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Goodwill and Impairment – Project Update

Objective

1 The objective of the session is to provide EFRAG FR Board with an update on the status of the IASB *Goodwill and Impairment* project.

2 EFRAG FR Board members will be asked for views on the IASB tentative decisions and the IASB staff alternative solutions on the disclosure proposals regarding subsequent performance information and expected synergies.

3 The recent FASB decision to ''pause'' their project on goodwill and impairment could place greater emphasis on disclosures, especially if the IASB decides not to re-introduce amortisation of goodwill.

Structure of this paper

4 This paper is structured as follows:

(a) Background;

(b) IASB tentative decisions;

(c) IASB preliminary views - Disclosures about subsequent performance and expected synergies from a business combination;

(d) The IASB staff proposed alternatives;

(e) EFRAG discussions; and

(f) Next steps.

Background

IASB project

5 The IASB issued the Discussion paper *Business Combinations – Disclosures, Goodwill and Impairment* ('the DP') in March 2020 with a comment period that ended on 31 December 2020.

6 The DP included suggestions on improving the disclosures about business combinations by adding information about the strategic rationale and objectives for the acquisition including information about synergies as well as the metrics management plan to use to monitor achievement of those objectives; its subsequent performance; improving the accounting for goodwill by assessing whether the amortisation should be reintroduced and some other targeted improvements/simplifications to the current impairment test including the suggestion to only require a quantitative impairment test of CGUs including goodwill to be performed when there would be an indication of an impairment.

7 EFRAG published its final comment letter in January 2021.

FASB project on goodwill and Impairment has ''paused"

8 During its deliberations of its project on goodwill and impairment, FASB had tentatively decided to amortise goodwill on a straight-line basis over a 10-year default period or over an estimated period (using an open list of factors to consider), limited to a 25-year cap. Testing goodwill for impairment would only be required upon a triggering event.

9 At its meeting on 15 June 2022, the FASB decided to ''pause'' its discussions on the goodwill and impairment project and remove the project from its technical agenda.

(a) FASB members noted that the project, if finalised, would result in a significant change to goodwill accounting and therefore needed a strong case for change. FASB members were not convinced that a strong case had been made. Users of financial statements had informed the FASB that they did not support amortisation of goodwill and would prefer better disclosure. A survey published by the CFA Institute in 2021 states that the move to amortisation by the FASB would result in a write-off of 30–40% of the equity of the largest US Corporations.[1]

(b) Furthermore, the IASB project remains at a research stage and at this stage the IASB had not redeliberated the subsequent accounting for goodwill. FASB members considered that convergence on the subsequent accounting for goodwill was an important consideration.

IASB tentative decisions

10 Since starting its re-deliberations of the proposals, the IASB has made the following tentative decisions:

(a) To retain project objective and scope which is to improve disclosure about business combinations and subsequent accounting for goodwill.

(b) Approved a project plan at its meeting in September 2021 and decided to focus its discussions on disclosures before making tentative decisions on the subsequent accounting for goodwill.

(c) Tentatively decided that, based on the *Conceptual Framework for Financial Reporting,* the proposed disclosure information could be provided in the financial statements.

(d) Tentatively decided not to define synergies which is a term already used in IFRS 3.

(e) Other tentative decisions include:

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[1] *"Goodwill balances in the United States are much larger than many realize. The survey results refer to the CFA Institute comment letter to the 2019 FASB ITC which noted that based on 2018 figures, goodwill amounted to $5.6 trillion or 32% of the equity of all US public companies and $3.3 trillion or 41% of the equity of the S&P 500. This same goodwill represented 5.82% and 9.28%, respectively, of the assets of these same companies.*

A move by FASB, as it is currently headed, to amortize goodwill over a fixed period of 10 years—to match private company accounting—would reduce the net income of the S&P 500 by $330 billion (i.e., $560 billion for all public companies) every year for 10 years—if the transition occurs over a 10-year period. Or, it would immediately reduce equity by 30–40%, if goodwill is netted against equity at transition. "

(i) to retain the requirement in paragraph B64(q)[2] of IFRS 3.

