Issues paper providing a high-level summary on input received

Objective

1 The purpose of this paper is to provide a high-level summary of the input received from outreach activities related to EFRAG's draft comment letter in response to the IASB's discussion paper *Business Combinations – Disclosures, Goodwill and Impairment* ('the DP').

Improving disclosures about acquisitions

The DP

2 The IASB's discussion paper proposes that an entity should provide disclosures on the strategic rationale and the chief operating decision maker's objectives for an acquisition as at the acquisition date. Subsequently an entity should provide information about whether it is meeting those objectives and the information should be based on how the chief operating decision maker monitors and measures whether the acquisition is meeting its objectives. If the chief operating decision maker does not monitor an acquisition, the entity should be required to disclose that fact and explain why it does not do so. If the chief operating decision maker stops monitoring whether the objectives of an acquisition are being met before two years after the acquisition, the entity should be required to disclose that fact and the reasons why it has stopped the monitoring.

3 The discussion paper is also proposing to require a company to disclose a description of the synergies expected from an acquisition, when they are expected to be realised, a range of the amounts of the synergies and the expected cost to achieve the synergies. In addition, it is proposed to specify that liabilities arising from financing activities and defined benefit pension liabilities are major classes of liabilities.

4 Finally, the discussion paper proposes to present in the year of the acquisition, pro forma information that shows revenue, operating profit before acquisition-related transaction and integration costs and cash flows from operating activities of the combined business for the current reporting period as though the acquisition date had been at the beginning of the annual reporting period (often termed 'pro forma information').

Input received

5 Views of constituents on the IASB's proposals regarding disclosures have been quite similar to the observations included in EFRAG's draft comment letter. That is, in principle, much of the suggested information would be useful for users but there are potential issues with:

(a) Faithful representation (e.g. it can be difficult to provide estimations of synergies and in order not to disclose commercially sensitive information, some information may not be disclosed, or boilerplate disclosure will be provided).

(b) Some of the information is commercially sensitive.

(c) The information may be difficult to audit.

6 Discussions have also been on whether some of the information should be presented in management commentary. In a survey for preparers, particularly information on synergies and whether objectives have been met was considered to be better placed in, for example, the management commentary.

7 There have been generally support for presenting liabilities arising from financing activities and defined benefit pension liabilities. On the other hand, there has been limited support for presenting proforma information on operating profit before acquisition-related transaction and integration cost (instead of profit or loss).

8 There has generally not been support for presenting pro forma information on cash flows from operating activities (information not considered useful unless working capital is also disclosed).

Comment letters

Disclosure requirements resolve the issue

9 Almost all preparers opposed, had concerns with or asked to review the usefulness of the current disclosures first. In contrast, users supported the proposed improving disclosures. Messages from standard setters were mixed. Some standard setters noted that the proposed disclosures are of limited use. Others thought the disclosures would be useful. Two standard setters argued from a different angle. While agreeing to or welcoming the objective of the disclosures, they either encouraged the IASB to perform extensive field testing, reach out to stakeholders and then significantly reconsider its proposals or suggested substantiating, amending and clarifying the disclosure objective. Auditors and regulators agreed with enhancing the information provided to investors about the subsequent performance of an acquisition.

Based upon CODM reviews

10 Some preparers noted that if the disclosures would be required, they should be based on the information and the acquisitions a company's CODM reviews. Other preparers asked the IASB to perform further field tests to obtain further evidence on whether these proposals would work in practice or noted the information should remain rather qualitative and materiality criteria should be considered.

11 Two standard setters suggested to consider a lower management level – at least in some cases - as the threshold for monitoring the acquisitions. In the regulators' view at least some key disclosures should be required for all the acquisitions which generate a material amount of goodwill, regardless of whether they are monitored by the CODM.

Commercial sensitivity

12 All preparers had concerns with relation to commercial sensitivity of the information, just like most of the standard setters. In contrast, users noted to understand that companies cannot provide commercially sensitive information but note that companies under the caption of "sensitiveness" in many cases do not provide information that in fact is not that sensitive. They agreed with EFRAG's comments that a balance should be reached. Also auditors suggested the IASB to consider the right balance between the benefits to investors and the commercially sensitivity of these disclosures. A regulator thought that generally commercial sensitivity is not a valid reason for not informing investors.

