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Key messages for EFRAG's Draft Comment letter on BCDGI

Issues Paper

Objective

1 The objective of this paper is to ask EFRAG FR TEG members for their views on the key messages for the EFRAG draft comment letter based on the IASB Exposure Draft *Business Combinations – Disclosures, Goodwill and Impairment* ('ED') expected to be published in March 2024.

2 The key messages in this paper have been developed by the EFRAG project team based on:

(a) IASB's tentative decisions and the topics/questions expected to be included in the ED.

(b) EFRAG's views and feedback provided during the discussions on the IASB's tentative decisions. A summary is provided in the cover note (please refer to agenda paper 04-01).

(c) The survey results on the key proposals (please refer to agenda paper 04-03).

3 This paper includes notes to EFRAG FR TEG members on the topics that the EFRAG project team considered useful to support the key messages. The notes briefly describe EFRAG's position in its Final Comment Letter ('FCL') to the Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment* ('DP') and how the IASB addressed feedback in reaching its tentative decisions.

Questions to EFRAG FR TEG

4 Do you agree with the key messages for each of the sections/topics in this agenda paper? If not please explain and provide your suggestions/alternative views.

5 For some sections/topics the EFRAG DCL should include a question to constituents and welcome suggestions from EFRAG FR TEG.

Background

6 The IASB published the DP in March 2020. EFRAG published its FCL in January 2021.

7 Based on the feedback received on the DP, users generally supported the proposed disclosure requirements since entities would provide more useful information on the rationale and subsequent performance of business combinations they undertake. However, many preparers expressed concerns about providing such information, since in some cases it could be commercially sensitive, forward-looking and unavailable. The proposals to improve the impairment test were less controversial and generally supported by respondents to the DP, including EFRAG.

8 When redeliberating the package of disclosure proposals in the DP, the IASB acknowledged the concerns of preparers; and the request from users for better information provided under IFRS 3 *Business Combinations*.

9 Therefore, the IASB tried to find a compromised solution that would be acceptable for both preparers and users, requiring some of the information for only "strategically important" business combinations and providing entities with an exemption from disclosing some of the information in specific circumstances.

Structure of this paper

10 The rest of this paper is structured as follows:

- (a) Project objective;
- (b) Improvements to the disclosure requirements in IFRS 3;
  - (a) Location of information;
  - (b) Disclosure objectives;
  - (c) Contribution of the acquired business;
  - (d) New information for each business combination;
  - (e) New information for (only) strategic business combination;
  - (f) Definition of a 'Strategically important' business combination;

(g) Who provides the information and for how long;

(h) Exemption from disclosing some information.

(c) Improvements to the impairment test in IAS 36 *Impairment of Assets*;

(d) Transition requirements;

(e) Amendments to other IFRS Standards.

Project Objective

11 The project objective is to improve the information under IFRS 3 *Business Combinations* entities provide to users of financial statements (users), at a reasonable cost, about the business combinations those entities make.

IASB tentative decisions

12 The IASB tentatively decided to leave the objective of the project unchanged from that described in the DP and to make no changes to the project's scope at this stage.

13 The IASB decided not to consider additional topics suggested by respondents in this project, except for two topics related to possible improvements to the effectiveness of the impairment test of cash generating units containing goodwill.

Key messages

14 EFRAG welcomes the IASB's efforts to explore whether companies can, at a reasonable cost, provide investors with more useful information about the acquisitions those companies make.

15 Similar to what is expected to be reflected in the ED, 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 improve the information users receive on business combinations at a reasonable cost to preparers.

Part 1 - Improvements to the disclosure requirements

Summary of the IASB's tentative decisions

	All material business combinations	Only 'strategically important' business combinations
Proposed exemption applies	In year of acquisition, quantitative information about expected synergies	In year of acquisition, information about management's objectives and targets Subsequently, a qualitative statement of whether actual performance met the entity's objective and target
No proposed exemption	In year of acquisition, strategic rationale for undertaking the business combination	Actual performance in subsequent periods

Source: IASB Presentation, Accounting Standards Advisory Forum, July 2023

Location of information

IASB tentative decisions

16 The IASB tentatively decided that, based on the *Conceptual Framework for Financial Report*ing, 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—such as information about the subsequent performance of a business combination, and quantitative information about expected synergies.

Notes to EFRAG FR TEG

17 In its FCL, EFRAG considered some of the disclosures (such as information about the performance of a business combination) to be forward-looking and argued that the information would belong to the management commentary. This would reduce the risk of litigations based on the information. EFRAG learned that the concern is primarily related to the disclosures on the (specific) objectives of an acquisition and whether these objectives have been met, and less related to the disclosures on the strategic rationale of a business combination.

18 In reaching its tentative decisions, the IASB acknowledged that some aspects of its proposals - particularly information about the strategic rationale for undertaking a business combination - could contain forward-looking information. However, the IASB also considered that other information (such as information about key objectives, targets and expected synergies) is not forward-looking in the context of the Conceptual Framework for Financial Reporting (Conceptual Framework). This is because the information relates to assumptions made at the time of the business combination.

19 The IASB considered whether the Conceptual Framework would permit that information to be included in financial statements. The IASB concluded that it did because the proposed disclosures relate to the assets and liabilities acquired in the business combination and is useful to users. Furthermore, during outreach with preparers the IASB was informed that they gather significant information when determining the amount to pay for a business combination. However, the IASB acknowledged that some information might be considered by some to be forward-looking. The IASB has responded to these concerns by requiring some information only for strategic business combinations and providing an exemption for some information in specific circumstances.

Key messages for DCL

20 **EFRAG agrees that the financial statements would be the best place to provide the proposed disclosure information subject to the relief proposed by the IASB** for requiring disclosure of some of the information only for "'strategically important" business combinations and developing an exemption from disclosing some the information in certain circumstances.

21 EFRAG notes that some consider the proposed disclosure requirements to emphasise the concept of stewardship that is embedded in the *Conceptual Framework* in the disclosure requirements, and this creates some tension and questions whether some of the disclosures belong in the financial statements.

22 The IASB considered whether the *Conceptual Framework* would permit that information to be included in financial statements. Paragraph 3.6 of the *Conceptual Framework* states that forward-looking information can be required in financial statements if it: (a) relates to the entity's assets or liabilities (including unrecognised assets or liabilities—or equity) that existed at the end of the reporting period, or during the reporting period, or to income or expenses for the reporting period; and (b) is useful to users.

23 EFRAG agrees that the *Conceptual Framework* does not prohibit the proposed information from being provided in the financial statements. EFRAG also acknowledges that the Practice Statement 1: *Management Commentary* does not provide mandatory guidance which could lead to the proposed disclosures not being provided by many entities.

24 EFRAG also notes that some users of financial statements are indifferent about whether the information is placed in the financial statements or the management commentary. However, some users noted that if the information was included in the management report, it had to be audited. There had to be the same rigour on the information as for the

financial statements. EFRAG therefore considers that if users want audited information, the information should be provided in the financial statements.

Disclosure objectives

IASB tentative decisions

25 The IASB tentatively decided to propose adding **two new disclosure objectives** to IFRS 3 that would require an entity to disclose information to help users of financial statements understand:

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

(b) the extent to which an entity's objectives for a business combination are being met.

Key messages for DCL

26 **EFRAG generally supports the IASB's proposal to add two new disclosure objectives, for better reflecting users' needs.** The new disclosure objectives also complement the proposed disclosure requirements, as a response to users' feedback suggesting that no sufficient information about business combinations is provided for conducting their analyses.

27 However, as discussed below EFRAG disagrees with some of the proposed disclosures and questions whether they will meet the new disclosure objectives.

Contribution of the acquired business

IASB tentative decisions

28 The IASB tentatively decided:

(a) to retain the requirement in paragraph B64(q) of IFRS 3.[1]

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

[1] This paragraph requires the acquirer to disclose for each business combination that occurs during the reporting period the amounts of revenue and profit or loss:

(i) of the acquiree since the acquisition date included in the consolidated statement of comprehensive income for the reporting period; and

(ii) 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**.

