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Input on the IASB Discussion Paper *Business Combinations – Disclosures, Goodwill and Impairment* Issues Paper

Objective

- 1 The purpose of this session is to:
 - (a) Receive EFRAG CFSS members' comments on the initial feedback received by the IASB in response to its discussion paper *Business Combinations – Disclosures, Goodwill and Impairment* ('the DP').
 - (b) Receive EFRAG CFSS members' initial comments on questions included in EFRAG's draft comment letter in response to the DP ('the DCL').
 - (c) Receive information on any plans of EFRAG CFSS members to further stimulate the debate on the DP.
- 2 This issues paper provides an overview on main proposals included in the DP together with EFRAG's preliminary views included in the DCL. The paper includes a summary of questions that EFRAG raises to its constituents in the DCL. Finally, this paper also provides an overview of the preliminary feedback received on the DP by the IASB.

Background

- 3 The IASB published the DP on 19 March 2020 and asks for comments by 31 December 2020. EFRAG published its DCL on 29 May 2020. Comments on the DCL are requested by 30 November 2020.

Better disclosures about acquisitions

Proposals in the DP

- 4 The DP proposes to require information about the strategic rationale and management's (the Chief Operating Decision Maker's, ('the CODM's')) objectives for an acquisition as at the acquisition date and subsequent disclosures about whether an acquisition is meeting those objectives. That information should be based on how the CODM monitors and measures whether the acquisition is meeting its initial objectives; this implies that the IASB is not proposing any specific metrics to disclose.
- 5 If the CODM does not monitor an acquisition, the company should be required to disclose that fact and explain why it does not. In such circumstances, the company should not be required to disclose any metrics. Furthermore, the company should be also required to disclose facts and reasons why it stops monitoring whether the objectives of an acquisition are being met before the end of the second full year after the year of acquisition.

- 6 The DP also proposes to require a company to disclose a description of the synergies expected from combining the operations of the acquired business with the company's business, when the synergies are expected to be realised, the estimated range of amounts of the synergies, and the expected cost or range of costs to achieve those synergies.
- 7 IFRS 3 currently requires companies to provide revenue and profit or loss information, in the year of acquisition:
 - (a) Of the combined business for the current reporting period as though the acquisition date had been at the beginning of the annual reporting period ('pro forma information').
 - (b) Of the acquired business after the acquisition date.
- 8 The DP proposes to retain these requirements, but instead of 'profit or loss', 'operating profit before acquisition-related transaction and integration costs' should be disclosed and, in addition, cash flows from operating activities should be disclosed.

EFRAG's preliminary views

- 9 In its DCL, EFRAG preliminary considers that information about the strategic rationale and management's objectives for an acquisition as at the acquisition date and subsequent disclosures about whether an acquisition is meeting those objectives could result in useful information. However, EFRAG considers that the proposed information should be based on a lower level than on what the CODM reviews. Accordingly, the disclosure could be based on the information the segment management review or at the level in the organisation that managerially monitors the acquisition (such as the chief decision maker in charge of monitoring the profit or loss of the specific CGU).
- 10 EFRAG preliminary disagrees with allowing companies to stop monitoring and thus disclosing whether an acquisition is meeting its objectives after two years without disclosing it. EFRAG considers that that three, instead, of two years need to pass.
- 11 EFRAG also notes that there would be some practical issues to consider in relation to the disclosures, both to ensure that users receive sufficient, reliable and relevant information and that the costs of preparing/disclosing the information would not outweigh the benefits. Among other things, EFRAG could be concerned about the auditability of the disclosures.
- 12 EFRAG considers that information about synergies could provide useful information and similar information could also be meaningful also for other elements of goodwill. Again, however, EFRAG questions whether the benefits of these disclosures, which reliability would depend on the specific circumstances, would outweigh the costs.
- 13 EFRAG has not yet formed a view on whether the proposed information should be placed in the management commentary instead of the financial statements as some consider the information to be based on management expectations and is referring to non-GAAP indicators.
- 14 EFRAG preliminary agrees with the proposal in the DP to retain current IFRS 3 requirements related to pro-forma information, to the extent practicable, and with replacing 'profit or loss' with 'operating profit before acquisition-related transaction and integration costs'. The DCL suggests that the IASB provides a principles-based definition for the new concepts of 'acquisition-related' and 'integration cost'.
- 15 EFRAG disagrees with the proposal to require entities to disclose the cash flows from operating activities of the acquired business after the acquisition date, and of the combined business on a pro forma basis for the current reporting period.

