NOTE TO TEG MEMBERS

The IASB Discussion Paper (DP) was released on the 19 March. When the key messages for the DCL were prepared, the EFRAG Secretariat did not have the final wording and the DP presents some additional detailed contents that were not anticipated.

We propose to split the discussion of the DCL in two sessions:

- **(a) EFRAG TEG webcast meeting the 26 March will focus on Questions 2 to 10 with the aim to finalise issues not discussed up to now; and**
- **(b) An additional webcast meeting will be held to cover questions 1, 11 to 14 (and any remaining) and seek the approval of EFRAG TEG, subject to wording changes.**

The second webcast meeting would ideally be the end of March/first week of April. A doodle will be issued soon.

The EFRAG Board will discuss and approve the DCL on the 21 April; EFRAG TEG wording changes will have to be completed in time for the normal document distribution.

This document does not include Notes to Constituents and the boxes with summarised EFRAG views (that will be prepared by the EFRAG Secretariat in the coming days).

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 September 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, *Discussion Paper 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.

[to be developed]

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 [To be included]

Question 1

2 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.

3 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.

(a) 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?

(b) 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

[to be developed]

4 [to be developed]

Section 2—Improving disclosures about acquisitions

Notes to constituents - Summary of the proposals in the DP

5 [To be included]

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.

(a) 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?

(b) 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).

(c) 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?

(d) 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?

(e) 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

[to be developed]

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

6 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 management expect from an acquisition are being realised. EFRAG notes that IFRS 3 currently does not require companies to provide entity-specific information about the subsequent performance of an acquisition.

7 EFRAG agrees with the IASB view that the accounting for goodwill (regardless of whether amortisation is reintroduced, or the impairment-only approach is retained) cannot in itself provide information about the success of an acquisition. 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 on what information could be useful for investors.

8 EFRAG, however, assesses that the proposals of the DP would not completely resolve the concerns by investors. This is also recognised in the DP. Paragraph 2.39 of the DP states that requiring the proposed disclosures only for those acquisitions monitored by the CODM may result in investors not receiving material information on acquisitions. The IASB should therefore consider requiring the disclosure for all the acquisitions that result in a material amount of recognised goodwill.

9 In addition, EFRAG shares the concern acknowledged in the DP about the verifiability of the information.

The specific disclosure proposals

10 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.

11 In particular, EFRAG considers that the revised requirements could overcome the limits of the current IFRS 3 requirements, which lacks 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 of a 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 metrices that support the quantitative entity-specific disclosure on the deviation between the initial target and the achieved performance in future periods.

12 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 earlier than two years after the acquisition;

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

13 EFRAG considers that the requirement of providing information about whether the objectives of an acquisition has been met using the metrics determined at the acquisition date is essential for assessing whether the objectives of an acquisition are being met. From the proposal it is not completely clear to EFRAG whether an entity would be required to disclose the value of the metric 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. We have assumed this to be the case in the remainder of our response to the DP.

14 Depending on the strategic rationale of a business combination, EFRAG acknowledges that it may not always be meaningful to provide metrics for the assessment of whether the objectives of the acquisition have been met. However, when goodwill is material in an acquisition, EFRAG considers that it would always be meaningful to monitor it. Accordingly, when material amounts of goodwill are recognised in a business combination, EFRAG does not agree with the proposal. In those cases, management would have to monitor whether the objectives of an acquisition have been met.

15 In order to ensure that users receive information to assess whether an acquisition has met its objectives, it would be appropriate for the IASB to specify an illustrative list of metrics that would have to be provided, unless the management uses different measures to assess whether the objectives of a business combination have been met. This is because the strategic rationales and the objectives of acquisitions can be very different, and the management of an entity may use other metrics than those that will be specified by the IASB to assess whether an acquisition has met its objectives. When this is the case, these metrics should be used instead.

16 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 as 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.