If disclosure of this information is impracticable the acquirer shall disclose the fact and explain why is impracticable.

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

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

Notes to EFRAG FR TEG

29 *In its FCL, EFRAG was supportive of retaining the information disclosure requirement (B64(q)), since trend information/pro forma information is useful to users to support their forecasts. Regarding using the "operating profit or loss" term, EFRAG supported this proposal, given that it would be defined in the Primary Financial Statements project.*

30 *EFRAG also noted the practical challenges when preparing this information but did not consider that the IASB should develop guidance on how to prepare pro forma information. Instead, EFRAG suggested to provide a principles-based definition for the new concepts of "acquisition-related" and "integration cost" for ensuring comparability of information.*

31 *EFRAG disagreed with the proposal to disclose cash flows from operating activities, as it would be costly to provide this information with limited usefulness of the resulting information.*

32 *In reaching its decisions, the IASB has considered the mixed views on the cost and benefits of the pro forma information disclosure requirement in paragraph B64(q) and concluded that this information was very important to users for their analyses.*

33 *The IASB also proposed to use the "operating profit or loss" term as defined in the IASB's Primary Financial Statements project, to ensure consistency and comparability. When considering whether to add application guidance for the requirement in paragraph B64(q), the IASB has concluded that it is not possible to provide application guidance that would be applicable to all business combinations. Instead, the IASB proposed to describe the disclosure objective and specify that this would be an accounting policy which would reduce diversity in practice. Finally, when considering whether to add the disclosure requirement on cash flows from operating activities, the IASB has concluded that it would be too costly to prepare this information.*

Key messages for DCL

34 **EFRAG agrees with the IASB's decision to retain the disclosure information in paragraph B64(q) of IFRS 3**, as this information is important for users to perform the year-on-year

comparisons of an entity's performance and to understand how the two businesses are combined.

35 **EFRAG is also supportive of replacing the term "profit and loss" with "operating profit and loss"**, as defined in the *Primary Financial Statements* project, as it would limit divergence in practice and increase comparability of information. Users also highlighted that information up to operating profit of acquired business is relevant, as the operating performance is independent on how the acquisition is structured and how the entity has allocated finance costs and tax expenses between an integrated acquired business and the existing business.

36 EFRAG heard concerns from stakeholders that more guidance is required on how to build pro forma information to ensure consistency in practice. In EFRAG's view (as stated above) this could be addressed by using the defined term "operating profit or loss", by explaining the objective of paragraph B64(q), and by specifying that this is an accounting policy as proposed by the IASB.

37 Constituents also had questions on what the IASB's proposal of specifying that the basis of preparation is an accounting policy would mean in practice (e.g., any basis of preparation would be acceptable). **Therefore, EFRAG recommends the IASB to clarify what would be the practical implications of its proposal on the accounting policy.**

New Information for <u>each</u> business combinations

Strategic rationale

IASB tentative decisions

38	The IASB tentatively decided to propose replacing the requirement for an entity to disclose the 'primary reasons for the business combination' in paragraph B64(d) of IFRS 3 with a requirement to disclose the '**strategic rationale for undertaking the business combination**'.

Notes to EFRAG FR TEG

39 In its FCL, EFRAG highlighted the benefits of the disclosures about strategic rationale and management's objectives at the acquisition date, would provide better information to investors for assessing the success of an acquisition.

40 In reaching its tentative decisions, the IASB has considered how to provide the link between an acquisition an entity makes and the entity's overall business strategy and concluded that by requiring disclosures on the "strategic rationale", rather than the "primary reasons" would provide this link.

Key messages for DCL

41 **EFRAG supports the IASB proposal to require an entity to disclose the "strategic rationale" for undertaking a business combination**, rather than the primary reasons for a business combination. The proposal aims to provide clarity on how the business combination fits into the overall business strategy of the business and how it is tied to the nature of synergies. Finally, the proposal is not expected to result in significant changes to current IFRS 3.

Expected synergies

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

43 The IASB tentatively decided to propose to require an entity to disclose **additional information about expected synergies** from combining operations of the acquiree and the acquirer, including:

(a) **quantitative information about expected synergies disclosed by category** (for example, total revenue synergies, total cost synergies and totals for each other type of synergy). Quantitative information about expected synergies could be disclosed as a range or a point estimate;

(b) **a description of the expected synergies** from combining operations of the acquiree and the acquirer by specifying each category of expected synergy; and

(c) when the **benefits from the synergies are expected to start and how long** they will last. This would require the acquirer to identify whether the synergies are expected to be finite or indefinite.

44 The IASB clarified that proposed requirement for an entity to disclose information about expected synergies would **apply only in the year of acquisition**. It would not require an entity to disclose information about the achievement of those synergies.

45 The IASB tentatively decided **not to define** synergies.

46 The IASB also tentatively decided to provide an exemption for quantitative information about expected synergies in specific circumstances. The ED is also expected to include an illustrative example of the information on expected synergies.

Notes to EFRAG FR TEG

47 *In its FCL to the DP, EFRAG agreed that additional information on* ***quantitative disclosure requirements*** *on expected synergies could provide useful information. However, from a*

cost/benefit perspective, EFRAG considered that the benefits would outweigh the costs only if the required information is already available to the entity as part of the M&A process or other internal sources. Otherwise, EFRAG suggested to limit the disclosure to qualitative information only.

48 *EFRAG also noted that to increase comparability between entities and to help to understand what should be considered synergies, the IASB should include a list of what synergies could be and/or what "synergies" encompass.*

49 *In its FCL, EFRAG asked the IASB to further examine whether the disclosures would be better provided in the management commentary and understand how to avoid the disclosure of commercially sensitive information. For example, using the comply or explain approach, similar to the approach for the exemption in IAS 37 Provisions, Contingent Liabilities and Contingent Assets or requiring entities, which wouldn't provide the disclosure requirement, to disclose that. EFRAG added that similar to disclosures on management objectives for an acquisition and its subsequent performance, the IASB would have to consider how to avoid entities having to disclose commercially sensitive information. EFRAG thus disagreed that commercial sensitivity would never be a reason to prevent disclosure of information that investors would find useful.*

50 *In case an acquisition is material, goodwill is material and synergies constitute a material part of goodwill, the proposed disclosures on synergies should be provided as required by paragraph B64 of existing IFRS 3.*

51 *In its FCL, EFRAG also said that the reliability and auditability would depend on the circumstances. In some circumstances, when the synergies are the key driver of an acquisition, the required information could be easily available to entities.*

52 *The IASB considered, and decided not to,* ***provide a definition for synergies****. The IASB noted that the term ''synergies'' is already understood by entities given that paragraph B64(e) of IFRS 3 requires an entity to disclose qualitative information about expected synergies. It is expected that when synergies are a material aspect of the business combination, entities should be able to quantify them.*

53 *In reaching its tentative decisions, the IASB considered the feedback from respondents to the DP* ***that information about expected synergies*** *might be commercially sensitive. The IASB observed that the level of aggregation at which an entity could disclose this information. The IASB learned that many entities that currently provide quantitative information about expected synergies outside financial statements, do so at a level that disaggregates between different categories of synergies—notably between cost and*

revenue synergies. This level of disaggregation between different categories of synergies was also supported by users of financial statements as they use the information differently.

Key messages for DCL

Quantitative information on expected synergies

54 **EFRAG disagrees with the proposal to disclose quantitative information about expected synergies**.

55 Feedback received by EFRAG from preparers (survey respondents) highlighted concerns with the proposal, with some preparers noting that the only way to resolve these concerns would be to remove it. These preparers did not consider that disclosure of synergies at an aggregated level would resolve their concerns. They also said that the exemption would not alleviate concerns about commercial sensitivity given that they may not be able to apply the exemption.

