Business combinations: Disclosures, Goodwill and Impairment - Update on feedback received

Objective

1 The objective of the session is to update EFRAG TEG on the feedback received on the outreach activities on the IASB's discussion paper[1] (DP) *Business Combinations: Disclosures, Goodwill and Impairment* and EFRAG's Draft Comment Letter ('DCL').

Outreach activities completed until 9 December 2020

2 EFRAG has engaged in various outreach activities to ensure getting responses from as wide a range of constituents as possible. Activities concluded include the following:

a) Field test with four preparers (conducted by the IASB);

b) Survey interviews with 12 preparers as an alternative or in addition to filling out the surveys issued by EFRAG;

c) Presentations to EFRAG Working Groups: EFRAG API, User Panel, EFRAG FIWG, EFRAG IAWG and CFSS;

d) Presentations at closed meetings with national standard setters or with industry or user organisations; and

e) In addition, the following feedback from webinars is also relevant:

Date	**Event**	**Agenda paper reference**
16/10/20	*Improving information regarding business combinations and subsequent accounting for goodwill – Which Way to Go?* Jointly hosted by EFRAG and the IASB Already included in October version of this paper.	04-07
23/10/20	*Joint outreach event on Business Combinations: Disclosures, Goodwill and Impairment* Jointly hosted by EFRAG, the IASB and FSR – Danish Auditors & DI Confederation of Danish Industry	04-08
09/11/20	*Changes to the accounting for Business Combinations: Disclosures, Goodwill and Impairment: Reflections from Norway.* Jointly hosted by EFRAG, the NASB, the NFF and the IASB.	04-09
12/11/20	*What are the views of users? Business Combinations: Disclosures, Goodwill and Impairment*	04-10

[1] The DP can be found here and EFRAG's DCL can be found here.

	Jointly hosted by EFRAG, EFFAS, ABAF/BVFA and the IASB.	
25/11/20	*Business Combinations: Disclosures, goodwill and impairment* Hosted by OIC and jointly attended by EFRAG and the IASB	N/A, a feedback statement was not released

3 This paper also benefits from the results of 30 surveys completed by preparers on the topic, although not all the questions were necessarily answered.

Remaining outreach activities

4 This feedback will be supplemented by comment letters to be received on EFRAG's DCL. The closing date for comments was 30 November 2020, but as this deadline was earlier than the IASB's deadline the team was welcoming near-final drafts. Therefore we still have to consider changes in the comment letters.

Structure of the paper

The feedback has been collated per question in the DP and organised in a way that best reflects the origin of dissenting views. A high-level summary is presented at the end of the paper.

Contents

Question 1 – Introduction

5 A preparer considered the shareholders as the primary users of the financial statements before users and therefore the financial statements should provide them with information about the relevance of the strategic direction taken. In this context the proposals do not adequately consider stewardship.

6 At a closed event, a preparer considered that the scope of the project is deficient as it excludes many significant transactions where holding management to account for its decision is equally important. According to the DP (2.46) users were addressing to get information to assess the return on total capital employed in an acquisition. The proposals should include disclosures for transactions outside the scope of IFRS 3 such as asset deals or a step acquisitions (no goodwill but excess payment through equity) or significant as management uses sources of investors and should be held to account for it. Similar feedback was reported to EFRAG from a Swedish outreach event.

7 A user considered the proposals not to be a package as the proposals on disclosures are distinct from the subsequent accounting of goodwill.

Questions 2 to 4 - Improving disclosures about acquisitions

Question 2 - Strategic rationale for an acquisition and subsequent performance[2]

8 During the outreach activities, views were significantly mixed as to whether the new disclosures requirements should be introduced.

9 While some preparers, users, regulators and auditors widely support the disclosure objectives, the majority of the preparers expressed concerns about the feasibility of providing such disclosures and especially the commercial sensitivity triggered. Some other concerns are shared across different categories of stakeholders.

10 The result of the polling question during the webinars show that most of the respondents agree with the usefulness of the proposed disclosures:

Will the IASB's proposed disclosure of management's objectives for an acquisition and subsequent disclosures about whether an acquisition is meeting those objectives provide useful information to assess management's stewardship? *(143 responses)*	**Yes** 91%	**No** 9%
Of which: preparers	*17%*	*5%*
Of which: users	*6%*	*1%*
Of which: auditors	*44%*	*1%*
Of which: regulators	*5%*	*-*

The results further show that all of the academics and most of the other participants also responded 'Yes'. However, the majority of the total respondents who answered 'Yes', note that due to completeness, reliability, the ability to provide the information, in practice, the information in many cases will not be particularly useful.

11 The results of the following polling questions during the webinars are as follows:

User event:

Do you currently get enough information about the subsequent performance of acquisitions? *(during the event on 12 November 2020) (23 responses)*	**Yes** 13%	**No** 87%
Of which: preparers	*9%*	*4%*
Of which: users	*0%*	*48%*

[2] Question 2 of the IASB's DP

Of which: auditors	*4%*	*26%*

In your experience, are management able to answer investor questions about the subsequent performance of an acquisition, i.e., are they aware of how well an acquisition is performing? *(during the event on 12 November 2020) (23 responses)*	**Yes** 48%	**No** 13%	**Sometimes** 39%
Of which: preparers	*9%*	*9%*	*13%*
Of which: users	*17%*	-	*13%*
Of which: auditors	*22%*	*4%*	*9%*

If the information that the IASB requires to be disclosed is commercially sensitive or sensitive because of internal reasons (e.g., potential restructurings), is that a good enough reason for companies not to provide the information to investors? *(during the event on 12 November 2020) (24 responses)*	**Yes** 46%	**No** 54%
Of which: preparers	*25%*	*4%*
Of which: users	*8%*	*21%*
Of which: auditors	*13%*	*25%*

The majority of the respondents who answered ‘No’ do not think that the information will be commercially sensitive.

General Events (mainly with NSS)

The IASB proposes to provide information (strategic rationale, objectives of an acquisition and subsequent performance) based on the information the entity’s chief operating decision maker (board of directors or similar) (‘CODM’) monitors. Do you think this is the right level? *(129 responses)*	**Yes** 67%	**No** 33%
Of which: preparers	*11%*	*11%*
Of which: users	*10%*	*2%*
Of which: auditors	*26%*	*13%*
Of which: regulators	*5%*	*1%*

Do you think that it is possible to disclose information on the achievement of the targets initially defined at acquisition date and of expected synergies, without triggering commercial sensitivity? *(139 responses)*	**Yes** 23%	**Maybe** 52%	**No** 25%
Of which: preparers	*1%*	*6%*	*12%*

Of which: users	*1%*	*4%*	*1%*
Of which: auditors	*15%*	*26%*	*7%*
Of which: regulators	*3%*	*3%*	*1%*

***Do you agree with the IASB's proposal to present the proposed information in the notes to the financial statements?** (126 responses)*	**Yes** 39%	**No** 45%	**Other** 16%
Of which: preparers	*2%*	*11%*	*5%*
Of which: users	*5%*	*6%*	*2%*
Of which: auditors	*13%*	*24%*	*5%*
Of which: regulators	*6%*	*-*	*2%*

The 'other' category represents the option to either disclose the information in the financial statements or management report or a different report (i.e., neither of the two).

12 A detailed summary of feedback received by category of stakeholders is included in the following paragraphs.

<u>Preparers</u>

Sensitivity of information

13 Feedback received by preparers show that preparers have strong concerns about commercial sensitivity of the proposed disclosures. The results of the survey, based on 30 responses (refer to paragraph 3), show that a higher level of commercial sensitivity is associated with the disclosure on whether an acquisition has met the expected objectives, with the information to be provided on synergies and on the expected benefits when agreeing the price to acquire a business. Pro-forma information, the strategic rationale and management objectives for an acquisition are regarded as moderately sensitive or sensitive to a limited degree, respectively. More background on the survey can be found in the Agenda Paper '*04-05 Results from surveys and interviews'* of 3 December 2020 TEG meeting here (paragraphs from 41 to 47).

14 The main arguments shared by preparers include the following:

a) They have concerns that strategic information will be provided to competitors, both within EU and foreign markets (i.e. US or China). In this latter case, providing information on a worldwide basis could lead to a difficult competitive environment as accounting standards of other countries currently do not require the same level of information;

b) In this regard one specified that he agreed with providing the strategic rationale for the acquisition but was concerned about disclosure of what drives the price and which long-term trends were expected as their peers in the US would not be required to do the same. They recognised in their industry (Software) that companies applying US GAAP seem already to be willing to pay higher purchase prices. The two-step approach under US GAAP seems to prevent to record impairments easily and makes companies paying higher prices. To avoid economic risk (by accumulating significant goodwill from overpayments) and to deliver useful information when applying IFRS would be a real disadvantage for companies applying IFRS;

c) One preparer had the concern that users that ask for the information might invest in their peer entities, and can sometimes be considered as competitors themselves;

d) The proposed disclosures are deemed to engage the legal responsibility of management board to the extent it is based on forward-looking information. This would then increase the risk of litigation;

e) One preparer specified that this could be a legal risk for sellers. Sellers could have a risk of lawsuits from former shareholders if the new acquirer publishes that a different strategy is more successful and gives details to this;

f) Several said - If disclosed, the objectives for an acquisition could put an entity in a worse position in future transactions;

g) One preparer was concerned that the proposal could discourage entities from entering into acquisitions, and it could result in a slow-down of M&A activities. Another preparer said that acquisitions could be difficult to carry out as a seller may not want to sell to an acquirer that applies IFRS if everything is made public later;

h) Disclosures about the strategic rationale may alert competitors to the other targets a company intend to pursue. Also information about the terminal value of a factory for example may provide useful information to competitors about your plans;

i) Furthermore, the contractual agreements may prohibit disclosure of some of the transaction information; and

j) Examples of commercially sensitive information in the retail market include net sales and operational margins as well as the components of the purchase price.