Questions for EFRAG's constituents included in the DCL

- 16 In relation to its response to the DP's disclosure proposals, EFRAG specifically seeks input on:
- (a) Whether the proposed disclosures should be presented in the notes to the financial statements or in the management commentary.
 - (b) Whether the information is auditable and whether information is considered more useful, relevant and/or reliable if it is audited.
 - (c) How the fact that a company is not monitoring a significant acquisition would affect analysis made by financial statements users.
 - (d) Whether it is possible to disclose useful information on the level of achievement of the financial or non-financial targets initially defined at acquisition date and of expected synergies, without triggering commercial sensitivity. EFRAG is interested in receiving practical examples in this regard.
 - (e) Any constraints within jurisdictions that could affect a company's ability to disclose the information proposed in the DP.
 - (f) Whether to retain current IFRS 3 requirements (see paragraphs 7 and 8 above).
 - (g) The usefulness of disclosing the cash flows from operating activities of the acquired business after the acquisition date, and of the combined business on a pro-forma basis for the current reporting period.
 - (h) Whether the IASB should investigate whether it could remove any of the disclosure requirements from IFRS 3 without depriving investors of material information, and any specific input on this topic.
 - (i) Operational implications (e.g. quality of data, internal control and auditability) of the disclosures proposed in the DP and their costs.

Initial input provided to the IASB

- 17 The IASB received initial feedback from stakeholders that they generally agree with DP's direction and think that the proposed information would be useful. However, some concerns over implementation have been preliminary reported.
- 18 Even if stakeholders consider disclosing objective and performance of an acquisition helpful to assess management's stewardship, they reported concerns about:
- (a) Its feasibility because of the acquired business being integrated.
 - (b) Commercial sensitivity of proposed information.
 - (c) The use of forward-looking information disclosure.
 - (d) The poor comparability of these disclosure across companies.
- 19 Initial feedback received from stakeholders also considers that these disclosures would be better placed in the management commentary.
- 20 Stakeholders also provided feedback on the fact that the proposed disclosure would be based on what the CODM monitors. Concerns are related to the current insufficient guidance in IFRS 8 to identify the CODM and to the information the CODM monitors that may be not granular enough.

Questions for EFRAG TEG and CFSS members

- 21 What is your initial view on EFRAG's preliminary positions (paragraphs 9 to 15)?
- 22 How does the feedback collected in your jurisdictions compares to the initial feedback received by the IASB (paragraphs 17 to 20)?
- 23 What is your initial input to the questions EFRAG is asking to constituents (paragraph 16)?

Goodwill, impairment and amortisation

Proposals in the DP

- 24 The DP identifies management over-optimism and the 'shielding effect' as the main reasons underlying the delay in companies recognising impairment losses on goodwill. The IASB explored whether it is feasible to make the impairment test more effective by mitigating these factors. However, it concluded (preliminary) that over-optimism is best addressed by auditors and regulators and not by changing IFRS Standards and that it is not feasible to design a significantly more effective impairment test.
- 25 Having concluded that the approach in IAS 36 for testing goodwill for impairment cannot be significantly improved at a reasonable cost, the DP considers whether to develop a proposal to reintroduce amortisation of goodwill.
- 26 The DP states that amortisation could take some pressure off the impairment test other than providing a simple mechanism that targets the acquired goodwill directly by reducing the carrying amount. Proponents of the reintroduction of the amortisation also considered that goodwill is a wasting asset with a finite useful life.
- 27 On the other hand, the DP reports that those in favour of retaining the impairment only model argue that it provides more useful information than amortisation. Moreover, they do not agree that goodwill is a wasting asset and believe that amortisation would not completely solve the issue as it would not eliminate the need for impairment testing.
- 28 While the preliminary view of a majority of IASB members is that the IASB should retain the impairment-only model – it was only a small majority, and the IASB is seeking stakeholders' view on the topic.
- 29 The DP includes the preliminary view that the IASB should develop a proposal to help investors in better understanding companies' financial position by requiring them to present on their balance sheet the amount of total equity excluding goodwill. However, as it considers changing the structure of financial statements to allow the presentation of this subtotal as too disruptive, companies would present this amount as a free-standing item.