56 EFRAG acknowledges that analysts/users use quantitative information on expected synergies to forecast profits and cash flows over future years (for example the next three to five years), and to assess the future evolution of an entity's risk profile and assess the success of a business combination. However, EFRAG remains concerned that:

(a) some of the quantitative information on synergies on the combined business involve a high level of uncertainty (forward-looking information), which might be extremely difficult to audit.

(b) some of the information could be considered to be commercially sensitive.

57 Overall, EFRAG doubts that the proposed disclosures on expected synergies would bring additional value for users, as they would rely mostly on the subjective management assertions that would not be possible to audit (or some could not be audited).

58 Therefore, EFRAG considers that the benefits of the proposal would outweigh the costs, only if the required information is already available to the entity as part of the M&A process or other internal sources.

59 EFRAG notes that the IASB acknowledged the concerns on providing the information on expected synergies and decided that an entity **need not disclose** an item of information on synergies, if doing so can be expected to prejudice seriously the achievement of any of the acquirer's key objectives for the business combination. Before an entity can apply the proposed exemption, it needs to first consider whether it is possible to disclose information in a different way, for example at a sufficiently aggregated level. The exemption is discussed below in paragraphs 119-135.

Disaggregation and timing of expected synergies

60 **Subject to the concerns noted above**, EFRAG agrees that requiring entities to provide a description of the expected synergies from combining operations of the acquiree and the acquirer by specifying each category of expected synergy is useful information to users.

61 A business combination can include either cost synergies or revenue synergies or both. Synergies could comprise a significant part of the price paid for a business combination, and therefore constitute a material part of goodwill. EFRAG therefore considers that the proposed level of disaggregation between different categories information in the year of acquisition on the type of synergy will help users of financial statements as they use the categories differently.

62 Furthermore, in EFRAG's view requiring disclosure to be disaggregated by category of synergy could help entities identify which categories can be quantified (considering the high level of uncertainty of information about synergies), and which are considered commercially sensitive in which case an entity could potentially apply the proposed exemption. This disaggregation might also address the difficulties noted in auditing the information.

63 Should the IASB continue with the proposals on expected synergies, EFRAG generally agrees with the proposal to require an entity to disclose when the benefits expected from the synergies are expected to start and how long they will last. In EFRAG's view, this information will help users to assess the timing and duration of the synergies.

Definition of synergies

64 **EFRAG generally disagrees with the IASB not defining/ describing synergies**. In EFRAG's view, the term "synergies" could have different meanings for different entities, and the lack of a description/guidance could result in inconsistent application of the term. Feedback received by EFRAG from preparers (survey respondents), highlighted that the majority supported having a definition of synergies.

65 Users have informed EFRAG that when companies typically report expected synergies, the information provided is diverse and different for each company, as "synergies" are not defined. Users have also said that usually, companies disclose qualitative information regarding revenue synergies (e.g., market share) or cost synergies (e.g., workforce reductions, purchasing savings) in management presentations or capital market roadshows.

66 **EFRAG agrees that specifying the categories of possible synergies that entities expect to have and should disclose** (for example revenue, cost or other types of synergies) is helpful.

New information for (only) strategic business combination

IASB tentative decisions

67 The IASB tentatively decided to **propose adding to IFRS 3** a requirement for an entity to disclose, **for 'strategically important' business combinations, information about**:

(a) **in the year of acquisition**, the **key objectives for the business combination and the related targets** the acquirer will use to determine whether the key objectives are being met. (Information about targets can be disclosed as a range or as a point estimate)

(b) **in the year of acquisition and in subsequent reporting periods**, the **extent to which the key objectives for the business combination and the related targets are being met**. This includes: (i) actual performance against the key objectives and targets for the business combination; and (ii) a statement of whether actual performance is meeting or has met the key objectives and targets for the business combination.

68 The information in (b) is required for as long as the acquirer's key management personnel reviews the performance of the business combination against its acquisition-date key objectives and targets. (KMP is discussed in paragraphs 101 - 117 below)

69 An entity is exempt from disclosing an item of information described in (a) and (b) if doing so can be expected to prejudice seriously the achievement of any of the acquirer's key objectives for the business combination. (The exemption is discussed in paragraphs 119-135 below)

Notes to EFRAG FR TEG

70 In its FCL, EFRAG highlighted that the disclosures about the management's objectives at the acquisition date would provide a good basis for investors to evaluate the success of an acquisition. EFRAG also noted that this information is relevant for assessing whether the acquisition meets the expectations set by management at acquisition date.

71 In its FCL, EFRAG supported the objective of providing both qualitative and quantitative information on whether the key objectives and targets are met in subsequent reporting period is appropriate, as the assessment on whether the acquisition is a success is not always possible using quantitative metrics. However, EFRAG expressed reservations on reliability and feasibility. For example, EFRAG assessed that the information required by the proposals could result in companies having to disclose information they would consider *commercially. Accordingly, EFRAG suggested the IASB to address this issue and suggested the following approaches.*

(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).*

(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.*

72 Like EFRAG, several respondents expressed concerns with the DP proposals to require information about the subsequent performance for business combinations that are monitored by the Chief Operating Decision Maker (CODM). Some of these respondents suggested that this information should be required only for business combinations that are considered to be major acquisitions. Feedback from users also supported that this type of information was primarily needed for the bigger acquisitions.

73 In reaching its tentative decisions, the IASB considered that information on key objectives and related targets would be useful for assessing the success and performance of a business combination. For the information on subsequent performance, the IASB considered that both quantitative and qualitative information (actual performance against the targets and the qualitative statement) would better address users' information needs.

74 In responding to the feedback received and address the concerns noted by preparers, the IASB tentatively decided to require the proposed information only for ''strategically important'' business combinations that are monitored by key management personnel. As discussed in the next section, a "strategically important'' business combination would be one for which not meeting any of its key objectives would seriously put at risk the entity achieving its overall business strategy.

Key messages for DCL

In the year of acquisition:

75 **EFRAG welcomes the IASB's proposal to require information on key objectives and targets for 'strategically important' business combinations at acquisition date.**

76 Stakeholders with a user background confirmed that this information would be useful for assessing the success of a business combination and for better understanding the management's expectations when agreeing on the acquisition price.

77 However, **EFRAG considers that further work is needed by the IASB to assess the practical issues noted by some preparers on providing some of this information on the key objectives for the business combination and the related targets**. In EFRAG's view, some of this information may be commercially sensitive and/or involve a high level of estimation given its forward-looking nature. This view was to a large extent supported by responses to a survey conducted by EFRAG.

Subsequent reporting periods:

78 **EFRAG welcomes the IASB's tentative decision to require the proposed information only for major business combinations,** which the IASB refers to as ''strategically important'', and to exempt an entity from providing the information when specific conditions are met. The combination of this relief could address (to some extent address) the practical issues noted by some preparers. **However, EFRAG considers further work is needed by the IASB to assess whether this is the case.**

79 EFRAG highlights the potential usefulness of the information on subsequent performance for users of financial statements, even when the acquired business is fully integrated into the business of the acquirer. Users have informed EFRAG that having this information would help them assess how profitable/successful the business combination had been and whether it met its initial expectation and the price paid for the acquisition. This would be an improvement to the information currently required by IFRS 3. Furthermore, given the IASB's tentative decision to retain the annual impairment test for goodwill, having better disclosures on subsequent performance is very important for users.

80 However, EFRAG notes feedback received from preparers (survey respondents) indicating mixed views on requiring the proposed information and whether only requiring this information for "strategically important" business combinations would solve the concerns around commercially sensitivity and practical challenges of providing the information, given factors as such integration of the acquiree into the consolidated group. The majority of survey preparer respondents also questioned whether the exemption from disclosing the information would be satisfactory to address these same concerns in view that in many cases the entity would not qualify for the exemption.

81 Furthermore, EFRAG considers that in some cases the proposed information would not meet the objective of providing relevant information to users as they will be difficult to

implement due to integration of the acquired business or other factors and could be considered commercially sensitive information. Given the forward-looking nature of the information on initial acquisition, EFRAG also highlights that there could be reliability issues to determine the information and auditability issues. The combination of these issues could result in entities providing boiler-plate information which would not serve user needs.