17 In EFRAG's view, as long as goodwill is recognised in the financial statements, it should be assumed that the management is able to assess whether the objectives of the acquisition is met. Accordingly, EFRAG does not support the proposal that if an entity stops monitoring whether the objectives of an acquisition have been met after two years, no additional actions would be required. If an entity would stop monitoring whether the objectives of an acquisition involving a significant amount of goodwill would be met, it would be difficult to assess whether the goodwill is impaired. Accordingly, the entity should be required to perform an impairment test in such event. The entity should disclose when it is no longer monitoring whether the objectives of the acquisition are met, and it should provide information about the total amount of goodwill that is related to acquisitions that it is no longer monitoring. This could allow users to assess whether there are parts of the total goodwill figure they would trust more than others.

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

18 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 the CODM reviews. In the view of EFRAG, when an acquisition includes a material goodwill component, the disclosure suggested in the DP should always be provided to the extent the information is material. Whether or not the information is reviewed by the entity's CODM should thus not affect which disclosures would be provided.

Commercial sensitivity

19 EFRAG assesses that the information required by the proposals could result in companies having to disclose information they would consider commercially sensitive. EFRAG, however, agrees with the DP that public companies would need to provide information requested by investors even if it is considered commercially sensitive. For some companies, the information proposed in the DP could be sensitive, for other companies it could be information requested in other IFRS Standards. For some companies the profit margin appearing in the statement of financial performance could thus be commercially sensitive. It could thus seem inconsistent to introduce exceptions for sensitive information to be disclosed in relation to acquisitions, but not in other situations.

20 Although EFRAG does thus not consider it difficult to take commercial sensitivity into account, it does note that the quality of the information that will be reported, particularly how specific it will be, will likely depend on how commercially sensitive the information is regarded by the preparer.

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

21 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.

Question for constituents

22 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, 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.

23 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

24 [To be included]

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

[to be developed]

25 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. However, unlike the DP, EFRAG does not think that the information should only be provided as long as the CODM monitors the acquisition. In EFRAG's view, the information should be provided as long as goodwill resulting from the acquisition is recognised in the financial statements.

26 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. 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 (CODM's) objectives for the acquisition.

Notes to constituents - Summary of the proposals in the DP

27 [To be included]

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

[to be developed]

Synergies

28 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. We consider that this information could be useful for investors and users.

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

(a) considers the DP to be unclear as to how a materiality threshold would apply to the disclosure;

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

Materiality threshold

30 It is unclear to EFRAG how the IASB intends to apply a materiality threshold for the disclosure. In paragraph 2.64 of the DP, it is stated that the IASB proposes to require a company to disclose the information in the year an acquisition occurs (here there is no mentioning of a threshold). However, in paragraph 2.65 of the DP it is stated that the proposal would require companies to provide the detailed information for all acquisitions with material expected synergies. Paragraph 2.65 of the DP thus indicates that when assessing the materiality of the information, the absolute size of the expected synergies should be considered. Based on the objective of the disclosure, EFRAG is uncertain whether this is the most useful approach.

31 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. Accordingly, EFRAG 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.

Practicality and cost/benefit aspects

32 Although EFRAG considers that the information about synergies that is proposed in DP in principle would be useful, EFRAG questions the reliability of the information that will eventually be reported. In order to be useful, any quantitative disclosure would have to be accompanied by an illustration of the judgement applied and of the relevant key hypotheses. EFRAG doubts whether the resulting benefits would overweight the costs.

33 In that regard, EFRAG also notes that information about expected synergies might be considered as commercially sensitive information, even though companies will not be required to disclose detailed plans on how they intend to realise the synergies. Some companies would therefore have strong incentives not to make the information as useful as it could be.

34 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.

Liabilities arising from financing activities and defined benefit pension liabilities

35 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

36 [To be completed]

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

[to be developed]

Pro forma information

37 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.

38 EFRAG agrees with those stating that this information is hypothetical. However, it does not agree that the information is not useful for that reason. 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.

