What do investors think?

BUSINESS COMBINATIONS: DISCLOSURES, GOODWILL AND IMPAIRMENT

12 November 2020

ABAF BVFA Centre of Expertise for Finance Professionals

EFRAG European Financial Reporting Advisory Group

EFFAS

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OVERVIEW

- Presentation from the IASB
- EFRAG presentation
- Panel discussion
  - Polling questions
  - Questions from the audience

Before we start

Housekeeping

The views expressed are those of the presenters, not necessarily those of the International Accounting Standard Board (Board) or the IFRS Foundation.

The Discussion Paper is available for download on the Goodwill and Impairment project webpage at www.ifrs.org/projects/work-plan/goodwill-and-impairment/.

Project background & overview

The Discussion Paper

Objective

To improve the information companies provide to investors, at a reasonable cost, about the acquisitions those companies make.

Timeline

2004	2013–2015	2015–present	March 2020
IFRS 3 issued*	PIR of IFRS 3	Goodwill and Impairment project	Discussion Paper

Feedback

The Board is mainly seeking comments on:

- the usefulness and feasibility of its new disclosure ideas; and
- new evidence or arguments on how to account for goodwill.

* IFRS 3 introduced the impairment-only approach and replaced IAS 22 which required amortisation.

The Board's preliminary views

1 Improving disclosures about acquisitions	Require companies to disclose: • management's objectives for acquisitions; and • how acquisitions have performed against those objectives subsequently. Some targeted improvements to existing disclosures.	
2 Improving the accounting for goodwill	A Can the impairment test be made more effective?	Not significantly, and not at a reasonable cost.
	B Should goodwill be amortised?	No, retain the impairment-only model.
	C Can the impairment test be simplified?	Yes, provide relief from the annual impairment test and simplify value in use.
3 Other topics	• Present on the balance sheet the amount of total equity excluding goodwill. • Do not change recognition of intangible assets separately from goodwill.	

❶ Improving disclosures about acquisitions

1 Improving disclosures about acquisitions

What is the issue?

Investors do not get enough information about acquisitions and their subsequent performance

- Such information would allow investors to hold management to account (stewardship).
- IFRS Standards do not specifically require companies to disclose information about the subsequent performance of acquisitions.

Board's preliminary view: require disclosures

At the acquisition date:

- Strategic rationale for acquisition
- Objectives for the acquisition
- Metrics for monitoring achievement of objectives

After the acquisition date:

Performance against objectives

1 Improving disclosures about acquisitions

Board's preliminary view: Companies should disclose information management uses internally to monitor acquisitions

What metrics should be disclosed?

- No single metric suitable, because business combinations are all different
- Management approach:
  - Less costly to produce
  - Insights into how management manages acquisitions
- Can be operational or financial metrics
- Might be information about combined business where integration occurs

Should all material acquisitions be disclosed?

- Disclosure of all material acquisitions could be onerous for serial acquirers
- Preliminary view: define 'management' as 'chief operating decision maker' (CODM) (IFRS 8 *Operating Segments*)
- Are these the acquisitions that investors would like to know more about?