EFRAG's preliminary views

- 30 In its DCL EFRAG states that it shares the IASB's reservations on the possibility to develop a different and more effective impairment approach. However, EFRAG believes that there are collateral areas of possible improvements.
- 31 In particular, EFRAG suggests that the guidance on allocation of goodwill to the CGUs could be enhanced to improve how the test is applied in practice. EFRAG considers that the guidance could be clarified to help allocate goodwill to the lowest level possible that outweighs costs of impairment testing and information needs based on value relevance.
- 32 EFRAG also suggests that the IASB could consider enhancing the guidance for reallocation of goodwill. It is currently driven by changes in the reporting structure,

whilst changes in the cash generation should be considered as the basis for the reallocation.

- 33 In addition, the DCL includes suggestions for possible disclosure solutions for a better transparency of estimations made by management: a) achievement of previous estimations (make over-optimism transparent); b) information on assumptions related to the period for which management has projected cash flows based on financial budgets (e.g. growth rate); and c) to disclose of the current level of cash flows/earnings to allow users to estimate future cash flows themselves.
- 34 EFRAG has not yet formed a view on whether amortisation of goodwill should be reintroduced and is then seeking views from its constituents. EFRAG is particularly interested in learning whether any new evidence, new arguments or new assessments of the existing evidence have emerged since the development of current requirements.
- 35 EFRAG does not support the IASB's proposal to require companies to present on their balance sheets the amount of total equity excluding goodwill.

Questions for EFRAG's constituents included in the DCL

- 36 In its DCL EFRAG is seeking views from its constituents on the following matters:
- (a) Whether the IASB should consider improving guidance on allocation and reallocation of goodwill to CGUs.
 - (b) Whether management over-optimism is best addressed by auditors and regulators and not by changing IFRS Standards.
 - (c) Usefulness and practicability of EFRAG's suggestions to address management over-optimism (refer to paragraph 33 above).
 - (d) Whether, in relation to goodwill amortisation, there are any new evidences, new arguments or new assessment of the existing evidences have emerged since the development of current requirements.
 - (e) Whether goodwill is a wasting asset or an accounting construct which is not useful to have in the statement of financial position.
 - (f) Whether, if amortisation should not be reintroduced, disclosures about the "age" of goodwill should be provided to reflect which part of goodwill is older and then, perhaps, less relevant.

Initial input received by the IASB

- 37 The IASB received initial feedback from stakeholders requiring guidance on allocating goodwill to CGUs. Stakeholders also suggest disclosure of actual versus forecasted cash flows to discourage management over-optimism.
- 38 Stakeholders remains split over the impairment-only model and the reintroduction of amortisation and no new evidence or arguments have been provided for either view so far.
- 39 The IASB collects a general disagreement for presenting total equity excluding goodwill.

Questions for EFRAG TEG and CFSS members

- 40 What is your initial view on EFRAG's preliminary positions (paragraph 30 to 35)?
- 41 How does the feedback collected in your jurisdictions compares to the initial feedback received by the IASB (paragraph 3738 and 39)?
- 42 What is your initial input to the questions EFRAG is asking to constituents (paragraph 36)?