39 The DP indicates that there are differences in how proforma information is prepared. EFRAG considers that for the information to be most useful, users need to know how it has been prepared. The best solution would be that companies would prepare it to use the same approach. Then users would become accustomed to the approach and would know what the information would represent. To ensure that companies would use the same approach, the IASB would have to develop some

guidance in the area. The IASB would, however, face some challenges in that regard. Either the guidance could reflect 'best practice' but not be practicable for many situations, or it could be practical for most situations, but then do not result in useful information as when an entity would apply a better practice. A solution could therefore be that the IASB develop a limited number of illustrative examples and companies could then refer to these alternatives when explaining how the pro forma information has been developed. Such an approach could ensure that an entity could find a practical solution without having to provide less useful information than if no guidance was developed.

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

40 EFRAG agrees with the proposal that instead of requiring an entity to disclose:

(a) profit or loss of the acquiree since the acquisition date included in the consolidated statement of comprehensive income for the reporting period; and

(b) profit or loss of the combined entity for the current reporting period as though the acquisition date for all business combinations that occurred during the year had been as of the beginning of the annual reporting period.

41 The entity should disclose:

(a) operating profit or loss before deducting acquisition-related costs and integration costs of the acquiree since the acquisition date included in the consolidated statement of comprehensive income for the reporting period; and

(b) operating profit or loss before deducting acquisition-related costs and integration costs of the combined entity for the current reporting period as though the acquisition date for all business combinations that occurred during the year had been as of the beginning of the annual reporting period.

42 The 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.

43 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.

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

Cash flows from operating activities

45 EFRAG is aware that many users of financial statements consider the statement of cash flows to be very important. For those users, information on cash flow from operating activities of acquired business after the acquisition date, and of the combined business on a pro forma basis for the current reporting period, could be useful.

46 EFRAG accordingly supports the proposal to add those disclosures.

Questions to EFRAG TEG / constituents

47 The IASB considered that it could provide specific guidance for companies about how to prepare the pro forma information required by IFRS 3, or the IASB could

require companies to disclose how they have prepared the pro forma information. The IASB will consider these possibilities once it has reviewed the feedback on this Discussion Paper and has understood better the information investors need and how best to provide that information. (IASB ED Paragraph 2.87)

Do TEG members consider that additional guidance would be needed?

(Depending on the discussion a question to constituents could be added in the DCL)

48 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 TEG members have specific input on this topic?

(Depending on the discussion a question to constituents could be added in the DCL)

<u>Section 3— Goodwill impairment and amortisation</u>

Notes to constituents - Summary of the proposals in the DP

49 [To be included]

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

[to be developed]

Designing an impairment test significantly more effective

50 EFRAG considers that impairment testing can be improved at reasonable cost by improving some aspects of the guidance on goodwill allocation to CGUs, including the guidance on goodwill allocation to divested businesses and reorganisations, and

improving the current disclosures to make eventual overoptimistic estimations more visible. The intended better disclosures about acquisitions over a certain period subsequent to the acquisition will, besides giving better information about the acquisition to the users, allow users to make a better assessment of the estimations made by management to calculate the recoverable amount.

51 In 2017, EFRAG issued the discussion paper *Goodwill Impairment Test: Can it be improved?* In this discussion paper EFRAG proposed a practical approach to deal with the shielding effect (particularly those arising from internally generated goodwill). Under this approach an entity would each year determine an accretion amount by applying a rate to the opening balance of goodwill. This amount would be added to the carrying amount of the CGU. If no impairment loss would be recognised, the balance of accretion would be carried forward. When the inclusion of the accretion results in the recognition of an impairment loss, the balance of the accretion would be correspondingly reduced. The entity would continue to determine the accretion until the goodwill would be fully written off.

52 Although there was acknowledgment of the basic assumption underlying the approach and its objective, the approach was not widely supported. It was thought that the approach would add complexity and subjectivity to the goodwill impairment model. For example, additional assumptions have to be made in order to determine the goodwill accretion rate, which will give rise to interpretation and application issues.

53 EFRAG has received the feedback from users that the current impairment model was not working properly. The main reason is the so called "shielding" effect. To a certain extent this effect is unavoidable, as it is linked to the requirement to run the test at the CGU level. As illustrated below, EFRAG considers that there are possible enhancements to the impairment test, in providing more robust identification of the level at which the CGU is determined.