1 Further improvements to IFRS 3 disclosures

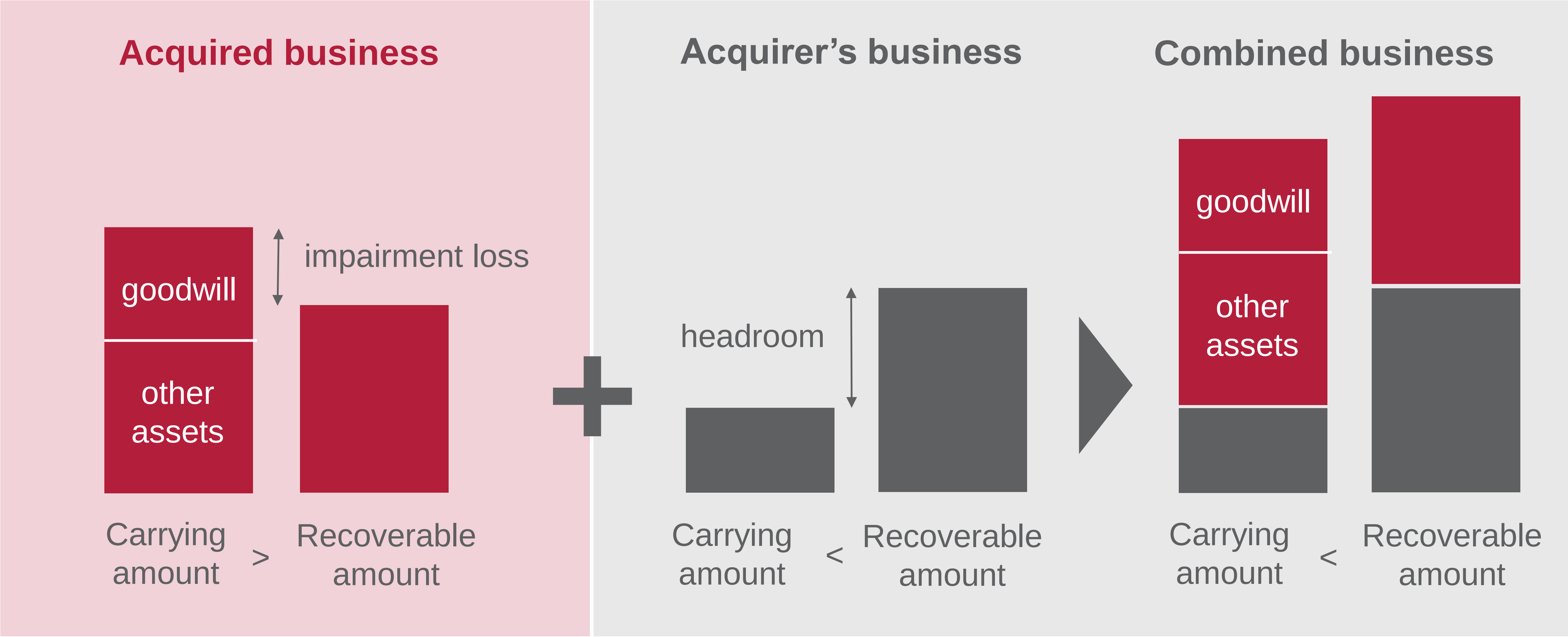
	Message from stakeholders	Preliminary view of the Board
Expected synergies	• Synergies are often an important part of an acquisition. • Help investors better understand the factors that contributed to the acquisition price.	Require companies to disclose in the year of acquisition the amount, or range of amounts, of synergies expected from an acquisition.
Defined benefit pension liabilities & debt	• Some investors consider these liabilities to form part of the capital employed for acquisitions. • Needed to assess return on capital employed.	Require companies to disclose the amount of defined benefit pension liabilities and debt of the acquiree at the acquisition date, separately from other classes of liabilities.
Pro-forma information	• Existing disclosure requirements lack guidance, resulting in diversity in practice. • Preparers question the usefulness of the information, while investors think that the information is important.	Require companies to disclose both actual and pro-forma revenue, operating profit and cash flows from operating activities.

❷ Improving the accounting for goodwill

2 Improving the accounting for goodwill

What are the issues?	Research undertaken by the Board
Impairment losses on goodwill are recognised too late	A Can the impairment test be made more effective?
Could be due to: • too optimistic cash flow estimates; or • shielding of goodwill from impairment by headroom (see next slide)	B Should goodwill be amortised?
The impairment test is complex and costly for companies	C Can the impairment test be simplified?

❷ Background—shielding



If acquired business is run separately:
→ tested for impairment separately
→ impairment loss

If acquired business is integrated with acquirer's business:
→ combined business is tested for impairment
→ no impairment loss

2 A Can the impairment test be made more effective?

Board's preliminary view

No feasible alternative test	The test is not intended to test goodwill directly	Disclosure solution
• It is not feasible to make the impairment test for goodwill significantly more effective at a reasonable cost to companies. • Shielding cannot be eliminated because goodwill has to be tested for impairment with other assets.	• The test cannot always signal how an acquisition is performing, but that does not mean that the test has failed. • When performed well, the test ensures that the carrying amount of the CGU as a whole is recoverable.	The disclosure requirements discussed on slides 4–5 could provide information that investors need about the performance of acquisitions.

❷ Ⓑ Amortisation of Goodwill vs Impairment-only

Amortising goodwill	Retaining the impairment-only model
some say…	others say…
Goodwill is overstated, so management is not held to account.	The impairment-only model provides useful confirmatory information to investors.
Amortisation is simple and targets acquired goodwill directly.	Amortisation is arbitrary and would be ignored by many investors.
The impairment test is not working as well as the Board intended.	If applied well, the impairment test works as the Board intended, ensuring that, as a group, goodwill and other assets of a business are not overstated.
Goodwill is a wasting asset. Amortisation is the only way to show the consumption of goodwill.	The benefits of goodwill are maintained for an indefinite period, so goodwill is not a wasting asset.
Amortisation would ultimately make the impairment test easier and less costly to apply.	Amortisation would not significantly reduce the cost of impairment testing, especially in the first few years.