15 Two preparer considers the commercial sensitivity to be limited, one as the information is already presented to the market at the time of an acquisition. The other was rather concerned having to provide disclosures on relatively small and regular acquisitions which may add to information overload and not be that useful to users. Where the acquisitions are relatively insignificant users may be content with qualitative information only about subsequent performance.

16 During a closed event on 1 December 2020 preparers provided several examples of sensitive information:

a) Disclosing the acquisition strategy could lead to discussions with the acquiree relating to achievements and its impact on any contingent consideration;

b) Information on intellectual property and R&D can be commercially sensitive when objectives and metrics are based on these;

c) Former shareholders can use information from the audited financial statements relating to the acquisition objectives and metrics as evidence in a lawsuit because they consider being underpaid; and

d) Preparers explained that their companies have a process to assess the sensitivity of information before publishing it. The assessment is performed by the legal department and management, however it is not standardised. One preparer noted that if IFRS Standards require disclosure, the own confidentiality statement does not have any value when the company is listed and must comply with the IFRS Standards.

17 During the Portuguese outreach event one preparer commented that his group was already providing some of the information required by the proposed disclosures. However, management was very careful to avoid the publication of sensitive

information, either commercially or internally, and it would have an impact on comparability between companies of the information provided.

18 During the Italian outreach event one preparer recognised the importance of allowing users to access as much information as possible, provided that the scope of the disclosures would not harm preparers' interests. He gave the opinion that there is a core set of information that must remain confidential, and the IASB would create an adequate balance between investors' needs and the protection of entity's competitive position.

19 Apart from commercial sensitivity, some preparers during the webinar on 16 October 2020 and other outreach activities noted that disclosures about synergies can also have organisational impact. Disclosure of sensitive information related to potential restructurings of the entity's labour force should be avoided. However, several preparers considered that where the reorganisation has been already announced when the financial statements are issued, this would no longer be sensitive.

Level of information to be provided - CODM

20 Feedback received from preparers showed mixed views about whether the proposed disclosures should be based on the information reviewed by the entity's Chief Operating Decision Maker ('CODM'). Preparers generally tend to support the proposal. However, some of them raised potential challenges when applying it.

21 Main arguments mentioned by preparers supporting the CODM to be the most appropriate level are the following:

a) Acquisitions not monitored by the CODM are generally deemed to be insignificant;

b) Requiring the provision of information monitored at a lower level would include minor acquisitions, would be costly and would not provide investors with relevant information; and

c) It would ensure the appropriate quality of information provided, as it is generally easier to track what the CODM is monitoring.

22 One preparer indicated that as part of its oversight, the CODM may briefly consider some performance measures related to insignificant and/or immaterial acquisitions once a year, therefore, insignificant acquisitions would still be captured by the proposals.

23 Another preparer noted during a closed meeting on 1 December 2020 that rather the size of an acquisition that is larger than a certain market capitalization should be used to determine which acquisitions to disclose. In that case it should not matter at which level it is monitored.

24 Other preparers indicated that the CODM only review segment information and the specific performance of an acquisition would only be considered by the management of the segment. The Segment CEO would consider the combined business plan. In some circumstances, the proposed disclosures might result in boilerplate information.

25 A preparer indicated that disclosures should be requested for transforming acquisitions and not for small acquisitions. It did not support disclosing a group of small acquisitions all together (when these are made to strength a particular unit) because internally they do not do it that way and it would therefore be burdensome. In addition, it noted that investors never asked him for this kind of 'bolt-on acquisitions'.

Feasibility

26 Preparers have mixed views about the feasibility of providing information under the proposed disclosures requirements. The results of the survey show that the 58,6%

of the respondents consider providing the disclosures as not feasible, due to inherent complexities, potential incremental costs and sensitivity of the information to be provided. More background on this assessment could be found in the Agenda Paper '*04-05 Results from surveys and interviews'* of 3 December 2020 TEG meeting (Paragraph 16).

27 Some participants in the survey and the field test reported that they are already providing a significant part of the information included in the IASB's proposal (not in the financial statements but instead through presentations and press releases). At acquisition date good information (like a fairness opinion) might exist which would make it easy to disclose the requested information (despite that it is not wanted because of commercial sensitivity). However, several reported specific issues (mainly related to the subsequent performance of an acquisition) that make the proposed disclosures complex:

a) Acquired businesses are often quickly integrated to the extent that it is no longer possible to monitor it separately from the combined business. On the other hand, divesting activities, either due to strategic or regulatory purposes, may complicate such disclosures. In these circumstances, the subsequent M&A activities may generally require significant execution time and the underlying strategies are often not fully planned at the acquisition date.

b) For those acquisitions that are merged into the already existing business, it would be very complex and judgmental to carve out the metrics of the acquired business with a high level of detail. However, it would be possible to provide information on the performance of the combined business. In addition, metrics are not always the same as they depend on the acquired business (they sometimes acquire business with no revenue such as technological business or R&D business).

c) Acquisitions may need a significantly extended period of time to achieve the expected benefits, especially in the current environment where digitalisation plays a key role and often requires more time to generate the expected benefits. At the acquisition date, it is not possible to set an expectation about when the success could be definitively achieved.

d) The objective of an acquisition, as well as the underlying metrics used to measure its success, could change over time as the knowledge over the acquired business deepens. In some circumstances, not all the relevant information is available at the acquisition date.

e) Furthermore, an acquisition may be followed-up on a "business-as-usual" basis rather than against acquisition-specific metrics set at the acquisition date External factors such as the pandemic could also change which metrics are considered to be relevant. Or external factors such as climate related goals might make it necessary to adjust the business. The monitored metrics might be impacted by such changes in business. Not to reach the initial expectations might not relate to a failure of the business.

f) It is sometimes too simplistic to state that an acquisition has been a success based on the achievement of one or more specific metrics. Sometimes entities may achieve few targets but may simultaneously spend more resources than expected. It would be complex to explain which metrics reflect a successful acquisition, especially in the context that most of these could be highly sensitive.

g) Providing information about subsequent performance might be a challenge due to the unavailability of data e.g. where synergies are not tracked. For example, for customer relationships, it would be very difficult to assess which customers have been gained by the acquisition and which not.

h) In the banking sector, there may be significant amount of metrics provided to the CODM and it may be difficult to choose the appropriate ones to properly reflect the success of the acquisition. This was echoed by a consumer goods retailing preparer.

i) Availability and usefulness of information depends a bit on internal organisation. One preparer referred that he was improving his M&A department to have comparable monitoring for acquisitions, but small or medium sized companies might save costs by working with what they get from the (ERP system) acquired entity.

j) It is possible to see indirectly whether an acquisition is successful by reviewing the entity's or segment performance.

k) Skeptical about the usefulness of disclosures in acquisitions that are part of an existing business. An improvement in metrics may relate to the acquired business or to other reasons. The more integrated the acquired business is, the less reliable the disclosure will be, and it may involve a lot of judgement.

28 At the Norwegian outreach event, the preparer panelist indicated that there are many factors like size, nature and industry of a business that influence and determine which information is the most useful and relevant. Therefore, to disclose relevant information and to avoid additional costs and complexity, the focus should be on disclosure objectives rather than specific requirements.

29 At the Portuguese outreach event two preparers in the panel considered that it would be generally feasible to provide users with further information on acquisition and its subsequent performance as, for example, material acquisitions had always been addressed by management with metrics and targets. However, they considered that on a long-term basis (2 or 3 years) it could not be longer feasible as a result of the integration and changes on underlying objectives and targets. It was commented that the disclosure requirements should be flexible enough to a right level of flexibility to preparers. One of them had concerns about incremental costs and reliability issue triggered by the proposed disclosures.

30 At a closed event on 1 December 2020 the following views have been expressed regarding the feasibility:

a) One preparer noted that more precise description of the objectives for the disclosure requirements is necessary. She questioned whether the disclosures are needed to hold management to account for their decisions or to compensate for the ineffectiveness of the goodwill. Only after the objectives are clear, the discussion can be held on the scope and usefulness of the disclosures. In addition, current legal requirements relating to formal approval of acquisitions and disclosure of proforma impact of an acquisition on the financial statements should be considered.

b) The general objective of an acquisition and rationale is already communicated with investors when entering into business combinations through press releases and investor presentations. It is not considered an issue to disclose these in the financial statement. However, disclosing the objectives and metrics is an issue because these are determined internally by management and not standardised, resulting in the same issue as currently with applying IFRS 8.

c) The proposed disclosures are appropriate to disclose for "mega acquisitions" but could be an overkill for smaller ones. Therefore, the disclosure requirement should apply to public companies (like IAS 33) and not to private companies. For smaller companies, investors might be interested more in granular information at acquisition related to the recognized assets to inform investors about what exactly is acquired, however the preparer does not support this additional disclosure.

d) Acquisitions are integrated within 2-3 years and management does discuss the performance internally, but it is not a topic for financial reporting.

e) The goodwill impairment test also provides information about assumptions taken and a sensitivity analysis. Therefore, requiring the disclosures in combination with the impairment test will be partly a duplication of the information in the financial statements. If the disclosures are introduced than goodwill can be written off immediately.

f) Detailed metrics and KPIs are often not available pre-acquisition or are not monitored post acquisition at the same basis. The pre-acquisition metrics/KPIs are very high level and based on information which might not be complete or accurate. Only after the acquisition relevant information becomes available and only after 6 months or one year metrics can be set. Therefore, the CODM does not monitor the metrics/KPIs set at acquisition. It might be that acquisitions become successful after ten years and based on totally different metrics/KPIs compared to the pre-acquisition ones. Other preparers added that the acquisition is not monitored in isolation, but together with the combined businesses at a high level as the aim is to integrate the acquired business.