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

54 EFRAG agrees with the view indicated in the DP, that two main reasons of the possible delay in recognising impairment losses on goodwill are the 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. In this regard, EFRAG notes that the shielding effect is generally greater the higher the level is at which goodwill is monitored for internal management purposes. That is, the shielding effect is generally greater when goodwill is allocated to groups of cash generating units containing many cash generating units.

Management over-optimism

55 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.

56 The DP concludes that the management over-optimism is best addressed by auditors and regulators, not by changing IFRS Standards. EFRAG may not completely agree with this. 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 often management's cash flow predictions have been too optimistic. Auditors and regulators will normally not be able to have better knowledge about the business development than management, and therefore

not replace the estimations made by management with their own estimations. For users of financial statements, it is most useful to have transparent information about estimations made to calculate the recoverable amount. It could be further discussed whether companies should examine and disclose the causes of the differences between the cash flow projections and the realised cash flows. Such disclosure is more useful if provided for the complete period until the terminal value is calculated as opposed to only providing information for the following year. This could provide more transparency to the financial reports as well as avoid the risk of over-optimistic cash flows.

Shielding effect

57 EFRAG recognises that the IASB considered the headroom approach to address the shielding effect. Similar to the accretion approach suggested by EFRAG (see paragraphs 53-54above), the headroom approach did seem to receive wide support when it was suggested.

58 Similar to EFRAG's accretion approach, 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, the approach would add complexity, particularly for companies that frequently acquire new businesses.

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

59 As noted above, EFRAG expects that, the shielding effect is generally greater when goodwill is allocated to groups of cash generating units containing many cash generating units.

60 EFRAG agrees with the DP that academic research generally shows that goodwill impairment losses are used opportunistically by management. For that to happen, it would be necessary that management can, to some extent, manage whether impairment losses would be recognised. 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 allocating goodwill to CGUs. Either by allocating goodwill to a too high level (by not monitoring it at a lower level) and/or by reallocating goodwill (for example, by means of changing segment reporting).

61 EFRAG considers that the guidance could be clarified to ensure that goodwill would be allocated to the lowest level possible. In fact, the current guidance only provides for a upper granularity limit (i.e. a CGU cannot be broader than a segment) but not also for a lower granularity limit (e.g. to be appropriately defined in strict coordination with the initial managerial assessment of the expected benefits of a business combination at acquisition, including the entity's specific disclosure on the initial and ongoing monitoring and internal steering process).

62 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. The current guidance allows to allocate goodwill independent from the structure of cash generating units. Operating segments can be defined independent from the structure of cash inflows and companies have the possibility to claim that they are not "monitoring" goodwill. The current guidance might even in extreme circumstances impair proper segment reporting by allowing companies that try to avoid impairment risk for goodwill to restructure internal reporting to combine business at risk with profitable units or by having a matrix for internal reporting purposes and selecting the arm of the matrix that has the lower impairment risk for segment reporting.

63 EFRAG admits that preparers could find it difficult to track goodwill that results from a business acquisition made some years ago. However, EFRAG considers preparers should be able to track goodwill from recent business combinations if properly allocated and if tracked to the intended payment. That means that goodwill has to be better allocated to cash generating units. EFRAG states that goodwill allocation to cash generating units should be required.

64 Such change in guidance should be accompanied by the change in guidance for reallocation of goodwill. At the moment the relative fair value approach leads to a situation that a unit with a weak performance can decrease impairment risk by reallocation. Reallocation should have its reasoning only by changed cash flow structures. 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.

65 Furthermore, the guidance in relation to disposals should be adjusted. 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 goodwill in the accounts of the selling entity. The general rule should not be the relative fair value approach at the time of disposal. Further consideration is necessary to avoid that goodwill will be withheld by the selling entity.

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

66 According to IAS 36 paragraph 134 an entity has to provide information to the method of estimation of cash flows but not to 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%) could make management estimations transparent and allow users to make their own judgement, especially as such level of cash flows reached forms the basis of the terminal value and thus the major part of the recoverable amount of the CGU.

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

Questions for TEG

68 Does EFRAG TEG agree that the impairment testing can be improved at reasonable cost? If so, do you agree with EFRAG's suggestions made in paragraph 50?

