Draft Comment Letter

You can submit your comments on EFRAG's draft comment letter by using the 'Express your views' page on EFRAG's website, then open the relevant news item and click on the 'Comment publication' link at the end of the news item.

Comments should be submitted by [date].

International Accounting Standards Board
7 Westferry Circus, Canary Wharf
London E14 4HD
United Kingdom

[XX Month 2020]

Dear Mr Hoogervorst,

Re: *IASB DP 2020/1 Business Combinations—Disclosures, Goodwill and Impairment*

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the discussion paper *DP/2020/1 Business Combinations—Disclosures, Goodwill and Impairment,* issued by the IASB on 19 March 2020 (the 'DP').

This letter is intended to contribute to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of definitive IFRS Standards in the European Union and European Economic Area.

[EFRAG has not formed a view at this stage 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 is justified. EFRAG is seeking views from its constituents and would welcome, in particular, new evidences to support a change. EFRAG's position regarding goodwill amortisation to be inserted following consultation with constituents]

EFRAG supports the objective of the DP to explore whether companies can, at a reasonable cost, provide investors with more useful information about the acquisitions those companies make. Similar to what is reflected in the DP, it is our understanding from discussions with users of financial statements that they do not think that sufficient information to assess acquisitions is currently presented in financial statements. It is therefore important to address this issue.

As it has previously been acknowledged by the IASB (and in this DP), there are shortcomings in how goodwill is currently accounted for. A main cause of the issues related to goodwill accounting is, in the view of EFRAG, that goodwill is a mixture of many different elements. It is a residual – an accounting construct – rather than a reflection of something 'real'. Another issue is then that goodwill is not tested for impairment directly, but indirectly by testing the cash generating units to which it is allocated. This creates the so-called "shielding effect" and does not allow for a detailed subsequent monitoring of the different components subsumed in goodwill. These issues seem to be the reason for users' views that reported goodwill has limited relevance. Indeed, it seems that many users disregard the goodwill figures reported in the statement of financial position.

EFRAG, therefore, regrets that the proposals in this DP do not aim at addressing, through disclosure or enhancements of the impairment model, the current shortcomings in goodwill accounting.

EFRAG supports including disclosure objectives to provide information to help investors to understand the benefits that a company's management expects from an acquisition when agreeing the price to acquire a business and the extent to which an acquisition is meeting management's objectives for the acquisition.

EFRAG also generally supports the proposals to require a company to disclose information about the strategic rationale and management's objectives for an acquisition as at the acquisition date and to subsequently disclose information about whether it is meeting those objectives. However, EFRAG notes that there would be some practical issues to consider in relation to those disclosures, both to ensure that users receive sufficient and relevant information and that the costs of preparing/disclosing the information would not outweigh the benefits.

In addition, for the disclosures suggested on expected synergies, EFRAG questions whether the benefits would outweigh the costs. Similarly, EFRAG does not consider that the benefits would outweigh the costs for the proposal to disclose cash flows from operating activities as part of the requirements currently included in paragraph B64(q) of IFRS 3 *Business Combinations.* EFRAG is seeking inputs from constituents on costs (Questions 2 to 5 of the DP).

Furthermore, EFRAG does not assess that there would be any benefits of presenting the amount of total equity excluding goodwill on the balance sheet. On the contrary, EFRAG considers that this could result in confusion.

Similar to the IASB, EFRAG had in the past tried, but was not able, to design the impairment test in a manner that would be more effective. However, in order to remediate some of the shortcomings of the current impairment model in practice, EFRAG considers that the guidance on how goodwill is allocated to cash generating units, in general and in case of disposal, can be improved. In addition, EFRAG assesses that better information related to the impairment test could be provided. These initiatives could potentially reduce the shortcomings of the impairment test. In addition, EFRAG seeks constituents' inputs on possible disclosure proposals to mitigate the risk of management over-optimism.

EFRAG appreciates the IASB's attempts to simplify the impairment test. However, EFRAG considers that not requiring a yearly impairment test for goodwill could further impair the effectiveness of the test. EFRAG would accordingly only support the suggested 'indicator only approach' if combined with amortisation of goodwill (or, perhaps, parts of goodwill).

In 2017, EFRAG published the discussion paper *Goodwill Impairment Test: Can It Be Improved?* In this discussion paper, EFRAG proposed to remove the restriction in IAS 36 *Impairment of Assets* that prohibits companies from including cash flows arising from a future uncommitted restructuring, or from improving or enhancing the asset's performance. It also proposed to remove the requirement to use pre-tax inputs and pre-tax discount rates to calculate value in use. These proposals were generally supported by EFRAG's constituents and EFRAG accordingly appreciates that the IASB is now considering these.

In considering the accounting for intangible assets, EFRAG considers it necessary that the IASB takes into account the concerns of investors who want to compare companies that grow by acquisitions more easily with those that grow organically and, as such, starts a project on IAS 38 *Intangible Assets*. EFRAG would be in favour of allowing some intangible assets to be included in goodwill if goodwill were to be amortised, however EFRAG questions the usefulness of such a change pending a broader project on IAS 38. The project could also be informed by EFRAG's pro-active work on the project *Better Information on Intangibles*.

Finally, in the view of EFRAG, convergence with the FASB on goodwill accounting should be attempted. However, convergence should not be an overriding objective.

EFRAG's detailed comments and responses to the questions in the DP are set out in the Appendix.

If you would like to discuss our comments further, please do not hesitate to contact Rasmus Sommer, Ricardo Torres, Galina Borisova or me.

Yours sincerely,

Jean-Paul Gauzès

President of the EFRAG Board

Appendix I - EFRAG's responses to the questions raised in the DP

Section 1 – Introduction

Notes to constituents - Summary of the proposals in the DP

1 *The IASB's overall objective is to explore whether companies can, at a reasonable cost, provide investors with more useful information about the acquisitions those companies make. Better information would help investors assess the performance of companies that have made acquisitions. Better information would also be expected to help investors more effectively hold a company's management accountable for management's decisions to acquire those businesses.*

2 *The IASB's preliminary views are that it:*

(a) *should develop proposals to enhance the disclosure objectives and requirements in IFRS 3* Business Combinations *to improve the information provided to investors about an acquisition and its subsequent performance (Section 2);*

(b) *cannot design a different impairment test for cash-generating units containing goodwill that is significantly more effective than the impairment test in IAS 36 at recognising impairment losses on goodwill on a timely basis and at a reasonable cost (Section 3);*

(c) *should not reintroduce amortisation of goodwill (Section 3);*

(d) *should develop a proposal to help investors better understand companies' financial positions by requiring companies to present on their balance sheets the amount of total equity excluding goodwill (Section 3);*

(e) *should develop proposals intended to reduce the cost and complexity of performing the impairment test by:*

(i) *providing companies with relief from having to perform an annual quantitative impairment test for cash-generating units containing goodwill if there is no indication that an impairment may have occurred; and*

(ii) *extending the same relief to companies for intangible assets with indefinite useful lives and intangible assets not yet available for use (Section 4);*

(f) *should develop proposals intended to reduce cost and complexity, and to provide more useful and understandable information by simplifying the requirements for estimating value in use by:*

(iii) *removing the restriction on including cash flows from a future uncommitted restructuring or from improving or enhancing an asset's performance (Section 4);*

(iv) *permitting the use of post-tax cash flows and post-tax discount rates (Section 4); and*

(v) *not changing the range of identifiable intangible assets recognised separately from goodwill in an acquisition (Section 5).*

3 *The IASB's preliminary views set out in the Discussion Paper form a package and are interconnected. The IASB considered the links when considering the package and whether it would meet the project's objective. The IASB asks that when stakeholders assess what best meets the project's objective, they also consider these links.*

4 *In reaching its preliminary views, the IASB considered the expected benefits and expected costs of the overall package. In the IASB's view this package of preliminary views is the most cost-effective response to the range of views expressed by stakeholders in the PIR of IFRS 3 about investor needs, benefits and costs in accounting for acquisitions and goodwill.*

Question 1

Paragraph 1.7 of the DP summarises the objective of the IASB research project. Paragraph IN9 of the DP summarises the IASB preliminary views. Paragraphs IN50–IN53 of the ED explain that these preliminary views are a package and those paragraphs identify some of the links between the individual preliminary views.

The IASB has concluded that this package of preliminary views would, if implemented, meet the objective of the project. Companies would be required to provide investors with more useful information about the businesses those companies acquire. The aim is to help investors to assess performance and more effectively hold management to account for its decisions to acquire those businesses. The IASB is of the view that the benefits of providing that information would exceed the costs of providing it.

Do you agree with the IASB's conclusion? Why or why not? If not, what package of decisions would you propose and how would that package meet the project's objective?

Do any of your answers depend on answers to other questions? For example, does your answer on relief from a mandatory quantitative impairment test for goodwill depend on whether the IASB reintroduces amortisation of goodwill? Which of your answers depend on other answers and why?

EFRAG's response

EFRAG supports the objective of the DP to explore whether companies can, at a reasonable cost, provide investors with more useful information about the acquisitions those companies make. It is our understanding that users of financial statements do not think that sufficient information to assess acquisitions is currently presented in financial statements. It is therefore important to address this issue. EFRAG, however, regrets that the proposals in this DP do not aim at addressing the current shortcomings in goodwill accounting.

The evolution of the project's objectives

5 EFRAG notes that the project resulting in this DP followed from the IFRS 3 *Business Combinations* Post Implementation Review ('IFRS 3 PIR'). Some of the feedback from the IFRS 3 PIR is summarised in Table 1.1 of the DP.

6 Following the IFRS 3 PIR, the IASB initiated a research project on goodwill and impairment that aimed to explore whether it is possible to simplify and improve the application of the impairment test, improve the disclosures about impairment of goodwill and simplify separation of specified identifiable intangible assets from goodwill in a business combination.

7 The IASB concluded that it would not be possible to make the impairment test significantly more effective and after no compelling evidence that including some intangible assets in goodwill save costs (but could increase the pressure on the impairment test for goodwill), the IASB decided, in July 2018, to refocus the objectives of the project. Thus, the IASB decided to develop the following project objectives:

(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) 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.

(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 paragraph 1.7 of the DP, it is explained that the objective of the project is to explore whether companies can, at a reasonable cost, provide investors with more useful information about the acquisitions those companies make.

Whether the IASB's preliminary views would meet the IASB's objectives

9 With reference to the objective of exploring whether companies can, at a reasonable cost, provide investors with more useful information about the acquisitions those companies make, EFRAG assesses that the IASB, by issuing this DP and with its further actions, could be in the process of meeting this objective. As the objective is 'to explore' whether or not the suggestions are subsequently implemented, this would not affect whether the objective is met.

10 With reference to the objectives listed in paragraph 7 above, EFRAG likewise thinks that the IASB could be in the process of meeting these objectives.

(a) EFRAG agrees that the proposals included in the DP identifies 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. However, EFRAG expresses a number of reservations on reliability and feasibility (refer to our responses to Question 2 to Question 5).

(b) EFRAG notes that the DP is 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.

(c) EFRAG also notes that the DP is 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.

11 If, however, the objective would be to solve the issues identified in the feedback from the IFRS 3 PIR, EFRAG would not assess the objective to be completely met.

12 For example, if the proposals were to be implemented, EFRAG would expect that the IASB would still receive mixed views on how well the proposed requirements are working in respect of impairment of goodwill and indefinite-life intangible assets.

13 Also, although the disclosures identified by the IASB could be useful to assess the future performance of an acquisition, there are some practical issues with these disclosures which may result in much more useful information not being reported after all (see EFRAG's answers to Question 2 to Question 5) . Furthermore, EFRAG highlights that the proposed disclosures on the subsequent performance of an acquisition overall will not resolve the issues related to current goodwill accounting.

14 In addition, EFRAG questions whether the benefits of providing the disclosures on synergies will outweigh the costs if entities do not already prepare this information for internal purposes. Additionally, EFRAG indicates that the usefulness of the required information about cash flows from operating activities would be very limited

and that it would be costly to prepare when the acquired business is fully integrated and does not prepare separate accounts.

15 EFRAG also questions the usefulness of a consultation (ref. to Question 12) on the possibility to recognise, as part of goodwill, some of the acquired intangibles that are currently recognised separately, considering the stated limitation in the DP, i.e. it is out of scope of this project to remediate the non-comparability that exists today in accounting for internally generated intangibles and acquired intangibles. EFRAG invites the IASB to start working on the topic, considering its relevance.

16 EFRAG agrees that the different proposals are to be seen as a package and have a high degree of interdependence. For this reason, for example, some consider that the move to an indicator-only impairment would somehow reduce the costs for preparers, however, it would be appropriate only in combination with amortisation, as the latter would help mitigate the risk of overstating the recoverable amount of CGU´s containing acquired goodwill.

EFRAG has not formed a view on the possible introduction of amortisation and is consulting its constituents on this topic.

17 Finally, EFRAG considers that requiring an entity to disclose on its balance sheet a subtotal of equity before goodwill will be more harmful than beneficial.

Section 2—Improving disclosures about acquisitions

Section highlights according to the IASB's DP

(a) *Investors want to understand how an acquisition is performing relative to management expectations.*

(b) *A company should be required to provide investors with the information that the company's management uses to monitor acquisitions.*

(c) *Investors could use this information to assess management's decisions to acquire businesses.*

Notes to constituents - Summary of the proposals in the DP

18 *The DP proposes that:*

(a) *A company should be required to disclose information about the strategic rationale and management's (the chief operating decision maker's (CODM's)) objectives for an acquisition as at the acquisition date.*

The DP notes that IFRS 3 requires a company to disclose the primary reasons for an acquisition. This disclosure requirement may result in companies providing some information about management's objectives, but, according to the DP, this information is unlikely to be specific enough to form the basis of the information that would help investors to assess the subsequent performance of the acquisition.

(b) *A company should be required to disclose information about whether it is meeting those objectives. That information should be based on how management (CODM) monitors and measures whether the acquisition is meeting its objectives, rather than on metrics prescribed by the IASB.*

According to the DP, management's objectives, being the objectives of the acquisition that management considers must be achieved for the acquisition to be a success, would form the basis of the information to help investors assess the subsequent performance of the acquisition.

Investors would be able to use the information to assess whether the price for the acquired business appears reasonable.

The preliminary view expressed in the DP would require companies to disclose information management uses to monitor the subsequent performance of an acquisition. If management plans to integrate an acquired business, it is possible that management plans to monitor the subsequent performance of the acquisition using information about the combined business. Companies would be required to disclose this combined information because management is using this combined information to understand how the acquisition is performing.

(c) *If management (CODM) does not monitor an acquisition, the company should be required to disclose that fact and explain why it does not do so. The IASB should not require a company to disclose any metrics in such cases.*

According to the DP, if a company's management does not monitor an acquisition against its original expectations, the IASB concluded that requiring the company to disclose a specified set of metrics would not always produce useful information. In such a case, the IASB expected that investors would want to know that management is not monitoring an acquisition and reasons why it does not do so.

(d) *A company should be required to disclose the information about whether it is meeting those objectives for as long as its management (CODM) continues to monitor the acquisition to see whether it is meeting its objectives.*

(e) *If management (CODM) stops monitoring whether those objectives are being met before the end of the second full year after the year of acquisition, the company should be required to disclose that fact and the reasons why it has done so.*

According to the DP the IASB's preliminary view is that, if management (CODM) continues to monitor whether the objectives of the acquisition are being met, a company should be required to provide information about the acquisition's subsequent performance for as long as the information remains necessary for investors to assess whether the original objectives of an acquisition are being met. However, if management stops monitoring the acquisition before the end of the second full year after the year of acquisition, the IASB suggests that a company should be required to disclose that fact and the reasons why it did not monitor the acquisition.

(f) *If management (CODM) changes the metrics it uses to monitor whether the objectives of the acquisition are being met, the company should be required to disclose the new metrics and the reasons for the change.*

According to the DP the metrics that management uses to monitor the progress of an acquisition may change over time—for example, when a company is reorganised. The IASB considers it unreasonable to require a company to continue disclosing metrics that no longer provide useful information to management and may no longer be available internally. However, changing the metrics without disclosing the reasons for that change could allow poor performance to be masked. To balance these concerns, the IASB's preliminary view is that it should not require a company to continue disclosing a metric it no longer uses internally. Instead, when a company makes such a change, it should be required to disclose that it made the change together with the reasons for the change and then disclose the revised metrics.

19 *Some stakeholders, mainly preparers, have expressed concerns that detailed disclosure of a company's post-acquisition intentions together with precise targets could be commercially sensitive. According to the DP this is not a sufficient reason to prevent disclosure of information that investors need. However, some investors suggest that the information they need to understand management's objectives and to hold management accountable against those objectives may not need to be as detailed and precise as other stakeholders initially thought.*

20 *Some stakeholders have expressed concerns that information about management's objectives for an acquisition along with detailed targets could, in some jurisdictions, be considered to be forward-looking information that could risk litigation and should be provided outside the financial statements—for example, in management commentary—to reduce the risk of litigation. According to the DP, in the IASB's view, information about the strategic rationale, objectives and related targets for an acquisition is not forward-looking information. The information reflects management's target at the time of the acquisition. It is not a forecast of the expected outcome at the time the company prepares its financial statements.*

Question 2

Paragraphs 2.4–2.44 of the DP discuss the IASB's preliminary view that it should add new disclosure requirements about the subsequent performance of an acquisition.