Management commentary or notes to the financial statements

31 The agenda Paper '*04-05 Results from surveys and interviews'* of 3 December 2020 TEG meeting (paragraphs from 48 to 54) provides for more background about the comments received from preparers in the survey. The results of the survey confirm that preparers strongly preferred the information: (i) about whether the acquisition has met its objectives; (ii) about the expected benefits when agreeing the price to be paid; and (iii) on synergies to be placed in the management commentary.

32 Preparers prefer placement within management commentary for disclosures that would be prepared based mainly on non-GAAP measures, that includes management views and assumptions, as well as involving forward-looking information. These result in complexity in terms of auditability (for example, whether the acquisition met its objectives, the information related to synergies and to the expected benefits when agreeing the price to acquire a business). One preparer suggested to allow a cross-reference from the notes to the management commentary (as it allows IFRS 7 B6).

33 One preparer would prefer to disclose this in the management commentary to avoid possible mistakes and as this is also subject to a consistency review by the auditors. Two other cited possible litigation; the forward-looking nature of the information as well as the difficulties around auditing of such information as reasons to maintain this information in analyst presentations etc. rather than as proposed.

34 Another preparer questioned during a closed event on 1 December 2020 the auditability. He commented that the amount of information will be different depending on the specific situation applicable to the acquisition. The information also relates to management's view and expectations therefor fitting in the management commentary. Therefore, he suggested to disclose the quantitative information (i.e., amounts paid or received) in the notes to the financial statements and to disclose the qualitative information in the management commentary.

35 During the Italian outreach event, the preparer panelist considered the management commentary to be the most appropriate placement for the proposed disclosures due to several reasons. First of all because, in his opinion, underlying information are mostly management assumptions and evaluations. In his view, the main aim of the proposed disclosures was not to give more quantitative information about the disclosure, but more to evaluate the success of an acquisition. Under an audit perspective, it would be then also more appropriate to have the disclosure only subjected to a *consistency assessment* rather than to a *reasonable assurance*.

36 He also raised some concerns related to the timing of the disclosures: as the financial statements are published annually several months after the closing date, providing the information by other means (i.e. investor relators) allow investors to have access to information on a more timely basis.

37 Three preparers at the Portuguese outreach event unanimously considered the management commentary as the most appropriate placement for the proposed disclosures, as based on non-financial information (i.e. market share, growth rate, market growth) and other operational indicators. Even when based on financial metrics, they were often non based on IFRS Standards and there was no link to financial statements or book value of goodwill.

38 Views from preparers are almost balanced regarding the information about the strategic rationale and management objectives for an acquisition.

39 Pro-forma information is considered to be better placed in the financial statements by the majority of respondents.

Management ceasing to monitor an acquisition before the end of the second full year after the acquisition

40 Comments in subparagraphs a) and c) of paragraph 27 are also relevant to the proposed disclosure if management ceases to monitor an acquisition before the end of the second full year after the year of acquisition. Preparers generally agree that a “two-year basis” may sometimes not be relevant. This is either due to an intense integration of the acquired business just after the acquisition or because an acquisition may need a significantly longer period of time to achieve the expected benefits. Some preparers expressed the view that if businesses are integrated into previous businesses, these are not monitored for an extensive period of time (one or two years the most).

41 In summary the period of monitoring depends on the acquisition, in many cases the monitoring of the acquisition will be replaced by the monitoring of the business in which the acquisition is integrated. Even acquisitions that are remaining in separate entities are likely not being monitored on the basis of the acquisition targets but on the basis of adjusted business plans (see as well d)).

<u>Users</u>

Additional disclosure metrics and subsequent performance

42 Users welcomed the proposed disclosures as useful to hold management accountable for its decisions and actions. Users agreed that they need more information about the acquisition and subsequent performance than they currently have. A user panellist at the Users’ outreach event agreed with the IASB approach to analyse the acquisitions in two aspects: how the acquisition impacts the entity, its balance sheet and its cash flows and was an acquisition decision a right one. To assess an acquisition, investors have to update models, forecasts, cash flow projections, etc. He considered that it is currently difficult to see if an acquisition was a good management decision as there is often little or no information about subsequent performance. It was also considered that a greater disaggregation would be important.

43 One other user panellist at the Users’ outreach event noted that on the one hand investors want acquisition accounting that fully reflects the value paid, on the other hand they are frustrated by acquisition accounting and systematically pick it apart. In large acquisitions there are comprehensive changes across the financial statements. Investors want to understand how the incremental changes will affect earnings, cash flows and balance sheet amounts. Normal accounting is disrupted by the purchase price accounting, including a step change in amounts for the acquisition. The needs of users break down in two areas: Firstly, assessing performance, i.e., understanding

the past and forecasting the future and assessing operating performance that is reported after fair value adjustments. It was noted that trend analysis is impacted by fair value adjustments that reduce the performance, such as inventory valuation increases and amortisation of new intangibles. That is why analysts want full information to adjust operational performance information and improve trend analysis.

44 One user agreed with preparers' position about the focus of the disclosures only on the material acquisitions, or acquisitions of very material individual assets. He contended that disclosures of minor acquisitions would not add value for users (as argued by preparers in paragraph 21b)).

45 The user panellist at the Norwegian outreach event questioned the usefulness of disclosing the strategic rationale and whether it should form part of the financial statements. He considered that the rationale is already provided at the acquisition. The metrics for monitoring the performance post-acquisition are very important, but also that information about the acquisition price and earn-out clauses or contingent consideration is required. He concurred with the proposals to enhance the pro-forma cash flow information provided. The period for which the information needs to be provided could be longer than 2 years for significant acquisitions.

46 The following information was considered to be particularly useful to assess the management governance and stewardship over the capital deployed: the proforma data about underlying profitability at the time of the acquisition, KPIs and metrics to measure subsequent performance and expected synergies.

47 On predicted synergies at acquisition date, users argued that as they are not reflected in the income statement they cannot be reconciled, which puts usefulness of such information in question.

48 However, users' views diverged from preparers' (see paragraph 26) with regard to the disclosures on the subsequent performance of acquisitions. Some users were interested in comparing the expected objectives and subsequent performance of an acquisition under different metrics (i.e., turnover was expressly mentioned). One user noted that successful acquisitions often have good tailormade monitoring. The situation of a conglomerate that is acquiring business that is sold after a few years is different from a buy and build strategy in an industrial company or a technology investor that does an acquisition for intellectual property reasons. Having the information available for tailormade monitoring is determinative in assessing the quality of the management. Good management will have a few KPIs that match the criteria of the acquisition, a less performing management will only assess high level criteria. Most management teams have some monitoring in place of large acquisitions. Sharing of the information the management is using would not only provide information on how the acquisition is doing but also on the quality of the management.

49 One user noted there were three different situations: i) large capitalisations vs small capitalisations, ii) regulated vs non-regulated entities and iii) very important acquisitions vs small acquisitions. In her experience larger regulated companies do monitor the acquisitions and have the information available. Another question is whether they share this information with the users. The information is included in investor presentations and not in the financial statements. Monitoring is done for one to two years depending on their aim. Small capitalisations have less information available than large capitalisations and are reluctant to share the information. The situation here could be improved. However, small companies have small accounting departments and these disclosures could be burdensome. Therefore, it needs to be a balance between benefit and cost. Regulated entities produce excessive amounts of information, here the struggle is to find what is valuable information.

50 Users highlighted the need to disaggregate the costs incurred to achieve the performance targets. They considered the data around the incremental costs incurred was very useful. In their view, the proforma information, costs and synergies allow to see the margin structure for an entity and to evaluate whether this margin structure is sustainable. Therefore, costs associated with the revenues should be disclosed.

51 Users considered the proforma information very useful but acknowledged that there was currently little guidance on how to calculate proforma, for example in respect of revaluations caused by purchase price allocation, etc.

52 Users confirmed that the information that the operating cash flows were only useful in combination with a normalised working capital information.

53 During a closed meeting with a user organisation, a user shared the view that the performance of an acquisition could be monitored for 2 or 3 years. He acknowledged that disclosures would only be included if the information is internally monitored but if this is not made, it would be a bad signal from a user perspective. Another user indicated that, from stewardship purposes, increasing disclosures of the acquired business is the best option.

54 During a closed event with a user organisation on 3 December 2020 users agreed with the general approach requiring disclosure relating to subsequent performance of acquisitions and added the following:

a) Rationale of an acquisition: supports for disclosing the rationale as it is important to know whether it is in line with the company's overall strategy. The rationale should be disclosed at the time of the acquisition as it might provide information on possible difficulties that the company is facing triggering the acquisition;

b) Metrics: information on metrics should be specific, for example a quantification of how much the acquisition is expected to contribute to revenues, cost savings, profits and impacts the debts and return on capital.

c) Acquisition price: users need to understand how the acquisition price is determined.

d) Monitoring: the expectation is that companies do monitor acquisitions and if companies stop monitoring this should be disclosed. The period for monitoring should be equal to the period it takes to integrate the acquired business. A default period of two years seems reasonable, could also be three, however suggested not to determine a default period.

e) Comparability: when comparable assets are acquired by different companies the valuation can be different. Users need to be able to understand how this difference in valuation occurs.

One added that the information has to be understandable and reconciled to the financial statements.

Sensitivity of information

55 Users acknowledged the thin balance between the commercially sensitive and useful information and agreed that in some cases entities might be reluctant to provide information which they consider sensitive and this might result in the boiler plate disclosures.