82 For the above reasons, EFRAG considers that that further work is needed to assess whether further relief is needed on the proposed information requirements.

Definition of a 'Strategically important' business combination

IASB tentative decisions

83 The IASB tentatively decided that a 'strategically important' business combination would be a business combination for which not meeting the objectives would seriously put at risk the entity achieving its overall business strategy.

84 To identify such business combinations, the IASB tentatively decided to propose using a closed list of thresholds—a business combination that **meets any one of those thresholds would be 'strategically important'**. The thresholds would be:

85 **Quantitative**—that is, a business combination in which:

(a) the **acquiree's operating profit** (to be defined by the IASB's Primary Financial Statements project) **exceeds 10% of the acquirer's operating profit**, for the acquirer's most recent annual reporting period ending before the business combination was completed;

(b) the **acquiree's revenue exceeds 10% of the acquirer's revenue** for the acquirer's most recent annual reporting period ending before the business combination was completed; or

(c) the amounts recognised as of the acquisition date for **all assets acquired (including goodwill) exceed 10% of the carrying value of the assets recognised on the acquirer's balance sheet** as at the acquirer's most recent reporting period date before the business combination.

86 **Qualitative**—that is a business combination that results in an entity entering:

(a) a new geographical area of operations or

(b) a new major line of business

Notes to EFRAG FR TEG

87 *The DP did not propose requiring the information for "strategically important'' business combinations.*

88 In its FCL, EFRAG agreed with the IASB's proposal to require information on subsequent performance, to respond to users' needs on the useful information that they were missing to better understand whether the management objectives for the acquisition are met. However, EFRAG pointed out that by requiring information only on business combinations monitored by the CODM, it would not address users' needs in receiving material information on acquisitions. Instead, EFRAG proposed to require information for all material business combinations that are monitored by relevant decision makers.

89 In its FCL, EFRAG also made some suggestions on how to address preparers' concerns – these are mentioned in paragraph 71 above.

90 In responding to feedback and reaching its tentative decisions, the IASB has considered stakeholders' concerns, especially around the cost of providing the disclosures and the high volume of information for all material business combinations, while retaining the usefulness of information to users. The IASB concluded that requiring information on subsequent performance only for a ***subset of material combinations*** *("strategically important") would strike a balance between costs and benefits. For identifying "strategically important" business combinations, a closed list of quantitative and qualitative thresholds would be appropriate.*

Key messages for DCL

91 **EFRAG considers that a combination of both quantitative and qualitative thresholders would be more appropriate** (for instance one of the quantitative **and** one of the qualitative thresholds should be met).

92 Feedback received by EFRAG from preparers (survey respondents) highlighted that a **combination of both** quantitative and qualitative thresholders would be more appropriate. For example, entering into a new geographical area does not necessarily mean that the business combination has strategic importance (it may involve very immaterial business combinations), and this is why at least one of the quantitative thresholds should be met in conjunction with a qualitative threshold.

93 EFRAG would also like to highlight the **need for application guidance** on how the definition of the "strategically important" business combination (i.e., not meeting its objectives would seriously put at risk the entity achieving its overall business strategy) would be applied in practice together with the closed list of thresholds. In fact, the definition is

principles-based, while the closed list of thresholds is prescriptive, which may raise application questions to preparers.

94 Some preparer respondents had **mixed views** on whether the IASB's proposal to use a closed-list approach consisting both of quantitative thresholds and qualitative thresholds captures the right population of strategic business combinations. The individual proposed thresholds are discussed below.

Quantitative thresholds

95 **EFRAG considers that the IASB should conduct further work on the proposed quantitative thresholds to assess whether they are the appropriate measures to capture the intended population of business combinations.**

96 EFRAG generally supports the quantitative properties that were proposed by the IASB ("operating profit", "revenue" and "total assets"), as they are already defined in IFRS Accounting Standards and are considered as appropriate measures for reflecting the different reasons for undertaking a business combination. The quantitative thresholds are also consistent with the ones used under IFRS 8 *Operating Segments.*

97 However, in addition to the three proposed quantitative properties, EFRAG heard feedback from users that an enterprise value threshold should be added as a criterion to determine "strategically important'' business combinations.

98 Finally, feedback received by EFRAG from preparers (survey respondents) provided mixed views on whether the proposed 10% measure is appropriate, with some supporting the proposals and others considering that the 10% is too high. Therefore, EFRAG considers that further work by the IASB is needed to assess whether **the thresholds capture the intended population of business combinations.**

Qualitative thresholds:

99 **EFRAG considers that the IASB should conduct further work on the proposed qualitative thresholds to assess whether they are the appropriate measure to capture the intended population of business combinations.**

100 Most respondents (preparers) to EFRAG's survey disagreed with the proposed qualitative thresholds, mainly because in their view they would result in including non-strategic business combinations.

Who provides the information and for how long

IASB tentative decisions

101 The IASB tentatively decided to:

(a) to specify a level of management within an entity to identify the information the entity is required to disclose about the subsequent performance of business combinations; and

(b) to describe that **level of management as the key management personnel**[2], of the reporting entity, as defined in IAS 24 *Related Party Disclosures*.

102 The IASB also tentatively decided for **''strategically important'' business combinations**:

(a) to maintain its preliminary view that an entity be required to disclose information about the subsequent performance of a business combination **for as long as the entity's management continues to monitor** whether the objectives of the business combination are being met (that is, the entity's management compares actual performance with the entity's objectives and targets for the business combination it established when entering into the business combination).

(b) to maintain its preliminary view that if an entity's management **does not monitor** whether its objectives for a business combination are being met, the entity should **disclose that fact and the reasons why it does not do so**.

(c) to maintain its preliminary view that if an entity's management **stops monitoring, before the end of the second full year after the year of the business combination**, whether its objectives for a business combination are being met, the entity should **disclose that fact and the reasons why it has done so**.

(d) to propose that an entity whose management stops monitoring, before the end of the second full year after the year of the business combination, whether its objectives for a business combination are being met, be required to disclose information about actual performance. The entity will be required to disclose information using the metric set out in the year of acquisition, if (and only if) information about actual performance using that metric is being received by the entity's management.

[2] Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity.

(e) The IASB did not proceed with its preliminary view in the DP to require an entity to disclose information about a change in metrics.

Notes to EFRAG FR TEG

Who provides the information?

103 *In its FCL EFRAG expressed concern that users may not receive sufficient information if the disclosures would only be based on the information that the CODM reviews.*

104 *EFRAG considered that the information it should be based on:*

(a) *a general materiality level;*

(b) *the information used to monitor the acquisition internally by the relevant decision maker ("CODM"). The relevant decision maker may correspond to the CODM or to a lower level, depending on the entity's strategy and organisation.*

105 *EFRAG acknowledged the advantage of referring to the information used by the CODM, as this term is already defined in IFRS 8 Operating Segments. However, EFRAG considered that it should also be possible to define "the relevant decision maker" level on which the disclosures on the success (or failure) of acquisitions should be based.*

106 *The IASB considered whether CODM is suitable to define senior level of management as proposed in the DP and considering feedback received decided to instead refer to the key management personnel ("KMP"), as defined in IAS 24.*

107 *In the IASB's view, CODM was linked to the reportable segment in IFRS 8 and assessment of the performance of a business combination should not necessarily be done at this level. In addition, there is a diversity in practice in assessing CODM level and hence, it might result in inconsistent application.*

108 *The IASB considered that using KMP has the following advantages:*

(a) *This term is defined in IFRS Accounting Standards;*

(b) *It is not linked to segment reporting.*

109 *How long the information is provided EFRAG generally agreed that it would be useful to disclose:*

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

(b) *if management stops monitoring the acquisition, whether the objectives are being met; and*

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

110 *In its FCL, EFRAG assessed 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. However, as the integration could take more than two years for a significant proportion of material acquisitions, EFRAG considered 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, instead of after the two years suggested in the DP.*

Key messages for DCL

Who provides the information?

