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 28 December 2020.

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

[XX Month 2020]

Dear Mr Hoogervorst,

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

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

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

[EFRAG has not formed a view at this stage on whether amortisation of goodwill should be reintroduced, in combination with an impairment requirement, or whether no major changes to the current accounting for goodwill are justified. EFRAG is seeking views from its constituents and would welcome, in particular, new evidences to support a change. EFRAG's position regarding goodwill amortisation to be inserted following consultation with constituents]

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

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

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

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

EFRAG acknowledges that information about the strategic rationale and management's objectives for an acquisition as at the acquisition date and subsequent disclosures about whether an acquisition is meeting those objectives would be useful. However, EFRAG notes that there would be some practical issues to consider in relation to those disclosures, both to ensure that users receive sufficient and relevant information and that the costs of preparing/disclosing the information would not outweigh the benefits. In this regard EFRAG notes that some of the quantitative information to be provided is based on management expectations and would often be non-GAAP measures. EFRAG has not formed a view whether placing this information in the financial statements, as opposed to placing it in the management commentary, would be preferable. EFRAG is seeking constituents' views on this topic.

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

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

If non-GAAP measures should be included in the financial statements, EFRAG supports including disclosure objectives in IFRS 3.

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

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

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

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

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

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

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

Yours sincerely,

Jean-Paul Gauzès

President of the EFRAG Board

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

Section 2—Improving disclosures about acquisitions

Section highlights according to the IASB's DP

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

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

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

Notes to constituents - Summary of the proposals in the DP

1 The DP proposes that:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Question 2

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

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

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

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

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

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

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

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

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

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

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

Paragraphs 2.29–2.32 explain the IASB's view that the information setting out management's (CODM's) objectives for the acquisition and the metrics used to monitor progress in meeting those objectives is not forward-looking information. Instead, the

IASB considers the information would reflect management's (CODM's) targets at the time of the acquisition. Are there any constraints in your jurisdiction that could affect a company's ability to disclose this information? What are those constraints and what effect could they have?

EFRAG's response

EFRAG considers that the proposed disclosure requirements could result in useful information to assess business acquisitions. However, for the requirements to be most useful, the information to be provided should not only be based on what information the CODM monitors. While EFRAG considers the information could be useful, it has some practical concerns including what information will be provided and whether it is practical and appropriate to disclose the proposed information in the financial statements instead of providing the information as part of the management commentary as the information is based on management expectations and refers to non-GAAP indicators. EFRAG supports conducting additional activities to understand the issue related to commercial sensitivity. EFRAG notes that the proposed disclosures will not resolve the issues related to current goodwill accounting.

Introductory remarks

4 EFRAG understands that the new disclosure proposals exposed for comments in this DP do not aim at providing enhanced information about the recoverability of the goodwill still recognised on the face of the balance sheet, which could include goodwill from acquisitions that go back many years. Instead, they aim at providing better information about how successful an acquisition has been. EFRAG acknowledges that such information is important, irrespective of the presence of a material amount of goodwill deriving from an acquisition. In fact, EFRAG considers that such information would also be useful outside business combinations, for other material investments the entity is conducting as part of its organic growth. The IASB could therefore consider more general information on the issue rather than just including requirements in IFRS 3.

Are the financial statements the right place for these disclosures?

5 In the paragraphs below, EFRAG provides some comments on the usefulness of the disclosures. It is mentioned that EFRAG shares the concern acknowledged in the DP about the verifiability of the information. In addition, EFRAG is concerned about the auditability and enforceability. In that regard, EFRAG notes that the metrics that will be provided are non-GAAP measures and it could accordingly be discussed whether it would be appropriate to provide the information in the financial statements. It could thus be considered whether it would fit better in the management commentary and should thus be something to be considered by the IASB in its project on the management commentary. EFRAG is seeking views from its constituents on the merit and practical implications of requiring this information in the financial statements, including having the information audited.

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 that management expects from an acquisition are being realised. EFRAG notes that IFRS 3 only requires disclosures about an acquisition when it takes place. Thus, IFRS 3 does

not require companies to provide entity-specific information about the subsequent performance of an acquisition.

7 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 could provide useful information. In that respect, EFRAG generally agrees with the suggestions included in the DP to provide information about subsequent performance of acquisitions to users.

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

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

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

11 EFRAG also shares the concern acknowledged in the DP about the verifiability of the information.

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

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

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

15 In relation to the reported goodwill figures, a side-effect of the proposal could, however, be that the level at which an acquisition is monitored would be an indication of the level at which goodwill should be tested for impairment. The new disclosure requirement could offer an anchor point for the level at which goodwill should be allocated to cash-generating units. EFRAG thus recommends that the IASB explores the possibility of including, in the guidance on the allocation of

goodwill to cash-generating units included in IAS 36, an expectation that the goodwill impairment test would be done at the level at which an entity monitors whether an acquisition is meeting its objectives.

The specific disclosure proposals

16 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.