56 On the commercial sensitivity it was argued that often the data is not as sensitive as entities would like to pretend. The fact pattern of every subsequent acquisition will be different from the past acquisitions, unless the entity is a serial acquirer, and therefore, the information can be disclosed. One panellist of the User outreach event thought it has become increasingly normal to give information to strategy, business

model, KPIs and targets. In her view the information asked for about acquisitions is not so commercially sensitive that it would be hurtful. The other disclosures around strategy can be taken as a lead on this, providing context. The overall price is important for accountability. A comprehensive update on how the acquisition will change cash flows is very useful. Post-acquisition, it is in the context of the broader strategic goals that one can see whether the acquisition has paid off or not. Companies are able to find a way to share meaningful information with investors, information that is integrated into the overall picture of strategy and performance. Often commercially sensitive information is already known by the competition, so it is actually not that sensitive. The user challenged that some information could be seen as commercially or internally sensitive.

57 Another panellist noted the main issue was the price for the acquisition and the valuation metrics being used. While the cash amount paid can be easily found, there is no information on leverage multiples, financing structure, debt and covenants used. Management is very reluctant to reveal the parameters used in the acquisition such as the EBITDA multiple, a discounted cash flow, growth rates in cash flows. In his view management may not wish to disclose those figures because the market may fear that the price paid is too high but that is the function of the market. It is a two-way communication between the market's assessment to what the management has done. However, in a buy and build strategy disclosing the numbers may have a negative impact on the price to be paid for a future acquisition. In general, he thinks that the benefit of the market being aware of the price is higher than the disadvantage that could exist for a specific company. Also, the use of public money is a cheaper way of financing, the opposite side of that being that some more information is to be publicly disclosed. In his view the values, metrics and growth rates in determining the values should be shared with the market.

58 During a closed event on 3 December 2020, it was emphasised that it should be avoided that too much information is considered to be commercially sensitive.

Level of information to be provided - CODM

59 Users considered that the disclosure information should be provided at the level at which a particular material acquisition was reviewed, be it CODM level or lower.

60 Even users have mixed views on whether disclosures should be based on the information the CODM monitors. One user reported that such information would be at an appropriate level (in agreement with IASB's proposals), while another argued that users may be interested in a different level of information (in line with EFRAG's preliminary views that it should be based on a lower level).

61 A user panellist in the Users' outreach event noted that information based on the CODM level would help to address the challenges of acquired business being integrated with the existing one. However, he also considered that EFRAG's proposal to go to a lower level than the CODM would provide useful information. In general, every acquisition requires a tailormade solution in monitoring, and it is also a determinative factor when assessing the quality of management. In his view, the assessment of standard high-level KPIs only is generally associated with a less performing management.

62 Another user noted during a closed event on 3 December 2020 that the information used by CODM might be mainly non-GAAP therefore it might not reconcile with the information in the financial statements. He questioned the usefulness. The user added some doubt about the CODM level based on practical experiences with IFRS 8 *Operating Segments*. From his point of view the CODM requirements in IFRS 8 Operating Segments do not work well as the usefulness of information or comparability might not be given.

Management commentary or notes to the financial statements

63 A user panellist in the Users' outreach event commented that management commentary could be also considered as an appropriate place for the disclosure. However, he acknowledged that the IASB cannot mandate what should be included in this document. Another user supported during a closed user organisation event on 3 December 2020 to include the information in the management commentary.

64 During closed meeting with a user organisation, a user noted that banks were already providing this information (for relevant transactions) in its management presentations, but it would be more reliable if it was audited.

Auditors

65 Auditors broadly welcome the additional disclosures proposed by the IASB.

66 Auditors agreed that some of the proposed disclosures could be provided within the financial statements and could be audited. However, considering its nature, some of the information might be better placed in the management commentary as it involves management analysis and perceptions and, as such, is not always verifiable. To include or audit forward-looking information in itself might not be an issue for the audit, but the new disclosures include management perception of the results and the management expectations about a particular business combination which raise audit issues. This is consistent with the views of preparers in paragraphs 31 and 32. However, the requirements around management commentary are currently voluntary. To require disclosing such information requires more field tests to assess the practicality.

67 One auditor during the Italian outreach event considered that, in order to have a reliable and auditable information, a clear definition by the entities of KPIs used to provide the disclosure would be the key priority. The more the KPIs are clear, precise and understandable (and to a certain extent measurable and linked to financial metrics) the more it would be possible to have it reliable and auditable. It would also ensure that the disclosures do not result in boilerplate information. Preparers' would be also required to maintain an adequate supporting documentation to track and demonstrate how the information has been prepared. In this context, he considered that disclosures based on financial metrics could be placed in the financial statements, whilst others based on Non-Gaap, forward-looking information and management assumptions would be better placed in the management commentary. He finally suggested that the IASB would further investigate with preparers what information is currently analysed and monitored by management, so that it can be of help in the subsequent phase of the project.

68 Feedback from two auditors show that they do not always consider the CODM to be the most appropriate level. Some auditors reported that the level at which the success of an acquisition is monitored could sometimes be lower (i.e., when an entity acquired a complex conglomerate monitored by the CODM on an aggregate basis). However, one auditor during the Italian outreach event appreciated the IASB attempt to base the disclosure on what is already monitored by management in order to avoid incremental costs.

69 Another two auditors during the Italian outreach event and EFRAG's working groups meeting agreed with preparers' concerns over commercial sensitivity. Balance between the needs of users and information that preparers are not willing to disclose is needed to determine the right level of granularity of information.

Other stakeholders

70 Preliminary views shared by the participants to a multi-stakeholder technical group of a national standard setter in a closed meeting are so far aligned with those of preparers. In particular:

a) Additional disclosures should not create new obligations for the measurement of performance. They also consider the information provided to the CODM to be the most appropriate.

b) They expressed concerns over the reliability and auditability for some of the proposed information. Information at the acquisition date could be placed in the financial statements, while that related to the subsequent performance would be better placed in the management commentary.

c) They agree that disclosures when management ceases monitoring of an acquisition before the end of a two-year period may sometimes be not sufficient but would depend on a case by case basis.

d) There is a shared view that commercial sensitivity can be significantly triggered by some of the proposed disclosures.

e) Expected objectives for an acquisition, as well as the underlying metrics used to measure its achievement, may change frequently as the knowledge of the acquired business improves. Therefore, certain targets may not be achieved but the acquisition could still be considered a success based on other factors. Such a change in metrics could be interpreted by investors as an acquisition being unsuccessful.

71 Views have been also collected from a German enforcer as part of the 16 October webinar. He generally confirmed the usefulness of the proposed disclosures. However:

a) He shared concerns over practicability of the proposed disclosures due to integration often occurring in practice after the acquisition; and

b) He questioned whether linking the proposed disclosures to information available to the CODM would result in a lack of new information provided to users, thereby not meeting the objective of the new disclosures.

72 At the CFSS meeting, a standard setter noted concerns that some companies that were rapidly integrating new business into their existing business might not provide the disclosures required by the IASB. They acknowledged that they should be careful not to confuse entities not able or willing to provide the proposed disclosures with those actively controlling acquisitions post-merger. In the latter circumstance, goodwill may not be actively managed while management may be more interested in synergies and in measuring them differently to the way defined by the accounting standards. He also warned about the legal implications or sensitivity of some disclosures. This view was also shared by an organization during a German outreach event, highlighting that competitors should not get sensitive information.

73 Some standard setters also commented on the disclosure about the CODM stopping to monitor the acquisition:

a) A standard setter considered that the proposed requirement should be restricted, because of the quick integration with the existing business. Furthermore, it may be also felt as a “punishment”;

b) Another standard setter questioned whether, in circumstances where goodwill was not monitored by an entity, it should remain on the balance sheet, and linked it to the question of how goodwill was accounted for in the first place;

c) A standard setter reported mixed views from his jurisdiction on whether it was possible to generate the disclosures if the newly acquired business was partly divested.

Question 3 - Expected benefits when agreeing the price to acquire a business[3]

74 Stakeholders' views on the overall disclosure requirements are the same as in paragraphs 13 to 73 above. Some specific comments are provided here.

75 If the disclosures should be provided, 80% of the respondent to the preparers' survey prefers this information to be included in the management commentary. Further background can be found in the Agenda Paper '*04-05 Results from surveys and interviews'* of 3 December 2020 TEG meeting (paragraphs 48 to 54).

76 At the 16 October webinar an audience member stated that the disclosure of the transaction price may deteriorate the negotiation position of the acquirer for future acquisitions as it would betray negotiation strategies.

77 Another preparer agreed and added that the transaction price is the result of negotiations between the two parties and does not necessarily express the expected amount of benefits and synergies. One other preparer also added that this information would give too much detail to external stakeholders about the negotiation dynamics beyond the intrinsic value of the acquired business.

78 However, in some cases, the expected benefits may be to increase market share as well as benefitting from economies of scale or improving profitability. Diversification such as operations in different territories or business areas may be an important driver. Other examples include technology and know-how, as well as market penetration, customer relationships, or focused on revenues.

79 Another preparer considers that there are three types of acquisitions:

a) Those with economic or cost saving objectives: then disclosures about efficiency and synergies would be useful;

b) Those to enter in a new market/geography: here synergies and cost savings would not be useful;

c) Those to enter a new business type or to acquire know-how: Here the metrics would not involve synergies or revenues.

80 This is also consistent with feedback received from EFRAG working groups meetings and from field-testing, where some participants argued that the proposed disclosures would involve too many details about how the expected objectives, including synergies, have been factored into the price.

81 Under a user's perspective, a panellist at the Users' outreach event commented that, while the cash amount paid could be easily found, there is currently poor information on leverage multiples, financing structure, debt, covenants used due to management reluctancy. However, he did not share management concern that the market may fear that the price paid is too high, because this is the function of the market.

Question 4 - Nature, timing and amount of expected synergies[4]

82 Feedback collected on synergies showed that stakeholders' views are in line with those relating to the disclosure of the expected objective for an acquisition and subsequent measurement of its performance. Some specific comments by type of respondents are provided here.