111 **EFRAG agrees with the IASB tentative decision to specify the level of management as the entity's key management personnel (KMP), as defined in IAS 24**, instead of using the CODM as defined in IFRS 8.

112 EFRAG considers that the two definitions are quite similar, but using KMP provides a general and principle-based definition and allows to disconnect the level of the review from the reportable segment level.

113 In EFRAG's view, since the information on subsequent performance is requested only for "strategically important" business combinations, the KMP represents the appropriate level of monitoring.

114 EFRAG highlights the importance of an alignment between roles and definitions in different IFRS Accounting Standards, for example in case of the integration of an acquired entity in an existing business which is reviewed by CODM.

115 In this respect, EFRAG welcomes the IASB's clarification that the level of management monitoring for the purposes of subsequent performance may not be the same as the level of management monitoring the business associated with goodwill for the purposes of impairment testing (please refer to the section improvements to impairment test for more details).

How long the information is provided?

116 **EFRAG agrees with IASB's tentative decisions to disclose information about the subsequent performance of a business combination for as long as the entity's management continues to monitor** it against its acquisition-date key objectives and targets.

117 EFRAG also agrees with the IASB's tentative decision that if an entity's management:

(a) does not monitor whether its objectives for a business combination are being met; or/and

(b) stops monitoring, before the end of the second full year after the year of the business combination;

the entity should disclose that fact and reasons for not doing so.

118 EFRAG agrees with a requirement to disclose the information as long as management monitors the subsequent performance and considers that two full years after the year of a business combination to be a reasonable minimum period for the information to be disclosed.

Exemption from disclosing some information

IASB tentative decisions

119 The IASB tentatively decided to propose **an exemption** in specific circumstances that would permit an entity not to disclose information about:

(a) management's objectives for a business combination;

(b) the metrics and targets management will use to monitor whether the objectives for the business combination are being met;

(c) quantitative information about synergies expected to arise from the business combination; and

(d) qualitative statement of whether actual performance of a business combination in subsequent periods met the entity's target for the business combination.

120 The IASB tentatively decided to **propose no exemption** from disclosing information about:

(a) the strategic rationale for the business combination; and

(b) the actual performance in subsequent periods using the metrics management uses to monitor whether the objectives for the business combination are being met. The IASB tentatively decided to **propose a principle for an entity to apply when using this proposed exemption**. An entity applying the principle would be allowed to use the exemption from disclosing a particular item of information if disclosing that information can be expected to prejudice seriously any of the entity's objectives for the business combination.

121 To help entities apply this exemption, the IASB tentatively decided to propose application guidance. This **application guidance** would require an entity:

(a) to consider factors including the effect of disclosing the information and the availability of the information in determining whether the exemption is applicable.

(b) to consider whether it is possible to disclose information at a **sufficiently aggregated level** to resolve concerns while still meeting the objectives of the disclosure requirements.

(c) to disclose, **for each item of information** to which an entity has applied the exemption, **that it has applied the exemption and the reason for applying the exemption** to that item of information.

(d) **to reassess in each reporting period whether the application of the exemption to an item of information is still appropriate**. If it is no longer appropriate to apply the exemption, the entity would be required to disclose the item of information previously exempted. An entity would be required to perform that reassessment for as long as the entity would otherwise be required to disclose information about the subsequent performance of the business combination.

Notes to EFRAG FR TEG

122 *The exemption was not proposed in the DP.*

123 *In its FCL, EFRAG considered that the proposed disclosure requirements could result in useful information. However, for the requirements to be most useful, EFRAG suggested that the information should be provided for all material acquisitions based on the information that the relevant decision-maker monitors. EFRAG also expressed some practical concerns about what information has to be provided.*

124 *EFRAG also noted that the IASB would have to consider how to avoid disclosing commercially sensitive information. EFRAG thus disagreed that commercial sensitivity would never be a reason to prevent disclosure of information that investors would find useful. EFRAG further noted that the proposed disclosures would not resolve the issues related to current goodwill accounting*

125 *To address the concerns of stakeholders about commercial sensitivity of the proposed disclosures on targets, cost-based targets and employee-related information, the IASB decided to propose exempting an entity from the requirement to disclose some information in specific circumstances.*

126 *The IASB developed a core principle underpinning the exemption - that an entity be exempted from disclosing some information, if doing so can be expected to prejudice seriously the achievement of any of the entity's key objectives for the business combination.*

127 *The research performed by the IASB indicates that not all information that would be required applying the proposals in the ED would be so commercially sensitive, that it should not be required in financial statements. Therefore, the IASB proposes to apply the exemption only to some items of the information.*

128 *The IASB further considered that litigation risks arising from an entity failing to meeting its key objectives for the business combination as a result of disclosing the forward-looking information would be addressed by the exemption. The IASB did not propose an exemption to address litigation risk arising from other sources, such as factors outside the control of the entity.*

Key messages for DCL

129 **EFRAG welcomes the IASB efforts to address concerns (such as commercial sensitivity) by proposing the exemption** to some items of information under specific circumstances.

130 **However, EFRAG questions whether the proposed exemption will achieve its intended objective** and recommends the IASB to conduct further work in this regard.

131 Feedback received by EFRAG from preparers (survey respondents) suggests that the proposed exemption does not alleviate their concerns on commercial sensitivity, in particular the requirement to provide the reason for applying the exemption can itself contain commercially sensitive information.

132 EFRAG agrees that the principle underpinning the exemption is similar to the one in paragraph 92[3] of IAS 37, however, in EFRAG's view, the context is a bit different. For example, when IAS 37 refers 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, forward-looking and may also conflict with certain legal regulations.

133 The feedback received by EFRAG from preparers (survey respondents) show that they disagree that the exemption would only apply "in extremely rare cases", as specified in

[3] In extremely rare cases, disclosure of some or all of the information required by paragraphs 84–89 can be expected to prejudice seriously the position of the entity in a dispute with other parties on the subject matter of the provision, contingent liability or contingent asset. In such cases, an entity need not disclose the information, but shall disclose the general nature of the dispute, together with the fact that, and reason why, the information has not been disclosed.

paragraph 92 of IAS 37. Preparers also noted that the aggregation will not necessarily resolve their concerns about the availability and commercial sensitivity of information.

134 On the other hand, EFRAG acknowledges the risk that the exemption could be interpreted too broadly and highlights the importance of proper application guidance. Therefore, EFRAG welcomes the proposed application guidance to help entities to identify the circumstances in which application of the exemption would be appropriate.

135 However, EFRAG highlights some practical challenges related to the effect of disclosing the information, and more specifically the entity's ability to assess what information its competitors have access to. In some other cases, EFRAG highlights the challenge of assessing whether the information is publicly available. Therefore, EFRAG recommends the IASB to conduct further work to assess where the exemption can be applied as intended.

Part 2 - Improvements to the Impairment test

Retaining the impairment only model

IASB tentative decisions

136 The IASB tentatively decided: (a) to maintain its preliminary view to retain the impairment-only model for the subsequent accounting for goodwill. (b) to retain the requirement to perform a quantitative impairment test annually, and not to pursue any of the alternatives to it that were suggested by respondents. (c) that it is not feasible to design a different impairment test that would, at a reasonable cost, be significantly more effective than the impairment test currently required by IAS 36.

Notes to EFRAG FR TEG

137 *In response to the feedback from the PIR of IFRS 3, the IASB explored whether to reintroduce amortisation of goodwill. In particular, the IASB considered whether amortisation could:*

(a) *provide a simple mechanism that targets the acquired goodwill directly;*

(b) *take some pressure off the impairment test.*

138 *The IASB's preliminary view in the DP was to retain the impairment only model to account for goodwill, although this view was reached by a narrow majority of the IASB members.*

139 *The feedback received by the IASB was mixed, the IASB acknowledged that both amortisation and impairment-only models have limitations.*

140 On balance, considering the extensive evidence collected, the IASB concluded that it had no compelling case to justify reintroducing amortisation of goodwill and hence decided to retain the impairment-only model for the subsequent accounting for goodwill.