Do you think those disclosure requirements would resolve the issue identified in paragraph 2.4 of the DP—investors' need for better information on the subsequent performance of an acquisition? Why or why not?

Do you agree with the disclosure proposals set out in (i)–(vi) below? Why or why not?

(i) A company should be required to disclose information about the strategic rationale and management's (the chief operating decision maker's (CODM's)) objectives for an acquisition as at the acquisition date (see paragraphs 2.8–2.12 of the DP). Paragraph 7 of IFRS 8 *Operating Segments* discusses the term 'chief operating decision maker'.

(ii) A company should be required to disclose information about whether it is meeting those objectives. That information should be based on how management (CODM) monitors and measures whether the acquisition is meeting its objectives (see paragraphs 2.13–2.40 of the DP), rather than on metrics prescribed by the IASB.

(iii) If management (CODM) does not monitor an acquisition, the company should be required to disclose that fact and explain why it does not do so. The IASB should not require a company to disclose any metrics in such cases (see paragraphs 2.19–2.20 of the DP).

(iv) A company should be required to disclose the information in (ii) for as long as its management (CODM) continues to monitor the acquisition to see whether it is meeting its objectives (see paragraphs 2.41–2.44 of the DP).

(v) If management (CODM) stops monitoring whether those objectives are being met before the end of the second full year after the year of acquisition, the company should be required to disclose that fact and the reasons why it has done so (see paragraphs 2.41–2.44 of the DP).

(vi) If management (CODM) changes the metrics it uses to monitor whether the objectives of the acquisition are being met, the company should be required to disclose the new metrics and the reasons for the change (see paragraph 2.21 of the DP).

Do you agree that the information provided should be based on the information and the acquisitions a company's CODM reviews (see paragraphs 2.33–2.40 of the DP)? Why or why not? Are you concerned that companies may not provide material information about acquisitions to investors if their disclosures are based on what the CODM reviews? Are you concerned that the volume of disclosures would be onerous if companies' disclosures are not based on the acquisitions the CODM reviews?

Could concerns about commercial sensitivity (see paragraphs 2.27–2.28 of the DP) inhibit companies from disclosing information about management's (CODM's) objectives for an acquisition and about the metrics used to monitor whether those objectives are being met? Why or why not? Could commercial sensitivity be a valid reason for companies not to disclose some of that information when investors need it? Why or why not?

Paragraphs 2.29–2.32 explain the IASB's view that the information setting out management's (CODM's) objectives for the acquisition and the metrics used to monitor progress in meeting those objectives is not forward-looking information. Instead, the IASB considers the information would reflect management's (CODM's) targets at the time of the acquisition. Are there any constraints in your jurisdiction that could affect a company's ability to disclose this information? What are those constraints and what effect could they have?

EFRAG's response

EFRAG supports the proposed disclosure requirements and considers that they could result in useful information to assess business acquisitions. EFRAG, however, disagrees that the only point of reference should be what information the CODM monitors and has some concerns about what information will be provided. EFRAG supports conducting additional activities to understand the issue related to commercial sensitivity. EFRAG notes that the proposed disclosures will not resolve the issues related to current goodwill accounting.

Introductory remarks

21 EFRAG understands that the new disclosure proposals exposed for comments in this DP do not aim at providing enhanced information about the recoverability of the goodwill still recognised on the face of the balance sheet, which could include goodwill from acquisitions that go back many years. Instead, they aim at providing better information about how successful an acquisition has been. EFRAG acknowledges that such information is important, irrespective of the presence of a material amount of goodwill deriving from an acquisition.

Would disclosure requirements resolve investors' need for better information on the subsequent performance of an acquisition?

22 EFRAG notes the concerns by investors that companies typically do not provide enough information to help investors understand the subsequent performance of an acquisition. Investors cannot assess whether management's objectives for the acquisition are being met—for example, whether the synergies that management expects from an acquisition are being realised. EFRAG notes that IFRS 3 only requires disclosures about an acquisition when it takes place. Thus, IFRS 3 does not require companies to provide entity-specific information about the subsequent performance of an acquisition.

23 EFRAG believes that, irrespective of the possible amendments to the accounting for goodwill, amending IFRS 3 to provide for enhanced disclosures about whether an acquisition has been a success is appropriate. In that respect, EFRAG generally agrees with the suggestions included in the DP to provide information about subsequent performance of acquisitions to users.

24 EFRAG, however, assesses that the proposals of the DP would not completely resolve the concerns by investors in relation to their information needs on acquisitions.

25 One of the issues is recognised in the DP. Paragraph 2.39 of the DP states that requiring the proposed disclosures only for those acquisitions monitored by the chief operating decision maker ('CODM') may result in investors not receiving material information on acquisitions.

26 In addition, as noted below, EFRAG does not agree with the DP that the information monitored by the CODM should be the only point of reference among the possible internal monitoring bodies. EFRAG, however, agrees with the IASB that basing the requirements on the information that is used internally to monitor an acquisition strikes a reasonable balance between meeting the needs of investors and making it feasible for companies to produce reliable information at a cost that is justified by the benefits to investors. In this regard, EFRAG also notes that the purpose of providing information about whether the objectives of an acquisition are being met, is primarily to allow users to assess the management's stewardship. Accordingly, it would be of limited use to require an entity to disclose a list of metrics that are not used to assess whether an acquisition is meeting its objectives.

27 EFRAG also shares the concern acknowledged in the DP about the verifiability and, in addition, auditability and enforceability of the information.

28 As further exemplified below, it has sometimes been difficult for EFRAG to assess how the IASB has intended the disclosures required to be provided. Should the IASB decide to include the proposals in an exposure draft, it would therefore be beneficial to provide some additional guidance on this in order to avoid significantly different interpretations of the requirements and/or boilerplate disclosures. For example, it should be clarified that the values of the metrics used to monitor an acquisition should be provided.

29 Finally, EFRAG understands that the purpose of the suggested disclosures is to provide information about the success (or failure) of an acquisition. The purpose is thus not to provide information about reported goodwill.

30 It could, of course, have been beneficial if the information on the success of an acquisition, in the case that it would involve a substantial amount of goodwill, could also be used to assess the reported goodwill figures. If the objective of an acquisition would not be met, this could indicate that the acquired goodwill would be impaired (but because of the shielding effect an impairment loss might not be recognised). However, the approach suggested in the DP will not be particularly useful for this purpose as information would only be provided to the extent that it is used to monitor the acquisition by the management.

31 In relation to the reported goodwill figures, a side-effect of the proposal could, however, be that the level at which an acquisition is monitored would be an indication of the level at which goodwill should be tested for impairment. The new disclosure requirement could offer an anchor point for the level at which goodwill should be allocated to cash-generating units. EFRAG thus recommends that the IASB explores the possibility of including, in the guidance on the allocation of goodwill to cash-generating units included in IAS 36, an expectation that the goodwill impairment test would be done at the level at which an entity monitors whether an acquisition is meeting its objectives.

The specific disclosure proposals

32 EFRAG agrees with the proposal to replace the requirement to disclose the primary reasons for an acquisition with a requirement to disclose:

(a) the strategic rationale for undertaking an acquisition; and

(b) management's objectives for the acquisition at the acquisition date.

33 In particular, EFRAG considers that the revised requirements could overcome the limits of the current IFRS 3 requirements, which lack entity-specific focus. EFRAG agrees that management's objectives, being the objectives of the acquisition that management considers to be achieved for the acquisition to be a success, would form the basis for better information to help investors assess the subsequent performance of the acquisition. EFRAG agrees with the two levels of definition in the requirements, i.e. to place the acquisition within the overall strategic plan of the entity and to detail the specific financial and non-financial aims. These aims are of particular importance, as their measurement leads to the metrics that support the quantitative entity-specific disclosure on the deviation between the initial target and the achieved performance in future periods.

34 EFRAG generally agrees with the requirements to disclose:

(a) information about the strategic rationale and management's objectives for an acquisition as at the acquisition date;

(b) whether it is meeting the objectives as long as it continues to monitor the acquisition – or the fact that it is not monitoring an acquisition;

(c) if it stops monitoring, whether the objectives are being met; and

(d) if it changes the metrics it uses, to monitor whether the objectives of the acquisition are being met.

35 EFRAG considers the requirement of providing information on whether the objectives of an acquisition have been met using the metrics determined at the acquisition date as essential for assessing whether the objectives of an acquisition are being met. EFRAG acknowledges that it is not always possible or ideal to assess whether the objectives of an acquisition have been met using quantitative metrics, sometimes it is only possible or better to apply a qualitative assessment. However, when quantitative metrics are applied, it is not completely clear to EFRAG whether the DP would require an entity to disclose the value of the metrics based on which the assessment is made or whether it could, for example, just state “we will assess whether an acquisition has met its objectives based on the increase in revenue from product X” and then subsequently “based on the increase in the revenue from product X, the management assesses that the objectives of the acquisition are being met”. EFRAG considers that the information will be useful if the value of the metrics is provided. EFRAG has assumed this to be the case in the remainder of its response to the DP.

36 In addition to providing information about the strategic rationale and management’s objectives for an acquisition as at the acquisition date, EFRAG considers that it would be useful to require an explanation of the entity’s investment criteria, including why the acquisition will be valuable for the entity and will provide additional value to the shareholders. This would further enhance the relevance of the information about the expected synergies.

37 EFRAG acknowledges that it may not always, depending on, for example, the strategic rationale of a business combination, be meaningful to provide quantitative metrics for the assessment of whether the objectives of the acquisition have been met. EFRAG, therefore, supports that the proposals do not require an entity to monitor whether the objectives of an acquisition have been met. EFRAG would not disagree with concerns that an entity could choose not to monitor whether the objectives of an acquisition have been met simply to avoid providing any disclosures about this. However, in those cases the entity would have to disclose that it is not monitoring the acquisition. As noted below, EFRAG considers that the information should be based on what is available at a lower level than the CODM. Accordingly, if it is disclosed that the entity is not monitoring an acquisition, this fact could be an important information for financial statement users. EFRAG understands that some users consider impairment losses to provide useful information in assessing management’s stewardship. Accordingly, indirectly, the requirement to disclose when an acquisition is not monitored could perhaps discourage some entities from such an approach. In other words, the requirement to disclose that an entity is not monitoring an acquisition could create a market discipline.

38 In order to assess whether the stated objectives of an acquisition as at the acquisition date are subsequently met, it is necessary to subsequently compare realised metrics with the objectives. It is difficult to assess whether the objectives of an acquisition as at the acquisition date are met, if the metrics used to assess this are different from the metrics used when setting the objectives. It could accordingly be considered whether it should be required that an entity that subsequently, for internal purposes, would apply other metrics to monitor an acquisition, should still prepare the metrics that were originally set to be used to assess the success of the acquisition. However, EFRAG considers that it would seem inconsistent from a cost/benefit perspective to require companies that change the metrics used to monitor whether the objectives for the acquisition are met, to keep monitoring the acquisition based on the old metrics (that may not be otherwise collected), while

companies that stop monitoring whether the objectives for the acquisition are being met are not required to do so. Requiring companies to disclose the new metrics and the reasons for the change, thus seems to be a good balance. While the new metrics may not provide useful information to assess whether the objectives of an acquisition has been met, the companies' disclosure of the reason for the change and the new metrics could be useful.

39 EFRAG agrees with the proposals that an entity should not be required to provide metrics about an acquisition if such metrics are not monitored by the management. This is because it will not always be meaningful to provide such metrics. Similarly, because the strategic rationales and the objectives of acquisitions can be very different, when it is meaningful to assess whether the objectives of a business combination is met by metrics, the metrics that would be meaningful to use for this assessment will vary. EFRAG therefore also agrees with the DP that the metrics to be provided should not be specified in IFRS 3 but should be those used by the management to monitor whether the objectives of the acquisition are being met. This being said, in order to clarify the types of metrics that could be disclosed, it would have been useful had the DP included an illustrative example of such metrics.

40 EFRAG assesses that after two to three years, it may be difficult, for practical reasons, to monitor whether the objectives of an acquisition have been met, as the acquired business eventually may become indistinguishable from the rest of the acquiring company's business. Sometimes, it may even be difficult much earlier. Also, the information about whether the original objectives of an acquisition have been met becomes less relevant as time passes. On the other hand, it may only be possible to assess whether the objectives of some acquisitions have been met after decades. For these acquisitions, it would therefore be useful to know whether the entity stops monitoring the success also after two years. Accordingly, EFRAG disagrees that an entity can stop monitoring whether the objectives of an acquisition have been met after two years, without disclosing this. EFRAG considers that it should be disclosed if an entity stops monitoring whether the objectives of an acquisition have been met within the first three years following the acquisition.

41 If an entity assesses that it is useful to continue to monitor the acquisition for a longer time, this information is also likely to be useful for the users of the financial statements. EFRAG, therefore, also supports that the entity should continue to disclose whether the objectives for an acquisition are being met as long as this is monitored by the management of the entity.

Basing the information provided on the information the entity's CODM reviews

42 EFRAG is not concerned that from the perspective of users, the volume of disclosures would be onerous if companies' disclosures are not based on the acquisitions that the CODM reviews. On the contrary, EFRAG is concerned that users may not receive sufficient information if the disclosures would only be based on the information that the CODM reviews.

43 On the other hand, EFRAG also considers that the cost of providing information about all acquisitions (and having this information audited) could result in a situation in which the cost of preparing the information would outweigh the benefits. However, as long as the information about an acquisition is prepared internally, the additional costs of providing the information would probably be reasonable compared with the benefits of the information.

44 EFRAG, therefore, believes that the information to be provided could be based on a lower level than on what the entity's CODM reviews. Accordingly, where applicable, the information to be provided could be based on the information the segment management reviews or it could be required to provide the information that is used to monitor the acquisition at the level in the organisation that managerially

monitors the acquisition, such as the chief decision maker in charge of monitoring the profit or loss of the specific CGU.

45 EFRAG acknowledges that there are advantages of referring to the information used by the chief operating decision maker, as this term is already defined in IFRS 8 *Operating Segments*. However, EFRAG considers that it should also be possible to define a lower level on which the disclosures on the success (or failure) of acquisitions should be based.

Commercial sensitivity

46 EFRAG assesses that the information required by the proposals could result in companies having to disclose information they would consider commercially sensitive. EFRAG notes that many current requirements, could have the same effect. For some companies, the profit margin appearing in the statement of financial performance could thus be commercially sensitive. EFRAG, however, also notes that entities seem to be most reluctant to provide commercially sensitive information that is forward looking. A balance therefore needs to be struck. If entities would not disclose any information about the objectives of an acquisition, it would be difficult for users of financial statements to assess the management's stewardship. An approach could be to only require entities to disclose the metrics that are essential for the success of an acquisition. However, that would mean that 'essential' would have to be defined.

47 EFRAG understands that the IASB, during the consultation period, will conduct additional activities to understand the issue related to commercial sensitivity. EFRAG supports those efforts. In that regard EFRAG, however, also notes that the most useful information is often the information that is most sensitive.

Constraints that could affect an entity's ability to disclose the proposed information

48 EFRAG is not aware of any constraints within the European Economic Area that could affect an entity's ability to disclose the information proposed in the DP.

Questions for EFRAG's constituents

49 Paragraph 37 above states that EFRAG expects that the requirement to disclose that an entity is not monitoring an acquisition could create a market discipline. If you are a user of financial statements, how would it affect your analysis if you receive information that an entity is not monitoring a significant acquisition?

50 The IASB considers that it is possible to disclose useful information on the level of achievement of the financial or non-financial targets initially defined at acquisition date and of expected synergies (see Question 4 below), without triggering commercial sensitivity. EFRAG is interested in understanding whether constituents agree with this approach and would like to receive practical examples in this regard.

51 Would there be any constraints within your jurisdiction that could affect an entity's ability to disclose the information proposed in the DP? If so, what are those constraints and what effect could they have?

Notes to constituents - Summary of the proposals in the DP

52 *In the IASB's view, investors need to understand why a company acquired a business, and what assets, synergies and other benefits it paid for. They use this information to assess whether the price for the acquired business is reasonable. Investors also want to understand whether management's objectives for an acquisition are being met.*

53 *Thus, the IASB's preliminary view is that it should develop a proposal to add further disclosure objectives that require companies to provide information to help investors to understand:*

(a) *the benefits that a company's management expected from an acquisition when agreeing the price to acquire a business; and*

(b) *the extent to which management's (CODM's) objectives for a business combination are being met.*

54 *The IASB's preliminary view is that it should develop proposals to make targeted improvements to the disclosure requirements in IFRS 3 (mainly IFRS 3 paragraph B64).*

Question 3

Paragraphs 2.53–2.60 of the DP explain the IASB's preliminary view that it should develop, in addition to proposed new disclosure requirements, proposals to add disclosure objectives to provide information to help investors to understand:

(a) the benefits that a company's management expected from an acquisition when agreeing the price to acquire a business; and

(b) the extent to which an acquisition is meeting management's (CODM's) objectives for the acquisition.

Do you agree with the IASB's preliminary view? Why or why not?

EFRAG's response

EFRAG supports the introduction of the disclosure objectives.

55 As per the answer to Question 2 above, EFRAG supports the proposed requirements to disclose information about the strategic rationale and management's objectives for an acquisition as at the acquisition date. EFRAG also supports the requirement to provide information on whether the entity is meeting the objectives.