(ii) to explain the objective of the requirement in paragraph B64(q)(ii) of IFRS 3 but not to provide guidance on how the information required by paragraph B64(q)(ii) should be prepared.

(iii) to specify in paragraph B64(q)(ii) of IFRS 3 that the basis that an entity applies in preparing the information required by that paragraph is an accounting policy.

(iv) to replace the term 'profit or loss' in paragraph B64(q) of IFRS 3 with 'operating profit or loss'. 'Operating profit or loss' will be as defined in the IASB's project on *Primary Financial Statements.*

(v) not to add a requirement to disclose information about cash flows arising from operating activities.

(vi) not to specify that liabilities arising from financing activities and defined benefit pension are major classes of liabilities.

(f) In April 2022, the IASB discussed the proposed disclosures on information about subsequent performance and expected synergies from a business combination. The IASB also discussed possible alternatives to address the concerns expressed by preparers and others on these proposals in particular commercial sensitivity of information linked to synergies and subsequent performance.

(g) In May 2022, the IASB discussed additional research on whether it is feasible to estimate the useful life of goodwill and the pattern in which it diminishes; and the potential consequences of transitioning to an amortisation-based model.

11 A detailed summary of the IASB tentative decisions is provided in the appendix.

IASB preliminary views - Disclosures about subsequent performance and expected synergies from a business combination

12 The IASB expressed the following preliminary views in the DP [3]:

(a) **Additional disclosure objectives** – include additional disclosure objectives to IFRS 3 *Business Combinations* that would require entities to disclose information that would help users understand:

(i) the benefits an entity expected from a business combination when agreeing the price to acquire that business; and

(ii) the extent to which management's objectives are being met.

(b) **Disclosure about performance of business combinations**

(i) in the year of a business combination, entities disclose the strategic rationale and objectives for that business combination and the metrics management plan to use to monitor achievement of those objectives; and

(ii) in subsequent years post-acquisition, entities disclose management's review of the entity's performance against those objectives.

[2] Paragraph 64(q) of IFRS 3 requires an entity to disclose (i) the amounts of revenue and profit or loss of the acquiree since the acquisition date; and (ii) the revenue and profit or loss of the combined entity for the current reporting period as though the acquisition date for all business combinations that occurred during the year had been as of the beginning of the annual reporting period.

[3] The DP contained other preliminary views about the disclosure requirements on business combinations but they are not the focus of this discussion.

This preliminary view builds on the requirement in paragraph B64(d)4 of IFRS 34 and is based on the information reviewed by the Chief Operating Decision Maker (CODM) to identify the population of business combinations being monitored.

(c) **Disclosure about expected synergies** – require entities to disclose in the year of a business combination quantitative information about the synergies expected as a result of the business combination.

This preliminary view is relevant only in the year of acquisition and builds on the requirement in paragraph B64(e) of IFRS 3[5]. The information under this preliminary view is not linked to the information reviewed by the CODM.

Feedback on the IASB preliminary views

Users

13 Users noted that they wanted to know whether management's objectives for an acquisition were being met. This information would help them assess management's ability to realise the expected benefits from an acquisition and assess whether an acquisition's subsequent performance indicates that management paid a reasonable price for the acquired business. Information about whether management's objectives are being met would allow investors to assess performance and more effectively hold management to account for its decision to acquire the business. Hence, investors would use the information to assess management's stewardship of the company's economic resources.

14 Additional outreach conducted by the EFRAG Secretariat in recent months confirmed the above. Furthermore, users informed that they would like to have all this information at one place, preferably in the financial statements. It can be less detailed than in the prospectus, but preferably standardised.

Preparers

15 The feedback (including from the additional outreach performed by the IASB staff) highlighted the following concerns from the preparers side:

(a) **commercial sensitivity** – that disclosure could contain sensitive information that, if disclosed, could harm the entity;

(b) **forward-looking information** – that disclosure could contain information about the future that, if disclosed, could increase litigation risk;

(c) **integration** – an entity may not be able to disclose information that is representative of the performance of a business combination if the acquired business is integrated into the entity's existing operations; and

(d) **auditability** – some information that would be required by the preliminary views may be costly, or difficult, to audit.