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

18 EFRAG generally agrees that it would be useful to disclose:

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

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

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

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

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

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

21 EFRAG acknowledges that it may not always, depending on, for example, the strategic rationale of a business combination, be meaningful to provide quantitative

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

22 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 would be more useful for an entity that subsequently, for internal purposes, would apply other metrics to monitor an acquisition, to still prepare and disclose the metrics that were originally set to be used to assess the success of the acquisition. However, if requirements to disclose non-GAAP metrics would be introduced, 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, would thus seems to be a good balance. While the new metrics may not provide useful information to assess whether the objectives of an acquisition has been met, the companies' disclosure of the reason for the change and the new metrics could be useful.

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

24 EFRAG assesses that after two to three years, it may be difficult, for practical reasons, to monitor whether the objectives of an acquisition have been met, as the acquired business eventually may become indistinguishable from the rest of the acquiring company's business. Sometimes, it may even be difficult much earlier. Also, the information about whether the original objectives of an acquisition have been met becomes less relevant as time passes. On the other hand, it may only be possible to assess whether the objectives of some acquisitions have been met after decades. For these acquisitions, it would therefore be useful to know whether the entity stops monitoring the success also after two years. Accordingly, EFRAG

disagrees that if the information is to be provided, an entity can stop monitoring whether the objectives of an acquisition have been met after two years, without disclosing this. EFRAG considers that it should be disclosed if an entity stops monitoring whether the objectives of an acquisition have been met within the first three years following the acquisition.

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

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

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

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

28 EFRAG, therefore, believes that if the information is to be provided, it should be based on a lower level than on what the entity's CODM reviews. Accordingly, where applicable, the information to be provided could be based on the information the segment management reviews or it could be required to provide the information that is used to monitor the acquisition at the level in the organisation that managerially monitors the acquisition, such as the chief decision maker in charge of monitoring the profit or loss of the specific CGU.

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

Commercial sensitivity

30 EFRAG assesses that the information required by the proposals could result in companies having to disclose information they would consider commercially sensitive. EFRAG notes that many current requirements, could have the same effect. For some companies, the profit margin appearing in the statement of financial performance could thus be commercially sensitive. EFRAG, however, also notes that entities seem to be most reluctant to provide commercially sensitive information that is forward looking. If the proposed information is to be provided, a balance therefore needs to be struck. EFRAG understands that the information about the objectives of an acquisition would be beneficial for users in assessing the management's stewardship. An approach could be to only require entities to disclose the metrics that are essential for the success of an acquisition. However, that would mean that 'essential' would have to be defined.

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

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

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

Questions for EFRAG's constituents

33 As stated in paragraph 5 above, EFRAG believes that there are merits in developing new guidance to provide the IASB's proposed disclosure, however EFRAG has not formed a view on whether the financial statements are the right place to disclose the information on the performance of an acquired business, relative to management expectations. Among other things, it might be difficult to audit the information if Standards do not provide guidance on how the non-GAAP metrics should be determined.

(a) Do you agree with the IASB's proposal to include this information in the notes to the financial statements? Why/why not? If you disagree with the IASB, do you think it could be included in the management commentary?

(b) Do you think that this specific information would be more useful, relevant and/or reliable, if it is audited?

(c) Do you think it would be possible to audit the information?

34 Paragraph 21 above states that EFRAG expects that the requirement to disclose that an entity is not monitoring an acquisition could create a market discipline. If you are a user of financial statements, how would it affect your analysis if you receive information that an entity is not monitoring a significant acquisition?

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

36 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

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

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

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

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

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

Question 3

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

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

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

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

EFRAG's response

EFRAG supports the introduction of the disclosure objectives, should the information be included in the notes to the financial statements.

40 As stated in the answer to Question 2 above, EFRAG considers that the proposed requirements to disclose information about the strategic rationale and management's objectives for an acquisition as at the acquisition date could result in useful information. Similarly, information on whether the entity is meeting the objectives would be useful.

41 As noted in paragraph 5 above, EFRAG has not formed a view on whether the proposed information should be provided in the financial statements. If it should, EFRAG agrees with these specific requirements as information to assess the expected benefits from an acquisition and the extent to which the acquisition is providing these benefits is useful. Such information is important for assessing the management's stewardship. In order for preparers to better understand the purpose of the disclosure requirements and hence be able to provide the disclosures best suited, EFRAG supports the introduction of disclosure objectives. If the information is to be provided within the Financial Statements, EFRAG, accordingly, agrees with the additional disclosure objectives that require companies to provide information to help investors to understand:

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

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

Notes to constituents - Summary of the proposals in the DP

42 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.

43 Investors have said that information on the nature, timing and amount of expected synergies is important. It would allow them to understand better the benefits a company's management expected when agreeing the price to acquire a business. This information would help investors to assess whether the price paid was reasonable. The information would also help investors hold management to account for its progress in achieving those synergies.

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

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

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

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

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

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

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

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

Question 4

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

(a) to require a company to disclose:

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

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

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

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

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

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

EFRAG's response

EFRAG considers that the suggested disclosure requirements on synergies could provide useful information. Similar disclosures for other components of goodwill could equally provide useful information. However, EFRAG questions whether the information should be provided in the financial statements and whether the benefits of providing the disclosures on synergies will outweigh the costs. EFRAG is therefore seeking inputs from constituents on costs (Questions 2 to 5). EFRAG supports separate disclosure of liabilities arising from financing activities and defined benefit pension liabilities acquired as part of an acquired business.