56 EFRAG agrees with these specific requirements as EFRAG considers it important that users of financial statements receive information to assess the expected benefits from an acquisition and the extent to which the acquisition is providing these benefits. Such information is important for assessing the management's stewardship. In order for preparers to better understand the purpose of the disclosure requirements and hence be able to provide the disclosures best suited, EFRAG supports the introduction of disclosure objectives. EFRAG, accordingly, agrees with the additional disclosure objectives that require companies to provide information to help investors to understand:

(a) the benefits that a company's management expected from an acquisition when agreeing the price to acquire a business; and

(b) the extent to which an acquisition is meeting management's objectives for the acquisition.

Notes to constituents - Summary of the proposals in the DP

57 *According to the DP, investors have said the information they want is not about goodwill itself, but information that gives them a better understanding of why a company paid the price it did for the acquired business.*

58 *Investors have said that information on the nature, timing and amount of expected synergies is important. It would allow them to understand better the benefits a*

company's management expected when agreeing the price to acquire a business. This information would help investors to assess whether the price paid was reasonable. The information would also help investors hold management to account for its progress in achieving those synergies.

59 *Stakeholders have told the IASB that synergies are often difficult to quantify. However, the IASB expects that management would have already made an estimate of expected synergies in agreeing the price for an acquired business. Stakeholders have also said that disclosures about expected synergies could be commercially sensitive. However, the IASB does not intend to require companies to disclose detailed plans on how they intend to realise the synergies.*

60 *Thus, the IASB's preliminary view is that it should require a company to disclose in the year an acquisition occurs:*

(a) *a description of the synergies expected from combining the operations of the acquired business with the company's business;*

(b) *when the synergies are expected to be realised;*

(c) *the estimated amount or range of amounts of the synergies; and*

(d) *the estimated cost or range of costs to achieve those synergies.*

61 *In addition, investors would like companies to disclose the amounts of financing and defined benefit pension liabilities because they view them as part of the total capital employed in the transaction by the acquirer.*

62 *Thus, the IASB's preliminary view is that it should develop proposals to specify that liabilities arising from financing activities and defined benefit pension liabilities are major classes of liabilities.*

Question 4

Paragraphs 2.62–2.68 and paragraphs 2.69–2.71 of the DP explain the IASB's preliminary view that it should develop proposals:

(a) to require a company to disclose:

(i) a description of the synergies expected from combining the operations of the acquired business with the company's business;

(ii) when the synergies are expected to be realised;

(iii) the estimated amount or range of amounts of the synergies; and

(iv) the expected cost or range of costs to achieve those synergies; and

(b) to specify that liabilities arising from financing activities and defined benefit pension liabilities are major classes of liabilities.

Do you agree with the IASB's preliminary view? Why or why not?

EFRAG's response

EFRAG supports the objectives of the suggested disclosure requirements on synergies and would suggest that the IASB explore expanding such requirements to other components of goodwill. However, EFRAG questions whether the benefits of providing the disclosures on synergies will outweigh the costs and is therefore seeking inputs from constituents on costs (Questions 2 to 5). EFRAG supports separate disclosure of liabilities arising from financing activities and defined benefit pension liabilities acquired as part of an acquired business.

Synergies

63 EFRAG generally supports the objectives of the suggested disclosure requirements on synergies expected from combining the operations of the acquired business with the company's business, as this information could be useful for investors and users. In relation to the description of the synergies and the benefits expected from these, as suggested in the DP, it could also be useful to describe any conditions on which the benefits would depend.

64 EFRAG notes that, if goodwill were to be amortised, and synergies would constitute a significant element of goodwill, there should be a link between the information provided on when the entity is expected to benefit from the synergies and the amortisation period of goodwill (or the part of goodwill related to the synergies), for those goodwill components for which this would be relevant. Whether the information would be relevant would depend on the type(s) of synergy(ies) identified, as it could be argued that some types of synergies are not "consumed". It will accordingly be necessary for management to assess whether synergies are subject to consumption (and thus have a finite life), or on the contrary have an indefinite life. If goodwill were to be amortised, it would then also be relevant to consider disclosure about the pattern by which the entity is expected to benefit from the synergies for the types of synergies that are consumed.

EFRAG has not formed a view on the possible introduction of amortisation and is consulting its constituents on this topic.

65 Although EFRAG generally supports the objectives of the suggested disclosures on synergies, EFRAG:

(a) considers that the information could also be provided for other elements that constitute goodwill (other than synergies), and/or at least a different type of materiality threshold could be introduced, as illustrated below; and

(b) has some reservations about the practical aspects and on the balance between cost and benefits of the proposed requirements.

Information for other elements of goodwill and a different materiality threshold

66 Paragraph B64 of IFRS 3 requires an entity to provide a qualitative description of the factors that make up the goodwill recognised, such as expected synergies from combining operations of the acquiree. According to the DP, investors have said the information they want is not about goodwill itself, but information that gives them a better understanding of why a company paid the price it did for the acquired business.

67 In order to provide better information about why a company paid the price it did for the acquired business, EFRAG considers that similar information as that suggested in the DP for synergies could also be required for other elements of goodwill. Expectations related to other types of intangible resources that would not qualify for (separate) recognition would thus be relevant in that regard.

68 If such additional requirements would not be introduced, it is EFRAG's view that the information about synergies should be provided in a manner that could provide users with information about the size of the remaining parts of goodwill. This would mean that a different materiality threshold should be set for the information on synergies.

69 EFRAG thus considers that when an acquisition is material and information about it is accordingly provided in the financial statements, it should first be assessed whether goodwill was material for the price paid for the acquired business. If goodwill is material and synergies constitute a material part of goodwill (which would therefore be mentioned in the disclosure required by paragraph B64), the proposed

disclosures on synergies should then be provided. This could mean that the reported range of synergies reported in isolation would not be material amounts (for example, when goodwill is just material and synergies is just one of several material parts of goodwill – then the synergies by themselves would not be material). However, it would then provide users with information about the size of the remaining parts of goodwill, such as intangible assets that do not qualify for separate recognition

70 While EFRAG believes that a materiality threshold set as described above would result in the most useful information, EFRAG is also aware that providing such information results in some practical issues and that the cost/benefit aspects would also need to be considered.

Practicality and cost/benefit aspects

71 Although EFRAG considers that the information about synergies that is proposed in the DP, in principle, would be useful, EFRAG questions the reliability of the information that will eventually be reported and acknowledges that some consider the information to be difficult to audit. EFRAG accordingly questions whether the resulting benefits would outweigh the costs.

72 EFRAG notes that the reliability and auditability will depend on the circumstances. Some of the information may be derived more or less directly from the measurement process of the purchase price allocation, which is currently audited. However, in order for the information to be a faithful representation of the expectation of a company's management when agreeing the price to acquire a business, it seems to be an underlying assumption that the purchase price allocation is done before an acquisition and not as a compliance exercise after the acquisition. EFRAG understands that, in practice, this assumption may often not hold.

73 EFRAG also notes that currently, there is diversity in practice on what entities consider "synergy". Depending on how the different components of expected cash flows as part of the purchase price and other future monetary benefits are considered and modelled, EFRAG acknowledges that the reliability and auditability will depend on the description in the notes.

74 EFRAG also notes that information about expected synergies might be considered to be commercially sensitive information, even though companies will not be required to disclose detailed plans on how they intend to realise the synergies.

75 Given these issues, EFRAG would therefore welcome further assessment of the practicability of these requirements, considering their possible added benefit in terms of decision-usefulness. In addition, the comments made in paragraphs 46 - 47 above also applies to the disclosure about expected synergies.

Liabilities arising from financing activities and defined benefit pension liabilities

76 EFRAG supports the proposal to specify that liabilities arising from financing activities and defined benefit pension liabilities are major classes of liabilities. This would mean that companies would disclose separately the amount of such liabilities acquired as part of the acquired business for each acquisition, if the information is material. EFRAG notes that the information would be useful for investors and is likely to be readily available because these items are required to be recognised and measured at the acquisition date.

Notes to constituents - Summary of the proposals in the DP

77 *During and after the Post-implementation Review of IFRS 3, stakeholders commenting on pro forma information have said that:*

(a) *the information is not useful because it is hypothetical;*

(b) *there is a lack of guidance on how to prepare the information and therefore companies prepare the information in different ways;*

(c) *information about the revenue and profit of the acquired business before the acquisition is not always readily available;*

(d) *it is costly to produce the pro forma information.*

78 *The IASB reached a preliminary view that it should:*

(a) *Replace the term 'profit or loss' in paragraph B64(q) of IFRS 3 with the term 'operating profit before deducting acquisition-related costs and integration costs'. Operating profit or loss would be defined as in the Exposure Draft General Presentation and Disclosures. The IASB expects that a measure based on operating profit would:*

(i) *provide investors with information about the operating performance of the main business activities of the acquired business that is independent of how the acquired business is financed; and*

(ii) *avoid the need for companies to make subjective allocations of finance costs and tax expenses if the acquired business has been integrated.*

(b) *Add to paragraph B64(q) a requirement to disclose cash flows from operating activities. The IASB expects that the disclosure of cash flows from operating activities would help those investors who use cash flow measures in their analysis.*

(c) *After the revisions in (a) and (b), retain the requirement for the information to be disclosed for the combined entity as if the acquisition had occurred at the start of the reporting period (pro forma information).*

Question 5

IFRS 3 *Business Combinations* requires companies to provide, in the year of acquisition, pro forma information that shows the revenue and profit or loss of the combined business for the current reporting period as though the acquisition date had been at the beginning of the annual reporting period.

Paragraphs 2.82–2.87 of the DP explain the IASB's preliminary view that it should retain the requirement for companies to prepare this pro forma information.

(a) Do you agree with the IASB's preliminary view? Why or why not?

(b) Should the Board develop guidance for companies on how to prepare the pro forma information? Why or why not? If not, should the IASB require companies to disclose how they prepared the pro forma information? Why or why not?

IFRS 3 also requires companies to disclose the revenue and profit or loss of the acquired business after the acquisition date, for each acquisition that occurred during the reporting period.

Paragraphs 2.78–2.81 of the DP explain the IASB's preliminary view that it should develop proposals:

- To replace the term 'profit or loss' with the term 'operating profit before acquisition-related transaction and integration costs' for both the pro forma information and information about the acquired business after the acquisition date. Operating profit or loss would be defined as in the Exposure Draft General Presentation and Disclosures.

- To add a requirement that companies should disclose the cash flows from operating activities of the acquired business after the acquisition date, and of the combined business on a pro forma basis for the current reporting period.

(c) Do you agree with the IASB's preliminary view? Why or why not?

EFRAG's response

EFRAG suggests that the IASB provides a principles-based definition for the new concepts of "acquisition-related" and "integration cost" to be used in preparing the pro forma information. EFRAG agrees with replacing 'profit or loss' with 'operating profit before acquisition-related transaction and integration costs' for both the pro forma information and information about the acquired business after the acquisition date. EFRAG disagrees with providing similar information for cash flows from operating activities.

Pro forma information

79 EFRAG agrees with the proposal in the DP to retain the requirement to disclose, to the extent practicable, the revenue and profit or loss of the combined entity for the current reporting period as though the acquisition date had been at the beginning of the annual reporting period.

80 Whilst the information will be hypothetical, EFRAG considers that it will still be useful. Trend information about an entity's financial performance is important for users. A material acquisition in a financial year will make information about the past less useful for predicting the future. EFRAG assesses that the pro forma information could be helpful in this regard.

81 The DP indicates that there are differences in how pro forma information is prepared. EFRAG would not disagree with this. However, EFRAG also notes that the information would be non-GAAP information and, as such, subject to judgement. In addition, in some jurisdictions detailed guidance on the preparation of such information is provided by other authorities and organisations, for example, by stock exchanges. Accordingly, EFRAG does not consider that it should be a priority for the IASB to develop guidance on how to build pro forma measures. To help enhance comparability, EFRAG, however, suggests that the IASB provides a principles-based definition for the new concepts of "acquisition-related" and "integration cost". In addition, EFRAG would support entities providing explanations about the judgement applied in the preparation of the pro forma information.

Replacing 'profit or loss' with 'operating profit before acquisition-related transaction and integration costs'

82 EFRAG notes that the manner in which business combinations are accounted for is disruptive for analysts' trend analyses. For example, when inventory is remeasured at fair value following the purchase price allocation, profit margins after the acquisition will not any more reflect the entity's estimation of future profit margins. Similar examples may be developed for all the items that are measured at fair value following the purchase price and for the amortisation of definite-life recognised intangibles. EFRAG notes that APMs are used that eliminates, from the operating profit, the impact of the effects of the purchase price allocation. EFRAG has therefore considered whether it would be more useful to present further modified figures than 'operating profit before acquisition-related transaction and integration

costs'. In addition to excluding acquisition-related transaction and integration costs, such a figure[1] could also exclude the effects of the revaluations to fair value.

83 Although EFRAG considers such figures to be useful, it is unsure how costly they would be to prepare. Accordingly, it is consulting its constituents on this issue in order to be able to assess whether the costs would outweigh the benefits of requiring entities to disclose, in the notes, performance figures excluding the effects of the purchase price allocation.

84 If, EFRAG would reach the conclusion that it would be too costly to prepare disclosures excluding the effects of the purchase price allocation, EFRAG would support replacing 'profit or loss' with 'operating profit before acquisition-related transaction and integration costs' in the disclosures currently required in paragraph B64(q) of IFRS 3.

85 That change will provide investors with information about the operating performance of the main business activities of the acquired business since the acquisition date that is independent of how the acquired business is financed and how the entity has allocated finance costs and tax expenses between an integrated acquired business and the existing business.

86 EFRAG's support is, however, conditional on 'operating profit or loss' being defined in IFRS. As mentioned in EFRAG's comment letter in response to IASB ED/2019/7 *General Presentation and Disclosures*, EFRAG generally supports the definition of operating profit or loss included in that exposure draft. Although the information suggested on operating profit or loss in the DP will be on a different level than the reporting entity, and hence non-GAAP measures, it is necessary to have some principles on what the information should include. For the same reason, if the IASB would replace 'profit or loss' with 'operating profit before acquisition-related transaction and integration costs', EFRAG would support the IASB in developing a principle-based definition to provide guidance on what 'acquisition-related transaction and integration costs' would include.

87 As a minor point, while the DP is referring to 'operating profit before deducting acquisition-related costs and integration costs', EFRAG suggests referring to 'operating profit or loss before deducting acquisition-related costs and integration costs' to align the figure and wording with the proposed definition of 'operating profit or loss'.

Cash flows from operating activities

88 EFRAG disagrees with the proposal to require entities to disclose the cash flows from operating activities of the acquired business after the acquisition date, and of the combined business on a pro forma basis for the current reporting period. EFRAG considers that the usefulness of this information would be very limited. EFRAG seeks input on the costs to prepare this information when the acquired business is fully integrated and does not prepare separate accounts.

89 EFRAG questions the usefulness of the information as those investors using cash flow information in their analyses would likely need additional information on cash flows rather than the subtotal of operating cash flows in order to be able to use the figure. Cash flows from operations can be heavily affected by, for example, whether a business would allow customers to defer their payments in the period before the acquisition date and such information would not be available to the users of the financial statements from the figure. In addition, without further guidance on how the

[1] Instead of only considering presenting a few figures, it could be considered to present a statement of figures as they would have been without the purchase price allocation.

figure should be calculated, EFRAG assesses that divergence in practice would arise which would further diminish the usefulness of the figure.

90 EFRAG believes that it could be costly to prepare the information. If the indirect method is applied for preparing the statement of cash flows, entities might have to prepare additional statements of financial position in order to be able to provide the information.

Questions for EFRAG's constituents

91 In paragraph 89 above, EFRAG questions the usefulness of disclosing the cash flows from operating activities of the acquired business after the acquisition date, and of the combined business on a pro-forma basis for the current reporting period. Would you find the suggested information useful? Please explain.

92 As a next step in this project, the IASB intends to investigate whether it could remove any of the disclosure requirements from IFRS 3 without depriving investors of material information (IASB DP Paragraph 2.88).

Do you have specific input on this topic?

Question to preparers: costs of the disclosure (ref. Questions 2 to 5)

93 As mentioned in paragraph 83 above, EFRAG is unsure about how costly it will be to prepare disclosures on how performance figures would have been without the effects of the purchase price allocation (including revaluation to fair value of most of the acquired business's assets and liabilities). Do you assess that this information would be costly to preparer? Please explain.

94 As mentioned in paragraph 83 above EFRAG seeks input on the costs to prepare the information about cash flows from operating activities of the acquired business after the acquisition date and of the combined business on a pro forma basis for the current reporting period, in particular when the acquired business is fully integrated and does not prepare separate accounts.

95 In general (ref. to Questions 2 to 5): EFRAG is also interested in receiving preparers' inputs on the operational implications (e.g. quality of data, internal control, auditability) of these disclosures and their costs.