The IASB staff proposed alternatives

16 In April 2022 the IASB discussed two alternatives proposed by the IASB staff aiming to reduce the preparers' concerns expressed above in paragraph 15 by either:

(a) reducing the **population of business combinations** for which information would be disclosed, for example by applying the disclosure requirements to

[4] Paragraph B64(d) of IFRS 3 requires an entity to disclose the primary reasons for the business combination and a description how the acquirer obtained control of the acquiree.

[5] Paragraph B64(e) of IFRS 3 requires a qualitative description of the factors that make up goodwill recognised, such as expected synergies from combining operations of the acquiree and the acquirer, intangible assets that do not qualify for separate recognition or other factors.

significant business combinations only or by introducing quantitative or qualitative threshold; or

(b) reducing the amount of information to be disclosed for each affected business combination by providing **the exemption** in particular circumstances.

Population of business combinations

17 Under this alternative, entities would be required to disclose information about the strategic rationale, management objectives and subsequent performance of business combinations and expected synergies for only a **subset of business combinations.** This could be done using one of the following three ways:

(a) Quantitative threshold - a quantitative threshold—for example a business combination in which the acquired business represents more than 5% of the reporting entity's revenue, profit, total assets or net assets. This is similar to the approach used in paragraph 13 of IFRS 8 *Operating Segments*.

(b) Qualitative threshold - for example business combinations that comprise a significant portion of a particular reportable segment or are separate reportable segments. This is similar to the approach used in IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* to identify discontinued operations.

(c) A factor / indicator-based threshold - for example by describing the type of business combinations information would be required for, and then listing some factors /indicators for an entity to consider in determining whether a business combination is in that subset. This is similar to the approach used in IFRS 10 *Consolidated Financial Statements* for identifying an investment entity (paragraphs 27–28 of IFRS 10 - define and then list characteristics of an investment entity).

Exemption

18 Under this alternative, an entity would be exempt from disclosing some information (proposed in the DP) if specific conditions are met. The entity would explain the circumstance and the reason for not disclosing the information.

19 The IASB staff identified two possible ways to develop an exemption:

(a) Information unavailable / Impracticability - An entity could be exempted from disclosing particular information if it would be impracticable to do so. This is similar to the exemption in paragraph B64(q) of IFRS 3, which permits an entity not to disclose information required by that paragraph if doing so is impracticable.

(b) Information available but negative consequences of disclosing - An entity could be exempted from disclosing particular information if, for example, doing so would result in the entity being unable to realise its objective for the business combination. This is similar to paragraph 92 of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, which permits an entity not to disclose information if doing so may prejudice seriously the entity's position in a legal dispute.

20 The IASB staff noted that exemptions to regulatory reporting requirements already exist in some jurisdictions where information is considered to prejudice the entity or the information contains confidential information.

EFRAG discussions

IASB tentative decisions

21 EFRAG FR TEG agreed with the IASB project plan discussed in September 2021 but noted that the disclosure requirements could be affected by the IASB decisions on the subsequent accounting for goodwill.

22 **Regarding the location of information** in paragraph 10(c) (in October 2021 the IASB tentatively decided that, based on the *Conceptual Framework for Financial Reporting*, **information can be required in financial statements**), EFRAG FR TEG members provided mixed views:

(a) Those supporting providing the information outside of the financial statements considered that the issue that the information should be audited was not a good reason why it should be included in the financial statements. The information was already included in other sources such as the prospectus and investor presentations.

(b) Those supporting inclusion in the financial statements considered that the financial statements already included various types of forward-looking information and this information was audited. Furthermore, not all jurisdictions had requirements for a management commentary report. The user view was that it would be better to have the information in the financial statements.

23 EFRAG FR TEG noted that regarding synergies, the IASB had decided not to define synergies as feedback received did not suggest that entities were not appropriately identifying expected synergies. Paragraph B64(e) of IFRS 3 already required an entity to provide qualitative information about expected synergies.