<u>Preparers</u>

83 If the disclosures should be provided, 83% of the respondent to the preparers' survey expressed their preference to have this information included in the management commentary. However, some preparers prefer that this information continue to form

[3] Question 3 of the IASB's DP

[4] Question 4 of the IASB's DP

part of analyst presentations and not the financial statements or management commentary. Further background can be found in the Agenda Paper '*04-05 Results from surveys and interviews'* of 3 December 2020 TEG meeting.

84 While comments reported from paragraph 13 to 40 directly apply also to the proposed disclosures on synergies, some preparers added some other specific comments.

85 A preparer stated that, as partial divesting of an acquired business often occurs in practice after the acquisition date, cost synergies may be unknown to the extent they are based on what the acquiror will keep of the acquired business.

86 Another preparer from EFRAG API reported that they have tried in the past to measure cost synergies, but the results were not useful for management of the business. He mentioned that they do not set a specific synergies target, and that synergies are not monitored as envisaged in the IASB's DP. During the closed event on 1 December 2020 the same preparer added that it is complex and judgmental to measure for example the level of cost savings from avoiding a certain project/activity. Other preparers during the same closed event agreed and added that same arguments are applicable in case a range of synergies is required to be disclosed and agreed that qualitative information can be provided but quantitative not.

87 Concerns expressed in paragraph 27c) also apply to synergies. Some preparers indicated that synergies can often materialise in the long term and generally do not provide measurable benefits in the initial phase of an acquisition. It would be then complicated to assess whether benefits expected from synergies are met at an earlier stage.

88 While the preparers reported a general consensus about the expected synergies on revenues being highly sensitive from a commercial point of view, views are mixed when discussing cost synergies. Some of the preparers participating in the survey and the field test said that they are already disclosing information to the market about cost synergies (not in the financial statements but instead through presentations and press releases). However, some preparer argued that also cost synergies may trigger confidentiality issues, especially under an internal point of view and should be internally discussed before disclosing (i.e., cost synergies based on part of the workforce becoming redundant.

89 In some cases, such as the automotive industry, cost savings may only be attained after a number of years due to the industry's contractual arrangements. Even then, it would be difficult to separate the savings due to the acquisition (economies of scale) versus other factors such as economic outlook, commodity prices and negotiations.

90 A preparer indicated that in some cases the acquiror does not pay the full value of the synergies and then the disclosures would be general in nature rather than related to the impairment test. Similarly, the monitoring and disclosures should be based on synergies paid for rather than all the expected synergies. An alternative would be to distinguish between paid synergies and unpaid for synergies. Where disclosures are based on all synergies irrespective of payment or not, it would be better suited to be included in the management commentary rather than the financial statements.

91 A preparer indicated that a detail list of expectations and assumptions linked to the purchase price exist as part of the fairness opinion but disclosing this in detail would be confidential (commercial sensitive and internally confidential), to disclose part of the information might not be useful. Another preparer noted that as there are different acquisitions, there are different information level about synergies. However, if the CODM is informed about these, it would be possible to disclose them.

92 Another preparer indicated that disclosing the metrics used for monitoring of synergies would be difficult to apply given the range of variables that may impact synergies as well as the extent of the information available. For example, more

synergies may be expected when the acquiree is not managed well. However, the estimation of such synergies will be judgemental and providing this information would not be useful. Providing such information shortly after the acquisition would be easier compared to later. The costs to achieve the expected synergies are also estimated where possible, but the same limitations apply to these.

93 A preparer highlighted that achieving synergies does not mean that you have a successful acquisition. Synergies can also be tweaked. In transformation deals, they plan synergies on a top-down approach and these are internally tracked. They also disclose synergies in the market at a high level. they already provide information to the market (not in the financial statements) because they feel that they need to be transparent. However, if there was an obligation, they would not have such a flexibility. Disclosing detailed synergies would reveal competitors how they think and approach synergies so they may end up paying some synergies. They would prefer a principle-based approach rather than specified disclosures.

Users

94 While comments reported from paragraph 42 to 64 also apply directly to the proposed disclosures on synergies, some users reported the following specific comments during EFRAG working group meetings and closed events held:

a) Where the object of an acquisition is to achieve scale, cost synergies are one of the most relevant information to be provided. Revenue synergies are more relevant when an acquisition focuses on intangibles. In both cases, this is an area where current information is insufficient;

b) Synergies are often the main driver used to justify the price paid for an acquisition.

95 A user expressed concern about the level of detail included in the proposed requirements, as the disclosures could potentially result in boiler-plate information. Confirmed by another user in a closed event on 3 December 2020.

Auditors

96 Comments by auditors reported from paragraphs 65 to 69 directly apply also to the proposed disclosures on synergies.

Other stakeholders

97 Comments by other stakeholders reported at paragraphs 70 and 73 also apply directly to the proposed disclosures on synergies.

98 A standard setter has considered, in a closed meeting, that the DP focuses unduly on synergies, whilst some other relevant components are not adequately taken into consideration. Examples include workforce and the related skillsets.

Question 5 - Enhancing current IFRS 3 disclosure requirements[5]

99 There were mixed views about whether “profit or loss” should be replaced with “operating profit before acquisition-related transactions and integration costs” for both the pro forma information and the information about the acquired business after the acquisition date.

100 Feedback received also showed that the proposal to disclose similar information for cash flows from operating activities is generally not supported across different categories of stakeholders.

101 A detailed summary of feedback received by category of stakeholders is included in the following paragraphs.

[5] Question 5 of the IASB’s discussion paper

Preparers

102 Preparers' survey show that the proposed disclosures are considered to trigger complexity and incremental costs. Particularly, a higher level of complexity and incremental costs is associated with the information for the current reporting period as though the acquisition date had been at the beginning of the annual reporting period. In this regard, concerns are related to the additional workload involved and to expected difficulties in preparing the financial figures. More background on the results of the survey can be found in the Agenda Paper '*04-05 Results from surveys and interviews'* of 3 December 2020 TEG meeting (paragraphs 26 to 40).

103 Preparers do mainly not support the proposals reported in paragraph 99. The main reported arguments include the following:

a) The notion of 'acquisition-related transaction costs' and 'integration costs' is currently undefined and unclear: it could potentially lead to inconsistent outcomes. Specifically addressed was what internal costs should be considered and whether the PPA effects should be considered; and

b) Excluding the effects on the purchase price allocation and the effects of the revaluation to fair value is considered costly and of limited value.

104 Preparers also do not support the proposal reported in paragraph 100, as in their view it could be complex to prepare and would not add meaningful information to investors.

105 However, one preparer considered providing "operating profit before acquisition-related transactions and integration costs" and similar information for cash flows from operating activities as feasible. However, during the Portuguese outreach event, it questioned how the cash flows could help investors in analysing the acquisition. Furthermore, the cost-benefit relationship was also doubted.

106 Another preparer judged that for significant acquisitions the cash flow information could be provided from the date of acquisition and would be valuable information. However, excluding the effects of the purchase price allocation would be difficult.

107 A preparer within EFRAG working groups reported concerns also on retaining the current requirements under IFRS 3 to provide pro-forma information, regardless of any changes to the measure to be disclosed. Figures provided under the current requirements are estimates based on financial statements issued by the previous owner, which is not necessarily indicative of the results that could have been achieved, i.e., it ignores synergies, savings and costs. Furthermore, providing this information is already costly.

108 Preparers noted during a closed event on 1 December 2020 that integration costs are judgmental and are not used internally. One of the preparers added during the same event that it is possible to provide assumptions, but not possible to come up with proforma cash flows as it will be highly judgmental and the auditability will be difficult.

Other stakeholders

109 A user in a closed meeting stated that information on how the acquired company has performed in the period from its last financial statement until the acquisition could be useful. During this period, the new management might already de facto control the acquired business, but they would only be accountable for the period after the acquisition. In his view, it could be an incentive to manage the earnings in that period to get better earnings after the acquisition.

110 Another user indicated that the information on cash flows could be useful (considers profits to be an opinion, but cash as a fact) to raise questions with management if the figure is unanticipated. However, this would be even more useful if it includes

changes in working capital to detect where management is inducing sales by relaxing payment conditions.

111 One auditor in EFRAG Working Groups expressed the concern about the complexity of providing the proposed disclosures for both operating profit before acquisition-related transactions and integration costs and on cash flows from operating activities. At the 16 October webinar an auditor also stated that the current guidance for the preparation of pro-forma information could be improved in order to reduce some divergences that occur in practice.

112 A standard setter has reported, in a closed meeting, the following feedback:

a) The proposal would trigger incremental costs and complexities;

b) Preparers put significant effort into performing a reliable PPA, and it would be unfair to lose the benefits of this.

c) The definition of what is 'integration cost' is it not clear, especially as it is not used elsewhere; and

d) Pro-forma information on cash flows could be difficult to construct, also considering that most of entities use an indirect method to measure the operating cash flows. As such, preparing the proposed disclosure would imply that the costs outweigh the benefits for an entity that was not part of the group for a certain period.

113 An academic in EFRAG Working Groups commented that she, like EFRAG, disagrees with providing proposed information for cash flows from operating activities.

114 During a German outreach event an organization requested to replace the requirements to disclose pro forma information with a requirement for companies to provide additional information, when necessary, to help investors assess how much the acquired business could have contributed to the combined business over a full year (paragraphs 2.84 and 2.85 of the DP).

Questions for EFRAG TEG

115 Does EFRAG TEG have comments or questions on this summary?

Questions 6 to 8 - Goodwill impairment and amortisation

Question 6 - Goodwill impairment[6]

116 While the polling result in the webinars with a more mixed audience delivers no clear majority in either direction, at a user-oriented event, participants considered a change the guidance necessary.