Section 3— Goodwill impairment and amortisation

Section highlights according to the IASB's DP

(a) *Goodwill can be tested for impairment only indirectly.*

(b) *Preliminary view to retain impairment-only model—no compelling evidence that a change is needed.*

(c) *Both methods of accounting for goodwill—impairment-only and amortisation with impairment—have limitations. Which method would more effectively hold management to account?*

(d) *Do stakeholders have new information to help the IASB?*

Notes to constituents - Summary of the proposals in the DP

96 *Many stakeholders have said that impairment losses on goodwill are sometimes recognised too late, long after the events that caused those losses.*

97 *The IASB identified two broad reasons for concerns about the possible delay in recognising impairment losses on goodwill:*

(a) *Management over-optimism—some stakeholders have concerns that management may sometimes be too optimistic in making the assumptions needed to carry out the impairment test.*

(b) *Shielding effect—a cash-generating unit, or group of cash-generating units, containing goodwill, typically contains headroom. Shielding arises because, applying current requirements, all reductions in total goodwill are allocated first to the unrecognised headroom. An impairment loss is recognised only when the recoverable amount of the cash generating unit falls below the carrying amount of the recognised assets and liabilities of the cash-generating unit. This means that a company recognises an impairment loss on acquired goodwill only once that headroom is reduced to zero. An acquisition could therefore underperform against management's expectations, but the company would recognise no impairment of acquired goodwill if it has sufficient headroom to absorb the reduction in value.*

98 *The IASB investigated whether it is feasible to make the impairment test for cash-generating units containing goodwill significantly more effective at recognising impairment losses on goodwill on a timely basis than the impairment test set out in IAS 36.*

99 *In doing so, the IASB investigated whether it could incorporate the estimate of headroom into the design of the impairment test, and by doing so:*

(a) *reduce the shielding effect;*

(b) *target the acquired goodwill more effectively; and*

(c) *require companies to recognise impairment losses on acquired goodwill on a more timely basis.*

100 *This 'headroom approach' would compare:*

(a) *the recoverable amount of the cash-generating units; with*

(b) *the sum of:*

(i) *the carrying amount of the recognised assets and liabilities of the cash-generating units; and*

(ii) *the headroom of the cash-generating units at the previous impairment testing date.*

101 *The IASB concluded that the 'headroom approach' would reduce shielding but not eliminate it, because:*

(a) *the allocation of any reduction in total goodwill is imperfect; and*

(b) *if the acquired business is performing poorly, better performance from other elements of the combined business could still shield the acquired goodwill from impairment.*

102 *Moreover, the 'headroom approach' could result in recognising impairments that are, in some circumstances, difficult to understand and the approach would increase cost.*

103 *Because goodwill does not generate cash flows independently and cannot be measured directly, it must be tested for impairment with other assets. Thus, the IASB has concluded that some shielding is always likely to occur.*

104 *For the above reasons, the IASB's preliminary view is that it is not feasible to design a different impairment test that is significantly more effective than the impairment test in IAS 36 at recognising impairment losses on goodwill on a timely basis at a reasonable cost.*

Question 6

As discussed in paragraphs 3.2–3.52 of the DP, the IASB investigated whether it is feasible to make the impairment test for cash-generating units containing goodwill significantly more effective at recognising impairment losses on goodwill on a timely basis than the impairment test set out in IAS 36 *Impairment of Assets*. The IASB's preliminary view is that this is not feasible.

(a) Do you agree that it is not feasible to design an impairment test that is significantly more effective at the timely recognition of impairment losses on goodwill at a reasonable cost? Why or why not?

(b) If you do not agree, how should the IASB change the impairment test? How would those changes make the test significantly more effective? What cost would be required to implement those changes?

(c) Paragraph 3.20 of the DP discusses two reasons for the concerns that impairment losses on goodwill are not recognised on a timely basis: estimates that are too optimistic; and shielding. In your view, are these the main reasons for those concerns? Are there other main reasons for those concerns?

(d) Should the IASB consider any other aspects of IAS 36 in this project as a result of concerns raised in the Post-implementation Review (PIR) of IFRS 3?

EFRAG's response

EFRAG shares the IASB's reservations on the possibility to develop a different and more effective impairment approach. However, EFRAG believes that, without putting into question the fundamentals of impairment in IAS 36, there are collateral areas of possible improvements. EFRAG suggests that the guidance on goodwill allocation to cash generating units is discussed and possibly amended to improve how the test is applied in practice. In addition, better disclosures of estimates used to measure recoverable amounts of cash-generating units containing goodwill could supplement the improvements to goodwill allocation guidance. EFRAG seeks constituents' inputs on possible disclosure proposals to mitigate the risk of management over-optimism.

Designing an impairment test to be significantly more effective

105 EFRAG notes that the main issues that the IASB is trying to solve with this project is that impairment losses on goodwill are sometimes recognised too late (long after the events that caused those losses) and, as such stakeholders have urged to make the impairment test more effective at recognising impairment losses on goodwill on a timely basis. In addition, EFRAG has received recent feedback from users that the current impairment model is unsatisfactory.

106 EFRAG has reservations on the possibility to develop a different and more effective impairment approach. Among others, in the past, also EFRAG tried to develop an alternative approach (2017, *Goodwill Impairment Test: Can it be improved?*) but that approach was not supported by the constituents in that consultation. However, EFRAG believes that, without putting into question the fundamentals of impairment in IAS 36, there are collateral areas of possible improvements, as described below. EFRAG anticipates that the benefits of exploring these enhancements may be justified irrespective of the eventual reintroduction of the amortisation, as the risk of overstating goodwill is reduced as a result of the amortisation process only several years after the initial recognition and in this period the risk of impairment can be material.

107 EFRAG agrees with the reasons identified, i.e. that estimates of cash flows may sometimes be too optimistic and the so called "shielding" effect (see paragraph 111). Because goodwill does not generate cash flows independently, it is tested for impairment within the cash-generating units expected to benefit from the acquisition. As the current guidance in IAS 36 refers, in addition, to the level at which the entity monitors goodwill, companies have some flexibility and can allocate goodwill on a judgemental basis. Companies that are not monitoring goodwill after acquisitions have to allocate goodwill at least to operating segments as defined under IFRS 8.

108 To a certain extent, this shielding effect is unavoidable, as:

(a) the impairment test is not targeted to measure the recoverable amount of goodwill but that of the CGU or group of CGUs;

(b) after the business combination, an additional shield normally arises from internally generated goodwill; and

(c) the potential shielding effect increases with a higher level of allocation and the potential mix of business with different profitability.

109 The level of allocation of goodwill could be discussed to improve the effectiveness of impairment testing by improving the guidance on allocation and having therefore impairments to be recognised at an earlier stage as triggering events can be monitored, as well, at a lower level.

110 EFRAG suggests that the guidance on goodwill allocation to cash generating units is discussed and possibly amended to improve how the test is applied in practice

(see paragraphs 116-123 below). In addition, better disclosures to estimates used to measure recoverable amounts of cash-generating units containing goodwill could supplement the improvements to goodwill allocation guidance (see paragraphs 126-127 below).

Reasons for the concerns that impairment losses on goodwill are not recognised on a timely basis

111 EFRAG agrees with the view indicated in the DP, that the two main reasons of the possible delay in recognising impairment losses on goodwill are management over-optimism (management may sometimes be too optimistic in making the assumptions needed to carry out the impairment test) and the shielding effect created arising from internally generated goodwill, unrecognised assets, and unrecognised differences between the carrying amount of recognised assets and liabilities and their recoverable amounts. EFRAG notes that the shielding effect is generally greater when goodwill is allocated to groups of cash generating units containing many cash generating units.

Management over-optimism

112 EFRAG acknowledges that management having a high level of optimism about future cash flows associated with the CGU to which goodwill is allocated, was cited by some investors and auditors as a main reason for delays in recognising impairment of goodwill.

113 The DP concludes that the management over-optimism is best addressed by auditors and regulators, not by changing IFRS Standards. EFRAG might not completely agree with this. Auditors and regulators might not be able to have better knowledge about the business development than management, and therefore they might not replace the estimations made by management with their own estimations. To address over-optimism, EFRAG suggests that the IASB considers developing possible disclosure solutions for a better transparency of the estimates made or their achievement. Furthermore, as a consequence of being generally overoptimistic over a certain period (e.g. five years) impairment test or additional disclosure requirements (like disclosing recoverable amount calculated on actual basis) could be discussed. EFRAG is asking constituents' view on the usefulness and practicability of some suggestions (see the question for constituents in paragraph 132).

Shielding effect

114 EFRAG admits that the IASB considered the headroom approach to address the shielding effect. The headroom approach does address the 'too little too late' concern. However, it does not do it perfectly. Its practical outcome would depend heavily on the allocation of impairments between acquired goodwill and unrecognised headroom. In addition, such approach would reduce shielding but not eliminate it.

115 Furthermore, the 'headroom approach' could result in recognising impairments that are, in some circumstances, difficult to understand adding complexity (particularly for companies that frequently acquire new businesses) and would add cost. Thus, the headroom approach did not seem to receive wide support when it was suggested. However, EFRAG considers that the approach, despite its complexity, had the conceptual merit of addressing the intrinsic limits of the impairment approach.

Allocation of goodwill to the cash-generating units ('CGUs')

116 As noted above, to reduce shielding to a certain extent and to reduce judgement and avoid any opportunistic behaviour, EFRAG suggests that the guidance on

allocation of goodwill to the cash-generating units could be enhanced to improve how the test is applied in practice.

117 EFRAG acknowledges that the shielding effect is generally greater when goodwill is allocated to groups of cash generating units containing several cash generating units or in cases where goodwill is allocated to one large CGU which size is significant compared to the acquired business.

118 EFRAG agrees with the DP that academic research generally shows that goodwill impairment losses are used opportunistically by management. EFRAG observes that this is linked to the level of judgement allowed by the current guidance. As noted above, this can happen by being over-optimistic (or the opposite) when estimating future cash flows. However, it can also be done by means of adopting a certain approach when allocating goodwill to CGUs. Either by allocating goodwill to a higher level (where managerial monitoring is possible at a lower level) and/or by reallocating goodwill (for example, by means of changing segment reporting).

119 EFRAG considers that the guidance could be clarified to help allocate goodwill to the lowest level possible that outweighs costs of impairment testing and information needs based on value relevance.

120 In addition, to mitigate ineffectiveness of the impairment test as a result of how it is applied in practice, the IASB could assess whether introducing additional guidance on the allocation of goodwill to CGUs could result in a more effective application of the impairment test. EFRAG understands that the current guidance allows, in some circumstances, to allocate in practice goodwill in a way that is not fully reflective of the structure of cash generating units and, therefore, not fully reflective of the intended benefit paid with the purchase price. The current guidance foresees that for the purpose of impairment testing, goodwill acquired in a business combination shall, from the acquisition date, be allocated to each of the acquirer's cash-generating units, or groups of cash-generating units, that is expected to benefit from the synergies of the business combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units or groups of units. Each unit or group of units to which the goodwill is so allocated shall: a) represent the lowest level within the entity at which the goodwill is monitored for internal management purposes; and b) not be larger than an operating segment determined in accordance with IFRS 8. Entities that claim that they are not "monitoring" goodwill, would test goodwill on segment level. In fact, in some circumstances, operating segments can be defined by entities independent from the structure of cash inflows and as companies have the possibility to claim that they are not "monitoring" goodwill, this could lead to the situation that allocation of goodwill is not connected to the reasons it was recognised as of the acquisition date. In such circumstances, events that trigger impairment may become more difficult to promptly be identified.

121 EFRAG understands that this guidance might provide room for opportunistic behaviour, and in extreme circumstances may even incentivise to adjust segment reporting so that, as a result of offsetting head-rooms between more and less profitable units, the risk of impairment is reduced.

122 EFRAG suggests exploring to rely more on the goodwill allocation guidance on the managerial assessment that is done at acquisition on how benefits and synergies deriving from a given acquisition are expected to materialise. This could be done also in coordination with the proposed new disclosure on the expected targets used to measure the performance of the business combination.

123 EFRAG considers preparers should be able to allocate goodwill from recent business combinations based on the decisions made to pay a certain purchase price. Beside better allocation to a relevant unit of account, this would allow better identification of events that indicate impairment. EFRAG considers that goodwill

allocation to cash generating units should be required. For example, to reduce the possibilities of opportunistic behaviour, a rebuttable presumption could be considered that the allocation level is below operating segment level. Any allocation to segment level should be reasonably explained in the notes by management with a focus on explanation of cash inflow structure and cash inflows that can be monitored and would trigger impairment.

124 The IASB could also consider enhancing the guidance for reallocation of goodwill. The current guidance requires reallocation if an entity reorganises its reporting structure in a way that changes the composition of one or more cash-generating units. Reallocation is driven by changing the reporting structure. In addition, the relative value approach leads to a situation that a unit with a weak performance can decrease impairment risk by reallocation. For the purposes of the subsequent measurement of goodwill, reallocation would be allowed in the enhanced guidance only provided that they are justified by a change in the cash flow structures. A re-allocation of reporting segments in its own would not be sufficient anymore.

125 EFRAG recognises that tracking of goodwill and allocating it properly to cash generating units will require better documentation. The basis for such documentation is related to the acquisition and further strategy development. Therefore, such documentation should be possible at reasonable cost.

Better disclosures to estimates used to measure recoverable amounts of cash-generating units containing goodwill

126 As indicated above in paragraph 112, EFRAG considers that better disclosures of the estimates used to measure recoverable amounts of cash-generating units containing goodwill could supplement the improvements of the goodwill allocation guidance.

127 In addition, the intended better disclosures about acquisitions over a certain period subsequent to the acquisition besides giving better information about the acquisition to the user, will allow users with a better understanding of the goodwill allocation and better assessment of the estimations made by management to calculate the recoverable amount.

Other aspects of IAS 36 the IASB could consider – guidance in relation to disposals of goodwill

128 Similar to the guidance in relation to the reallocation of goodwill, the IASB could also consider enhancing the guidance in relation to disposals of goodwill. If an underperforming business is sold, the current guidance might lead to a situation that the goodwill related to that business or the synergies that were expected to be realised when acquiring this business remain, as they are part of the goodwill recognised in the accounts of the selling entity. EFRAG acknowledges that goodwill cannot be sold. However, the current approach relies on a relative value approach at the time of disposal and this does not have a strong conceptual basis, as it is rather a convention and may leave room for opportunistic behaviour. Further consideration is necessary to avoid that goodwill will remain in the accounts of the selling entity, without realising any benefits expected.

Questions for EFRAG's constituents

129 Do you agree that the IASB should consider improving guidance on allocation and reallocation of goodwill to cash generating units as this would improve the discipline in the application of impairment testing in practice? Do you see such improved guidance in connection with better information about business combinations as a basis for a better assessment on whether there is any indication for impairment?

130 Do you think that the benefit from changing such guidance would outweigh costs? Would there be significant additional costs?

131 Do you agree with the IASB's view that management over-optimism is best addressed by auditors and regulators, not by changing IFRS Standards? Please explain why.

132 To address management over-optimism, EFRAG suggests that the IASB considers developing possible disclosure solutions for a better transparency of the estimates made or their achievement. EFRAG considers that the below possible approaches, or a combination of them, could provide more transparency and more discipline in relation to being over-optimistic by the management. Such a requirement will allow users to make a better assessment of the estimations made by management to calculate the recoverable amount. EFRAG notes that such possible requirements could help in identifying events that trigger impairment. Furthermore, as a consequence of being generally overoptimistic over a certain period (e.g. five years) impairment test or additional disclosure requirements (like disclosing recoverable amount calculated on actual basis) could be discussed. Therefore, EFRAG is asking constituents' view on the usefulness and practicability of the following suggestions:

(a) *Historical estimations to allow to asses being overoptimistic or realistic*

Similar to the disclosure requirements suggested in the DP addressing whether objectives of acquisitions have been met, a disclosure requirement could be introduced on how the management's cash flow predictions differ from the obtained cash flows and make it therefore transparent if being over-optimistic. Most useful in this regard would be assessment of target achievement on a mid-term basis for more than the respective preceding year (e.g. assessment of the last prior three years of the mid-term assumptions by comparing projections to the actuals achieved). Such information about achievement of prior projections could be given on a qualitative or quantitative basis.

(b) *Improve information to assumptions over the period for which management has projected cash flows based on financial budgets*

Another possible approach could be to improve the usefulness of the mid-term period information as required by IAS 36 paragraphs 134(d)(ii) or 134(e)(ii) as the recoverable amount is driven by assumptions taken to reach a terminal. According to IAS 36 paragraph 134, an entity has to provide information about the method of estimation of cash flows but not the specific growth rate within the period over which management has projected cash flows based on financial budgets/forecasts. Such growth rate has to be specified only for the terminal value. Requiring to disclose how the growth rate in the terminal level compares to the current growth rate (e.g. increased by 30%) or to disclose the level of profit margin applied when going into the terminal value could make management estimations transparent and allow users to make their own judgement, especially as such a level of cash flows reached forms the basis of the terminal value and thus the major part of the recoverable amount of the CGU.

(c) *Current level of cash flows/ margins or earnings*

Lastly, a requirement could be introduced to provide quantitative information of the present performance, present relevant margins or current cash flows and therefore give information to the users to do estimations and projections themselves. That information could be used to assess whether a recoverable amount is in question and to give transparency to estimation uncertainty. Furthermore, this approach would avoid any discussion about disclosing forward looking information.

133 Do you consider additional disclosures in relation to estimates used to measure recoverable amounts of cash-generating units containing goodwill is necessary as suggested above? Could those suggested disclosures provide more transparency and more discipline in relation to being over-optimistic by the management? If so, which option in paragraph 132 do you consider best addressing the management over-optimism issue and provide more transparency and more discipline:

(a) achievement of previous estimations (make over-optimism transparent);

(b) information to the period for which management has projected cash flows based on financial budgets?

