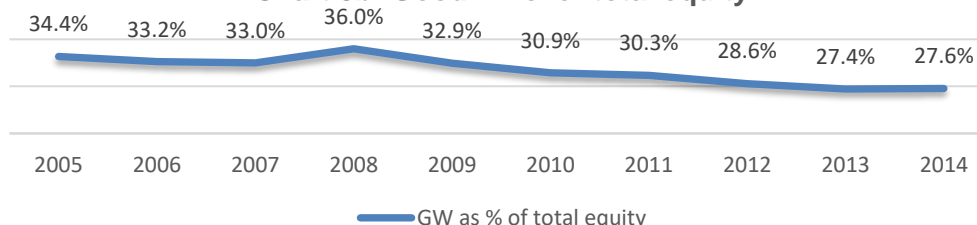


Trend of goodwill as a percentage of total equity

- 26 From 2005 to 2014 the ratio of goodwill to net assets, or the book value of equity, averaged 34% for companies with goodwill (see table below³). The ratio has been decreasing since 2008 and reached its lowest point in 2014 with 29%.

The ratio excluding entities in the financial industry is significantly higher and fluctuates between 42% and 60%. This adjusted ratio has also been decreasing since 2008 and it stabilised at 48% in 2014.

Chart 8b: Goodwill over total equity



Research for limited sample over a longer horizon

- 27 While the two research efforts have divergent bases, the EFRAG Secretariat considered that the results over the full period may be informative. Where possible⁴, the data for entities that fell under both research efforts, have been combined and analysed.
- 28 Information⁵ from 191 entities for the period from 2007 to 2019 was collated and analysed and the reported goodwill increased from EUR 722bn to EUR 1,216bn.

³ The percentages in this graph are prepared based on the absolute numbers as presented in the graph in paragraph 2.13 of the research report.

⁴ Results of companies from the United Kingdom (due to Brexit) and the EEA (purely for reasons of convenience) were excluded. Some entities could not be found in the January 2021 sample.

⁵ The information for 2007 to 2014 is from the previous EFRAG study and was extracted from S&P. The remaining information was extracted from Eikon Refinitiv. The EFRAG Secretariat was unable to extract the information for the full period from Eikon Refinitiv.

- 29 The amounts reported for goodwill increased from approximately EUR 722 bn to EUR 1,216 billion. The other metrics also increased throughout the period. The development of the relative metrics over the period was as follows:

Chart 9a: Goodwill over total assets

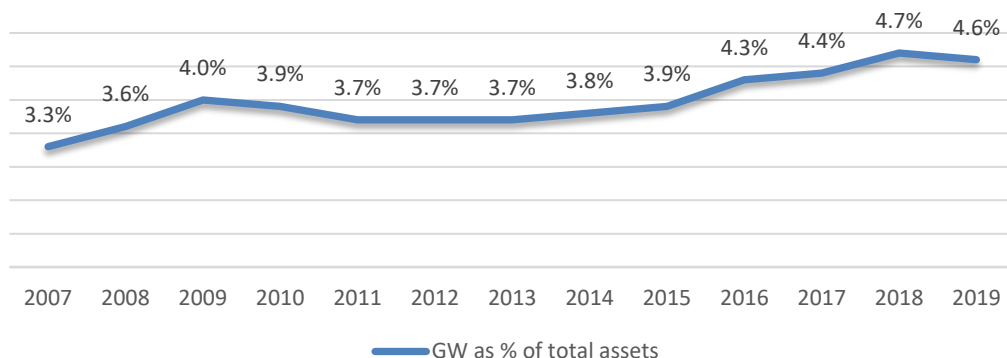
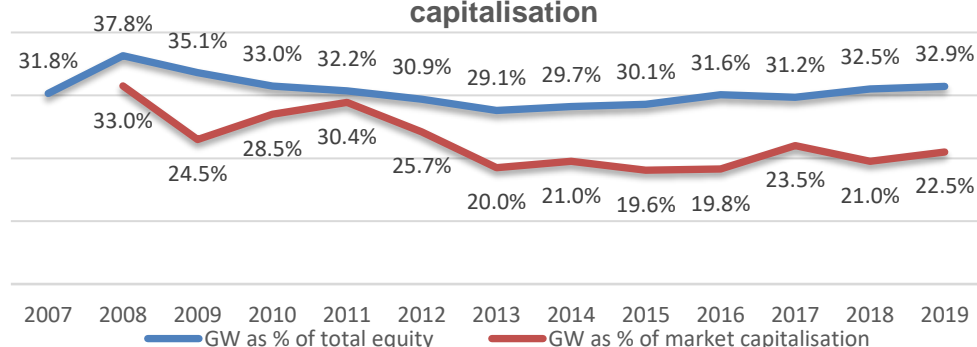