141 In its FCL, EFRAG appreciated the IASB's attempts to simplify the impairment test. However, EFRAG had reservations about introducing an indicator-only approach and did not support this approach in connection with the impairment-only model.

142 EFRAG also noted the controversial nature of the question of whether the impairment-only model should be kept, subject to suggested improvements or the amortisation of goodwill should be reintroduced. EFRAG acknowledged the conceptual and practical arguments for both the impairment-only model and reintroduction of amortisation and notes that more and more voices were raised in favour of the latter mainly for practical reasons. However, considering that an accounting policy should only be changed if it would provide reliable and more relevant information, EFRAG suggested the IASB further explore improvements to the existing impairment test and any cost and consequences of reintroducing amortisation.

143 In its FCL, EFRAG did not support the indicator-only approach in connection with the impairment-only model. EFRAG acknowledged that although having some potential for costs savings, the indicator-only approach will result in a loss of important information to users enabling them to support their business valuations and could increase management overoptimism, and auditors or regulators would have no comparison to impairment tests prepared in previous years.

144 EFRAG also shared the IASB's reservations about the feasibility to design an impairment test that is significantly more effective at the timely recognition of impairment losses on goodwill at a reasonable cost (see next question for more details).

Key messages for DCL

145 **EFRAG agrees with the IASB tentative decisions to retain the annual impairment testing requirement,** not to pursue any of the alternatives to an annual quantitative impairment test and that it is not feasible to design a different impairment test that is significantly more effective than the impairment test in IAS 36 at a reasonable cost.

146 In EFRAG's view, performing the annual impairment test is a good exercise for auditors, regulators and preparers as it introduces an internal and external governance over the financial reporting process.

Reduce shielding and management over-optimism (July 2023)

IASB tentative decisions

147 To reduce shielding and management over-optimism, the IASB tentatively decided:

(a) to replace 'goodwill is monitored for internal management purposes' in paragraph 80(a) of IAS 36 with 'business associated with the goodwill is monitored for internal management purposes';

(b) to clarify the meaning of the proposed new wording for paragraph 80(a) by providing limited clarifications of what is meant by 'monitoring' a business associated with goodwill;

(c) to clarify that 'operating segment' in paragraph 80(b) of IAS 36 is intended to show the highest level that can be used by an entity in the impairment test when applying paragraph 80(a);

(d) to clarify why IAS 36 requires an entity to allocate goodwill to a cash-generating unit or a group of cash-generating units; and

(e) to take no further action on any of the other suggestions from respondents to the Discussion Paper for improving the effectiveness of the impairment test.

148 The IASB tentatively decided to require an entity to disclose the reportable segments in which cash-generating units containing goodwill are included.

149 The IASB also tentatively decided to explain the difference between management monitoring 'strategically important' business combinations for the purpose of subsequent performance disclosure and management monitoring a business associated with the goodwill for the purpose of impairment testing.

Notes to EFRAG FR TEG

150 *It should be noted that the objective of this project is not a comprehensive review of IAS 36 but to respond to the feedback to the PIR of IFRS 3 and to address concerns about the timeliness of goodwill impairment. Therefore, the IASB is not considering changing fundamentals of IAS 36, but only addressing limited improvements. Shielding and management over-optimism were identified as major reasons for why impairment test is not working as intended.*

151 *To address shielding, the IASB considered whether it could design a different impairment test to the one in IAS 36 that would be significantly more effective at recognising impairment losses on goodwill at a reasonable cost, and concluded it was not feasible to do so. In particular, the IASB considered a so-called headroom approach, in which at least a*

portion of any reduction in the recoverable amount would be attributed to the acquired goodwill, rather than allocating it first to the unrecognised headroom. However, this approach was not supported by the stakeholders and the IASB did not pursue it.

152 *The IASB nevertheless proposed some targeted improvements to the calculation of value in use and additional disclosure requirements discussed in the next question below.*

153 *The IASB tentatively decided not to pursue any other suggestions of respondents to improve the effectiveness of the impairment test, mostly on the grounds that they will not have major impact, will be costly or represent application issues not to be addressed via standard-setting.*

154 *The IASB proposed additional disclosures to require an entity to disclose the reportable segment in which a CGU containing goodwill is included because:*

(a) *this information would help users better assess the reasonableness of assumptions used in the impairment test and thereby help reduce management over-optimism. Users would be able to compare these assumptions to information they receive about reportable segments and to their own assumptions for the future performance of those reportable segments;*

(b) *disclosing this information would not result in significant costs for preparers.*

155 *In its FCL, EFRAG suggested in order to address shielding that the guidance on goodwill allocation to cash generating units needs to be 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 cash-generating units containing goodwill could supplement the improvements to goodwill allocation guidance.*

156 *EFRAG provided the below reasons of why the shielding effect is unavoidable:*

(a) *the impairment test is not targeted to measure the recoverable amount of goodwill but that of the CGU or group of CGUs;*

(b) *after the business combination, an additional shield normally arises from internally generated goodwill; and*

(c) *the potential shielding effect increases with a higher level of allocation and the potential mix of business with different profitability.*

157 *EFRAG noted that the shielding effect is generally greater when goodwill is allocated to groups of cash generating units containing several cash generating units or in cases where goodwill is allocated to one large CGU whose size is significant compared to the acquired*

business. The IASB partially addressed this in its tentative decision in paragraph 147(d) above.

158 *EFRAG made several suggestions on allocation of goodwill to CGUs:*

(a) *to rely more on the goodwill allocation guidance on the managerial assessment that is done at acquisition on how benefits and synergies derived from a given acquisition are expected to materialise - not addressed by the IASB.*

(b) *to consider a rebuttable presumption that the allocation level is below operating segment level – addressed in points (a) to (c) of the IASB tentative decisions above;*

(c) *to enhance the guidance for reallocation of goodwill, for example to only allow reallocation if it is justified by a change in the cash flow structures. A reallocation of reporting segments on its own should not be sufficient - not addressed by the IASB.*

159 *EFRAG did not agree with the IASB conclusion in the DP that management over-optimism is best addressed by auditors and regulators, and suggested that additional disclosures could help achieving a better transparency of the estimates made, as well as improved guidance for identification of impairment testing trigger events.*

160 *EFRAG suggested the following additional disclosure requirements:*

(a) *the assumptions relating to the terminal value;*

(b) *assumptions over the period for which management has projected cash flows based on financial budgets;*

(c) *achievements of previous estimations on a qualitative or quantitative basis.*

161 *EFRAG acknowledged however that these disclosures could be costly and/or commercially sensitive.*

162 *EFRAG also suggested following possible improvements to IAS 36 which were not pursued by the IASB:*

(a) *To provide a granular set of indicators of impairment triggering events;*

(b) *To provide guidance on disposal of goodwill to avoid that it stays in the accounts when related business is sold;*

(c) *To provide additional guidance on what is a reasonable and supportable cash flow projection (paragraph 33 of IAS 36).*

Key messages for DCL

Suggestions to reduce shielding - Allocating goodwill to CGUs

163 **EFRAG welcomes the IASB efforts to address shielding and management over-optimism to improve the effectiveness of the impairment test.** EFRAG notes, however, that without changing the fundamentals of the impairment test, these improvements remain of a collateral nature. Therefore, **EFRAG agrees with the IASB tentative decisions** as they respond to a certain extent to the EFRAG concerns expressed in its FCL.

164 In its FCL, EFRAG suggested that to reduce shielding to a certain extent and to reduce judgement and avoid any opportunistic behaviour, the guidance on allocation of goodwill to the cash-generating units could be enhanced to improve how the test is applied in practice.

165 EFRAG also acknowledged that the shielding effect is generally greater when goodwill is allocated to groups of cash generating units containing several cash generating units or in cases where goodwill is allocated to one large CGU whose size is significant compared to the acquired business.