(c) to disclose the current level of cash flows/ earnings to allow users to model themselves?

134 Do you consider that the options listed are feasible and practicable for prepares and provide useful information for users? Please explain your response and explain whether you prefer a combination of them, or whether you consider that other qualitative information could be required.

135 Do you consider it necessary to introduce consequences like discussed in paragraph 113 for those that are generally overoptimistic?

Notes to constituents - Summary of the proposals in the DP

136 *Having concluded that the approach in IAS 36 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. This is because amortisation could:*

(a) *take some pressure off the impairment test, which may make the impairment test easier and less costly to apply.*

(b) *provide a simple mechanism that targets the acquired goodwill directly. By reducing the carrying amount of acquired goodwill, amortisation might help resolve the concerns of those stakeholders who believe the carrying amount of goodwill can be overstated because of management over-optimism or because goodwill is not tested for impairment directly.*

137 *The IASB considered whether reintroducing amortisation or retaining the impairment only model.*

138 *Proponents of reintroducing amortisation generally give one or more of the following arguments:*

(a) *The Post-implementation Review (PIR) of IFRS 3 suggests that the impairment test is not working as the IASB intended (impairment losses are not recognised on a timely basis, limited information value, the impairment test is complex and costly to perform).*

(b) *Carrying amounts of goodwill are overstated and, as a result, a company's management is not held to account for its acquisition decisions. Some argue that because goodwill can only be tested for impairment as part of a CGU, the resulting shielding by headroom causes too high a risk that carrying amounts of acquired goodwill could be overstated. Stakeholders with this view therefore argue the carrying amount of goodwill does not faithfully represent the future benefits still expected from the acquisition. Some stakeholders take the view* *that the impairment test is not effective at holding management to account for the significant amounts of goodwill recognised in acquisitions.*

(c) *Goodwill is a wasting asset with a finite useful life, and amortisation would reflect the consumption of goodwill. Some argue that acquired goodwill is a wasting asset with a finite useful life. If acquired goodwill is consumed, investors would find it useful for the company to inform them about that consumption by recognising an amortisation expense in the income statement in the same period as the company obtains the benefits from consuming the goodwill.*

(d) *Amortisation would reduce the cost of accounting for goodwill.*

139 *Proponents of retaining the impairment-only model generally give one or more of the following arguments:*

(a) *The impairment-only model provides more useful information than amortisation. Some investors have said that amortisation expense provides investors with no useful information If determining the useful life of goodwill is arbitrary and the information provided by the impairment test is useful, even if it only has confirmatory value. Some also argue that amortisation of goodwill could make the information provided less useful. Amortisation could reduce the likelihood of an impairment loss being recognised because the reduction in carrying amount makes it less likely that the carrying amount would not be recoverable.*

(b) *If the test is performed well, it would be expected to meet its objective of ensuring that the carrying amount of acquired goodwill is recoverable from cash flows it is expected to generate jointly with other assets. The PIR of IFRS 3 and the IASB's subsequent research have not found new evidence that the test is not sufficiently robust. Some argue that the impairment test is working as the IASB intended when it designed the impairment test in 2004, because the IASB was already aware of the shielding effect.*

(c) *Acquired goodwill is not a wasting asset with a finite useful life, nor is it separable from goodwill subsequently generated internally. Some argue that companies acquiring businesses do so with the expectation that the acquired goodwill will be maintained indefinitely. They consider that some elements of goodwill have indefinite useful life, for example:*

(i) *cost savings that are expected to be recurring; and*

(ii) *the knowledge and processes to generate future returns beyond the timeframe of the recognised assets of the business.*

(d) *Reintroducing amortisation would not save significant cost because it would not eliminate the need for impairment testing.*

140 *There are different views on whether there is a sufficient reason to change. Different IASB members place different weight on different arguments. Some of the main arguments IASB members considered in reaching their views were as follows:*

(a) *Those who favoured reintroducing amortisation argued that:*

(i) *It has not proved feasible to design an impairment test that is significantly more effective at recognising impairment losses on goodwill on a timely basis. In their view, the IASB should reintroduce amortisation to respond to the PIR of IFRS 3 feedback that the impairment test is not robust enough to recognise impairment losses on goodwill on a timely basis.*

(ii) *Carrying amounts of goodwill around the world have been increasing. Some IASB members see this as evidence that without amortisation* *management is not being properly held to account for its acquisition decisions and that amortisation is needed to maintain the integrity and reputation of financial reporting.*

(iii) *Goodwill is a wasting asset with a finite useful life, and reintroducing amortisation is the only way to depict that goodwill is being consumed.*

(b) *Those who favoured retaining the impairment-only approach argued that:*

(i) *Although the impairment test does not test goodwill directly, recognising an impairment loss provides important confirmatory information, even if delayed, that confirms investors' earlier assessments that those losses have occurred, helping hold management to account. The useful life of goodwill cannot be estimated, so any amortisation expense would be arbitrary. Therefore, investors would ignore it and amortisation could not be used to hold management to account for its acquisition decisions.*

(ii) *The IASB should not reintroduce amortisation solely because of concerns that the impairment test is not being applied rigorously or simply to reduce goodwill carrying amounts. In the view of some IASB members, goodwill could be increasing for many reasons—for example, because of the changing nature of the economy and greater value being generated by unrecognised intangible assets.*

(iii) *The IASB has no compelling evidence that amortising goodwill would significantly improve the information provided to investors or, particularly in the first few years after an acquisition, significantly reduce the cost of performing the impairment test.*

141 *A small majority (eight out of fourteen IASB members) reached a preliminary view that the IASB should retain the impairment-only model. The IASB accepts that both accounting models for goodwill have limitations. The IASB reached a preliminary view that it should retain an impairment only approach, but this was by a small majority and so the IASB would particularly like stakeholders' views on this topic.*

142 *The IASB would especially welcome feedback that helps it understand:*

(a) *why stakeholders have concerns that recognition of impairment losses on goodwill is not timely, and whether amortisation could and should resolve those concerns; and*

(b) *what information best helps investors to hold companies' management accountable for acquisition decisions at a reasonable cost.*

143 *If the IASB decides to reintroduce amortisation, it will need to consider more detailed topics, including how should the useful life of goodwill and its amortisation pattern be determined.*

144 *The IASB has also considered and rejected two other approaches for accounting for goodwill:*

(a) *immediate write-off of goodwill; and*

(b) *separating goodwill into components and accounting for the components separately.*

Question 7

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.

(a) 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.)

(b) 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?

(c) 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?

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

(e) 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?

(f) 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?

EFRAG's response

EFRAG has not formed 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 is justified. EFRAG is seeking views from its constituents and would welcome in particular new evidences to support a change.

145 The IASB is consulting on the possible introduction of the amortisation, only as a possible remedy for the impossibility to significantly improve the approach in IAS 36 for testing goodwill for impairment at a reasonable cost.

146 **EFRAG has not formed 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 is justified. EFRAG observes that conceptual merits and limits can be found in both the approaches. EFRAG is therefore seeking views and new evidences from its constituents. The following paragraphs are accordingly not expressing a position or preference but have been included in this draft comment letter to provide constituents with a basis for their answers, complementing the arguments already included in the IASB DP.**

147 When discussing amortisation, EFRAG notes that it is important to distinguish between different amortisation regimes. For example, amortisation could be introduced with or without an impairment model. Similarly, it could be considered whether amortisation could be performed on a "voluntary" basis, reflecting the economic nature of the benefits, only for those components of goodwill considered wasting assets. The DP seems only to be discussing goodwill amortisation as something that should be mandatory and is not discussing whether any part(s) of goodwill should be treated/accounted for differently (for example, if any part is considered a wasting asset). Also, it should be considered whether an amortisation approach should specify the amortisation period or a maximum amortisation period.

List of arguments in favour and against amortisation

148 EFRAG concurs with the IASB's list of possible arguments that have been put forward by constituents as illustrated in the DP (paragraphs 3.57 to 3.85) against and in favour of amortisation, in combination with the current impairment-only approach.

149 That is, in favour of amortisation it can be argued that:

(a) The amortisation could be a solution to indirectly overcome the limits that the impairment test is having in practice. In particular:

(i) Impairment losses are not recognised on a timely basis, the impairment test may accordingly not be as rigorous as the IASB initially expected it to be.

(ii) The value of the information resulting from the impairment test is limited, often only confirmatory as the information is provided too late to have predictive value.

(iii) The impairment test is complex and costly to perform.

(b) Carrying amounts of goodwill are overstated (because of the shielding effect) and, as a result, a company's management is not held to fully account for its acquisition decisions. As the IASB has concluded that it is not feasible to significantly improve the impairment test, amortisation would help to reduce goodwill carrying amounts. Because of the shielding effect, impairment losses are also not recognised when an acquisition fails to meet its objectives. This may mislead investors into thinking that the acquisition continues to be a success. The impairment test is thus not holding management to account for the goodwill recognised. Amortisation would show that a company needs to generate profits to recover the expense of the acquisition. Also, amortisation of goodwill would reduce incentives for opportunistic behaviour of the management in relation to goodwill accounting, would lower the amount of internally generated goodwill being recognised and would not mislabel consumption as impairment losses.

(c) Goodwill is a wasting asset with a finite useful life, and amortisation would reflect the consumption of goodwill. This would help holding management to account because it would show that the acquisition is not successful if it does not generate income in excess of this cost.

(d) Amortisation would reduce the cost of accounting for goodwill.

150 On the other hand, in favour of retaining the current impairment-only model, it can be argued that:

(a) The impairment-only model provides more useful information than amortisation, which does not provide useful information if determining the useful life of goodwill is arbitrary. Even if the information from the impairment-only model only has confirmatory value, this information is useful. In addition, amortisation could further shield acquired goodwill against impairment losses by mislabelling some or all impairment losses as consumption. This would reduce the usefulness of information for assessing the management's stewardship. Additionally, in subsequent periods, amortisation could obscure the amount originally paid, which in turn make it more difficult to assess stewardship for those investors that do this by analysing returns on invested capital.

(b) If applied well, the impairment test achieves its purpose. If the test is performed well, it would ensure that the carrying amount of acquired goodwill is recoverable from cash flows it is expected to generate jointly with other assets. If issues arise because of the application of the impairment test, this should be addressed through enforcement rather than through standard-setting. No impairment test can separate whether the pre-existing internally generated goodwill, rather than the acquired goodwill, has been impaired and replaced by goodwill generated after the acquisition. The IASB made that clear before introducing the impairment-only approach. Arbitrary amortisation of goodwill would also not result in the carrying amount of goodwill that faithfully represents the future benefits still to be expected from goodwill.

(c) Acquired goodwill is not a wasting asset with a finite useful life. Companies acquiring businesses do so with the expectation that the acquired goodwill will be maintained indefinitely, and amortisation would not be appropriate when goodwill has an indefinite useful life. Acquired goodwill is also not separable from goodwill subsequently generated internally. Distinguishing between acquired goodwill and goodwill subsequently generated internally does not portray any real economic phenomenon.

(d) Reintroducing amortisation would not save significant costs. Reintroducing amortisation would not eliminate the need for an impairment test and would accordingly not reduce the cost of impairment testing significantly, particularly in the first few years after an acquisition unless an unrealistically short amortisation period is chosen.

151 Over the past eight years, EFRAG has run several consultations on goodwill impairment and amortisation.

(a) In 2012, EFRAG issued the questionnaire: *Goodwill impairment and amortisation – questionnaire* together with the OIC.

(b) In 2014, EFRAG issued the discussion paper: *Should Goodwill still not be amortised? – Accounting and Disclosure for Goodwill* together with the OIC and the ASBJ.

(c) In 2016, EFRAG issued the quantitative study: *What do we really know about goodwill and impairment?*

(d) In 2017, EFRAG issued the discussion paper: *Goodwill Impairment Test: Can It Be Improved?*

152 A short summary of the proposals and conclusions obtained in these consultation documents and the replies provided by respondents are included in Appendix II of this letter. In these consultations, constituents have provided arguments either in favour of amortising goodwill or in favour of the current impairment-only approach. In addition to the arguments in the DP listed above in paragraphs 149 and 150, EFRAG accordingly notes the following arguments in favour and against amortisation:

(a) In favour of amortisation, it is argued that:

(i) The impairment approach without amortisation (the impairment only approach) reinforces the 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.

(ii) 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).

(iii) 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 preparers the opportunity to convey information about the components of goodwill (see paragraphs 245 - 248).

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

(v) Goodwill is not representing anything 'real' but is just 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.

(b) In favour of the current impairment-only approach, it is argued that:

(i) 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.

(ii) 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.

(iii) 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 meet the expectation.

(iv) 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.

153 For many of the arguments presented above in favour of amortisation and the current impairment-only approach, there are also counter arguments. For example, while it can be argued that the impairment-only approach reinforces the cyclicality of net income, it can also be argued that the purpose of financial reporting should be to provide useful information about an entity – not to smooth economic downturns. Another example, where EFRAG has heard arguments and counter arguments relates to how goodwill amortisation could impact a level playing field in bidding wars. For example, if IFRS would require goodwill amortisation, but US GAAP would not. EFRAG has heard both the arguments that:

(a) Companies reporting under accounting requirements that would require goodwill to be amortised (in addition to being subject to an impairment test) would have a disadvantage compared to companies reporting under accounting requirements that would require an impairment-only approach. The argument provided is that profit or loss under an impairment-only approach would not be affected by the price paid for the acquired entity (unless there would be an impairment). The management in a jurisdiction requiring an impairment-only approach would thus be able to pay a higher price for another business as the price paid would not affect the performance reported based on which the stewardship of the management is assessed.

(b) Companies reporting under accounting that would require goodwill to be amortised (in addition to being subject to an impairment test) would have an advantage compared to companies reporting under accounting requirements that would require an impairment-only approach. This is because when goodwill is amortised, the likelihood of an impairment loss decreases. While amortisation cost reported in financial statements are considered as "normal" costs, impairment losses are considered as a sign that the management has purchased a business at a too high price (i.e. the management has failed). Companies reporting under an amortisation approach (plus an impairment approach) would therefore be able to offer a higher price for another business and is therefore more likely to win a bidding war with companies reporting under an impairment-only approach.

Could amortisation help to solve the "too late" problem?

154 As mentioned above, EFRAG has not formed a view on whether goodwill should be amortised. However, EFRAG considers that, from a practical point of view, amortisation of goodwill may indirectly contribute to avoid everlasting goodwill. Irrespective of the conceptual merits of the amortisation, a systematic path of reduction through amortisation expenses would result in the progressive derecognition of goodwill.

Is acquired goodwill distinct from goodwill subsequently generated internally in the same cash-generating units?

155 For accounting purposes, unless the entire approach of allocation to CGUs for impairment under IAS 36 is put into question, which EFRAG would not support at this stage, distinguishing acquired goodwill from subsequently generated internally goodwill is not possible in the view of EFRAG. The impairment test is designed to compare the carrying amount of the CGU with its value-in-use and the latter comprises undistinguished cash flows generated at CGU level by the organised group of acquired and pre-existing assets and liabilities. We agree with the IASB that this "shielding" effect is an intrinsic attribute of the current IAS 36 approach.

Under the impairment-only model, are companies adding back impairment losses in their management performance measures?

156 EFRAG observes that recent studies on the use of alternative performance measures, including evidence used by the IASB in developing its recent proposals on the Exposure Draft *General Presentation and Disclosure,* have shown that one of the most frequent items that companies remove from their profit or loss when illustrating the "normal" or "recurring" net result is the impairment loss on goodwill.

Academic studies on goodwill

157 EFRAG has also reviewed academic studies on goodwill. While providing insight on various issues related to goodwill accounting, EFRAG has not found that the studies provide a clear direction on whether goodwill should be amortised or not.

Questions for EFRAG's constituents

158 EFRAG would welcome constituents' views and arguments to the IASB questions listed in Question 7 of the DP. **EFRAG is particularly interested in learning whether any new evidence or arguments have emerged since 2004.**

159 When looking for new evidence and impact analyses, we invite you to also refer to other areas of regulation that may provide indirect incentives to prefer one or the other approach, such as tax deductibility of goodwill or prudential treatment of goodwill in case of regulated entities.

160 Two of the different arguments in favour of amortisation included in paragraphs 149 and 152 above are that:

(a) Goodwill is a wasting asset; and

(b) Goodwill is an accounting construct, which is not useful to have on the statement of financial position.

Do you think that goodwill (or some of the parts goodwill consists of) is (are) a wasting asset(s)? Do you consider goodwill to be an accounting construct that it is not useful to have recognised in the statement of financial position? Please explain.

161 Paragraph 156 states that goodwill impairment losses are often added back when entities are presenting "underlying profit" (or similar non-GAAP measures). If amortisation were to be reintroduced, do you think that companies would adjust or create new management performance measures to add back the amortisation expense? Why or why not?

162 If amortisation is not reintroduced, do you consider that it would be useful to require companies to disclose information about the "age" of goodwill to reflect which part of their goodwill is older (and thus, by some is considered to be less relevant)?