2 B Amortisation of Goodwill vs Impairment-only

Board's preliminary view

There is no compelling evidence that amortisation would significantly improve financial reporting

Retain the impairment-only approach

The Board majority was small.
Stakeholders are invited to provide new arguments to help the Board decide how to move forward on this topic.

2 C Simplifying the impairment test

Relief from an annual impairment test

Having to perform the test annually, even when they have no reason to suspect an impairment has occurred, adds unnecessary cost.

- Remove requirement to test CGUs containing goodwill for impairment at least annually.
- Companies must still assess whether there is any indicator of impairment, and perform the impairment test if there is.

Simplifying value in use estimates

IAS 36 contains certain restrictions on value in use that add cost and complexity to the test, and deviates from common industry practice.

- Remove restriction on including some cash flows in value in use estimates.
- Cash flow forecasts still need to be reasonable and supportable.
- Allow use of post-tax discount rates and post-tax cash flows.

❸ Other topics

3 Other topics

Presenting total equity before goodwill	Intangible assets
Goodwill is different from other assets because it: • can only be measured indirectly; and • cannot be sold separately.	Some believe that recognising these assets separately helps explain what the company has bought in an acquisition. Others think that the information is of limited use.
Presenting **total equity excluding goodwill** on the balance sheet helps to make this amount **more prominent**, drawing investors' attention to companies whose goodwill constitutes a significant portion of their net assets.	In the Board's view: • there is no compelling evidence to change existing requirement; and • aligning the accounting treatment for all intangible assets is beyond the scope of this project.

Summary—package of preliminary views

A balanced package

		Objectives		Board's preliminary view
		More useful information	Reduce cost	
1	Improve disclosures about acquisitions	✓	✗	Yes, change
2	Amortise goodwill	✗	✓	No, do not change
	Provide relief from annual quantitative impairment test	…	✓	Yes, change
	Amend how value in use is estimated	✓	✓	Yes, change
3	Present total equity excluding goodwill	✓	…	Yes, change
	Include some intangible assets in goodwill	✗	✓	No, do not change

✓ In line with objective ✗ In conflict with objective … No significant impact

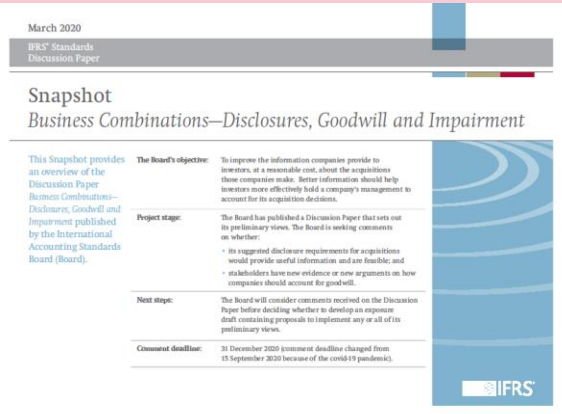
Get involved in this consultation

Contact our investor engagement team to schedule an outreach meeting:

- E-mail: investors@ifrs.org

More resources for CFA France members here

- Website: www.ifrs.org/investor-centre
- Twitter: @IFRSinvestors



March 2020

IFRS® Standards
Discussion Paper

Snapshot

Business Combinations—Disclosures, Goodwill and Impairment

This Snapshot provides an overview of the Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment* published by the International Accounting Standards Board (Board).

The Board's objective:	To improve the information companies provide to investors, at a reasonable cost, about the acquisitions those companies make. Better information should help investors more effectively hold a company's management to account for its acquisition decisions.
Project stage:	The Board has published a Discussion Paper that sets out its preliminary views. The Board is seeking comments on whether: • its suggested disclosure requirements for acquisitions would provide useful information and are feasible; and • stakeholders have new evidence or new arguments on how companies should account for goodwill.
Next steps:	The Board will consider comments received on the Discussion Paper before deciding whether to develop an exposure draft containing proposals to implement any or all of its preliminary views.
Comment deadline:	31 December 2020 (comment deadline changed from 15 September 2020 because of the covid-19 pandemic).

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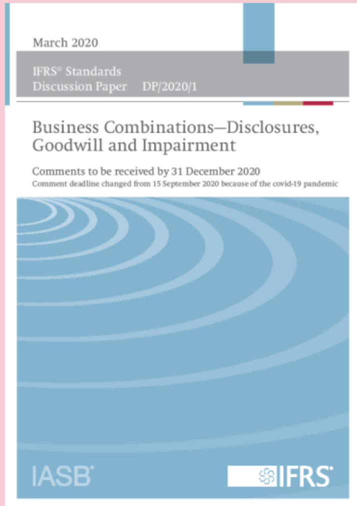
Check out the Snapshot for more information about the proposals



March 2020

IFRS® Standards
Discussion Paper DP/2020/1

Business Combinations—Disclosures, Goodwill and Impairment

Comments to be received by 31 December 2020

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Access the Discussion Paper

Submit a comment letter.