69 Does EFRAG TEG have any other suggestion on how the impairment testing can be improved at reasonable cost (for example with goodwill amortisation)?

Notes to constituents - Summary of the proposals in the DP

70 [To be included]

Question 7

71 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

[to be developed]

EFRAG has not formed a view and consults constituents

72 EFRAG has not formed a view on whether amortisation of goodwill should be reintroduced, in combination with the impairment approach, or whether no major changes to the current accounting for goodwill is justified. EFRAG is seeking views from its constituents.

73 EFRAG observes that conceptual merits and limits can be found in both the approaches, however the IASB is consulting on the possible reintroduction of 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.

List of arguments

74 EFRAG concurs with the IASB' list of possible arguments that have been put forward by constituents as illustrated in the DP (paragraphs 3.68 and 3.69), to support respectively the change to the standard in order to introduce amortisation and the current accounting without amortisation.

75 In addition to those arguments, following from one of EFRAG's consultations, it can also be argued that the impairment approach without amortisation (the impairment-

only approach) is pro-cyclical. In addition, the calculation of the recoverable amount of a CGU reflects prevailing market inputs, including the discount rate. Such rate reflects in turn the perceived level of risk of the industry segment to which the CGU belongs, as well as the entity's and CGU's specific perceived level of risk. When an industry segment is experiencing a period of crisis, the increase in discount rate at industry level is a pro-cyclicality factor, as the probability of a recoverable amount lower than the carrying value is higher for all the companies belonging to the industry. The pro-cyclicality is even higher if one considers that a higher perceived risk in a segment is often associated with a projected reduction in its profitability, which in turns result in lower projected cash flows as input of the impairment test.

76 Furthermore, EFRAG notes the argument included in paragraph 3.62 of the DP. 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. As illustrated above, the argument provided is that the statement of performance of companies reporting under an impairment-only approach would not be affected by the price paid for the acquired entity (unless there would be an impairment).

(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. The argument provided is that 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?

77 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?

78 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. 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?

79 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 ED *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.

Questions to EFRAG's constituents

80 Over the past eight years EFRAG has run several consultations on goodwill amortisation. A short summary of the proposals in these consultation documents and the replies provided by respondents are included as notes to constituents in Appendix II. In these consultations, constituents have provided mixed views on whether goodwill should be amortised or not. The list of consultations:

(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?*

81 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.

82 During the IASB's consultation period, EFRAG will perform additional outreach with the purpose of assessing whether 1) goodwill is considered to be a wasting asset or not 2) reintroducing goodwill could have consequences for a selection of issues.

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

84 In addition, EFRAG is interested in having constituents' input to Question 7 (e) of the IASB DP, i.e.: *if amortisation were to be reintroduced, do you think companies would adjust or create new MPM to add back the amortisation expense?*

Notes to constituents - Summary of the proposals in the DP

85 [To be included]

Question 8

86 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

[to be developed]

Total equity excluding goodwill

87 EFRAG agrees that goodwill presents some differences with other assets, as 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.

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

89 As stated in paragraph 3.109 of the DP, the IASB has already proposed in its Exposure Draft *General Presentation and Disclosures* to require 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.

90 EFRAG admits 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 amendment 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.

91 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.

Section 4—Simplifying the impairment test

Notes to constituents - Summary of the proposals in the DP

92 [To be included]

Question 9

93 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

[to be developed]

Indicator-only approach

94 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.

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

(a) it would reduce complexity and help to improve consistency within IAS 36; and

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

96 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. However, there were also respondents who did not favour of introducing a 'Step Zero' approach. They were concerned that it would not significantly reduce the operational costs, while likely further delaying the recognition of goodwill impairments.

97 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.

98 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's proposal to remove the requirement to perform a quantitative impairment test every year.

99 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. It could thus be difficult for preparers to execute the complex test in a situation when impairment is triggered. This could further impair the effectiveness of the impairment test.

100 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 terminal value. Budgets are mainly prepared for a period of 3 years, to go to terminal value might need 5 years or longer. If such estimation is optimistic in situations of a triggering event, auditors or regulators do not have the same quality of historical comparison to justify the quality of the estimation of the companies.