Synergies

48 Similar to the comment made in paragraph 5 EFRAG, notes that there may be issues related to the auditability of the proposed information on synergies. This issue and other practical aspects of providing the disclosures are discussed in paragraphs 57 - 61 below. EFRAG has not formed a view on whether the proposed disclosures should be provided in the notes to the financial statements. Despite these issues, EFRAG does consider that the proposed disclosures provide useful information and

EFRAG's comments in relation to the usefulness of the information are thus provided in the following paragraphs.

49 EFRAG thus generally considers that the suggested disclosure requirements on synergies expected from combining the operations of the acquired business with the company's business could be useful for users of financial statements. In relation to the description of the synergies and the benefits expected from these, as suggested in the DP, it could also be useful to describe any conditions on which the benefits would depend.

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

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

51 Although EFRAG generally thinks the suggested disclosures on synergies could be useful, EFRAG:

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

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

Information for other elements of goodwill and a different materiality threshold

52 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.

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

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

55 EFRAG thus considers that when an acquisition is material and information about it is accordingly provided in the financial statements, it should first be assessed whether goodwill was material for the price paid for the acquired business. If goodwill is material and synergies constitute a material part of goodwill (which would

therefore be mentioned in the disclosure required by paragraph B64), the proposed disclosures on synergies should then be provided. This could mean that the reported range of synergies reported in isolation would not be material amounts (for example, when goodwill is just material and synergies is just one of several material parts of goodwill – then the synergies by themselves would not be material). However, it would then provide users with information about the size of the remaining parts of goodwill, such as intangible assets that do not qualify for separate recognition

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

Practicality and cost/benefit aspects

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

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

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

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

61 Given these issues, EFRAG would therefore welcome further assessment of the practicability of these requirements, considering their possible added benefit in terms of decision-usefulness. In addition, the comments made in paragraphs 30 - 31 above also applies to the disclosure about expected synergies.

Liabilities arising from financing activities and defined benefit pension liabilities

62 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

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

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

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

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

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

64 The IASB reached a preliminary view that it should:

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

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

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

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

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

Question 5

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

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

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

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

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

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

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

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

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

EFRAG's response

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

Pro forma information

65 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.

66 Whilst the information on 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 is hypothetical, EFRAG considers that it is useful. Trend information about an entity's financial performance is important for users. A material acquisition in a financial year will make information about the past less useful for predicting the future. EFRAG assesses that the pro forma information could be helpful in this regard. EFRAG, however, considers that the information provided will be non-GAAP in nature and this may result in practical issues. EFRAG has not formed a view on whether this information should be included in the financial statements (see paragraph 5 above) and is seeking views from constituents.

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

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

68 EFRAG notes that the manner in which business combinations are accounted for is disruptive for analysts' trend analyses. For example, when inventory is remeasured at fair value following the purchase price allocation, profit margins after the acquisition will not any more reflect the entity's estimation of future profit margins. Similar examples may be developed for all the items that are measured at fair value following the purchase price and for the amortisation of definite-life recognised intangibles. EFRAG notes that APMs are used that eliminates, from the operating profit, the impact of the effects of the purchase price allocation. EFRAG has

therefore considered whether it would be more useful to present further modified figures than 'operating profit before acquisition-related transaction and integration costs'. In addition to excluding acquisition-related transaction and integration costs, such a figure[1] could also exclude the effects of the revaluations to fair value.

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

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

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

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

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

Cash flows from operating activities

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

75 EFRAG questions the usefulness of the information as those investors using cash flow information in their analyses would likely need additional information on cash flows rather than the subtotal of operating cash flows in order to be able to use the figure. Cash flows from operations can be heavily affected by, for example, whether a business would allow customers to defer their payments in the period before the acquisition date and such information would not be available to the users of the

---

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

financial statements from the figure. In addition, without further guidance on how the figure should be calculated, EFRAG assesses that divergence in practice would arise which would further diminish the usefulness of the figure.

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

Questions for EFRAG's constituents

77 In paragraph 75 above, EFRAG questions the usefulness of disclosing the cash flows from operating activities of the acquired business after the acquisition date, and of the combined business on a pro-forma basis for the current reporting period. Would you find the suggested information useful? Please explain.

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

Do you have specific input on this topic?

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

79 As mentioned in paragraph 69 above, EFRAG is unsure about how costly it will be to prepare disclosures on how performance figures would have been without the effects of the purchase price allocation (including revaluation to fair value of most of the acquired business's assets and liabilities). Do you assess that this information would be costly to preparer? Please explain.

80 As mentioned in paragraph 69 above EFRAG seeks input on the costs to prepare the information about cash flows from operating activities of the acquired business after the acquisition date and of the combined business on a pro forma basis for the current reporting period, in particular when the acquired business is fully integrated and does not prepare separate accounts.

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