More useful if audited / possible to audit

13 One preparer noted that many acquisitions are based on cost synergies and tracking these cost savings after the acquisitions for the purpose of a disclosure may be difficult, unreliable and thus irrelevant for the users.

14 Most standard setters noted the information is difficult to audit or creates auditability issues. Some standard setters noted the information provided by the companies will be more useful or relevant and/or reliable if it is audited. One standard setter thought it would be possible to prepare the information in a manner that would make it possible to audit.

Notes to the financial statements vs management commentary

15 Almost all preparers noted the information should be provided in the management commentary. Users noted that currently, information about the business strategy is included in the management commentary. They added that reliability and auditability of the information in M&As should not depend on the circumstances. As the process of consolidation develops new or different information might appear but the information disclosed should be reliable.

Disclosures about synergies and additional major classes of liabilities

The DP

16 The IASB's preliminary view is to develop proposals to disclose a description of the synergies expected from combining the operations of the acquired business with the company's business; when the synergies are expected to be realised; their estimated amount or range of amounts and the expected cost or range of costs to achieve those synergies.

Input received

17 A large majority of the preparers expressed preference to have this information included in the management commentary. Some preparers indicated that synergies can often materialise in the long term and generally do not provide measurable benefits in the initial phase of an acquisition. While the preparers reported a general consensus about the expected synergies on revenues being highly sensitive from a commercial point of view, views are mixed when discussing cost synergies

18 Users noted that cost synergies are one of the most relevant information to be provided. Revenue synergies are more relevant when an acquisition focuses on intangibles. In both cases, this is an area where current information is insufficient.

Comment letters

19 While almost all the participants recognised that information on synergies underlying the proposed disclosures provides investors with useful information, many of them were against producing the information requested under a quantitative perspective. Furthermore, almost all the preparers believed that similar information is already provided to investors in the management commentary and in other communication to investors outside the financial statements.

20 Some of the participants suggested that further clarifications and guidance on the concept of synergy, including how it should be estimated, would increase comparability of the disclosures between companies.

21 A significant portion of the preparers and standard setters considered the proposed disclosures on synergies to trigger commercial sensitivity issue. The same input has been also provided by an auditor.

22 Almost all the preparers and the standard setters providing specific input on this issue considered that the management commentary was the most appropriate placement for this disclosure.

23 Users were divided. One of them noted that users would like to know in a quantifiable manner what are the synergies and estimated contribution to results of the combined business. Another one considered that synergies are seldom hard numbers and an excessive focus on short-term savings can cause long-term damage. It noted that is important that the IASB would not unintentionally create an environment where management will focus on hitting short-term synergy targets at the expense of longer-term stewardship, as bad drafted standards could lead to undesirable management behaviour.

24 Auditors and almost all standard setters considered that the disclosures on expected synergies would provide useful information to investors to better understand the potential impact of an acquisition on the combined financial statements of an entity.

25 Apart from few instances, the majority of participants agreed to specify that liabilities arising from financing activities and defined benefit pension liabilities are major classes of liabilities.

Goodwill impairment and amortisation

The DP

26 The preliminary view of the IASB is that it would not be possible to make the impairment test significantly more effective at recognising impairment losses on goodwill on a timely basis. Also, it is the preliminary view of the IASB is that it should not reintroduce amortisation of goodwill and instead should retain the impairment-only model for the subsequent accounting for goodwill.

27 The DP proposes to remove the requirement to perform a quantitative impairment test every year. A quantitative impairment test would not be required unless there would an indication of impairment.

Input received

28 At outreach events, there has been some support for some of the following disclosure suggestions included in EFRAG's draft comment letter to reduce over-optimism:

(a) Disclosure of how actual cash flows differ from management's previous cash flow predictions (back-testing);

(b) Disclosure of the current level of cash flows to allow users to model themselves;

(c) Improved information on assumptions related to the period for which management has projected cash flows and specifically about terminal value projections.

29 However, some preparers have noted that the disclosures would be costly/complex to provide and could be commercial sensitive.

30 EFRAG has seeking views from constituents on the guidance on allocating or reallocating goodwill to cash-generating units to address the shielding effect. That shielding is he main reason for too little too late was mainly confirmed during the outreach. Some considered it difficult or costly to address shielding in the proposed way, others considered it an issue that should be addressed as that allows opportunistic behaviour. The polling result shows 56% in favour of addressing the issue.