101 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 previously. This could be lost if an indicator-only approach is introduced.

102 EFRAG also notes that introducing an impairment-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.

103 In conclusion, EFRAG considers that indicator-only approach in isolation (i.e. without amortisation) would relax even more the reliance of users 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, the value of the information these impairment losses provide is reduced).

Indicator approach in combination with amortisation

104 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 evidences supporting such a change.

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

106 EFRAG would be sympathetic with the idea of adopting an indicator-only approach, only if amortisation is reintroduced. However, missing compelling new evidences to support introduction of impairment, EFRAG does not support this approach.

Potential indicators of impairment

107 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, entity's market cap and evidence from internal factors that point to a potential decline in the value of the asset.

108 EFRAG noted that in its Discussion Paper *Goodwill Impairment Test: can it be Improved?* 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 actual earnings vs budget, cost factors and changes in management. The IASB is proposing in this DP enhanced disclosures requirements about performance of acquisitions. EFRAG considers that the IASB should consider how the information about this performance may further provide additional evidence of impairment, to be integrated in a possible amendment to the impairment assessment requirements.

Same relief for other intangible assets

109 EFRAG supports applying the same approach for other intangible assets with indefinite useful lives and for intangible assets not yet available for use. EFRAG agrees that adopting a similar approach would:

(a) reduce scope for accounting arbitrage when different impairment models 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).

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

111 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

112 [To be included]

Question 10

113 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).

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

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

(b) 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

[to be included]

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

115 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.

116 In its discussion paper *Goodwill Impairment Test: Can It Be Improved?* from 2017, EFRAG consulted on this issue. 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. For example, future restructurings would have to be approved by management.

117 EFRAG also considers that the IASB's 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.

118 In addition, EFRAG agrees with the DP that the proposal:

(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, rather than forecasts produced solely for external financial reporting once or twice a year;

(c) make the impairment test easier to understand;

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

119 However, EFRAG considers 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 admits that the IAS 36 already contains a discipline over cash flows expected to arise from a future uncommitted restructuring or expected to arise from improving or enhancing the asset's performance.

120 However, we consider that this current guidance in not sufficient and thus over-optimism 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 restructuring cash flows in the calculation. It should, for example, be considered that only allow future restructuring that have been approved by management should be included.

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

121 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.

122 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.

123 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 creation and reversal of temporary differences.

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

125 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[1]), such as how deferred taxes should be reflected in the future cash flows or if the carrying amount of the CGU should be adjusted.

126 Lastly, EFRAG supports that this IASB's proposal will apply not only to cash-generating units containing goodwill but to all assets and cash-generating units within the scope of IAS 36.

[1] 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.

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

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

Previous consultations of EFRAG

128 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 figure 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 of 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 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 very late when business perspectives were already poor.

(xiv) Most respondents who thought that goodwill impairment losses were pro cyclical 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 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 turned into going concern goodwill/internally generated goodwill;
- 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;
- 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 impairment test to when there would be an indication of impairment;
- reducing the frequency of the impairment test;
- only requiring 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;

- clarifying the requirements.

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

- disclosing total acquired and internally generated goodwill;
- decomposing changes in value in use;
- 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 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 in the impairment test. In general, respondents who supported the amortisation of goodwill considered that the IASB should develop guidance to help preparers determining 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. Improvements to the guidance and disclosures in IAS 36 *Impairment of Assets* 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 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?* 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 share 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 financials 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 was at the highest level 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 in a small number of companies, particularly in the telecommunications and financials industries;

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

(d) The EFRAG Discussion Paper *Goodwill Impairment Test: Can It Be Improved?* issued in 2017. The suggestions included in the paper and constituents' responses are summaries 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 its judgement to determine an appropriate method to allocate goodwill to the CGUs and that EFRAG's proposals seem 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 impairments.

(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 restructurings without making artificial adjustments to remove them). Nonetheless, a number of respondents called for some level of safeguard. For example, future restructurings would have to be approved by management and this should be a requirement.

(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 that 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 users' 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.