117 The following table shows the results of the relevant polling question during three (general) webinars:

The IASB's preliminary view is that it is not feasible to design a different test that is significantly more effective at recognising losses on a timely basis at a reasonable cost. Should the IASB consider addressing the shielding effect improving guidance on the allocation and reallocation of goodwill to CGUs? *(100 responses)*	**Yes** 56%	**No** 44%
Of which: preparers	*8%*	*13%*

[6] Question 6 of the IASB's discussion paper

Of which: auditors	*22%*	*15%*
Of which: other	*26%*	*16%*

Participants who responded 'Yes' agree that the current goodwill (re)allocation requirements might provide room for opportunistic behaviour and that the IASB should consider improving guidance. Similar to preparers, a majority of the few users that responded do not agree with proposing different guidance, as this would not be possible at reasonable cost.

118 The EFRAG DCL proposes the following disclosure requirements as a potential measure to reduce over-optimism:

a) Disclose how actual cash flows differ from management's previous cash flow predictions (back-testing);

b) Disclose the current level of cash flows to allow users to model themselves;

c) Improve information on assumptions related to the period for which management has projected cash flows and specifically about terminal value projections.

The result of the polling question 'which of the proposed disclosures will reduce over-optimism?' during the three webinars are as follows:

	Preparers	*Auditors*	*Other*	*Total*
All of the proposed disclosures requirements	3%	14%	13%	30%
Only one of the proposed disclosure requirements	11%	19%	21%	51%
None of the proposed disclosure requirements	7%	6%	6%	19%
Total (104 responses)	21%	39%	40%	100%

Where only one of the proposed disclosure requirements is selected, almost all of the respondents agree either with proposal a) or c) and few agree with b).

119 In general, a wide majority of the audience who participated in a user-focused webinar considered that the impairment test could be improved so that investors would rely more on it. The following table shows the results of the relevant polling question during that webinar:

	Users	*Auditor*	*Preparers*	*Others*	*Total*
Improvements through amendments in goodwill allocation and reallocation requirements	11%	11%	11%	-	33%
Improvements through specific disclosures to prevent management overoptimism	6%	6%	5%	5%	22%
Improvements through better guidance and transparency on triggering events	6%	5%	6%	-	17%
Improvements only through all of the above	-	-	6%	6%	12%

It is not possible to improve it at a reasonable cost	10%	6%	-	-	16%
Total (18 responses)	33%	28%	28%	11%	100%

Allocation and reallocation

Preparers

120 A majority of the preparers consider that the guidance on the initial allocation of goodwill to CGUs as well as the guidance on the reallocation of goodwill based on the relative value approach should not be further developed.

121 For the result of polling during outreach events please see paragraph 117 above. A majority of the preparers voted that the guidance should not be adjusted.

122 In the survey replies received to date, this is not considered to be the reason for the perceived failure of the impairment testing of goodwill (see paragraphs from 59 to 63 of paper '*04-05 Results from surveys and interviews'* of 3 December 2020 TEG meeting).

123 At one of the closed events, it was discussed that if a rebuttable presumption of allocation of goodwill to a level below segment was introduced, the key question was the conditions to rebut the presumption. In their view, goodwill allocation should be aligned with how management manage business. Furthermore, they did not consider that reorganisations were intended to avoid goodwill impairment but rather that they were motivated by business reasons such as dealing with underperforming businesses or achieving synergies.

124 During interviews with preparers, they expressed the following views:

a) Goodwill might be allocated to a higher CGU level to cover synergies as well. The goodwill impairment test might be prepared on a higher level compared to which management monitors KPIs of the acquisition;

b) Disagreed that the IAS 36 impairment test is not effective. The impacts of "too little too late" and "shielding effects" can be solved by adding further guidance on how goodwill is allocated to the CGUs; and

c) Agreed with the proposal included in EFRAG draft comment letter for the reallocation of goodwill to the correct level of CGUs.

125 During an outreach event, a different preparer noted that it was not necessary to develop additional guidance. In a different outreach event, a preparer indicated that the focus should be on the value of the CGU and the CGU may or may not contain goodwill and may or may not support goodwill at a combined level but challenges are there with and without goodwill. However, it was also noted that in practice the mechanism of goodwill impairment recognition does not work the same when goodwill is allocated to a CGU or a group of CGUs and this is something the IASB should look at.

126 During the 24 November 2020 webinar, panellists mainly agreed that it was not possible to make the impairment test more effective at a reasonable cost. Mixed views were provided on whether guidance on the initial allocation of goodwill to CGUs as well as the guidance on the reallocation of goodwill based on the relative value approach should be further developed. As reasons to develop the guidance, a preparer noted that currently there is too much room for judgment while another preparer highlighted that when reorganisations are made the allocation of goodwill could be complex, and it was often difficult to explain if goodwill resulted from the original acquisition or from integration of businesses. During a closed meeting the guidance in relation to disposals was discussed. The example was given that a business is sold for Nil or for a negative amount and that would lead to a situation

where the goodwill retains with the selling entity and accumulates over time. One preparer mentioned that at the moment of disposal the old goodwill will be allocated to the business to be disposed of. So goodwill should not accumulate from sold businesses in his entity, but that would be a valid application issue.

Management over-optimism

Preparers

127 Preparers have some reservations about the proposed disclosures. The polling result during the webinars (see paragraph 118) show that the majority considers some of the proposals or all of them as being useful to address over-optimism. A minority considers it not useful to introduce such guidance.

128 In the survey preparers assess the difficulty in including the disclosures referred to in paragraph 118 as well as their reluctance. In the replies received they consider the 'back-testing' disclosure to be the most difficult while the disclosure of current cash flows to be the least. They are also more reluctant to disclose the cash flows of the period than the other disclosures. From the surveys received, it seems that they are more reluctant to include the information than the difficulty of obtaining it (see paragraphs 64 to 68 of paper *'04-05 Results from surveys and interviews' of 3 December 2020 TEG meeting*). Additionally, preparers provided the following qualitative comments:

a) In addition to being costly, the disclosures would trigger commercial sensitivity;

b) 'Back-testing' disclosure would trigger commercial sensitivity;

c) Current cash flows used in value in use calculation are based on their own analysis but adjusted by the inputs resulting from the consensus of analysts. As analysts make their own projections, this disclosure would not be useful;

d) Management over-optimism about future cash flows is being addressed by auditors and regulators but also by robust internal control systems and governance;

e) Agreement that overoptimism is an issue and agreement with the disclosures proposed by EFRAG in its draft comment letter. 'Back-testing' disclosure and more information on actual cash flows are historical information and readily available. This information would be useful for investors. Though the information might be partially commercially sensitive, it is preferable over disclosures related to the subsequent performance of an acquisition;

f) Disclosures are better approach than auditors and regulators but there is a risk of being over conservative; and

g) A more meaningful sensitivity analysis could be requested.

129 During the 16 October 2020 webinar, a preparer agreed with the disclosures a) and c) referred to in paragraph 118 to provide more discipline. Additionally, he suggested that over-optimism should have consequences e.g., by shortening the planning period before going into the terminal value. He also considered that improving transparency requirements on the objectives of an acquisition do not help in identifying triggering events for a potential goodwill impairment as they have been designed for other purposes.

130 During the 9 November 2020 webinar, a preparer indicated that it is difficult to deal with over-optimism through standard-settings or disclosures. In its view, this is an application issue. Adding more disclosures would not solve this issue but would add a burden on companies in finding good ways to convey the complexities of those often internally dependant assumptions.

131 During a German outreach event, in relation to the disclosures proposed by EFRAG that address management overoptimism, the requirements of IAS 36.134 were discussed. The question where is that additional disclosure requirement and if so, why additional disclosures and why is IAS 36 paragraph 134 not sufficient. It was discussed that in practice the disclosures currently provided are more qualitative information rather than meaningful quantitative information. However, some preparers conveyed that disclosures were not a solution.

132 During the 24 November 2020 webinar, panellists provided mixed views on whether management over-optimism is best addressed by auditors and regulators and on the disclosures suggested by EFRAG to overcome the risk of management over-optimism. A preparer, who found the 'back-testing' disclosure useful and objective, noted that companies created and used business plans as a management tool and not for impairment test. Therefore, business plan should be ambitious as it should serve as a target for management. Another preparer indicated that, although the 'backtesting' disclosure seemed a good proposal, it was necessary to go into further details such as the cash flow method to be used (operating cash flow or free cash flow), however he also recognized that being too prescriptive was risky.

<u>Users</u>

133 During a user focused outreach event the following views were expressed:

a) Prices on the market always come ahead of the management decision to make an impairment, either because of delay with presenting annual financial statements or management unwillingness. Therefore, there is a problem with the timing of impairments.

b) The fundamental problem is that the impairment test is not testing goodwill, even indirectly. If shielding effect is not dealt with, the impairment test is not testing goodwill at all.

c) Over-optimism can delay the impairment and that is where auditors and regulators should take a responsibility to oblige management to use tougher forecasts and assumptions to avoid over-optimism.

d) Indicator-based approach would provide some information about triggering events and management assessments which could help with over-optimistic assumptions

134 During an EFRAG user panel meeting some users agreed that the allocation of goodwill had to be made at the lowest level that outweights costs for the impairment test to work. However, one user considered that segment allocation may be more appropriate than CGU allocation. He expressed the view that often CGUs do not coincide with segments and analysts do not have information on CGUs to challenge management assumptions at the CGU level. To challenge management, having the allocation at the level that analysts have data is useful, even though it would increase the shielding effect and reduce impairments. A different member argued that further disclosure on the assumptions of management in the goodwill impairment test process would be useful to analysts and investors. He considered that requiring a tabula form that included assumptions such as discount rates, cash flow growth or terminal value assumptions, would help to hold management accountable.

135 During a closed user meeting, there was a consensus view between the users joining the event that the impairment test is not working. A user of the group noted that there should be clear triggering events that would almost certainly result in the recognition of an impairment.

136 In another closed user event similar views were provided. Meaningful disclosures with a sufficient level of granularity can help to understand the assessments. One

user considered goodwill as not so important. Another discussed the downsides of going back to amortisation (RoE would be artificially increased).