Simplifying the impairment test

Proposals in the DP

- 43 While the DP concludes that it could not make the impairment test significantly more effective, the IASB investigated whether it could simplify the test without making it significantly less robust.
- 44 The IASB's preliminary view is that it should develop a proposal to remove the requirement for a company to perform an annual impairment test for CGUs containing goodwill if there is no indication that the cash-generating units may be impaired. The same proposal would also be developed for intangible assets with indefinite useful lives and intangible assets not yet available for use.
- 45 The DP suggests removing from IAS 36 the prohibition to include cash flows arising from a future restructuring to which a company is not yet committed or from improving or enhancing an asset's performance when calculating value in use. Also, the DP suggests removing the explicit requirement to use pre-tax cash flows and pre-tax discounts rate.

EFRAG's preliminary views

- 46 In its DCL, EFRAG concurs that there is a potential to achieve cost savings in adopting an indicator-only approach, however, EFRAG has reservations on the IASB's proposal to remove the requirement to perform an annual quantitative impairment test. EFRAG notes that there are cases where it is obvious already from the indicator analysis that there is no need for impairment and as such the detailed calculation would not add useful information to assess the recoverability of the carrying amount. In these cases, EFRAG believes that an indicator only approach may play a role and the IASB could consider leveraging on what is already in IAS 36 paragraph 99. An indicator-only approach might, however, result in a lower reliance by users on the results of the impairment test. This could potentially accentuate the 'too little too late' issue and could result in a further loss of information on governance and management stewardship of capital employed (if the 'too little too late' issue is accentuated, it reduces the value of the information these impairment losses provide). EFRAG could be concerned that this could further reduce the effectiveness of the impairment test and the confidence on the reliability of the test.
- 47 EFRAG supports the IASB' proposal to remove the restriction in IAS 36 that prohibits companies from including cash flows arising from a future uncommitted restructuring, or from improving or enhancing the asset's performance. However, additional guidance would be required on when to include restructuring cash flows in the calculation.
- 48 EFRAG also supports the IASB' proposal to remove the explicit requirement to use pre-tax inputs and pre-tax discount rates to calculate value in use.

Questions for EFRAG's constituents included in the DCL

- 49 In its DCL EFRAG is seeking views from its constituents on some of the proposals included in the DP as described above. In detail, EFRAG is seeking input from constituents on:
- (a) Whether they agree with EFRAG's concerns regarding the introduction of an indicator-only approach and, if so, if they have any suggestion about how to mitigate this issue.
 - (b) Whether they think that there are other cash flows (other than those summarised at paragraph 45 above) that should also be allowed to be included in the VIU calculation.
 - (c) Whether they consider significant the risk of impairment losses going undetected when post-tax inputs are used that would have been recognised had pre-tax inputs being used (e.g. when VIU calculation takes into account items such as unused tax losses carry-forward which would not meet the criteria for recognition under IAS 12).
 - (d) Whether they identify any other risk factor that could arise from the use of post-tax inputs.

Initial input received by the IASB

- 50 Some stakeholders are concerned that an indicator-only approach could impact the robustness of the impairment test. Suggestions have been made to allow companies to roll forward calculations more easily.
- 51 Stakeholders agree on proposed changes on VIU calculation. However, some express concern about potential impacts on impairment test robustness. A suggestion is to require impairment test before restructurings.

Questions for EFRAG TEG and CFSS members

- 52 What is your initial view on EFRAG's preliminary positions (paragraph from 46 to 48)?
- 53 How does the feedback collected in your jurisdictions compares to the initial feedback received by the IASB (paragraph 50 and 51)?
- 54 What is your initial input on the questions EFRAG is asking to constituents (paragraph 49)?

Intangible assets

Proposals in the DP

- 55 The DP investigates whether the IASB should change the criteria for recognising intangible assets acquired in a business combination by permitting or requiring companies to include in goodwill identifiable intangible assets acquired in a business combination meeting certain criterion.
- 56 The IASB preliminary view is that it should not develop a proposal to change the current recognition criteria.