31 A majority of participants (more than 80%) in EFRAG's webinars have been in favour of reintroducing amortisation of goodwill. During interviews and from panelists more balanced views were provided.

32 Mixed views were provided in relation to the introduction of an indicator only approach. A slight majority seemed to be not in favour of the approach.

Comment letters

33 Preparers generally consider additional guidance on allocation or reallocation of goodwill or additional disclosures to make management overoptimism more transparent as unnecessary. However, such proposals were welcomed by other groups of participants.

34 A majority of participants (15 out of 23) in the comment letters, representing national standard setters, preparers and users were in favour of reintroduction of goodwill amortisation. These participants consider that impairment model is not working as intended and cannot be improved at a reasonable cost and therefore amortisation is a practical solution. Conceptually, they mainly considered goodwill to be a wasting asset which should be amortised to reflect its consumption.

35 The majority of the comment letter participants, represented mostly by auditors and national standard setters, do not support the indicator-only approach but would only support it if amortisation of goodwill was reintroduced. Preparers are more likely to support the indicator-only approach and they argue that the quantitative impairment test does not add value when significant headroom is available. Some participants also request additional guidance on the identification and use of indicators if the indicator-only approach is introduced.

Simplifying the impairment test further

The DP

36 The DP proposes to remove the restriction that prohibits companies from including some cash flows in estimating value in use arising from a future uncommitted restructuring, or from improving or enhancing the asset's performance; and to allow companies to use post-tax cash flows and post-tax discount rates in estimating value in use.

Input received

37 Generally, it has been supported to remove the restriction that prohibits companies from including some cash flows in estimating value in use arising from a future uncommitted restructuring, or from improving or enhancing the asset's performance; and to allow companies to use post-tax cash flows and post-tax discount rates in estimating value in use.

Comment letters

38 Many participants support the IASB's preliminary view that no further simplifications need to be developed and are in particular opposed against using a single method for the recoverable amount. Other simplifications suggested by participants:

(a) Some participants request further guidance on allocation of goodwill to CGUs as it would improve the effectiveness of the impairment test;

(b) Few participants request further guidance on determining the discount rate, referring to the educational material for IFRS 13 (2013) as an example of useful guidance;

(c) Few participants request further guidance on including the carrying amount of lease liabilities and cash outflows relating to lease instalments under IFRS 16 Leases when calculating the VIU, to avoid divergence in practice; and

(d) Few participants request further guidance requiring separate recognition of technical goodwill relating to deferred tax liabilities as the use of this technical goodwill is directly related to the settlement of the related deferred tax liability and should not be shielded.

Intangible assets

The DP

39 The DP proposes that the IASB should not develop a proposal to allow some intangible assets to be included in goodwill.

Input received

40 Mixed input has been received on this issue. Some do see benefits (or no loss of relevant information) in including some intangible assets acquired in a business combination in goodwill, while others prefer the current requirements.

Comment letters

41 The majority of the participants support the proposal to not develop requirements to add intangible assets acquired in a business combination to the carrying amount of goodwill. The main argument is that it provides useful information to users regarding the consideration paid for the acquisition and in line with the increasing importance of intangibles in contemporary economies. Nonetheless, most of the participants acknowledge the challenges relating to the subjectivity and complexity of valuation, however these can be overcome. Many participants support a dedicated and comprehensive review project on IAS 38 Intangible Assets, but some participants urge for a narrow-scoped review on short-term relating to intangible assets acquired in a business combination.

Convergence with the FASB

The DP

42 IFRS 3 Business Combinations was issued, and subsequently revised, as a result of a joint project between the Board and the FASB. Consequently, IFRS 3 is largely converged with the FASB Topic 805 Business Combinations. The IASB wishes to learn whether respondents want changes their views depending on how US GAAP is to be further developed.

Input received

43 Most input, so far, has been in line with the position in EFRAG's draft comment letter that convergence on goodwill accounting should be aimed for but should not be a pre-condition for an IFRS. However, some preparers have expressed concern that divergence between IFRS and US GAAP could create an unlevel playing field.

Comment letters

44 Almost all participants support convergence with the FASB and in general emphasise that it should not be the main goal. Many participants request that the IASB ensures convergence with the FASB's position on disclosure of subsequent performance of acquisitions as divergence may result in competitive disadvantage for companies that comply with IFRS Standards. Many other participants request that the IASB ensures convergence with the FASB's position on subsequent accounting for goodwill.