

Business Combinations – Disclosures, Goodwill and Impairment

EFRAG Board Meeting

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European Financial Reporting Advisory Group

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QUESTION 1



INTRODUCTION - IASB DISCUSSION PAPER

The IASB published the Discussion Paper 2020/1 *Business Combinations—Disclosures, Goodwill and Impairment* issued on **19 March 2020** and asks for comments on the DP by **31 December 2020**.

The IASB DP contains 14 questions. The following slides include a summary of the **IASB's questions** and a short summary of the proposed **EFRAG's responses**.





Improving disclosures about acquisitions

QUESTIONS 2 - 5

Question 2

Rationale for and subsequent performance of an acquisition

IASB Question (summarised)

Will the suggested disclosures (see below) resolve investors' need for better information on the subsequent performance of an acquisition?

Do you agree with the disclosure proposals to provide:

- i. Information about the strategic rationale and management's (CODM's) objectives for an acquisition as at the acquisition date.
- ii. Information about whether it is meeting those objectives based on how management (CODM) monitors and measures whether the acquisition is meeting its objectives.
- iii. Disclosures if management (CODM) does not monitor an acquisition.
- iv. The disclosures in (ii) for as long as its management (CODM) continues to monitor the acquisition.
- v. Disclosures if management (CODM) stops monitoring an acquisition within two years.
- vi. Disclosures about the new metrics if management (CODM) changes the metrics used to monitor an acquisition.

Do you agree that the information provided should be based on the information and the acquisitions a company's CODM reviews. Could concerns about commercial sensitivity inhibit companies from disclosing such information? Are there any constraints in your jurisdiction that could affect a company's ability to disclose this information?

EFRAG proposed 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. EFRAG has not yet formed a view and is consulting its constituents on 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.

EFRAG proposed response in paragraphs 21 to 52 of the DCL

EFRAG proposed questions to constituents in paragraphs 53 to 56 of the DCL

Questions 3 – Disclosure objectives

IASB Question (summarised)

The IASB's preliminary view is 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 proposed response

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

EFRAG proposed response in paragraphs 60 to 61 of the DCL

Question 4 – Information about synergies

IASB Question (summarised)

The IASB's preliminary view is 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 proposed 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.

EFRAG proposed response in paragraphs 68 to 82 of the DCL

Question 5 – Pro forma information

IASB Question (summarised)

The IASB's preliminary view is that it should retain the requirement for companies to prepare pro forma information.

- (a) Do you agree with the IASB's preliminary view? Why or why not?
- (b) Should the IASB develop guidance for companies on how to prepare the pro forma information? Why or why not?

The IASB's preliminary view is 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.
- 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.


Do you agree with the proposals?

EFRAG proposed 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.

EFRAG proposed response in paragraphs 85 to 96 of the DCL

EFRAG questions to constituents in p. 99 to 101 of the DCL



Effectiveness of the impairment test
Additional simplifications
Any other comments

QUESTIONS 6, 11 AND 14

Question 6 – Designing an impairment test that is significantly more effective

IASB Question (summarised)

- 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?
- 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?
- 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?
- 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 proposed response

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

EFRAG proposed response in p. 111 to 134 of the DCL and EFRAG questions to constituents in p. 135 to 141 of the DCL

Question 11 – Additional simplifications

IASB Question (summarised)

The IASB's preliminary view is that it should not further simplify the impairment test.

- (a) Should the IASB develop any of the simplifications summarised in paragraph 4.55 of the DP? If so, which simplifications and why? If not, why not?
- (b) Can you suggest other ways of reducing the cost and complexity of performing the impairment test for goodwill, without making the information provided less useful to investors?

EFRAG proposed response

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

- Adding more guidance on the difference between entity-specific inputs used in value in use and market-participant inputs used in fair value less costs of disposal.
- Mandating only one method for estimating the recoverable amount of an asset or requiring a company to select the method that reflects the way the company expects to recover an asset.
- Allowing companies to test goodwill at the entity level or at the level of reportable segments.

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

EFRAG proposed response in paragraphs 225 to 230 of the DCL

Question 14 – Any other comments

IASB Question

Do you have any other comments on the IASB's preliminary views presented in the DP?


Should the IASB consider any other topics in response to the PIR of IFRS 3?

EFRAG proposed response

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

EFRAG proposed response in paragraphs 251 to 258 of the DCL

EFRAG proposed questions to constituents in paragraphs 259 to 264 of the DCL



Reintroduce amortisation of goodwill?
Indicator-only approach
Convergence with the FASB

QUESTIONS 7, 9 AND 13

Question 7 – Reintroduce amortisation of goodwill?

IASB Question (summarised)

- Do you agree that the IASB should not reintroduce amortisation of goodwill?
- What new evidence or arguments have emerged since 2004 to make you change your view, or to confirm the view you already had?
- Would reintroducing amortisation resolve the main reasons for the concerns?
- Do you view acquired goodwill as distinct from goodwill subsequently generated internally in the same cash-generating units?
- If amortisation were to be reintroduced, do you think companies would adjust or create new management performance measures to add back the amortisation expense?
- 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 TEG proposed response

EFRAG has not formed a view on whether amortisation of goodwill should be reintroduced, in combination with an impairment requirement, or whether no major changes to the current accounting for goodwill is justified. EFRAG is seeking views from its constituents and would welcome in particular new evidences to support a change.