EFRAG's preliminary views

- 57 EFRAG agrees that recognising intangible assets acquired in a business combination separately from goodwill might be costly and complex. EFRAG also considers questionable whether the benefits of identifying some intangible assets outweigh related costs.

- 58 EFRAG acknowledges that the IASB has considered it to be outside the scope of the project to address the concerns of investors who want to compare more easily companies that grow by acquisition with those that grow organically. In order to avoid delays on the overall project EFRAG recommends to consider this issue in a second phase of the project together with a revision of IAS 38.

Questions for EFRAG's constituents included in the DCL

- 59 In its DCL, EFRAG is seeking views from its constituents on whether they would include in goodwill intangible assets acquired in a business combination that are currently recognised separately.
- 60 EFRAG is also asking constituents how they are currently using information about intangible assets currently recognised separately.

Initial input received by the IASB

- 61 Stakeholders' views are mixed about whether the change in recognition criteria for recognising intangible assets acquired in a business combination may provide useful information.

Questions for EFRAG TEG and CFSS members

- 62 What is your initial view on EFRAG's preliminary positions (Paragraphs 57 and 58)?
- 63 How does the feedback collected in your jurisdictions compares to the initial feedback received by the IASB (Paragraph **Error! Reference source not found.**)?
- 64 What is your initial input to the questions EFRAG is asking to constituents (Paragraphs 59 and 60)?

Convergence with US GAAP and FASB's invitation to comment

Proposals in the DP

- 65 The DP reports that in July 2019 the FASB issued the "Invitation to Comment: Identifiable Intangible Assets and Subsequent Accounting for Goodwill". The IASB's research project and the FASB's project are separate and although they exchange information, they are not working jointly on the projects.
- 66 The FASB's Invitation to Comment covers similar topics to the IASB's Discussion Paper.
- 67 In the DP the IASB is seeking views from its stakeholders about whether their answers to any of the questions in the DP would depend on whether the outcome is consistent with US GAAP as it exists today or as it may be after the FASB's current work.

EFRAG's preliminary views

- 68 EFRAG's responses to the questions in the DP do not depend on whether the outcome is consistent with US GAAP. However, EFRAG considers that the IASB outcome could be influenced by the FASB's current work.

Questions for EFRAG TEG and CFSS members

- 69 What is your initial view on EFRAG's preliminary position (paragraph **Error! Reference source not found.**)?

EFRAG’s ongoing outreaches activities

- 70 To stimulate the discussion on the DP and to learn constituents’ views on the DP and on the preliminary views in the DCL, EFRAG is organising series of webinars or physical meetings (if circumstances would allow) together with the IASB, EFRAG CFSS members and other organisations:
- (a) A joint event with the Danish Standard Setter will be co-hosted on October 23rd, 2020;
 - (b) EFRAG is also currently organising some joint-events with national standard setters from Benelux, Italy and Norway that will take place in the period October – November;
 - (c) EFRAG is also planning to host an additional event that will focus on the issues where EFRAG has the most questions for constituents;
 - (d) EFRAG has also issued a survey to European preparers (listed entities) with active M&A agendas and relative significant amounts of goodwill. Information on how to participate can be found at the following [link](#). EFRAG Secretariat is seeking participants from various jurisdictions and would highly welcome the support of CFSS members to reach out preparers. This outreach is planned to be completed before the end of October.
 - (e) EFRAG is also arranging field-tests/interviews on the disclosure requirements together with the IASB. EFRAG Secretariat is seeking participants from various jurisdictions and would highly welcome the support of CFSS members to reach out preparers who would be willing to try to prepare the proposed disclosures in a real case (which can be anonymised) and inform about the difficulties and any suggestions for resolving those difficulties. This outreach is planned to be completed before the end of October.

Questions for EFRAG TEG/CFSS

- 71 Do EFRAG CFSS members have collected or anticipate that they will collect interest of preparers to participate in EFRAG’s survey?
- 72 Are EFRAG CFSS members interested in promoting outreaches and events jointly with EFRAG?
- 73 How EFRAG CFSS members intend to further stimulate the debate on the DP?