Chart 9b: Goodwill over total equity and market capitalisation



Questions for the EFRAG Board

- 30 Does the EFRAG Board have comments on the research performed?

Impact on wording in final comment letter for EFRAG FCL

- 31 The current wording in the FCL is as follows:

“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. It would avoid the volatility in profit or loss caused by impairment charges.” (Paragraph 118)

“It would be prudent to prevent the (observable) constant rise in goodwill⁶.” (Paragraph 119 (e))

Questions for the EFRAG Board

- 32 Given the findings in this paper, does the EFRAG Board agree with the current wording in the final comment letter as set out in paragraph 31?

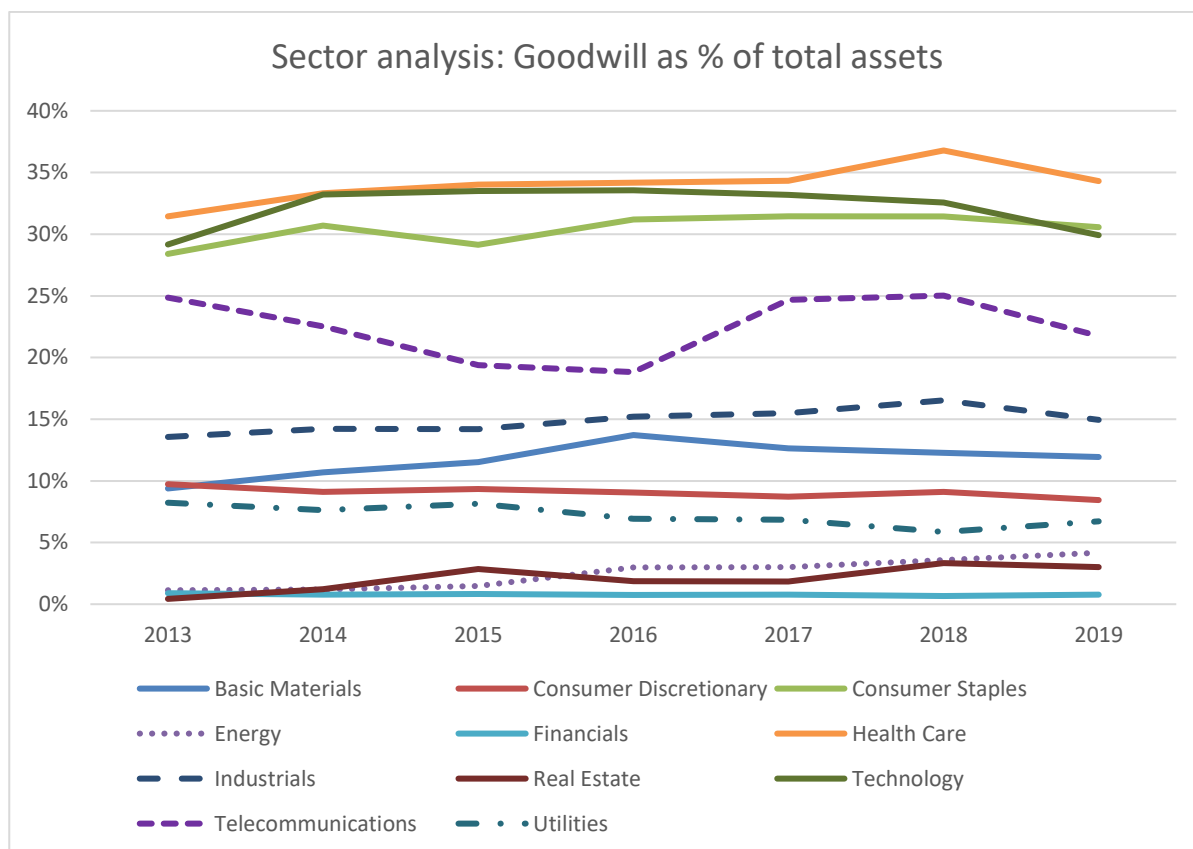
⁶ Paper by the ASBJ and HKICPA Staff (ASAF meeting, April 2020, AP 1A); Cappel and Hartmann (2018)