137 One user in one of the above mentioned closed events was referring to companies with a significant gap between the equity and market capitalisation as example that the impairment test is not working. He considered it useful to have an explanation/disclosure requirement for such a situation. To disclose where the sum of the recoverable amounts is significantly higher than the market capitalisation, he considered useful as well by recognising that in some situation the valuation might not be prepared for all parts of the entity to have a sum of the parts that could be compared with the market capitalisation.

138 A user believes that improvements of the impairment test cannot be a solution to enable investors to hold management accountable, however improved disclosures such as meaningful KPI's could help. Another user's view is that internally generated goodwill should not be allowed to be used to avoid goodwill impairment. Furthermore, management over-optimism is real because impairment became a 'political' issue.

<u>Auditors</u>

139 Overall, auditors do not refute the main causes identified by the IASB for the "too little, too late", i.e., over-optimism and the so called "shielding" effect. They proposed alternatives to overcome these such as improvement of the current guidance and the level of allocation of goodwill (as suggested by the EFRAG DCL), including very specific disclosures and providing a more robust model for IAS 36. Another auditor suggested to replace the concept of monitoring goodwill with monitoring the related busines. A different auditor suggested, in line with the IASB, that management over-optimism should be dealt with through regulatory pressure, so that management would be more objective, together with the auditors.

140 One auditor agrees with the academic research results showing correlation between the identification of key audit matters and the quality and quantity of disclosures as explained in paragraph 148. He also emphasised the importance of informing stakeholders that the objective of impairment tests is not to measure the subsequent performance of a business. He added that over-optimism can be (partially) addressed by improving the disclosure requirements or the level of allocation of goodwill to CGUs. For example, similarly to US GAAP or as suggested by EFRAG with one level below segment level by default. He also explained that the risk of failure is not linear over time (gradual decline) but can result in a sudden deterioration and significant impairment losses.

141 During the Italian outreach event one auditor commented that the level of judgement was not a reason for a change of the current impairment-only model. He expressed his favour for the EFRAG's proposal to provide additional disclosures about management projections and how they met the actual results. Furthermore, he considered that the over-optimism could be better addressed by some internal safeguards that companies may put in place. For example, an IFRS adopter is deemed to apply an internal control system that would be effective enough to avoid any unreasonable assumption when performing an impairment test.

142 The auditor panellist at the Italian outreach event also considered that the shielding effect cannot be avoided at all as goodwill is a residual component and cannot be tested separately. However, he commented that enhancing the current guidance on allocation of goodwill to CGUs might be of help. In fact, he generally noted that the most common practice is to allocate goodwill at operating segment level, with no material effort by preparers in allocating it at a lower level. He also argued that reallocation is sometimes arbitrarily leveraged by management to create the shielding effect.

143 Two auditors suggested to consider market capitalisation and provide a reconciliation between market and book value, especially in situations where the market capitalisation is lower than the valuation result.

Other stakeholders

144 A national standard-setter agreed with EFRAG that there are different options for improving the impairment test while ensuring that the costs do not outweigh the benefits. It also noted that guidance on allocation to CGUs should be improved to avoid segment allocation abuse. They do not believe that additional disclosures could fix management over-optimism. If systematic business plan disclosures were required, explanations would have to be provided for any differences. There would be an overload of disclosures and any differences would be seen as a lack of performance. Therefore, they are not in favour of providing additional information on the actual compared to the estimate. Disclosures on key assumptions required by IAS 36 as part of the impairment test already provide useful information. Therefore, no additional information would be required. They do not necessarily agree that overoptimism is a cause of the 'too little too late' issue.

145 An enforcer agreed with EFRAG's view that the allocation of goodwill should take place at the lowest possible level that outweighs cost to reduce the shielding effect. He also expressed the view that there is potential for improvement related to paragraph 33 of IAS 36 as it is difficult to determine whether assumptions are reasonable given the lack of disclosures at CGU level. In this regard, he suggested that the IASB include additional guidance relating to the reasonableness and supportability of assumptions. The operating cycle of a business may be insightful, e.g., by using an average cash flow level since entities often use the highest cash flow level reached after the planning period to calculate the terminal value. Furthermore, he suggested that more guidance to ensure consistency between assumptions used in the impairment test calculation: growth rate, risk rate, interest rate, inflation rate.

146 From a valuation perspective, the main issue relating to the impairment test is the shielding effect of internally generated goodwill, although there is no solution that eliminates the shielding effect whilst reducing the cost and complexity of the impairment test. During the webinar on 16 October, a panellist with a valuation background referred to three articles published by IVSC on the subject. Artificial headroom created by the amortisation of acquired intangible assets plays another important role. She explained that probably the most radical solution might be to recognise internally generated intangibles which is a wider topic that might deserve a special consideration. She also set out possible alternatives to the current impairment test level and considered it useful to test on a lower level. However, while addressing the shielding issue or reducing complexity, the potential improvement alternatives have different pros and cons.

147 She referred to potential improvements discussed by IVSC like a step-up approach and direct comparison at the request of preparers to reduce costs and complexity. The direct comparison of the recoverable amount at acquisition and at reporting date would make the (sometimes complex and judgmental) determination of the carrying amount of the CGU unnecessary. However, the drivers of the value creation could relate either to the legacy business or to the new acquired business and the origin would not be identified. Finally, the identification of trigger events is key for impairment testing and should be done on a more granular basis. Disclosure of the investment rationale and the key performance indicators for an acquisition could be useful benchmarks for tracking post-acquisition developments.

148 Academic research indicates that goodwill impairment is considered complex and at the discretion of management. There is evidence of the opportunistic use of the impairment test, both from a timing and value perspective. Research also indicate

that monitoring and oversight have a positive impact on enhancing the quality of the impairment test and the related disclosures. This suggests that the issue around the over-optimism is indeed an application issue where the solution may lie with auditors and regulators. Another study showed that identifying the impairment testing as a key audit matter improved the quality and quantity of the relating disclosures.

149 One Academic agreed that guidance in the standard should not be a playing fields to avoid impairments and being enforceable.

150 During a German outreach event an organization expressed the view that if there are accounting practices that are not suitable, this will not be solved by disclosing those unsuitable practices.

Potential reversal of impairment

151 The majority of the respondents during the two webinars disagreed with the benefit of introducing the reversal of goodwill impairment:

Would introducing the reversal of goodwill impairment be appropriate to take some pressure from the impairment testing? *(23 responses)*	**Yes** 39%	**No** 61%

The auditors and preparers contributed significantly to the results. Users and regulators equally agreed and disagreed.

152 A representative of a standard setter noticed that although it would be a good idea to include reversals of goodwill impairments, they had hardly seen any reversals of tangible asset impairments and none of intangible assets, when allowed to do so. Therefore, this possibility would not be used.

153 During a German outreach event it was considered that reversal of impairments would not be useful and that interest rate changes should not be a reason for any reversal of impairments.

154 During the Portuguese outreach event one moderator questioned why it was possible to reverse impairment loss on brands but not on goodwill. In her opinion, it could be one of the reasons of delay in recognition of impairment losses, because when you decide to impair, you need to be sure that this is an irrecoverable loss

Question 7 – Reintroductions of Amortisation[7]

155 The table below summarises the responses of participants to a polling question on the reintroduction of the amortisation of goodwill during the four webinars:

Are you in favour of reintroduction of amortisation of goodwill? *(157 responses)*	**Yes** 78%	**No** 22%
Of which: preparers	*17%*	*4%*
Of which: auditors	*29%*	*11%*

Almost all of the academics and a majority of both regulators and users also responded 'Yes'. The majority of all the respondents who responded 'Yes', do not have a conceptual argument. Rather, they prefer the reintroduction of amortisation for practical reasons to take the pressure off the impairment test and reduce cost, although many consider that there are conceptual reasons to reintroduce amortisation.

[7] Question 7 of the IASB's discussion paper

156 The responses of participants to the Italian outreach event to a polling question on the reintroduction of the amortisation of goodwill showed that the 63% (out of 44 responses) would be in favour.

157 Regarding the nature of the goodwill, the following table includes the results of a polling question answered by the audience during one of the webinars:

	Preparers	*Auditors*	*Other*	*Total*
Goodwill is a wasting asset or an accounting construct and should be gradually removed from the balance.	10%	14%	10.5%	34.5%
Goodwill is not a wasting asset or represent a mix of wasting and non-wasting elements.	10%	41%	10.5%	61.5%
None of the above. No major change should be made at goodwill accounting.	0%	4%	0%	4%
Total (29 responses)	20%	59%	21%	100%

Most respondents indicated that goodwill is not a wasting asset or that it corresponds to a mix between wasting and non-wasting elements.

<u>Preparers</u>

Impairment only vs. Reintroduction of goodwill in general

158 As shown above, during polling (paragraph 155) preparers were in favour of reintroducing amortisation. Despite the outcome of the polling question asked in public Outreach meetings, the preparers participating in the respective panels of the public events favoured, with a slight majority, the impairment only approach.

159 The Survey result (see paragraphs 79 and 82 of paper '*04-05 Results from surveys and interviews'* of 3 December 2020 TEG meeting) indicates that there are mixed views on whether goodwill is a wasting asset, a non-wasting asset or partially wasting. There are also mixed views as to whether goodwill is a real economic asset or an accounting construct, though a slight majority consider it to be a real economic asset. Paragraphs 170 to 175 below include qualitative comments obtained with the interviews with preparers on this matter.

160 The Survey result (see paragraphs 79 and 82 of paper *'04-05 Results from surveys and interviews'* of 3 December 2020 TEG meeting) indicates that a majority of the preparers consider that there are no new evidence or arguments (or new assessments of existing evidence) that should be taken into account when assessing whether the amortisation should be reintroduced. The new evidence or arguments proposed by those who consider that they do exist are listed in paragraphs 176 a) to 176 f) below.