IASB staff alternatives on the disclosure requirements

EFRAG FR TEG

24 EFRAG FR TEG discussed the IASB staff alternatives at its meeting in May 2022.

(a) Members had mixed views on the commercial sensitivity of the proposed disclosures, some considering it to be one of the main issues, while others referring to the existing similar confidential-type disclosures already required under current IFRS Standards.

(b) Some EFRAG FR TEG members noted that the subject of the IASB proposals was different to the issues to which IAS 37 applies and pointed out the difference in timing. They noted, that when IAS 37 refers, for example, to a restructuring provision, the restructuring is already announced and is known, whereas the proposed disclosure requirements relate to the expected restructuring. This information may be commercially sensitive and in conflict with certain legal regulations.

EFRAG FR TEG-CFSS

25 EFRAG FR TEG -CFSS discussed the alternatives in June 2022 in preparation for the July 2022 ASAF meeting. There were mixed views on the alternatives, with both posing a set of challengers to make them work in practice. Some members questioned whether the concern about commercial sensitivity. These members noted that some current IFRS Standards already require information that could also be considered commercially sensitive.

(a) Some members supported an alternative that could reduce the population of business combinations for which the information was provided and link the required disclosure to information that is monitored by management (CODM as defined under IFRS 8 *Operating Segments*.

(b) Several members considered that reducing the population for which information would be required based on a threshold (quantitative or qualitative) or a set of criteria would be difficult. There was also a question of how to define ''significant'' business combinations in view that current materiality requirements would already take that into account.

(c) Several members did not support an exemption on the basis that companies could use the exemption to avoid providing the information (and this would not be a solution). Companies might also try to apply the exemption by analogy to other situations in other IFRS Standards to avoid compliance. Furthermore, from auditors' perspective an exemption might lead to a lot of difficult discussions.

EFRAG Academic Panel

26 In June 2022, the EFRAG Academic Panel discussed the IASB staff alternatives. Members provided mixed views.

(a) Some supported an exemption, which could also include a sort of "rebuttable assumption" similar to the concept introduced by the sustainability reporting.

(b) One member noted that research highlighted the fact that some companies are not complying with the current disclosure requirements of IFRS 3. The concern for commercial sensitivity is linked to the information already required by IFRS 3 and other IFRS Standards if it is followed correctly. So, perhaps asking for more disclosure and information is not the right way to address the issue but finding a way to guide entities to be fully comply with the current requirements could be more effective.

(c) Another member noted that IAS 36 *Impairment of Assets* already provides a well-develop framework for explaining how the impairment test on goodwill is performed. So, he wondered whether it might be appropriate to integrate the subsequent disclosure requirements discussed in the IASB DP with the current disclosure requirements on the impairment test

EFRAG FIWG

27 Also in June 2022, the EFRAG FIWG discussed the IASB staff alternatives. Some of the main comments provided were:

(a) One member favoured a solution to limit the population of business combinations for which information would be disclosed. The subset of business combinations could be identified, or thresholds used, as already done by the IASB in other circumstances. On the contrary, the "comply or explain" approach may not be a useful solution. This approach could be a possible solution for information reported in the management commentary, but it could be very difficult to follow it in the core financial statements. The member acknowledged the difficulties related to the subsequent integration of the business and noted that no artificial numbers should be created just to comply with the disclosure requirements. He acknowledged the users' appetite for additional information and less appetite from preparers to provide it.

(b) Another member noted that the proposed additional information was already provided by entities in the investor related communications and available on the company's website. The estimate of some synergies (e.g., revenue synergies) has a very high level of uncertainty and there are no homogeneous methods to calculate and monitor them in practice. For this reason, this type of information may be difficult to audit. In this context, the "comply or explain" approach with a reference to the information provided in a document outside the financial statements could be a solution. It would avoid providing the information in the financial statements where it is not auditable.