Appendix 1: Sector analysis

Introduction

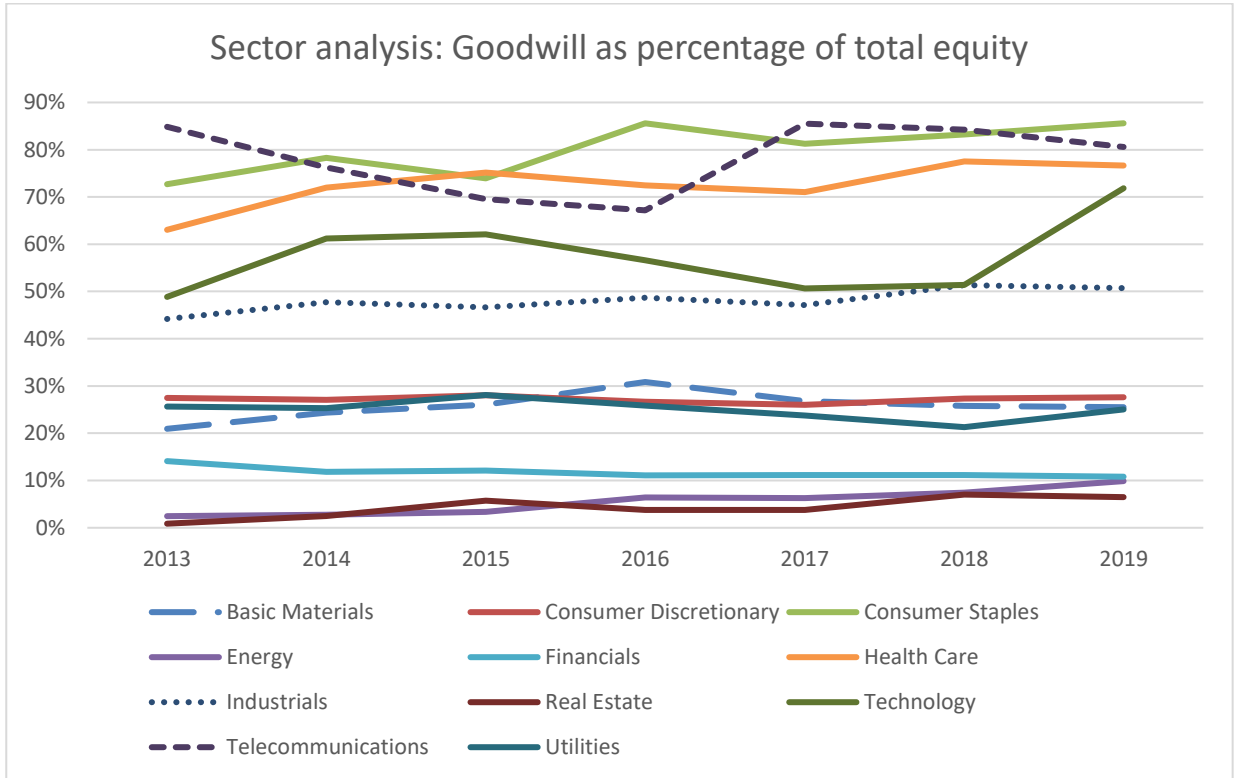
- 1 An analysis of the information⁷ in the main body of the paper was done on a sector basis but a full understanding of the results would require further exploration and investigation which is not possible in the time frame. However, the EFRAG Secretariat considered that it may be of interest especially if further research were to be conducted.