166 EFRAG notes that feedback from auditors and enforcers shown that it was particularly difficult to enforce the goodwill allocation to a level lower than operating segment which was considered by many entities as a default and that more guidance on how to make this allocation and identify the lowest level would be very helpful.

167 Therefore, EFRAG welcomes the IASB proposed amendments to the paragraphs 80(a) and 80(b). In EFRAG's view, they can help emphasising the requirement to allocate goodwill to the lowest reporting level and thus reducing shielding effect.

168 EFRAG suggests, however, to further reduce shielding effect to consider providing more guidance on reallocation of goodwill between the reporting segments and only allow it when it is justified by a change in the cash flow structures.

169 EFRAG also considers that the proposed clarification why goodwill should be allocated to a cash-generating unit or a group of cash-generating units would be useful.

Suggestions to reduce management over-optimism

170 Although agreeing with the IASB's conclusion that over-optimism is inherent in management projections, EFRAG does not completely agree that it should be better addressed by auditors and regulators. EFRAG notes that auditors and regulators may not have better knowledge about the business development than management and therefore, they might not replace the management's estimations with their own. To address the risk

that estimates used by management could be too optimistic, EFRAG suggests that the IASB consider developing possible disclosure solutions for a better transparency of the estimates made or their achievement and improving the guidance for identification of impairment testing trigger events.

171 EFRAG also suggests that requiring a sensitivity analysis could partially alleviate the risk of management over-optimism.

172 EFRAG also notes that more guidance on how to deal with right of use assets, especially in the case when assets are removed from a CGU to be impaired separately and whether to include or exclude lease payments in impairment test is needed (interaction with IFRS 16 *Leases*).

Additional disclosure requirements

173 **EFRAG agrees with the IASB tentative decision to require an entity to disclose the reportable segments in which cash-generating units containing goodwill are included**. EFRAG is of view that it can provide useful information to users without preparers incurring excessive costs. However, EFRAG highlights, that the relevance and usefulness of the information depends on the relative size of CGU compared to the reporting segment.

Level of management monitoring

174 EFRAG welcomes the IASB's tentative decision to clarify that the level of management monitoring for the purposes of subsequent performance may not be the same as the level of management monitoring the business associated with goodwill for the purposes of impairment testing.

175 EFRAG agrees that it will provide more clarity and would avoid the situations when goodwill is tested for impairment not at the lowest level of management that monitor the business associated with the goodwill but at the level of key management personnel which provides strategical decisions.

Value in use

IASB tentative decisions

176 On future restructurings, the IASB tentatively decided:

(a) **to remove a constraint on cash flows used to estimate value in use. An entity would no longer be prohibited from including cash flows:**

(i) arising from future restructuring to which the entity is not yet committed;

(ii) from improving or enhancing an asset's performance.

(b) to retain the requirement to assess assets or cash-generating units in their current condition; and

(c) to add no additional constraints on the inclusion of those cash flows beyond those already in IAS 36.

177 On the pre-tax cash flows, the IASB also tentatively decided:

(a) **to remove from IAS 36 the requirement to use pre-tax cash flows and pre-tax discount rates in estimating value in use;**

(b) to require an entity to use internally consistent assumptions for cash flows and discount rates regardless of whether value in use is estimated on a pre-tax or post-tax basis;

(c) to retain the requirement to disclose the discount rates used;

(d) to remove the requirement that the discount rate disclosed be a pre-tax rate; and

(e) to require an entity to disclose whether a pre-tax or a post-tax discount rate was used in estimating value in use.

178 On other suggestions to reduce cost and complexity, the IASB tentatively decided:

(a) not to add more guidance to IAS 36 about the difference between:

(iii) value in use; and

(iv) fair value less costs of disposal;

(b) not to mandate a single method for measuring recoverable amount;

(c) not to provide additional guidance on performing the impairment test for entities in the financial services sector; and

(d) not to provide additional guidance to clarify the interaction between IAS 36 and either IFRS 13 *Fair Value Measurement* or IAS 21 *The Effects of Changes in Foreign Exchange Rates*.

Notes to EFRAG FR TEG

179 The tentative decisions of the IASB on value in use are in line with EFRAG responses to its FCL where EFRAG supported permitting cash flow projections to include future restructurings and future enhancements to an asset and permitting the use of post-tax inputs in the calculation of value in use.

180 In its FCL, EFRAG noted that the IASB's proposal could eliminate an inconsistency in IAS 36, in the sense that it would capture within the value in use the cash flows that will arise from any ***existing potential*** *to restructure or enhance an existing asset (or CGU) rather than ignoring this potential. This adjustment would bring alignment with the treatment of restructuring cash flows in the determination of fair value.*

181 EFRAG, however, asked for additional clarification on whether cash flows from capacity investments should be included in the asset enhancements. This issue is not addressed by the IASB.

182 On the pre-tax rate EFRAG noted that it is not observable and, therefore, not used by users for valuation purposes. EFRAG considered that the IASB proposal would simplify the calculation of value in use and reduce the cost when companies only have observable post-tax discount rates for an asset/CGU.

183 EFRAG also asked for additional clarification on the alignment with IAS 12 Income Taxes when post-tax cash flows are used. This issue is not addressed by the IASB.

Key messages for DCL

Future restructurings and enhancements

184 **EFRAG welcomes the IASB's proposal to remove the prohibitions on inclusion of cash flows relating to future restructuring and asset enhancements in the estimate value in use**. This decision is in line with the EFRAG recommendation in its FCL.

185 EFRAG considers that the IASB's proposal would capture within the value in use the cash flows that will arise from any existing potential to restructure or enhance an existing asset (or CGU) rather than ignoring this potential. They will also align with the way restructuring cash flows are considered when determining fair value. In EFRAG's view, this proposal will bring more consistency with management forecasts, simplify and reduce costs of impairment test.

186 EFRAG reminds that most respondents to its 2017 Discussion Paper *Goodwill Impairment Test: Can It Be Improved?* supported the suggestion as it would take into consideration management's views of the business and simplify the impairment test. This view was also confirmed by the feedback EFRAG received during outreach events on the DP.

187 Although acknowledging the question on how to maintain the requirement to assess cash flows from an asset or CGU in its current condition (paragraph 44 of IAS 36) conceptually fits with including future restructurings, improvements or enhancements to the cash flows from the asset/CGUs, EFRAG notes that considerations of an asset current potential for

future restructuring and/or enhancements could address the conceptual concerns. In EFRAG's view (as expressed in its FCL) including cash flows from a future restructurings or enhancements would reflect a potential to be restructured already contained within the asset, which would be in line with the requirements of paragraph 44 of IAS 36.

188 EFRAG also considers that guidance on how to define these cash flows would help avoiding excessive judgement and reducing management over-optimism. EFRAG notes that different interpretations exist on whether other cash flows (in- or outflows) used internally for estimations should be included in the value in use calculation (e.g., cash flows from capacity or productivity investments to enhance the asset´s performance). In the view of EFRAG it should be clarified that such cash flows could be included to ensure that value in use calculations are based on cash flow projections which are prepared and monitored internally.

Pre-tax cash flows

189 **EFRAG agrees with the IASB's proposal to remove from IAS 36 the requirement to use pre-tax cash flows and pre-tax discount rates in estimating value in use**, in order to be more aligned with market practices. EFRAG considers that this proposal would reduce the cost of the goodwill impairment test, provide more useful information and make the test more understandable. In addition, using post-tax discount rates and post-tax inputs would be more consistent with other IFRS Standards. This method will also help aligning the value in use with fair value calculations where it is not prescribed if post or pre-tax cash flows and discount rates should be used.

190 EFRAG reminds that almost all respondents to its 2017 DP *Goodwill Impairment Test: Can It Be Improved?* supported allowing the use of a post-tax rate.

191 However, EFRAG notes that permitting the use of post-tax cash flows could give rise to a number of practical questions (see paragraphs BCZ81- BCZ84 of the Basis for Conclusions of IAS 36) and suggests to add guidance and illustrative examples regarding the inclusion of deferred taxes in future cash flows and in the carrying amount of the asset/CGU in a post-tax calculation, especially considering that deferred tax assets are currently outside of the scope of IAS 36.