EFRAG IAWG

28 The EFRAG IAWG provided written input on the IASB staff alternatives.

29 One member noted that business combinations are made for variety of reasons and it can be hard to capture the success or failure of a business combination using standardised information. For instance, if you do a business combination in order to eliminate a competitor and this would result in a higher profit margin for the other companies in the group over a very long time period, it would be difficult to standardise the information required to measure this. Furthermore, often an acquired company is merged within the group with another company and, therefore, will not provide any financial information on their own anymore, making it impossible to clearly identify cashflows stemming from the business acquired.

30 Finally, in this member view, amortisation of goodwill would limit the goodwill impairment testing (operationally easier) and is more theoretically correct as goodwill acquired will inevitably turn into goodwill created over time.

The IASB next steps

31 The next steps are foreseen as follows:

(a) In July 2022, the IASB staff will seek advice from ASAF members on aspects of the preliminary views related to disclosures about business combinations described in the Discussion Paper Business Combinations—Disclosures, Goodwill and Impairment.

(b) In Q3 2022, the IASB staff will complete research on practical concerns about the preliminary views to add (a) disclosure objectives to IFRS 3; and (b) requirements to disclose information about the subsequent performance of business combinations and quantitative information about expected synergies and ask the IASB to decide on whether to proceed with those preliminary view.

(c) In Q4 2022, the IASB will decide on (1) whether to reintroduce amortisation of goodwill; and (2) whether to move the project from the research to standard-setting phase.

(d) After Q4 2022, the IASB will decide on other aspects of the project (for example, simplifying how value in use is estimated).

Questions to the EFRAG FR Board

32 Do you have any comments on the IASB tentative decisions in paragraph 10?

33 Do you have a preference for the IASB staff alternatives in paragraph 16? If so, please explain.

34 Do you have any other comments on the project developments?

Appendix – Additional Information

Summary of the IASB tentative decisions

1 The table below provides an overview of IASB discussions and tentative decisions so far.

Topic	Decisions reached	Meeting Date
Feedback received on DP	In March 2021, the IASB discussed a summary of the feedback received on its preliminary views expressed in the DP. In April 2021, the IASB received a summary that focused only on **user feedback**. In May 2021, the IASB discussed a **literature review** that summarised the evidence from academic papers on topics relevant to the questions in the DP. The literature review was based on an academic literature review that provides an overview of academic papers on empirical goodwill research published in the last 20 years, published articles and other academic material.	March - May 2021
Objective of the project	The IASB tentatively decided to retain the objective of the project unchanged from that described in its DP. The objective is to explore whether entities can, at a reasonable cost, provide users with more useful information about the acquisitions those entities make. The IASB also tentatively decided to make no changes to the project scope. The IASB considers its preliminary views as a package that meets the project objective.	June 2021
Project plan	The IASB decided on a project plan. As part of that project plan the IASB is prioritising analysis of feedback on: • disclosures about business combinations; and • whether to retain the impairment-only model or whether to reintroduce amortisation for goodwill (the subsequent accounting for goodwill). The IASB staff sent a request to **IFASS** members asking for information on how goodwill is accounted for under local GAAP and views on the estimation of goodwill useful lives and possible challenges on transition should amortisation be reintroduced	September 2021
Location of information	The IASB tentatively decided that, based on the *Conceptual Framework for Financial Reporting*, information can be required in financial statements about the benefits an entity's management expects from a business combination and the extent to which management's objectives are being met. The IASB discussed practical concerns over requiring entities to include such information in financial statements. In particular, the IASB discussed the staff's	October 2021