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EFRAG Draft Comment Letter

DISCLAIMER

The views expressed in this presentation are those of the presenter, except where indicated otherwise. EFRAG positions, as approved by the EFRAG Board, are published as comment letters, discussion or position papers, or in any other form considered appropriate in the circumstances.

EFRAG initial position

EFRAG due process and general position

- Supports the objective of exploring whether companies can, at a reasonable cost, provide investors with more useful information about the acquisitions those companies make. However, there would be some practical issues to consider in relation to the proposed disclosures.
- EFRAG's draft comment letter includes some proposals for how to remediate some of the shortcomings of the current impairment model.
- EFRAG is seeking views from its constituents on some of the proposals included in the DP, an answer to the question on whether the proposals in the DP, as a package, meet the objectives of the DP, will only be provided after receiving this input.

IMPROVING DISCLOSURE ABOUT BUSINESS COMBINATIONS

Improving disclosure about business combinations

EFRAG preliminary views

- Useful disclosures :
  - the strategic rationale and objectives for an acquisition
  - whether the acquisition is meeting those objectives
  - synergies
  - pro-forma revenue and operating profit before integration costs
- Does not solve the issues related to goodwill accounting, as this disclosure is disconnected from the book value of the goodwill
- Should be based on a level lower than what the 'CODM' monitors
- Practicability (e.g. auditability) and reliability: would the benefits of the disclosures outweigh the costs?
- In financial statements or management commentary?
- An entity should disclose if it stops monitoring an acquisition after three years instead of two
- Pro-forma information on cash flows from operating activities would not be particularly useful

Improving disclosure about business combinations

EFRAG requests input on

- Disclosure of commercially-sensitive information?
- Presentation in the management commentary or in the financial statements?
- Operational implications of DP proposals: its cost, reliability and any jurisdictional constraints?
- Feasible (at a reasonable cost) and useful to disclose KPIs excluding acquisition-related transaction and integration costs and the effects of the purchase price allocation?
- Would information that an entity is not monitoring a significant acquisition affect users?
- Can any current disclosure requirements in IFRS 3 be removed without depriving investors of material information?

GOODWILL IMPAIRMENT AND AMORTISATION

Goodwill, impairment and amortisation

EFRAG preliminary views

- More effective impairment approach difficult
- Recommends improving guidance (stakeholders' views needed)
  - allocation of goodwill to CGUs
  - no reallocation unless a change in the cash flow structure
  - aligning the impairment test with expected benefits at acquisition
  - No support for presenting total equity excluding goodwill.
- EFRAG seek views on whether the IASB should consider introducing reversal of impairments, including in an interim period.

- Over-optimism is not necessarily best addressed by auditors and regulators.
- Possible disclosure solutions to address over-optimism (stakeholders' views needed)
  - compare realised cash flows with predictions
  - assumptions used for the period for which cash flows are projected based on financial budgets
  - current level of cash flows, margins or earnings

Goodwill, impairment and amortisation

European Financial Reporting Advisory Group

EFRAG requests input on

- Any new evidence etc, around goodwill amortisation to support a major change in goodwill accounting?
- Is goodwill a wasting asset and should it be amortised? EFRAG's preliminary view is that it could have been considered whether amortisation could be performed on components of goodwill considered wasting assets.
- Is goodwill an accounting construct? If so, neither impairment losses nor amortisation provide useful information to users.
- Would users add back goodwill amortisation when calculating performance measures?
- Would it be useful (for users) and feasible (for preparers) to provide information about the age of goodwill (with no amortisation).
- If goodwill were to be amortised 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).

EFRAG has not yet formed a view on reintroduction of amortisation.

OTHER IMPORTANT TOPICS

Simplifying the impairment test

Simplifying the impairment test

- Reservations about indicator-only approach
- Support for:
  - Use of post-tax inputs
  - Restructuring/ Asset improvement cash flows
- However:
  - Additional guidance needed on inclusion of restructuring cash flows
  - Undetected impairment losses due to post-tax inputs?

Intangible assets

- Intangible assets part of goodwill to only later with a revision of IAS 38

Convergence with US GAAP

- EFRAG response independent from FASB actions

Divestments

- More guidance on goodwill allocation to divested businesses and re-organisations

Comment on EFRAG's draft comment letter

EFRAG's draft comment letter is available here on EFRAG's website: www.efrag.org.

Comment deadline: 30 November 2020.

Questionnaire/interview request for preparers is available here.

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