EFRAG proposed response in paragraphs 151 to 163 of the DCL

EFRAG proposed questions to constituents in paragraphs 164 to 168 of the DCL

Question 9 – Indicator-only approach

IASB Question (summarised)

- Should the IASB develop proposals to remove the requirement to perform a quantitative impairment test every year? Why or why not?
- Would such proposals reduce costs significantly? 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.
- In your view, would the proposals make the impairment test significantly less robust? Why or why not?

EFRAG TEG proposed response

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

EFRAG proposed response in paragraphs 182 to 200 of the DCL

Question 13 – Convergence with the FASB

IASB Question (summarised)

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

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

EFRAG TEG proposed response

EFRAG's responses to the questions in the DP do not depend on whether the outcome is consistent with US GAAP. EFRAG considers that convergence with the FASB on how to account for goodwill should be taken into account, but it should not be an overriding objective.

EFRAG proposed response in paragraphs 248 to 250 of the DCL



Total equity excluding goodwill
Value in use simplifications

QUESTIONS 8 AND 10

Question 8 – Presentation of equity before goodwill

IASB Question (summarised)

The DP explains 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.

- (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 TEG proposed response

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

EFRAG proposed response in paragraphs 171 to 175 of the DCL

Question 10 – Simplifications of value in use calculation

IASB Question (summarised)

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

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

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?
- (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?

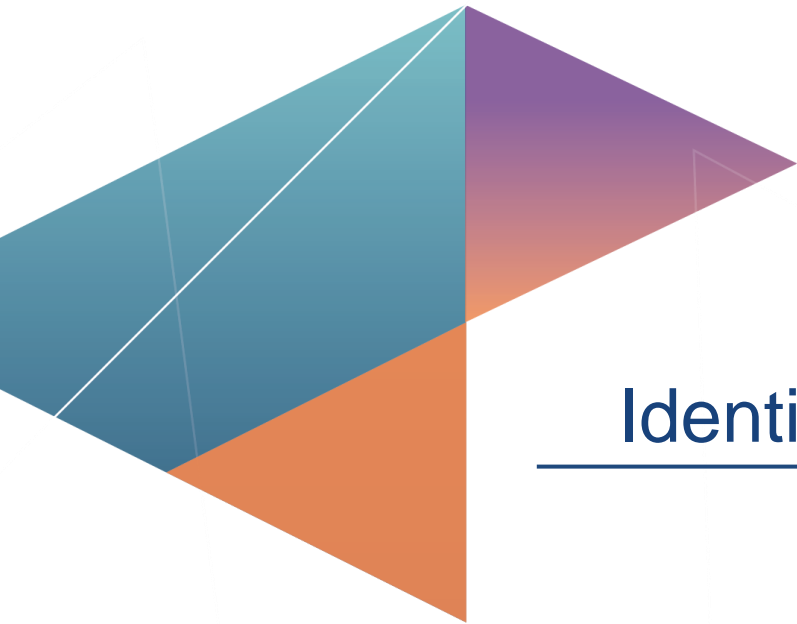
EFRAG TEG proposed response

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

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

EFRAG proposed response in paragraphs 208 to 219 of the DCL

EFRAG questions to constituents in par. 220 to 222 of the DCL



Identifiable intangible assets

QUESTION 12

Question 12 – Intangibles assets

IASB Question (summarised)

Do you agree that the IASB should not develop a proposal to allow some intangible assets to be included in goodwill? Why or why not?

- (a) If you do not agree, which intangible assets should be permitted to be included in goodwill, and why? Would such a change mean that investors would no longer receive useful information? Why or why not? How would this reduce complexity and reduce costs? Which costs would be reduced?
- (b) Would your view change if amortisation of goodwill were to be reintroduced? Why or why not?

EFRAG TEG proposed response

In considering the accounting for intangible assets, EFRAG thinks that it is necessary that the IASB takes into account the concerns of investors who want to compare companies that grow by acquisitions more easily with those that grow organically and, as such, start a project on IAS 38. EFRAG would be in favour of allowing some intangible assets to be included in goodwill if goodwill were to be amortised, however EFRAG questions the usefulness of such a change pending a broader project on IAS 38. EFRAG has not formed a view on goodwill amortisation at this stage.

EFRAG proposed response in paragraphs 236 to 243 of the DCL



Objectives of the IASB project

QUESTION 1

Question 1 – Objectives of the IASB research project

IASB Question

The IASB has concluded that this package of preliminary views would, if implemented, meet the objective of the project.

- Do you agree with the IASB's conclusion? Why or why not? If not, what package of decisions would you propose and how would that package meet the project's objective?
- Do any of your answers depend on answers to other questions? For example, does your answer on relief from a mandatory quantitative impairment test for goodwill depend on whether the IASB reintroduces amortisation of goodwill? Which of your answers depend on other answers and why?

EFRAG TEG proposed response

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

EFRAG proposed response in paragraphs 5 to 17 of the DCL



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EFRAG
Aisbl - ivzw
35 Square de Meeüs
B-1000 Brussel
Tel. +32 (0)2 207 93 00
www.efrag.org