Goodwill and Total Assets

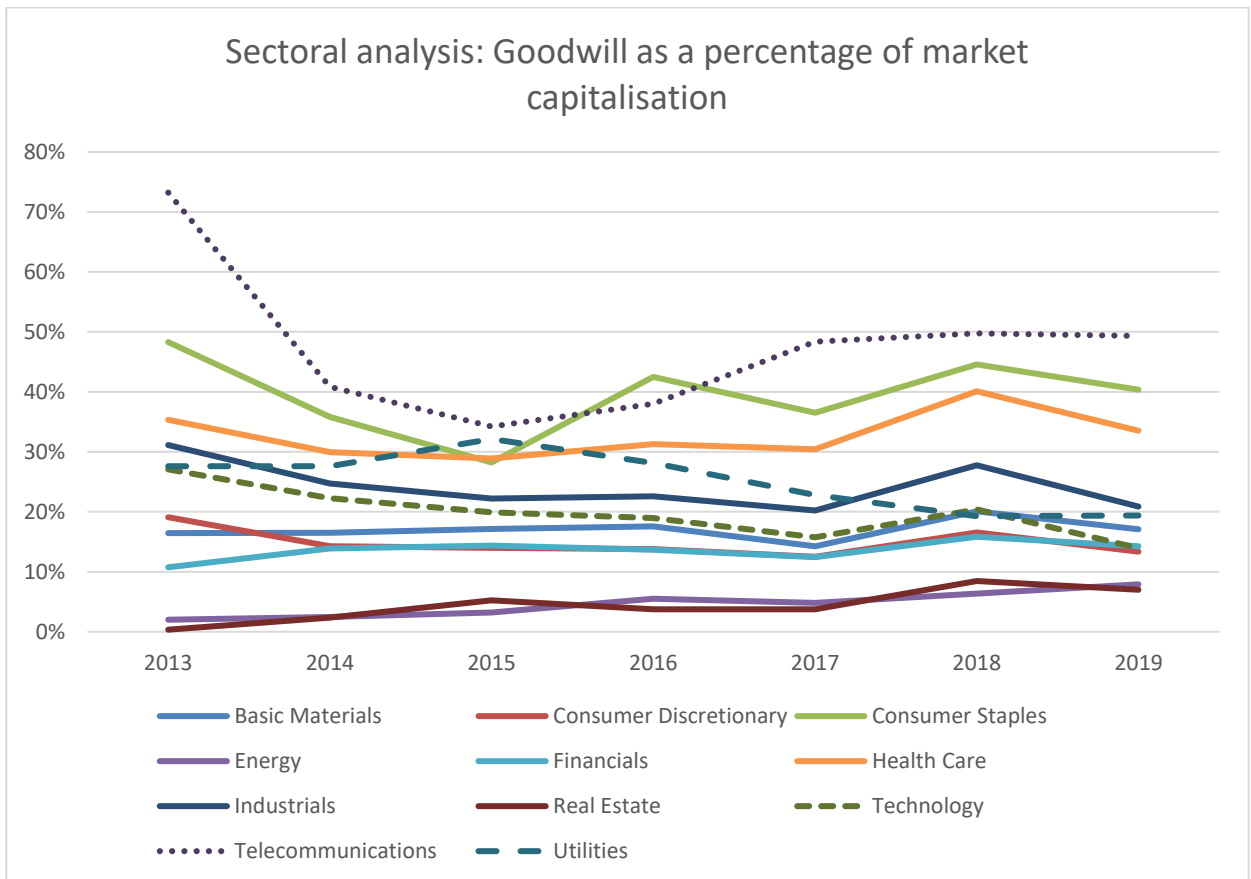


⁷ Various metrics to analyse the evolution of goodwill for companies listed on the exchanges of the European Union where the Total assets exceed EUR 1 at its 2019 year-end, and it reported goodwill in any of the years during the period 2013 to 2019. Information was extracted from Eikon Refinitiv.

Goodwill and Total Equity



Goodwill and market capitalisation



Appendix 2: Country analysis

Introduction

- 1 Similar to the sectoral analysis included in Appendix 1, an analysis of the information was performed based on the geography of the exchange⁸. The results of that analysis are set out below for information purposes, but significant further work would be required to interpret these numbers and especially the development of the metrics over time on a country basis.