192 Given variety of methods to calculate post-tax cash flows (adjusting the future cash flows and the carrying amount of the asset/CGU with the related remaining tax depreciation; using a market participant perspective; or a normative tax rate, etc), EFRAG suggests that additional application guidance and/or examples illustrating different methods of calculating post-tax cash flows would be useful and increase consistency.

Part 3 – Transition requirements

IASB tentative decisions

193 The IASB tentatively decided:

(a) to require an entity to apply the proposed amendments to the disclosure requirements in IFRS 3 to business combinations for which the acquisition date is **on or after the effective date** of the amendments, with **earlier application permitted**;

(b) to require an entity to apply the proposed amendments to IAS 36 to impairment tests **on or after the effective date** of the proposed amendments, with **earlier application permitted**;

(c) **not** to provide first-time adopters with a **specific exemption** from applying the proposed amendments to IFRS 3 and IAS 36; and

(d) to require eligible subsidiaries to apply the proposed amendments to the prospective IFRS Accounting Standard Subsidiaries without Public Accountability: Disclosures, **without restating comparative information**, from the effective date of those proposed amendments, with **earlier application permitted.**

Key messages for DCL

194 **EFRAG agrees with the IASB's proposal to require the application of the amendments to IFRS 3 and IAS 36 prospectively, as retrospective application would be costly, require the use of hindsight and may not result in benefits to users**.

195 Entities would need time to update their internal systems and some of the information may not be available. In addition, some of the proposed requirements (especially disclosures) may be difficult to be implemented retrospectively without the use of hindsight and therefore compromising benefits to users. EFRAG also agrees that voluntary application should be permitted, since users should be able to benefit from the resulting information if entities elect to early apply the requirements.

196 **EFRAG also agrees with the IASB's proposal not to propose relief for first-time adopters from any of the amendments to IFRS 3 or IAS 36**, since any relief would result in loss of information for users of financial statements. Information about business combinations in the first year of applying IFRS Accounting Standards is considered useful. EFRAG acknowledges the costs for first-time adopters associated with that proposal, but still notes that benefits exceed costs.

Part 4 – Amendments to other IFRS Standards

Proposed changes to the Subsidiaries without Public Accountability Standard

IASB tentative decisions

Information about expected synergies

197 The IASB tentatively decided:

(a) to propose to the Subsidiaries Standard be amended after its issue to require an eligible subsidiary to disclose **quantitative information about expected synergies**, **subject to the same exemption** proposed for an entity applying IFRS 3 in the BCDGI project.

(b) Not to require eligible subsidiary to provide any other disclosure required by this project.

Notes to EFRAG FR TEG

198 The IASB is planning to issue the new IFRS Accounting Standard [IFRS XX Subsidiaries without Public Accountability: Disclosures] before the amendments proposed in this Exposure Draft are finalised. This new IFRS Accounting Standard proposes reduced disclosure requirements for the eligible subsidiaries without public accountability. Therefore, the IASB applied the principles used to develop the reduced disclosure requirements to the proposed disclosure requirements in this ED. The following information is particularly of interest to the users of financial statements of [eligible subsidiaries] (paragraph BC 34 of the Basis for Conclusions on the Exposure Draft Subsidiaries without Public Accountability: Disclosures):

(a) *Information about cash flows and obligations, commitments or contingencies, whether or not recognised as liabilities. Disclosures in full [IFRS Accounting Standards] that provide this sort of information are necessary for [eligible subsidiaries] as well;*

(b) *Liquidity and solvency. Disclosures in full [IFRS Accounting Standards] that provide this sort of information are necessary for [eligible subsidiaries] as well;*

(c) *Measurement of uncertainties;*

(d) *Entity's accounting policy choices;*

(e) *Disaggregation of amounts presented in an [eligible subsidiary's] financial statements is important for understanding those financial statements;*

(f) *Some disclosures in full [IFRS Accounting Standards] are more relevant to investment decisions in public capital markets than to the transactions and other events and conditions encountered by typical [eligible subsidiaries].*

Key messages for DCL

199 EFRAG notes that the consideration of reduced disclosure requirements for eligible subsidiaries in the scope of the forthcoming draft Accounting Standard [IFRS XX Subsidiaries without Public Accountability: Disclosures] ("Subsidiaries Standard") will be a part of any future amendments to existing IFRS Accounting Standards or a new IFRS Accounting Standard where disclosure requirements are amended, added or deleted.

200 **Therefore, EFRAG welcomes the IASB considering whether the reduction of the proposed disclosure requirements is warranted for eligible subsidiaries** within the scope of the forthcoming Subsidiaries Standard applying the principles described in the paragraph BC 34 of the Basis for Conclusions on the Exposure Draft *Subsidiaries without Public Accountability: Disclosures.*

201 However, EFRAG highlights that the IASB is requesting comments on consequential amendments to a future Subsidiaries Standard that had not been yet issued or endorsed in the EU. Therefore, the endorsement of the Amendments resulting from this ED related to the reduced disclosures, is conditional on the outcome of the EU endorsement process of the future IFRS Accounting Standard [IFRS XX *Subsidiaries without Public Accountability: Disclosures*].

202 EFRAG further notes that financial institutions, including insurance companies, are out of the scope of the forthcoming Subsidiaries Standard. This means that their subsidiaries applying IFRS Accounting Standards would have to provide a comprehensive package of new disclosure requirements on financial liabilities and equity required by this ED without any reduction.

203 EFRAG notes that the user profile of the subsidiaries without public accountability is different from the one of publicly traded entities and agrees with the IASB that users of eligible subsidiaries' financial statements are first interested in the information about short-term cash flows, obligations, commitments and contingencies and about liquidity and solvency.

204 EFRAG agrees with the IASB tentative decision not to require eligible subsidiaries to disclose information about the subsequent performance of business combinations. This is because the users of the eligible subsidiaries are more interested in the short-term cash flows and liquidity.

205 In line with its earlier comments on synergies, **EFRAG disagrees with the IASB's tentative decision to require an eligible subsidiary to disclose quantitative information about expected synergies.** EFRAG considers that despite that this disclosure responds to the users' needs about information on short-term cash flows, as currently drafted, does not alleviate preparers' concerns about the commercial sensitivity and forward-looking nature of information. In addition, EFRAG considers that the benefits of providing quantitative information about expected synergies for eligible subsidiaries would not outweigh the costs.

206 In its FCL on the IASB ED *Subsidiaries without Public Accountability*, EFRAG considered that disclosure about the primary reasons for the business combination (paragraph B64(d) of IFRS 3) would be relevant for users of financial statements and not be costly for preparers. Therefore, **EFRAG suggests the IASB to consider including the requirement to disclose the "strategic rationale" for undertaking the business combination for eligible subsidiaries.**

207 **EFRAG also recommends the IASB to reconsider its decision not to make amendments to Subsidiaries Standard in order to remove the term "major" from paragraph B64(i) of IFRS 3**, because of the developments on this project. In October 2023, as a part of the sweep issues on the Subsidiaries project, the IASB decided to align the wording of Subsidiaries Standard with the wording of full IFRS Standards and not IFRS for SMEs. This decision will require to adapt the Subsidiaries Standard by removing the word "major" from paragraph B64(i) of IFRS 3.

208 **EFRAG agrees with the IASB decision not to include the amended disclosure objectives in the Subsidiaries Standard**, as it was decided that the Standard will not contain disclosure objectives.

209 As the Subsidiaries Standard does not require eligible subsidiaries to disclose information required by paragraph B64(q) of IFRS 3, **EFRAG supports the IASB's decision not to include the proposed amendments to this paragraph**.

210 EFRAG also **agrees with the IASB's tentative decision not to require an eligible subsidiary to disclose in which reportable segments the CGUs containing goodwill are included** because eligible subsidiaries are not required to apply IFRS 8.