Notes to constituents - Summary of the proposals in the DP

163 *The IASB's preliminary view is that it should develop a proposal to help investors better understand companies' financial positions by requiring companies to present on their balance sheets the amount of total equity excluding goodwill. The IASB reached this view because it was considered that:*

(a) *Goodwill is different from other assets with a unique nature.*

(b) *Presenting this amount could help to highlight those companies for which goodwill is a significant portion of their total equity.*

164 *Presenting total equity excluding goodwill as a subtotal within the structure of the balance sheet could highlight the subtotal's relationship with other items in the financial statements. However, changing the structure of the financial statements to allow the presentation of this subtotal could be too disruptive. Therefore, the IASB does not intend to pursue such a change and companies would present this amount as a free-standing item.*

Question 8

Paragraphs 3.107–3.114 of the DP explain the IASB's preliminary view that it should develop a proposal to require companies to present on their balance sheets the amount of total equity excluding goodwill. The IASB would be likely to require companies to present this amount as a free-standing item, not as a subtotal within the structure of the balance sheet (see the Appendix to this Discussion Paper).

(a) Should the IASB develop such a proposal? Why or why not?

(b) Do you have any comments on how a company should present such an amount?

EFRAG's response

EFRAG does not support the IASB's proposal to require companies to present on their balance sheets the amount of total equity excluding goodwill.

Total equity excluding goodwill

165 EFRAG agrees that goodwill is different from other assets, for example:

(a) Goodwill cannot be measured directly, and it is therefore initially measured as a residual.

(b) Goodwill cannot be sold separately.

(c) Goodwill is often allocated to groups of cash-generating units for impairment testing whereas other assets are tested for impairment individually or as part of a single cash-generating unit.

166 However, EFRAG considers presenting the subtotal would create confusion as to whether goodwill is an asset or not.

167 If material, goodwill is already presented in a separate line on the balance sheet as part of intangibles according with IAS 1 *Presentation of Financial Statements*. Moreover, as stated in paragraph 3.109 of the DP, the IASB has proposed in its Exposure Draft *General Presentation and Disclosures* to requiring goodwill to be presented as a separate line item on the balance sheet. Thus, EFRAG considers that if goodwill is presented separately in the statement of financial position, it would be possible for users to calculate total equity before goodwill, if the user would find that useful, without creating confusion about whether goodwill is an asset or not.

168 EFRAG admits that presenting an amount of total equity excluding goodwill could help to highlight those companies for which goodwill is a significant portion of their total equity. However, EFRAG considers requiring companies to disclose in their financial statements this proposed subtotal will be more harmful than beneficial. EFRAG acknowledges that presenting the amount as a free-standing item could be less harmful than presenting it as a subtotal in the statement of financial position itself. However, the manner in which the free-standing amount is presented in the appendix to the DP seems confusing.

169 For all the above reasons, EFRAG does not support the IASB's proposal to require companies to present on their balance sheets the amount of total equity excluding goodwill.

<u>Section 4—Simplifying the impairment test</u>

Notes to constituents - Summary of the proposals in the DP

Section highlights according to the IASB's DP

(a) *Performing a quantitative test annually does not necessarily make the test more effective when there is no indicator of impairment.*

(b) *Simplifications would reduce the cost and complexity of performing the test.*

(c) *Some of the same simplifications would also make the value in use more understandable.*

Notes to constituents - Summary of the proposals in the DP

170 *Having reached that it could not make the impairment test significantly more effective at recognising impairment losses on goodwill on a timely basis at a reasonable cost, the IASB investigated whether it could simplify the test without making it significantly less robust.*

171 *This section discusses the IASB's preliminary view that it should develop proposals intended to make the impairment test less costly and less complex, while improving some aspects of the information it provides.*

172 *The IASB's preliminary view is that it should develop a proposal to remove the requirement for a company to perform an annual impairment test for cash-generating units containing goodwill if there is no indication that the cash-generating units may be impaired. That proposal would also apply to intangible assets with indefinite useful lives and intangible assets not yet available for use. A company would still need to assess at the end of each reporting period whether there is any indication that there may be an impairment.*

173 *Some IASB members may be prepared to remove the requirement for an annual impairment test, but only if the IASB also reintroduces amortisation of goodwill. In their view, reintroducing amortisation would reduce reliance on the impairment test and justify removing the requirement for an annual impairment test.*

174 *A narrow majority (eight out of fourteen IASB members) favour removing the requirement for an annual impairment test, even though the IASB's preliminary view is that it should not reintroduce amortisation. They agree that removing the requirement would make the test marginally less robust. However, they also consider that when the company has no indicator of impairment the benefits of testing for impairment are minimal and so do not justify the cost in those cases.*

175 *Because moving to an indicator-based approach would place more reliance on identifying indicators of impairment, the IASB plans to assess whether it needs to update the list of indicators in paragraph 12 of IAS 36.*

Question 9

Paragraphs 4.32–4.34 of the DP summarise the IASB's preliminary view that it should develop proposals to remove the requirement to perform a quantitative impairment test every year. A quantitative impairment test would not be required unless there is an indication of impairment. The same proposal would also be developed for intangible assets with indefinite useful lives and intangible assets not yet available for use.

(a) Should the IASB develop such proposals? Why or why not?

(b) Would such proposals reduce costs significantly (see paragraphs 4.14–4.21 of the DP)? If so, please provide examples of the nature and extent of any cost reduction. If the proposals would not reduce costs significantly, please explain why not.

(c) In your view, would the proposals make the impairment test significantly less robust (see paragraphs 4.22–4.23 of the DP)? Why or why not?

EFRAG's response

EFRAG disagrees with introducing an indicator-only approach unless goodwill amortisation is reintroduced. EFRAG has not yet formed a view on reintroduction of amortisation.

Indicator-only approach

176 EFRAG welcomes the IASB's efforts to investigate (once it was concluded that the impairment test could not be more effective at recognising impairment losses on goodwill on a timely basis at a reasonable cost) whether it could simplify the test without making it significantly less robust.

177 EFRAG agrees that an indicator-only approach would have the following benefits:

(a) it would reduce complexity and, if amortisation was also introduced, it would help to improve consistency within IAS 36 with the accounting treatment of intangible assets with definite live; and

(b) allow cost savings for preparers by reducing frequency of the test.

178 In making its assessment about the cost savings, EFRAG has considered comments received in response to its discussion paper *Goodwill Impairment Test: Can It Be Improved?* issued in 2017. In this paper, EFRAG consulted on introducing a 'Step Zero' approach similar to US GAAP. The majority of the respondents would generally welcome such an approach to reduce cost and complexity on the quantitative assessment. However, there were also respondents who did not favour the introducing of a 'Step Zero' approach. They were concerned that it would not significantly reduce the operational costs, while it would likely further delay the recognition of goodwill impairment losses. Moreover, it could be argued that this approach could put pressure on the qualitative assessment (for example auditors or regulators would ask for a strong justification of why there is not an indicator of impairment), and therefore, the cost and complexity of the quantitative assessment would be simply shift to the qualitative assessment but overall not reduced.

179 As noted in the DP, the 'Step Zero' approach is not the same as the indicator-only approach suggested in the DP. However, the results may indicate whether there would be cost savings by introducing an indicator-only approach.

180 Although EFRAG agrees with the DP that there could be some cost savings related to an indicator-only approach, EFRAG would not, in isolation, support the IASB' proposal to remove the requirement to perform an annual quantitative impairment test.

181 EFRAG notes that the impairment test is considered to be complex by many preparers. Accordingly, if companies do not perform an impairment test regularly, their expertise in performing the test is likely to decline. Thereafter, it could be difficult for preparers to execute the complex test in a situation where impairment is triggered. This could further reduce the effectiveness of the impairment test.

182 In addition, the discussed problem of management being overoptimistic could be increased as auditors or regulators have no comparison to impairment tests prepared in previous years. Companies normally do not prepare budgets with the intention or sufficient timing to reach a basis for a terminal value. Budgets are mainly prepared for a period of 3 years, to get to a terminal value might need 5 years or

longer. If management's estimation is too optimistic in the event of an impairment triggering event, auditors or regulators may not have the same quality of historical comparative information to the general achievement of goals to assess the current estimate.

183 In this regard, EFRAG also notes that academic research has generally found that goodwill impairment charges have become more value relevant after the impairment-only approach was introduced. A reason for this could be that the impairment test is now performed with more rigour than was the case previously. This could be lost if an indicator-only approach is introduced.

184 EFRAG also notes that introducing an indicator-only approach could result in some loss of information that users of financial statements find useful, such as information about the discount rates, long-term growth rates, profit and capital expenditure assumptions and sensitivities used in the quantitative impairment test. Although if such information is not disclosed for CGUs without goodwill allocated to nor for the entity as a whole, users find this information useful, as it provides granular information about the prospects for a CGU which can support their valuation for the business as a whole, when looking at components. EFRAG understand they would rarely use the goodwill balance in isolation when undertaking this valuation exercise, but this does not negate the usefulness of the current disclosure to them. Linked to the comments elsewhere, EFRAG considers benefits would arise for users if there were greater clarity around the allocation to CGUs which would align with users' perspective around valuation when looking at "sum of the parts" approaches.

185 In conclusion, EFRAG considers that indicator-only approach in isolation (i.e. without amortisation) would lessen users' reliance on the results of the impairment test. This could accentuate the 'too little too late' issue and could result in a further loss of information on governance and management stewardship of capital employed (if the 'too little too late' issue is accentuated, it reduces the value of the information these impairment losses provide).

Indicator approach in combination with amortisation

186 As per our response to question 7, this Draft Comment Letter doesn't express a view on the possible introduction of amortisation. EFRAG is consulting its constituents to get possible new evidence supporting such a change.

187 The IASB DP is proposing to adopt an indicator-only approach, without introducing amortisation. EFRAG, as illustrated above, disagrees with this approach.

188 EFRAG would be sympathetic with the idea of adopting an indicator-only approach, only if amortisation is reintroduced. EFRAG considers that such approach would reduce the pressure from the impairment assessment (however, it would depend on the amortisation period – for example especially if such period would be short rather than long).

189 However, without compelling new evidences to support introduction of amortisation, EFRAG does not support this approach.

Potential indicators of impairment

190 EFRAG agrees with the IASB that having a robust set of indicators for an indicator-only impairment model is important. EFRAG notes that paragraph 12 of IAS 36 already sets out a non-exhaustive list of indicators. This list includes external and internal sources of information that an entity should consider in assessing whether an asset is impaired such as declines in the value of the asset, significant changes in the environment in which the entity operates that might adversely affect the value of the asset, the entity's market capitalisation and evidence from internal factors that point to a potential decline in the value of the asset.

191 EFRAG noted that its Discussion Paper *Goodwill Impairment Test: can it be Improved? includes* a list of potential indicators of impairment. The possible additions might include a failure to meet the key objectives of the acquisition or macroeconomic and entity specific conditions, such as observable prices for CGU, evolution of entity's actual earnings vs budget, cost factors and changes in management. The IASB is proposing in this DP enhanced disclosure requirements on the performance of acquisitions. EFRAG suggests that the IASB should consider how the information about this performance may provide additional evidence of impairment, and how it can be integrated in a possible amendment to the impairment assessment requirements.

Same relief for other intangible assets

192 EFRAG supports the IASB's target to adopt the same approach for goodwill as well as for other intangible assets with indefinite useful lives and for intangible assets not yet available for use, except of amortisation of assets that are not yet available for use in case amortisation would be introduced. EFRAG agrees that adopting such an approach would:

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

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

193 In addition, it would result in a uniform impairment model in IAS 36.

194 With reference to the indicator-only approach, the views reported above on goodwill are equally valid for other intangible assets.

Notes to constituents - Summary of the proposals in the DP

195 *The IASB's preliminary view is that it should develop a proposal to remove from IAS 36 the restriction on including cash flows arising from a future restructuring to which a company is not yet committed or from improving or enhancing an asset's performance. This proposal would apply not only to cash-generating units containing goodwill but to all assets and cash-generating units within the scope of IAS 36. The IASB reached this view because it was considered that this approach will:*

(a) *reduce cost and complexity.*

(b) *make the impairment test less prone to error because estimates of value in use would probably be based on cash flow projections which are prepared, monitored and used internally for decision-making regularly.*

(c) *make the impairment test easier to understand.*

(d) *make the impairment test easier to perform and therefore could make it easier to audit and enforce.*

196 *Some argue that simply removing the restriction on these cash flows could increase the risk that management may use inputs that are too optimistic in estimating value in use. However, The IASB's preliminary view is that setting a probability threshold or requiring additional qualitative disclosures is unnecessary for these cash flows. These cash flows would still be subject to the same requirements that apply to all cash flows included in estimates of value in use—companies would be required to use reasonable and supportable assumptions based on the most recent financial budgets or forecasts approved by management.*

197 *In addition, The IASB's preliminary view is that it should develop a proposal to:*

(a) *Remove the explicit requirement to use pre-tax cash flows and pre-tax discount rates in estimating value in use.*

(b) *Require a company to use internally consistent assumptions for cash flows and discount rates regardless of whether value in use is estimated on a pre-tax or post-tax basis.*

(c) *Retain the requirement for companies to disclose the discount rates used but remove the requirement that the discount rate disclosed should be a pre-tax rate.*

198 *The IASB reached this preliminary view because it was considered that removing the requirement to use pre-tax cash flows and pre-tax discount rates would:*

(a) *make the test easier to understand by aligning it with common valuation practice.*

(b) *not require companies to calculate pre-tax discount rates solely to satisfy the disclosure requirements of IAS 36.*

(c) *provide investors with more useful information, because companies generally use post-tax discount rates as an input in estimating value in use. The disclosure of a post-tax discount rate would be more useful information for investors than disclosure of a pre-tax discount rate, which generally is not understandable or observable.*

(d) *better align value in use in IAS 36 with fair value in IFRS 13 Fair Value Measurement.*

(e) *maintain consistency with an amendment made in 2008 to IAS 41 Agriculture (for the discount rate) and an amendment to IAS 41 (for cash flows) proposed in 2019*

199 *This proposal would apply not only to cash-generating units containing goodwill but to all assets and cash-generating units within the scope of IAS 36.*

200 *However, some stakeholders have concerns and questions about how to avoid double counting of future tax consequences.*

201 *The IASB in making a similar change to IAS 41 the IASB simply deleted 'pre-tax' and did not add any further guidance. The IASB intends to adopt the same approach in this case.*

Question 10

The IASB's preliminary view is that it should develop proposals:

(a) to remove the restriction in IAS 36 that prohibits companies from including some cash flows in estimating value in use—cash flows arising from a future uncommitted restructuring, or from improving or enhancing the asset's performance (see paragraphs 4.35–4.42 of the DP); and

(b) to allow companies to use post-tax cash flows and post-tax discount rates in estimating value in use (see paragraphs 4.46–4.52 of the DP).

The IASB expects that these changes would reduce the cost and complexity of impairment tests and provide more useful and understandable information.

(c) Should the IASB develop such proposals? Why or why not?

(d) Should the IASB propose requiring discipline, in addition to the discipline already required by IAS 36, in estimating the cash flows that are the subject of this question? Why or why not? If so, please describe how this should be done and state whether this should apply to all cash flows included in estimates of value in use, and why.

EFRAG's response

EFRAG supports the IASB' proposal to remove the restriction in IAS 36 that prohibits companies from including cash flows arising from a future uncommitted restructuring, or from improving or enhancing the asset's performance. However, additional guidance would be required on when to include restructuring cash flows in the calculation.

EFRAG supports the IASB' proposal to remove the explicit requirement to use pre-tax inputs and pre-tax discount rates to calculate value in use.

202 EFRAG supports permitting cash flow projections to include future restructurings and future enhancements to an asset and permitting the use of post-tax inputs in the calculation of value in use. EFRAG supports that these changes apply not only to cash-generating units containing goodwill but to all assets and cash-generating units within the scope of IAS 36.

Permitting cash flow projections to include future restructurings and future enhancements to an asset

203 EFRAG supports the IASB' proposal to remove the restriction in IAS 36 that prohibits companies from including some cash flows in estimating value in use—cash flows arising from a future uncommitted restructuring, or from improving or enhancing the asset's performance.

204 EFRAG consulted on this issue in its 2017 discussion paper *Goodwill Impairment Test: Can It Be Improved?* Most of the respondents supported the suggestion as it would take into consideration management's views of the business and simplify the impairment test (it would allow companies to use directly their budgets and forecasts, which are likely to include the impact of future restructurings without making artificial adjustments to remove them). A number of respondents, however, called for some level of safeguard against all types of plans and ideas being reflected in the projections. This could, for example, be a requirement that only future restructurings that have been approved by management could be included in the projections.

205 EFRAG also considers that the IASB' proposal could eliminate an inconsistency in IAS 36 in the sense that it would capture within the value in use the cash flows that will arise from any existing potential to restructure or enhance an existing asset (or CGU) rather than ignoring this potential and align with the way restructuring cash flows are considered when determining fair value.

206 In addition, to the extent that it allows to adopt cash flow estimations closer to the managerial forecasts in the business plan, EFRAG agrees with the DP that the proposal:

(a) reduce cost and complexity;

(b) make the impairment test easier to understand; and

(c) make the test easier to perform and therefore could make the impairment test easier to audit and enforce.

207 To the extent that it allows to adopt cash flows estimation closer to the managerial forecast in the business plan, EFRAG agrees with the IASB that this proposal might make the impairment test less prone to error because estimates of value in use would probably be closer to cash flow projections which are prepared, monitored and used internally for decision-making regularly, rather than forecasts that are

produced solely for external financial reporting once or twice a year. However, EFRAG questions whether other cash flows (in- or outflows) used internally for estimations should be also included in the value in use calculation (for example cash flows from capacity or productivity investments to enhance the asset´s performance) to ensure that value in use calculations are based on cash flow projections which are prepared and monitored internally (*see question to constituents in paragraph 214*).