Total goodwill reported

- 2 The following reflects the total goodwill reported by entities listed on the exchange(s) in a particular country. Furthermore, only those countries where the goodwill reported exceeded EUR 1bn in any of the years under review have been included below:

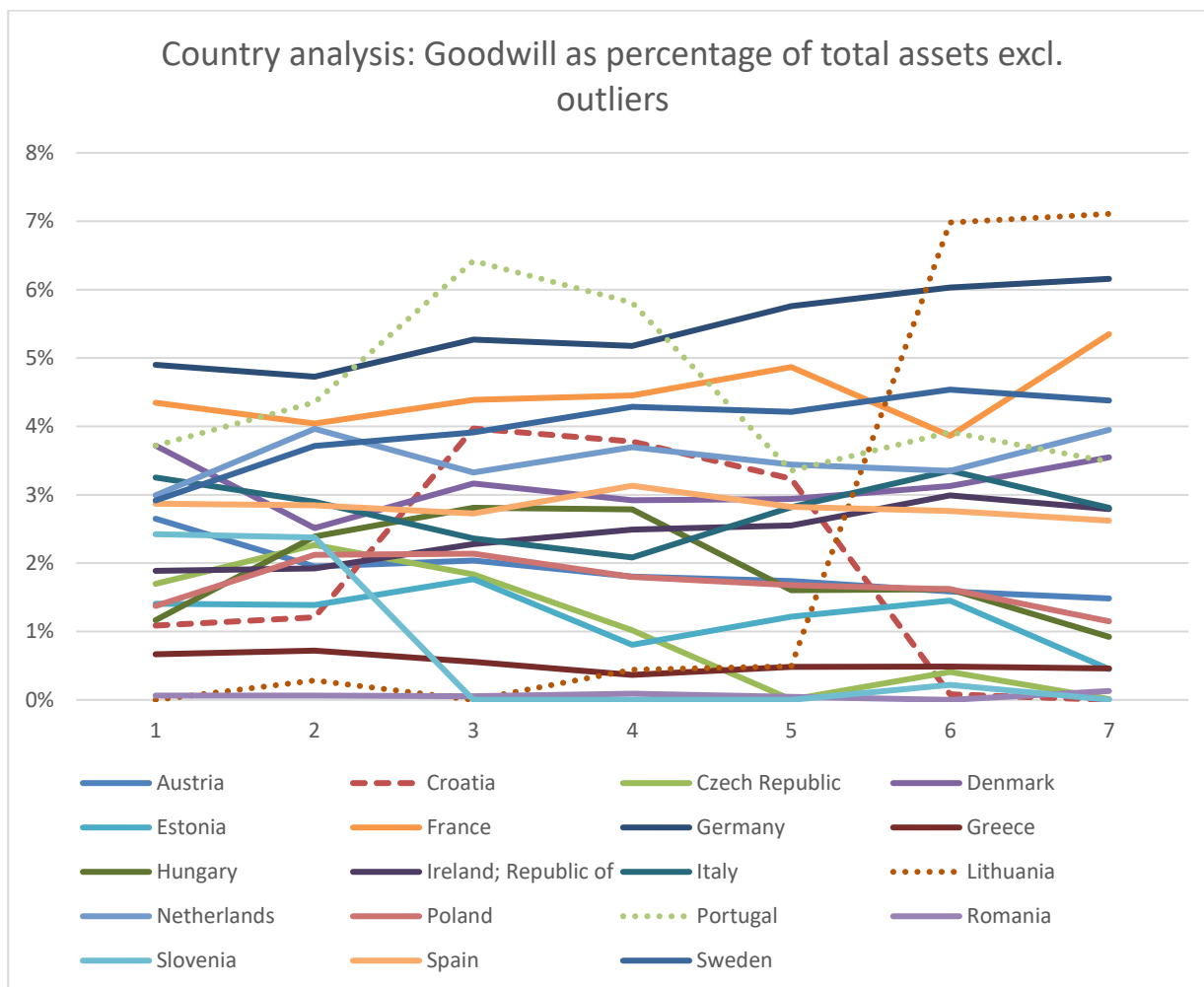
	<u>Obs.</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>
		Amounts in EUR billions						
Austria	35	14	10	10	10	11	10	10
Belgium*	44	69	80	83	153	136	138	141
Czech Republic	6	1	1	1	1	0	0	0
Denmark	50	23	18	22	22	22	24	30
Finland	115	17	16	15	21	23	24	26
France*	266	362	366	395	415	451	519	546
Germany*	304	253	276	317	315	346	374	407
Greece	16	3	3	2	1	1	1	1
Hungary	7	1	1	2	2	1	1	1
Republic of Ireland	13	5	5	6	6	6	8	8
Italy*	115	108	102	84	76	104	125	110
Luxembourg	1	3	3	3	3	3	3	3
Netherlands*	60	63	93	87	104	95	95	119
Poland	80	4	8	8	7	8	8	6
Portugal	22	7	8	12	10	6	7	7
Spain*	5	92	97	100	115	109	107	106
Sweden	3	49	68	70	76	75	80	82
Total		1,074	1,156	1,216	1,337	1,397	1,525	1,602

'Obs.' refer to number of observations, i.e., number of companies in sample per specific country.