	additional research and analysis of concerns over requiring entities to disclose information that might be considered forward-looking in some jurisdictions. The IASB will continue its redeliberations on its preliminary views on the package of disclosure requirements at future meetings, including whether not to proceed with some or all of the disclosure requirements for practical reasons.	
Expected synergies arising from a business combination *Contribution of the acquired business* *Liabilities arising from financing activities and defined benefit pension liabilities*	*Expected synergies* To better the practical concerns raised by respondents, the IASB, will test examples with stakeholders that illustrate disclosure of information about: • total expected synergies disaggregated by nature; for example, total revenue, total cost and totals for other types of synergies; and • when the benefits expected from the synergies are expected to start and how long they will last (which would require an entity to identify whether those synergies are expected to be one-off or recurring). The IASB also tentatively decided: • not to define 'synergies'. • not to make changes to its preliminary view as a result of feedback on other specific aspects of its preliminary view. *Contribution of the acquired business* The IASB tentatively decided: • to retain the requirement in paragraph B64(q) of IFRS 3. • to explain the objective of the requirement in paragraph B64(q)(ii) of IFRS 3 but not to provide guidance on how the information required by paragraph B64(q)(ii) should be prepared. The IASB tentatively decided to specify in paragraph B64(q)(ii) of IFRS 3 that the basis that an entity applies in preparing the information required by that paragraph is an accounting policy. The IASB tentatively decided to replace the term 'profit or loss' in paragraph B64(q) of IFRS 3 with 'operating profit or loss'. 'Operating profit or loss' will be as defined in the IASB's project on Primary Financial Statements. The IASB tentatively decided not to add a requirement to disclose information about cash flows arising from operating activities. *Liabilities arising from financing activities and defined benefit pension liabilities* The IASB discussed feedback on its preliminary view on developing proposals to specify that liabilities arising	November 2021

	from financing activities and defined benefit pension liabilities are major classes of liabilities. The IASB tentatively decided to achieve the objective of its preliminary view by not specifying that these liabilities are major classes of liabilities but instead by proposing to amend: • paragraph B64(i) of IFRS 3 to remove the term 'major'; and • paragraph IE72 of the Illustrative Examples accompanying IFRS 3 to illustrate liabilities arising from financing activities and defined benefit pension liabilities as classes of liabilities assumed.	
Expected synergies arising from a business combination and information on subsequent performance	In this meeting the IASB discussed: • feedback from additional outreach activities on the IASB's preliminary views, as described in the DP, concerning potential improvements to the current disclosure requirements about business combinations; and • how to advance or develop those preliminary views.	April 2022
Subsequent accounting for goodwill	In July 2022, the IASB redeliberated its preliminary views on the subsequent accounting for goodwill and whether to reintroduce amortisation of goodwill and discussed disclosures about business combinations and improving the effectiveness of the impairment test in IAS 36. The IASB had a joint meeting with the FASB (education purposes) where both boards discussed various aspects of their respective projects on goodwill and impairment and their tentative decisions (these projects do not constitute a joint project).	July 2021
	At its May 2022 meeting, the IASB discussed additional research on: • whether it is feasible to estimate the useful life of goodwill and the pattern in which it diminishes; and • the potential consequences of transitioning to an amortisation-based model.	May 2022

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2 EFRAG considered that the proposed disclosure requirements could result in useful information to assess business acquisitions. However, for the requirements to be most useful, the information should be provided for all material acquisitions based on the information that the relevant decision-maker monitors.

3 EFRAG noted some practical concerns including what information will be provided noting that some information might be better provided in the management commentary instead of the financial statements. In that regard, EFRAG noted that the information is based on management expectations and refers to non-GAAP indicators. However, EFRAG would also have reservations about allowing entities to present the information in the management commentary by either including the requirements in the management commentary practice statement or allowing entities to provide the information in the management commentary by cross reference.

4 EFRAG also noted that the IASB would have to consider how to avoid entities having to disclose commercially sensitive information. EFRAG thus disagrees that commercial sensitivity would never be a reason to prevent disclosure of information that investors would find useful. EFRAG made some suggestions how the IASB could address the issue of commercial sensitivity:

(a) One approach could be a ‘disclose or explain’ approach under which an entity does not disclose specified information, if disclosing the information would seriously harm the entity’s possibilities to achieve the expected objectives (or by other means result in a significant unfavourable position for the entity). This approach would be similar to the approach included in paragraph 92 of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. Under a ‘disclose or explain’ approach, the IASB would have to consider how the approach should be applied when some information might be commercially sensitive while others might not to avoid that, for example, only the ‘good’ information is disclosed.

(b) Another approach, the IASB could consider in the case an entity would not provide the required disclosures, would be to either require entities to determine the additional information it would need to meet the disclosure objectives or to specify alternative information to allow users making some assessment of the management’s decisions to acquire a business.