208 EFRAG considers that simply removing the restriction on these cash flows could increase the risk that management may use inputs that are too optimistic in estimating value in use. EFRAG considers that the suggested guidance in the DP is not sufficient to mitigate such risk of over-optimism which cannot be only addressed by auditors or regulators. EFRAG recommends the IASB to more effectively address this issue and considers what would be necessary to develop further guidance on when to include cash flows arising from restructuring or enhancing the asset's performance in the calculation.

Permitting the use of post-tax inputs in the calculation of value in use

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

210 Therefore, EFRAG supports the IASB' proposal to remove the explicit requirement to use pre-tax inputs and pre-tax discount rates to calculate value in use. EFRAG considers that this proposal would reduce the cost of the goodwill impairment test; provide more useful information; and make the test more understandable. In addition, using post-tax discount rates and post-tax inputs would be more consistent with other IFRS Standards.

211 EFRAG notes that this proposal would simplify the calculation of value in use and reduce the cost when companies only have observable post-tax discount rates for an asset/CGU. Companies usually use weighted average cost of capital (WACC) as a starting point for determining the discount rate, and the WACC is typically a post-tax rate. The relevance of the calculation would not be affected, because both basis (post and pre-tax) should result in the same recoverable amount when the pre-tax rate is adjusted to reflect the timing of the creation and reversal of temporary differences.

212 EFRAG also consulted on this issue in its 2017 discussion paper *Goodwill Impairment Test: Can It Be Improved?* Almost all respondents supported allowing the use of a post-tax rate.

213 However, the discussion paper also highlighted that allowing a post-tax basis could raise some issues. For example, it would be unclear if this would have implications for the amount of tax that should be allocated to the different CGUs. Moreover, since the estimates of future cash flows should include cash inflows or outflows from income tax receipts or payments, a number of practical questions would arise (as noted in paragraphs BCZ81 to BCZ84 of the Basis for Conclusions of IAS 36[2]), such as how deferred taxes should be reflected in the future cash flows or if the carrying amount of the CGU should be adjusted.

[2] The Basis for Conclusions in IAS 36 (paragraphs BCZ81 and BCZ82) explains the two components of future tax cash flows that can affect recoverable amount, and notes that to avoid 'double-counting' the future tax consequences of temporary differences are not considered in determining recoverable amount.

Questions for EFRAG's constituents

214 The DP suggests removing the restriction that prohibits companies from including cash flows arising from a future uncommitted restructuring, or from improving or enhancing the asset's performance. Do you think that there are other cash flows (inflows and outflows) that should also be allowed to be included in the value in use calculation (e.g. cash flows from investments that could increase the production capacity for a group of assets that are part of the same cash generating unit)?

215 Post-tax input for the calculation of value in use of a cash generating unit might, unless otherwise specified, take into account items such as unused tax loss carry-forwards which would not meet the criteria for recognition under IAS 12 *Income Taxes* (and would accordingly not be included in the carrying amount of a cash generating unit). Potentially this could result in a goodwill impairment loss not being recognised when post-tax inputs are used, that would have been recognised had pre-tax inputs been used. Do you consider this risk to be significant? Do you think that it should be explicitly required that when post-tax inputs are used, this input should be aligned with the principles of IAS 12? Do you think there are other ways to deal with the issue?

216 In addition to the issue described above in paragraph 215, do you think that there are other issues or risks that could arise from the use of post-tax inputs in the value in use calculation?

Notes to constituents - Summary of the proposals in the DP

217 *The IASB considered whether to provide the following simplifications and guidance for the impairment test:*

(a) *Adding more guidance on the difference between entity specific inputs used in value in use and market participant inputs used in fair value less costs of disposal.*

(b) *Mandating only one method for estimating the recoverable amount of an asset (either value in use or fair value less costs of disposal) or requiring a company to select the method that reflects the way the company expects to recover an asset.*

(c) *Allowing companies to test goodwill at the entity level or at the level of reportable segments rather than requiring companies to allocate goodwill to groups of cash-generating units that represent the lowest level at which the goodwill is monitored for internal management purposes.*

(d) *Adding guidance on identifying cash-generating units and on allocating goodwill to cash-generating units.*

218 *However, the IASB's preliminary view is that it should not develop proposals for any of these potential simplifications or guidance because:*

(a) *The guidance in IAS 36 and IFRS 13 is sufficient.*

(b) *The IASB's reasons for basing the definition of recoverable amount on both value in use and fair value less costs of disposal when developing IAS 36 remain valid.*

(c) *Testing goodwill at a higher level could delay further the recognition of impairment losses of goodwill by increasing the effect of shielding.*

(d) *It would be difficult to provide guidance on identifying cash-generating units and allocating goodwill that could apply to all companies.*

Question 11

Paragraph 4.56 of the DP summarises the IASB's preliminary view that it should not further simplify the impairment test.

(a) Should the IASB develop any of the simplifications summarised in paragraph 4.55? If so, which simplifications and why? If not, why not?

(b) Can you suggest other ways of reducing the cost and complexity of performing the impairment test for goodwill, without making the information provided less useful to investors?

EFRAG's response

EFRAG supports the IASB's preliminary view to not develop the following proposals:

(a) Adding more guidance on the difference between entity-specific inputs used in value in use and market-participant inputs used in fair value less costs of disposal.

(b) Mandating only one method for estimating the recoverable amount of an asset or requiring a company to select the method that reflects the way the company expects to recover an asset.

(c) Allowing companies to test goodwill at the entity level or at the level of reportable segments.

However, EFRAG does not support the IASB view to not add further guidance on allocating goodwill to cash-generating units.

219 EFRAG welcomes the IASB's effort trying to develop further simplification to the impairment test. However, EFRAG supports the IASB view to not develop the following proposals:

(a) Adding more guidance on the difference between entity-specific inputs used in value in use and market-participant inputs used in fair value less costs of disposal;

(b) Mandating only one method for estimating the recoverable amount of an asset (either value in use or fair value less costs of disposal) or requiring a company to select the method that reflects the way the company expects to recover an asset; and

(c) Allowing companies to test goodwill at the entity level or at the level of reportable segments rather than requiring companies to allocate goodwill to groups of cash-generating units that represent the lowest level at which the goodwill is monitored for internal management purposes.

220 EFRAG has reached the above view because:

(a) EFRAG agrees with the DP that the guidance in IAS 36 and IFRS 13 is sufficient for preparers.

(b) In its 2017 discussion paper *Goodwill Impairment Test: Can It Be Improved?* EFRAG consulted on a single calculation approach: fair value less costs of disposal ('FVLCD') or Value in Use ('VIU'). The majority of the respondents that replied to this question did not support the introduction of a single method for determining the recoverable amount as it would not result in a significant simplification (companies are not currently required to calculate both VIU and fair value less cost of disposal ('FVLCD')) and that both VIU and FVLCD were considered relevant for the calculation of the recoverable amount.

(c) EFRAG agrees with the DP that impairment losses are often late and inadequate as a result of inadequate allocation of goodwill to the cash-generating units ('CGUs') (either at too high level or due to its constant reallocation to the most profitable CGU).

Adding guidance on identifying cash-generating units and on allocating goodwill to cash-generating units

221 As noted in EFRAG's response to Question 6, EFRAG expects that generally, the shielding effect is greater when goodwill is allocated to groups of cash generating units containing several cash generating units.

222 As indicated, EFRAG would agree that goodwill impairment losses may be used opportunistically by management. For that to happen, it would be necessary that management to some extent can make excessive use of judgement when assessing whether impairment losses would be recognised. As noted above, it can also be done by means of allocating goodwill to CGUs.

223 For the above reasons and as indicated in EFRAG's response to Question 6, while EFRAG does not have specific suggestions on how to design the impairment test more effectively, it suggests that the guidance for how goodwill is allocated to cash generating units could be amended to improve how the test is applied in practice. The IASB could assess whether introducing additional guidance on the allocation of goodwill to CGUs could result in a more effective application of the impairment test (see further detail in EFRAG's response to question 6).

224 In addition, this proposal could provide useful information for users. Users find this information useful, as it provides granular information about the prospects for a CGU which can improve their valuation for the business as a whole when looking at components.

Section 5—Intangible assets

Section highlights according to the IASB's DP

(a) *Does separate recognition of all identifiable intangible assets in a business combination provide useful information?*

(b) *The IASB found no compelling evidence that a change in the recognition requirements is needed.*

(c) *Stakeholders who want the IASB to consider broader changes to the accounting for intangible assets can explain why in the 2020 Agenda Consultation.*

Notes to constituents - Summary of the proposals in the DP

225 *The IASB has considered whether it should change the criteria for recognising intangible assets acquired in a business combination.*

226 *The IASB considered stakeholder feedback about whether to permit or require companies to include in goodwill identifiable intangible assets acquired in a business combination meeting a criterion such as the following (which partly overlap):*

(a) *Specified types of intangible assets such as customer relationships, brands and non-compete agreements.*

(b) *Intangible assets not already recognised in the acquired company's financial statements.*

(c) *Intangible assets that would not have been recognised in the acquirer's financial statements if generated internally.*

(d) *Intangible assets that do not meet the contractual legal criterion.*

(e) *Organically replaced intangible assets, as opposed to wasting assets.*

(f) *Intangible assets that have indefinite useful lives and are not already generating cash inflows largely independent of cash flows from other assets or groups of assets*

227 *The IASB identified disadvantages of the approaches listed in the above paragraph:*

(a) *Goodwill would be commingled with identifiable intangible assets with different characteristics, leading to a loss of information about those assets.*

(b) *Reducing the proportion of intangible assets recognised separately would not respond to the frequent calls to improve financial reporting by providing more information about intangible assets that are increasingly important in modern economies.*

(c) *If the IASB does not reintroduce amortisation of goodwill, then including intangible assets with finite useful lives within goodwill would lead to a loss of information about the consumption of those intangible assets. If the IASB reintroduces amortisation of goodwill, commingling these intangible assets with goodwill may make it even more difficult to determine an appropriate useful life for goodwill.*

(d) *Some additional complexity could arise. For example, if identifiable intangible assets are included within goodwill and subsequently sold, what profit should a company recognise on disposal?*

228 *Furthermore, preparers have expressed varying views on the cost of implementing the current requirements. In addition, investors have mixed views on whether separate recognition of identifiable intangible assets provides useful information.*

Their views also vary on how to determine which intangible assets should be recognised separately to provide useful information.

229 *Overall, the IASB concluded it did not have compelling evidence that it should permit or require some identifiable intangible assets to be included in goodwill. Thus, the IASB's preliminary view is that it should not make any changes.*

Question 12

Paragraphs 5.4–5.27 of the DP explain the IASB's preliminary view that it should not develop a proposal to allow some intangible assets to be included in goodwill.

Do you agree that the IASB should not develop such a proposal? Why or why not?

(a) If you do not agree, which of the approaches discussed in paragraph 5.18 should the IASB pursue, and why? Would such a change mean that investors would no longer receive useful information? Why or why not? How would this reduce complexity and reduce costs? Which costs would be reduced?

(b) Would your view change if amortisation of goodwill were to be reintroduced? Why or why not?

EFRAG's response

In considering the accounting for intangible assets, EFRAG thinks that it is necessary that the IASB takes into account the concerns of investors who want to compare companies that grow by acquisitions more easily with those that grow organically and, as such, start a project on IAS 38.

EFRAG would be in favour of allowing some intangible assets to be included in goodwill if goodwill were to be amortised, however EFRAG questions the usefulness of such a change pending a broader project on IAS 38. EFRAG has not formed a view on goodwill amortisation at this stage.

230 EFRAG has received feedback that recognising intangible assets acquired in a business combination separately from goodwill might be costly and complex. Furthermore, some of these intangible assets tend to be ignored (at least by some users) particularly if the measurement is perceived to be too subjective. It is accordingly questionable whether the benefits of identifying some intangible assets outweigh the costs.

231 On the other hand, EFRAG also notes that if additional items are added to goodwill, the goodwill figure might become even less understandable than it is today.

232 EFRAG's view on whether or not some intangible assets could be included in goodwill would depend on:

(a) whether amortisation of goodwill would be reintroduced; and

(b) how internally generated intangible assets should be accounted for.

Goodwill amortisation

233 EFRAG believes that subsuming some intangible assets in goodwill would have a lower impact if the IASB decides to reintroduce goodwill amortisation. If goodwill were to be reintroduced, whether or not intangible assets would be amortised would not be affected by them being subsumed in goodwill – assuming that if goodwill would be amortised other intangible assets would also be amortised. In that case, "only" the amortisation period and amortisation pattern would be affected. The latter would not even be affected if goodwill would be divided into components (see paragraphs 245 - 248 below).

234 Accordingly, if goodwill (and other intangible assets) were to be amortised, it is more likely that the costs of recognising some types of identifiable intangible assets would outweigh the benefits. In this regard, EFRAG also notes that the requirement to identify non-recognised intangible assets was introduced with the impairment-only approach.

Internally generated intangible assets

235 EFRAG regrets that the IASB has considered it to be outside the scope of the project to address the concerns of investors who want to compare more easily companies that grow by acquisition with those that grow organically.

236 EFRAG, however, acknowledges that including this issue in the project could result in the project taking considerably longer time to complete. This would mean that useful disclosures about business combinations and simplifications to the impairment test could be delayed.

237 Particularly if the IASB decides not to reintroduce goodwill amortisation (see paragraphs 233 - 234 above), EFRAG would recommend that the issue on whether some intangible assets could be included in goodwill should be considered in a second phase of the project. This phase of the project could thus take into account changes on how to account for internally generated intangible assets that could be introduced if the IASB would decide to revise IAS 38. The project could also be informed by EFRAG's pro-active work on the project *Better Information on Intangibles*.

Section 6—Other recent publications

Notes to constituents - Summary of the proposals in the DP

238 *In July 2019 the FASB issued the Invitation to Comment: Identifiable Intangible Assets and Subsequent Accounting for Goodwill. The IASB's research project and the FASB's project are separate and although they exchange information, they are not working jointly on the projects. Nevertheless, they have been monitoring each other's work because the projects focus on similar topics because IFRS 3 and 'Topic 805 Business Combination' are largely converged.*

239 *In its Invitation to Comment, predominantly for public business entities, the FASB sought stakeholders' views about whether:*

(a) *To change the subsequent accounting for goodwill. The FASB sought stakeholders' views on whether to reintroduce goodwill amortisation for public business entities or to further simplify the goodwill impairment test. Potential simplifications could include assessing goodwill for impairment following an event or change in circumstances that indicates goodwill is more likely than not impaired or providing an option to test goodwill at the company level.*

(b) *To modify the requirements for recognising intangible assets acquired in business acquisitions, the FASB sought stakeholders' views on whether to:*

(i) *extend the private company option to public business entities*

(ii) *establish a new principle-based criterion to determine which identifiable intangible assets should be included in goodwill; or*

(iii) *include all intangible assets in goodwill.*

(c) *To add or change disclosures about goodwill and intangible assets. The Invitation to Comment discussed providing information on the key performance targets supporting an acquisition and information about performance against those targets for several years after the acquisition. However, the Invitation to Comment sought stakeholders' views on other ideas for new or enhanced disclosures because of concerns about:*

(i) *the cost of providing such information;*

(ii) *the complexity of integration; and*

(iii) *the disclosure of forward-looking information.*

240 *The FASB's Invitation to Comment therefore covered similar topics to the IASB's Discussion Paper. Some stakeholders have told the IASB that maintaining convergence between IFRS Standards and US GAAP is important to them.*

241 *Additionally, In March 2019 the Australian Accounting Standard Board published Research Report 9 Perspectives on IAS 36: A case for standard setting activity. This report considers IAS 36 impairment testing for all assets, not just for goodwill.*

Question 13

IFRS 3 is converged in many respects with US generally accepted accounting principles (US GAAP). For example, in accordance with both IFRS 3 and US GAAP for public companies, companies do not amortise goodwill. Paragraphs 6.2–6.13 of the DP summarise an Invitation to Comment issued by the US Financial Accounting Standards Board (FASB).

Do your answers to any of the questions in the DP depend on whether the outcome is consistent with US GAAP as it exists today, or as it may be after the FASB's current work? If so, which answers would change and why?

EFRAG's response

EFRAG's responses to the questions in the DP do not depend on whether the outcome is consistent with US GAAP.

EFRAG considers that convergence with the FASB on how to account for goodwill should be taken into account, but it should not be an overriding objective.

Other recent publications – Global convergence

242 EFRAG's responses to the questions in the DP do not depend on whether the outcome is consistent with US GAAP as it exists today, or, probably more important, as it may be after the FASB's current work.

243 EFRAG considers that for the approach to account for goodwill convergence with the FASB should be considered as an aspirational and not overriding objective. The FASB current work should influence the decision as convergence reduces the costs of both preparers and users in preparing and analysing financial statements. Convergence also enhances comparability and different approaches for goodwill accounting could also affect the level playing field in mergers and acquisitions (M&A transactions).