* Countries with balances exceeding EUR 100bn for reported goodwill for 2019 year-ends.

⁸ In most cases the country of the exchange agrees to the country of incorporation of the entity, but not in all cases.

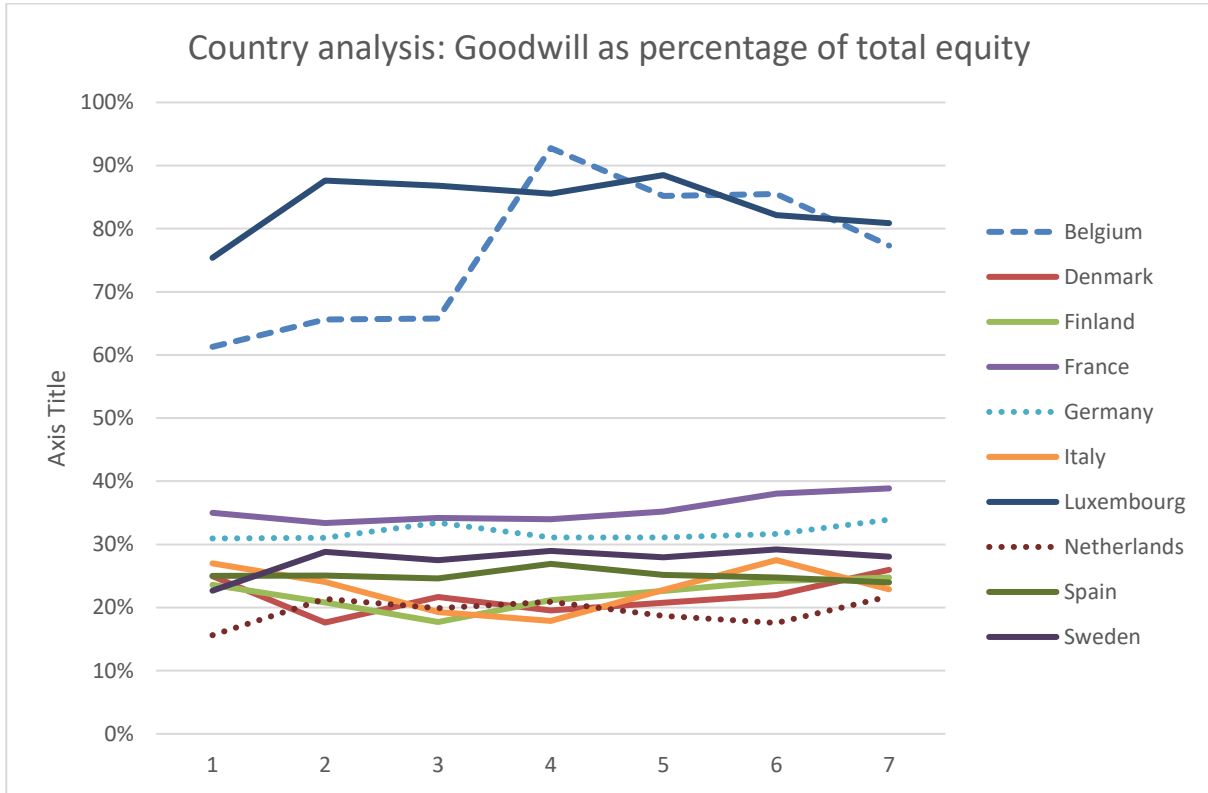
Goodwill and Total Assets



3 The graph above excludes outliers such as Belgium, Bulgaria, Finland, Latvia and Luxembourg for ease of reading. The information for these countries is as follows:

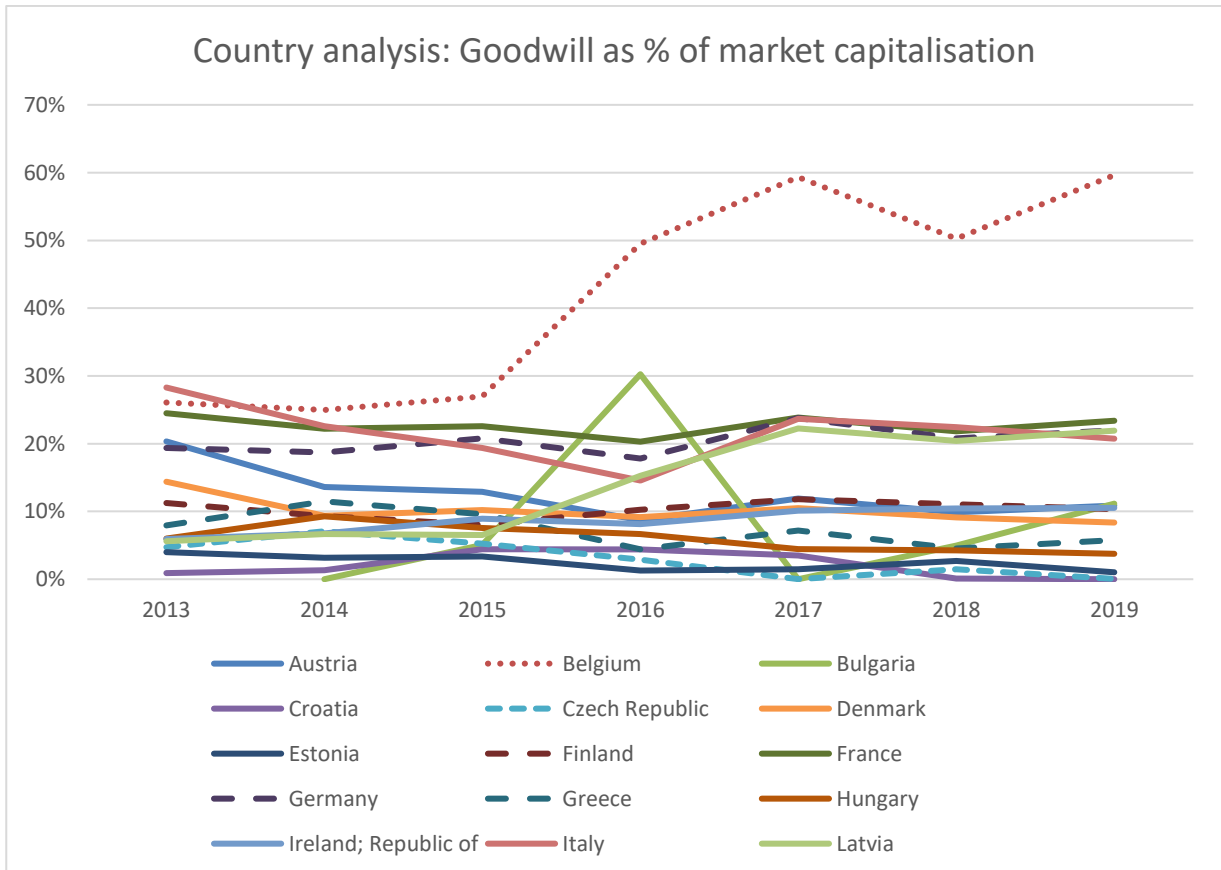
	2013	2014	2015	2016	2017	2018	2019
Belgium	13%	16%	14%	20%	19%	19%	18%
Bulgaria			3%	16%		15%	9%
Finland	9%	9%	8%	10%	10%	10%	10%
Latvia	5%	6%	7%	12%	14%	14%	13%
Luxembourg	36%	37%	36%	37%	38%	35%	35%

Goodwill and Total Equity



4 This graph includes only those countries where the resulting metric exceeds 15% in all the years under review.

Goodwill and Market Capitalisation



Appendix 3: Information in tabular form

Introduction

- 1 As some may find the information in the graphs in the main body of the paper easier to digest in tabular form, this appendix provides the same information in such a format.