244 Based on a limited outreach to M&A professionals, EFRAG understands that if one jurisdiction requires goodwill to be amortised (in addition to impairment) and another jurisdiction only requires goodwill to be subject to an impairment test, it may create a perceived unlevel playing field during M&A bidding wars. Although the effect is only assessed to be moderate by the participants in the limited outreach, it is assessed that the accounting treatment of goodwill would have an effect even when it does not create real economic differences. For that reason, EFRAG considers that the IASB outcome could be influenced by the FASB's current work.

Question 14

Do you have any other comments on the IASB's preliminary views presented in the DP? Should the IASB consider any other topics in response to the PIR of IFRS 3?

EFRAG's response

EFRAG considers that the DP could have encouraged a discussion on separating goodwill into components. In addition, EFRAG considers that the IASB should also have considered more guidance on goodwill allocation to divested businesses and reorganisations.

Discussion on separating goodwill into components

245 EFRAG notes that in IFRSs literature the general approach when accounting for non-current assets is to consider components with different useful lives separately. In the *Conceptual Framework for Financial Reporting*, it is noted that "In principle, each of an entity's rights is a separate asset" (par. 4.11 of the *Conceptual Framework for Financial Reporting*). Either of these could accordingly also be the starting point, but not necessarily the ending point, in relation to goodwill.

246 There could very well be good arguments for considering the unit of account differently when it comes to accounting for goodwill than when accounting for other non-current assets. However, those arguments are only very limited considered in paragraphs 3.105 to 3.106 of the DP.

247 EFRAG notes that the *Conceptual Framework for Financial Reporting* includes eight paragraphs on selecting the unit of account. Such guidance was not included in the

Conceptual Framework when IFRS 3 was developed. When reconsidering how to account for goodwill, it would have been natural for the IASB to consider the new aspects of the *Conceptual Framework for Financial Reporting* and describe how these aspects have been considered.

248 In addition, EFRAG indicates that paragraph 3.105 of the DP states that the IASB has not further discussed and considered separating goodwill into components because such an approach is considered complex and subjective. However, this argument could be at odds with the suggestions for enhanced disclosures aimed to provide more detailed information.

Guidance on goodwill allocation to divested businesses

249 EFRAG notes, as highlighted in Question 6 and Question 11, that IAS 36 might not have enough and clear guidance on goodwill allocation to divested businesses (relative value, IAS 36 paragraph 86) and reorganisations (IAS 36 paragraph 87). The current IFRS guidance may, in case a business is divested at a very low amount, allocate an insignificant amount of goodwill to the divested part, even in situations in which a big amount of goodwill was recognised when the divested part was acquired. This is because the relative value would be the basis for the allocation of goodwill. In other cases the guidance could, unless the entity can demonstrate that some other method better reflects the goodwill associated with the operation disposed of, result in more goodwill being allocated to a divested, reorganised business than might have been initially recognised when the reorganised businesses were acquired. For the reasons mentioned, EFRAG questioned whether the existing guidance is the right one or whether this guidance should be reconsidered. In that sense, EFRAG would suggest adding in IAS 36 explicit requirement to derecognise goodwill when entities sell a cash generated unit that still has goodwill allocated to it.

Guidance on goodwill allocation to reorganisations

250 Reorganisations include both the situations in which there are reorganisations within/between CGUs and those where there are no real reorganisations, but only a change in how segments are defined for the purpose of the segment reporting. In practice those types of reorganisations result in goodwill being detached from its initial allocation to CGU’s. As a result, when an impairment test is performed, it no longer assesses the carrying amount of the goodwill against (only) the future cash flows the goodwill is assumed to affect. Accordingly, the impairment test may become less effective.

251 EFRAG considers that the DP could have discussed whether the guidance on reallocation should only be applied when the cash flow structure has changed. That is, changes in how segments are defined for the purpose of the segment reporting should not affect how goodwill is allocated to cash generating units. EFRAG recognises that tracking goodwill and allocating it properly to cash generating units will require better documentation. However, such documentation should be possible without undue cost.

252 For the reasons provided above, EFRAG suggests the IASB to develop further guidance on goodwill allocation to divested businesses and reorganisations.

Questions for EFRAG’s constituents

253 Paragraph 19 of IAS 12 states that “[w]ith limited exceptions, the identifiable assets acquired, and liabilities assumed in a business combination are recognised at their fair values at the acquisition date. Temporary differences arise when the tax bases of the identifiable assets acquired, and liabilities assumed are not affected by the business combination or are affected differently. For example,

when the carrying amount of an asset is increased to fair value but the tax base of the asset remains at cost to the previous owner, a taxable temporary difference arises which results in a deferred tax liability. The resulting deferred tax liability affects goodwill."

254 This means that a portion of goodwill may result from the effects of deferred tax liabilities. This portion of goodwill does not represent the "core goodwill", i.e. the fair value of the going concern element of the acquiree's existing business and the fair value of the expected synergies and other benefits from combining the acquirer's and acquiree's net assets and businesses (see BC313-BC318 of IFRS 3). This portion of goodwill is only due to an accounting mismatch arising from the fact that deferred taxes are not recognised at fair value in business combinations.

255 It may be argued that, after the business combination, the portion of goodwill resulting from the effects of deferred tax liabilities should be reduced over time (i.e. reversed to P&L) to reflect the reduction of the deferred tax liabilities that originated that portion of goodwill.

256 Is the portion of goodwill resulting from the effects of deferred tax liabilities significant compared with the goodwill recognised in your financial statements/in your jurisdiction (e.g. >10% of recognised goodwill)?

257 Would you support a change in the goodwill accounting (along the lines of paragraph 255 above), such that the portion of goodwill resulting from the effects of deferred tax liabilities, is subsequently measured at an amount that reflects the deferred tax liabilities that originated that portion of goodwill? Please explain. The IASB is proposing in this DP to allow for the adoption of post-tax inputs for the calculation of the value in use. How would such a proposal interact with the issue described in the above paragraphs (i.e. goodwill originated by an accounting mismatch due to effect of deferred tax liabilities? Please explain.

258 Would you anticipate other tax implications from the proposals in the DP?

Appendix II: Evidence related to goodwill and how to account for goodwill

259 This appendix summarises the information retrieved from previous consultations and papers of EFRAG and other information collected on goodwill amortisation.

Previous consultations of EFRAG

260 Previous studies and discussion papers performed by EFRAG in relation to goodwill include:

(a) *Goodwill impairment and amortisation – questionnaire* issued in 2012. The study was performed in cooperation with the OIC. The results of this questionnaire showed:

(i) Respondents had different views on what goodwill normally consists of.

(ii) Some of the respondents did not use the information on goodwill presented in financial statements whereas others did. Some of the respondents that did not use the information thought that it was too uncertain (unclear what goodwill consisted of or the calculation was considered unverifiable) or did simply not find the information useful for their projections. Other respondents used the reported goodwill or the disclosures when assessing risks, future cash flows and stewardship.

(iii) Respondents, using the goodwill information, used the goodwill amount differently in their analysis depending on what they thought goodwill included.

(iv) Respondents were split in their views on whether the amount of goodwill recognised in the balance sheet or the changes in the amount recognised provided the most relevant information.

(v) Most respondents using the goodwill information, did not treat goodwill acquired in a cash-settled business combination differently from goodwill acquired in a business combination settled by an exchange of shares.

(vi) Some respondents using the goodwill information treated the goodwill figure differently from information about other intangible assets. For example, some:

- amortise goodwill (and review it for impairment);
- require additional disclosures;
- expense goodwill on acquisition;
- immediate offset goodwill against equity;
- account for goodwill similarly to other intangible assets;
- permit recognition of internally generated intangible assets; and
- calculate goodwill as the difference between the book value of equity and the (long-term) market value of equity.

(vii) Some respondents thought the accounting information on the impairment of goodwill was useful, for example, it provided information on key planning assumptions for each CGU. Others noted that users had expected impairment losses before they were recognised in the financial statements, and the information was therefore considered of limited use.

(viii) Most respondents reflected possible future impairment losses on goodwill in their analyses.

(ix) Most respondents did not usually foresee an impairment loss to be recognised after a change in the management.

(x) Some respondents thought that under the current requirements, internally generated goodwill is recognised and that this is inconsistent with IAS 38.

(xi) Some respondents thought there would be conceptual reasons for adopting the same approach for goodwill as for other intangible assets.

(xii) Different views were presented for and against reversing goodwill impairment losses.

(xiii) The questionnaire considered the effects of goodwill impairments in time of the financial crisis. Different views were presented in relation to the effect of goodwill impairments through the economic cycle. Some thought that the effects on the macro economy should not be considered when developing accounting standards. Some thought that the impairment requirements were pro cyclical as:

- no amortisation would lead to higher prices for companies; and
- impairment losses were usually recognised too late when the business prospects were already poor.

(xiv) Most respondents who thought that goodwill impairment losses were procyclical thought that amortisation could reduce the effect.

(xv) Respondents had different views on whether the costs of performing the impairment test were significant and proportionate relative to the importance of the information. Some thought that it was costly and that the information was not particularly useful as:

- it was too subjective;
- acquired goodwill changes into going concern goodwill/internally generated goodwill (and, accordingly, it is not the acquired goodwill that is tested)
- it was not related to the operational performance and frequent impairment losses would just create noise when assessing performance;
- the supporting information in the notes was incomplete; and
- it could result in unbeneficial behaviour of the management of an entity.

(xvi) Some thought the costs could be reduced by:

- allowing/requiring amortisation of goodwill;
- limiting the impairment test to when there would be an indication of impairment;
- reducing the frequency of the impairment test;
- only requiring the impairment test when the book value of equity compared with the market capitalisation of the company would exceed a given threshold;
- introducing a less prescriptive approach;

- introducing a more standardised approach; and
- clarifying the requirements.

(xvii) Some respondents suggested the information could be made more useful by:

- disclosing the total goodwill acquired and internally generated goodwill;
- decomposing changes in value in use; and
- applying a hypothetical value for 'internal goodwill'.

(xviii) Some respondents did not think the requirements should be changed as the information was valuable for users.

(b) EFRAG, OIC and ASBJ Discussion Paper (the 'DP') *Should Goodwill still not be amortised? – Accounting and Disclosure for Goodwill* issued in 2014. This DP concluded that the reintroduction of goodwill amortisation would be appropriate, because it reasonably reflects the consumption of the economic resource acquired in the business combination over time, and can be applied in a way that achieves an adequate level of verifiability and reliability. In addition, the DP concluded that further improvement should also be considered in the area of disclosure requirements.

Most respondents agreed with the main conclusion of the DP that the impairment-only model for acquired goodwill did not provide the most appropriate solution for subsequent measurement of goodwill. These respondents agreed with the preliminary views of the DP that amortisation of goodwill should be reintroduced, but also pointed out that there are areas for improvement in the impairment testing. In commenting on this matter, they referred to various reasons including the fact that amortisation would reasonably reflect the consumption of the economic resources acquired in the business combination and allocate the costs of acquired goodwill to the periods it was consumed. Nonetheless, these respondents provided mixed views on whether the IASB should indicate a maximum amortisation period. Some respondents acknowledged the subjectivity and high level of judgement in determining the useful life of goodwill. However, they believed that the level of subjectivity and judgement was not higher than that of the impairment test.

In general, respondents who supported the amortisation of goodwill considered that the IASB should develop guidance to help preparers determine the useful life of the acquired goodwill. In contrast, a minority of respondents, mostly users, were supportive of the current impairment-only approach. These respondents explained that the amortisation model was fairly meaningless, and it would not be beneficial to users of financial statements. Many respondents considered that the impairment-only approach was a challenge in practice and that there was room to improve the guidance in IAS 36. These respondents identified a number of difficulties related to the current approach and provided some suggestions on what should be improved. When questioned about whether there was a need to improve disclosure requirements on impairment tests, respondents provided mixed views. Some considered that there was room for improvement, while others did not. Nonetheless, respondents emphasised that any additional disclosure requirements should be considered in the context of the overall amount of disclosure requirements, which are already considered extensive. In addition, many respondents highlighted that the relevance of impairment testing for goodwill, and consequently the need for improved guidance and disclosures, would significantly decrease if the IASB reintroduced amortisation.

Many respondents considered that, if the IASB reintroduced amortisation of acquired goodwill, it should require the same for virtually all intangible assets (including those with indefinite useful lives). They also suggested that the IASB reconsider the requirement to recognise separately intangible assets in business combinations, especially when the IASB decides to reintroduce the requirement regarding amortisation of acquired goodwill.

(c) The quantitative study *What do we really know about goodwill and impairment?* was issued in 2016. The study presented an analysis of a sample of 328 European companies. The data showed that:

(i) From 2005 to 2014 the total amount of goodwill recognised increased from 935 billion euros to 1.341 billion euros, with an increase of 43%;

(ii) A small number of companies account for a large proportion of the carrying amount of goodwill. The level of concentration has been decreasing slightly over time;

(iii) The goodwill to total assets ratio has remained fairly stable over the years at approximately 3,7%. The ratio is significantly higher when companies in the financial industry are excluded from the total. The ratio excluding financials decreased gradually from 19,5% in 2009 to 16,6% in 2014;

(iv) The goodwill to net assets (or equity) ratio has been decreasing since 2008, but it was still significant in 2014 (29%);

(v) The amount of impairment losses recognised peaked in 2008 and 2011, years when the performance of the financial markets was negative. On average, impairment losses represented 2,7% of the opening balance of goodwill. Although in 2012 the financial markets were already showing signs of recovery, the level of impairments in 2012 were similar to 2008;

(vi) Impairment losses were significantly concentrated within a small number of companies, particularly in the telecommunications and financial industries;

(vii) Absolute and relative levels of goodwill and impairment losses varied significantly across industries. The carrying amount of goodwill increased for most industries but decreased for telecommunication services. The ratios of goodwill over total assets and goodwill over net assets also varied across industries, with telecommunication services and consumer staples being the leaders. The industries with the biggest impairment charges were telecommunication services, financials and materials.

(d) The EFRAG Discussion Paper *Goodwill Impairment Test: Can It Be Improved?* was issued in 2017. The suggestions included in the paper and constituents' responses are summarised below.

(i) The paper suggested additional guidance on the allocation of goodwill to CGUs (e.g. allocation based on the pre- and post-acquisition fair value of each CGU (or group of CGUs) that is expected to benefit from the acquisition). Respondents provided mixed views on this suggestion. Some would welcome additional guidance as it would bring more direction and discipline to preparers on how to allocate goodwill. However, others considered that IAS 36 already allowed companies to use their judgement to determine an appropriate method to allocate goodwill to the CGUs and that EFRAG's proposals seemed to be a rule-based and driven by anti-abuse concerns. Still, some suggested that the allocation methods proposed in the paper could become part of the illustrative and non-mandatory guidance accompanying IAS 36.

(ii) The paper proposed additional disclosure of information on composition of goodwill (i.e. information (in amounts) about which acquisitions the total amount of goodwill is related to). Many respondents did not support additional disclosures as it would be difficult and onerous to track and assess each individual component of goodwill over time.

(iii) The paper proposed to introduce a 'Step Zero' in the impairment test (a qualitative assessment of the likelihood of an impairment loss). The majority of the respondents generally welcomed the introduction of the Step Zero as the requirements in IAS 36 for the calculation of the recoverable amount are complex, costly and have to be performed at least annually even if there is no indication of an impairment and the CGU has a significant headroom. Those that disagreed with the Step Zero were mainly concerned that it would not significantly reduce the operational costs while likely delaying the recognition of goodwill impairment losses.

(iv) The paper suggested a single calculation approach: fair value less costs of disposal ('FVLCD') or Value in Use ('VIU'). The majority of the respondents that replied to this question did not support the introduction of a single method for determining the recoverable amount as it would not result in a significant simplification (companies are not currently required to calculate both VIU and fair value less cost of disposal ('FVLCD')) and that both VIU and FVLCD were considered relevant for the calculation of the recoverable amount. Nonetheless, many respondents considered that the VIU was the most appropriate method to calculate the recoverable amount and considered that the VIU should be retained if a single method was to be introduced.

(v) The paper proposed to allow consideration of cash flows from future restructurings when testing for impairment. Most of the respondents supported EFRAG's suggestion as it would take into consideration management's views of the business and simplify the impairment test (it would allow companies to use directly their budgets and forecasts, which are likely to include the impact of future. Nonetheless, a number of respondents called for some level of safeguard against including all types of plans and ideas in the projections. A requirement could, for example, be that future restructurings would have to be approved by management before being included in the projections.

(vi) The paper proposed to allow the use of a post-tax rate when testing for impairment. Almost all respondents supported allowing the use of a post-tax rate since companies often conduct the impairment tests on a post-tax basis with an additional iteration simply to derive a pre-tax discount rate. Therefore, the introduction of a choice would simplify the calculation of the VIU and reduce costs.

(vii) Finally, the paper proposed to deduct an accretion amount from the recoverable amount of a CGU for the purpose of the impairment test. The accretion amount would be calculated as the carrying amount of goodwill multiplied by an accretion rate (e.g. the discount rate used for the impairment test). In general, respondents acknowledged the basic assumption underlying the goodwill accretion approach and its objective. However, the majority of the respondents did not support EFRAG's goodwill accretion approach as it would add complexity and subjectivity to the goodwill impairment model. In addition, respondents argued that if acquired goodwill is an asset that is being consumed and decreasing over time, then the discussion should be focused on the reintroduction of goodwill amortisation, which is a simpler approach. Nonetheless, two user representative associations considered that the goodwill accretion approach could be a reasonable compromise to solve the issues related to internally generated goodwill and timeliness of impairments.