Results from January 2021 research

Reported items in absolute terms

Table 1 - Chart 1	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>
Goodwill	1,074	1,156	1,216	1,337	1,397	1,525	1,602

Table 2 -Chart 2a & 2b	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>
Total assets	27,001	29,284	29,939	30,882	31,028	35,614	33,713
Total equity	3,842	4,101	4,284	4,573	4,806	5,003	5,168
Market capitalisation	5,680	6,243	6,571	7,497	6,501	8,044	8,133

All amounts in EUR billions

Relative metrics

Table 3 – Chart 3	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>
Goodwill/total assets	3.98%	3.95%	4.06%	4.33%	4.50%	4.28%	4.75%
Goodwill/ total equity	27.96%	28.20%	28.38%	29.24%	29.07%	30.48%	31.01%
Goodwill/ market capitalisation	18.91%	18.52%	18.50%	17.83%	21.49%	18.96%	19.70%

Top 25 Goodwill reporters

Absolute numbers

Table 4 – Chart 4a & 4b	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>
Goodwill	424	482	482	550	589	634	659
Total assets	5,068	5,532	5,695	5,854	5,928	6,200	6,461
Total equity	749	805	818	867	916	975	978
Market capitalisation	1,272	1,343	1,348	1,433	1,226	1,528	1,413

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All amounts in EUR billions

Relative metrics

Table 5 – Chart 5	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>
Goodwill/total assets	8.4%	8.7%	8.5%	9.4%	9.9%	10.2%	10.2%
Goodwill/ total equity	56.6%	59.9%	59.0%	63.4%	64.3%	65.1%	67.4%
Goodwill/ market capitalisation	33.3%	35.9%	35.8%	38.4%	48.0%	41.5%	46.6%

Top 25 Goodwill reporter balances as percentage over balances of whole sample

Table 6 – Chart 6	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>
Goodwill	18.77%	18.89%	19.02%	18.96%	19.11%	17.41%	19.17%
Total assets	39.48%	41.70%	39.67%	41.13%	42.14%	41.60%	41.13%
Total equity	19.49%	19.64%	19.10%	18.96%	19.07%	19.49%	18.92%
Market capitalisation	22.40%	21.51%	20.52%	19.12%	18.86%	18.99%	17.37%

Results from previous research

Absolute numbers

Table 7 – Chart 7a/b/c	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>
Goodwill	935	1,004	1,182	1,204	1,232	1,316	1,329	1,296	1,244	1,341
Total assets	26,714	30,424	31,946	31,684	30,800	32,900	35,919	36,000	33,622	38,314
Total equity	2,721	3,020	3,579	3,345	3,745	4,264	4,383	4,531	4,533	4,866

All amounts in EUR billions

Relative metrics

Table 8 – Chart 8a/b	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>
Goodwill/ total assets	3,5%	3,3%	3,7%	3,8%	4,0%	4,0%	3,7%	3,6%	3,7%	3,5%
Goodwill/ total equity	34,4%	33,2%	33,0%	36,0%	32,9%	30,9%	30,3%	28,6%	27,4%	27,6%

Research for limited sample over a longer horizon

Absolute numbers

Table 9.1	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>
Goodwill	722	831	845	902	892	882	839	912	955	1,058	1,081	1,171	1,216
Total assets	21,860	22,919	21,385	23,224	24,179	24,163	22,703	24,232	24,228	24,818	24,567	25,123	26,225
Total equity	2,267	2,196	2,407	2,735	2,776	2,856	2,888	3,072	3,172	3,352	3,468	3,604	3,692
Market capitalisation		2,516	3,452	3,165	2,936	3,436	4,186	4,341	4,871	5,352	4,598	5,578	5,396

Amounts in EUR billions

Relative metrics

Table 9.2 – Chart 9a/b	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>
Goodwill/ total assets	3.3%	3.6%	4.0%	3.9%	3.7%	3.7%	3.7%	3.8%	3.9%	4.3%	4.4%	4.7%	4.6%
Goodwill/ total equity	31.8%	37.8%	35.1%	33.0%	32.2%	30.9%	29.1%	29.7%	30.1%	31.6%	31.2%	32.5%	32.9%
Goodwill/ market capitalisation		33.0%	24.5%	28.5%	30.4%	25.7%	20.0%	21.0%	19.6%	19.8%	23.5%	21.0%	22.5%