161 During the outreach activities referred to in paragraph 2 preparers provided different arguments on whether goodwill amortisation should be reintroduced.

162 Those in favour of reintroducing amortisation provided the following arguments:

a) As many companies impair their goodwill during negative economic cycles, the reintroduction of amortisation would avoid pro-cyclicality;

b) Currently, the impairment of goodwill is highly conditional upon the level at which goodwill is allocated. If goodwill amortisation were reintroduced, all acquisitions would be treated equally;

c) Goodwill was not an asset but an accounting construct that had no real relation to business reality; therefore, it would be a coincidence if impairments matched business reality;

d) One preparer specified: The allocation and reallocation of goodwill impacts the effectiveness of the test. When goodwill allocated together with less risky assets, shielding comes in. If goodwill included with similar projects and one of it becomes impaired, than all the other projects also impair. Therefore, goodwill impairment testing cannot deliver the sensitive information;

e) Goodwill is a wasting asset; and

f) One considered that impairment testing would be conceptual appropriate but her strong argument in favour of amortisation was that the impairment test was not working, being highly complex and judgemental. She did not consider goodwill to be a wasting asset, but if synergies would be obtained at some point, they will be realised through profit or loss over time. From her point of view it was better to focus the discussion on the useful life of goodwill.

163 Those in favour of keeping the impairment-only model provided the following arguments:

a) The impairment-only model provides more useful information to users compared to systematic amortisation;

b) The accounting treatment for the performance of goodwill would be the same for successful and unsuccessful transactions;

c) Impairment testing is the right conceptual approach;

d) Amortisation is a forced rule that would be perceived as a purely mechanical accounting rule that would not provide a true signal of a good or bad acquisition but would only represent a compromise to reduce the value over time. In fact, M&A acquisitions create value for a company;

e) Reintroduction of goodwill amortisation could potentially prevent companies to acquire entities as it would reduce its profitability ratios;

f) There could be potential issues in terms of the level-playing field in the M&A market between IFRS and non-IFRS entities;

g) One premise of a business combination is the going concern principle. However, goodwill amortisation is not in accordance with this premise; and

h) There are situations where goodwill is wasting, situations where is not wasting and mixed situations. If non-wasting goodwill were amortised, there would not be option of going back. However, this would not be a problem with the impairment test.

164 During the 9 November 2020 webinar, a preparer indicated that the reintroduction of amortisation would not have a conceptual basis and would be a practical solution. On the other hand, the link between goodwill and the current business of an entity is sometimes weak. As time passes, the entity's business changes, and goodwill has no longer an informative value for investors. Challenges are associated with both alternatives, but she generally struggles with the consequence of having an impairment loss as the only way to reduce the amount of goodwill from the balance sheet. This is generally perceived as a failure by the market.

165 During a German outreach event most of participants supported the preliminary view of the German standard setter, which is that amortisation should be reintroduced, mainly for practical reasons. In some of the participants' view there is a high risk in the economy to accumulate goodwill.

166 During the Italian outreach event one of the preparers in the panel expressed the view that, overall, the current impairment model worked well. However, he also pointed out few side effects: for example, the impairment only model instead of a straightforward amortisation led in practice to sudden and unexpected impairment recognised in the companies' financial statements with strong impact on financial markets. He considered that the subsequent development of APM and Non-Gaap measures helped in reducing the impact of those impairment losses when linked to market scenarios rather than to entity's specific issues. Nevertheless, he also considered that backing to an amortisation model would have limited relevance for investors, that are more interested in other metrics (i.e. synergies, level of achievement of management objectives, etc.) that the IASB is properly trying to address through the discussion paper.

167 Another preparer in the Italian outreach event highlighted some perceived limit of the current impairment framework. He thought that, in the banking industry, even an impairment loss has a limited informative value for investors. In his experience market reactions to a significant impairment loss are quite immaterial. For example, he mentioned that, in the past years, his group recognised a huge goodwill impairment loss but the market reaction was an increase in the shares price. He thought that analysts are generally able to predict the trends underlying an impairment test even before the impairment loss is recognised in the annual financial statements. He generally found that investors interest on the impairment losses, including the underlying technicalities, is limited.

168 Preparers panelist during the Italian outreach event also provided the following comments:

a) The only element that would trigger an interest in the discussion under an analyst point of view would be its impact on the entity's dividend policy. If, under a regulatory point of view, the dividend policy would not take into consideration the 100% of the amortisation charge, he believed it would be still ignored by investors; and

b) The convergence with FASB current work is an important element to consider in the view of a playing field level of EU companies compared to US ones. In his view, EU companies should not be penalised in the market only due to the application of a different accounting framework compared to US entities.

169 During a closed specific industry meeting with preparers mixed views were provided on whether amortization should be reintroduced and on whether goodwill is a wasting asset. Those who were against the reintroduction of amortization expressed the view that there were no new arguments and that it did not provide useful information, while those in favor argued practical aspects such as the reduction of goodwill and the lower workload. One of the preparers indicated that, to the extent that many users disregard the accounting treatment of goodwill, a potential solution would be to allow the use of an accounting policy choice between amortisation and impairment only model.

170 A preparer noted during an interview that when acquiring businesses, they focus on technologies and future technology value is recognized as part of goodwill. As technology has in its nature a limited useful life, they consider goodwill to be a wasting asset.

171 A preparer pointed out that in its sector acquisition helped to have a competitive advantage in the market, but after 10-15 years, the strategy is fully internalised and it does not make much sense to keep goodwill in the balance. He also noted that it could lead to an increase of financial resources retained into the entity as an effect of the lower dividend paid, as this is based on net income.

172 A different preparer indicated that goodwill is mainly a wasting asset as synergies do not last forever. There may be some synergies that last longer but are not the main part. Furthermore, it is good to explain what the goodwill consists of to show what the payment was for.

173 Another preparer expressed the view that goodwill in its business is a long-life asset. In a transaction they had a few years ago, goodwill related mainly to synergies and they continue benefitting from those synergies.

174 During an interview one preparer expressed the view that goodwill might have different components, some of them are wasting others are not. Some of them have a shorter or longer useful life. In his view, the introduction of the impairment-only approach resulted in the willingness to pay higher purchase prices. Amortisation could help it to return to a more normal level. The impact on pricing for acquisitions was mentioned by others as well.

175 Some preparers consider goodwill as a non-wasting asset, as it has an economic substance and value and is a fundamental component of the going concern assumptions.

176 Some of the preparers have noted that new arguments for reintroducing goodwill amortisation have emerged since 2004. These are as follows:

a) Several crises have occurred in recent years that show high volatility in the global economy which makes forecasting more complicated than in the past;

b) In practice, the impairment test does not work as evidenced by the frequency of these discussions;

c) The erosion in value of traditional businesses is an indication that there are new arguments. Digitalisation as well as new disruptive communication and sales channels make indefinite useful lives no longer justifiable;

d) Comparability with other accounting standards that apply amortisation such as Japanese GAAP;

e) The weight of goodwill on total assets in companies' balance sheet is dramatically increased; and

f) In some industries and related regulations (i.e., Solvency II for Insurance industry) the goodwill is deducted from the equity.

Reintroduction of amortisation – potential useful life

177 If amortisation were to be reintroduced, a simple majority of preparers consider that the useful life of the goodwill would have to be management's reasonable estimate. However, views are mixed (see paper '*04-05 Results from surveys and interviews'* of 3 December 2020 TEG meeting). There are some concerns expressed in relation to the useful life. During the webinar on 23 October 2020, a preparer expressed concern that the determination of the useful life of goodwill would outweigh the benefits of introducing amortisation and that different amortisation periods would affect comparability.

178 During a German outreach event some participants expressed the view that the useful life should be relatively short (between 5 and 10 years), although other participants provided other views such as that there should be a high cap or that it should be determined, on a meaningful basis, consistently with the PPA. However, some opinions were in the line that in the event that amortisation was reintroduced, the transition would have to be doable for companies and a very short life would have a big impact on the income statement and even trigger some covenants. It was also noted by a participant that the impact should be on the profit and loss account instead on the OCI and whether it would be presented within the operating results or within the financial results.

179 One preparer during the Italian outreach event considered it as a sensitive issue. Prior to the Civil Code reform dated 2006, the Italian Civil Code provided for an amortisation period to be based on a default period. After 2006 reform, local regulation requires entities to determine the amortisation period and provides for a default period only in case it cannot be reliably determined. He considered that, as far as the goodwill is considered as a pure accounting difference between the price paid and the FV of net assets acquired, the determination of the useful life would be a construct with no conceptually based solution. He reaffirmed that, for this purpose, the most important issue is to have a better understanding of what composes goodwill.

180 During an interview, a preparer noted that some discretion and judgement should be left to the company with respect to the useful life of goodwill to base the useful life on the economics of the respective business.

Reintroduction of amortisation – impairment testing

181 If amortisation of goodwill were to be reintroduced, most preparers consider that impairment test should only be performed if there are impairment indicators (see Paragraph 80 of paper '*04-05 Results from surveys and interviews'* of 3 December 2020 TEG meeting).

Age of goodwill

182 A majority of the respondents of the survey consider that the cost of disclosing information about the “age” of goodwill would be slightly higher than moderate (see paragraph 81 of paper '*04-05 Results from surveys and interviews'* of 3 December 2020 TEG meeting). Regardless of the election of the impairment only model or the amortisation, a preparer noted that disclosing information on the “age” of goodwill is very useful as it will help users to assess the success of acquisitions. However, several others stated that due to reallocation of goodwill and disinvestments it is not possible to deliver such disclosures.

<u>Users</u>

Impairment only vs. Reintroduction of goodwill in general

183 Users of financial statements propose different approaches. However, some of them consider that goodwill is not particularly useful. Some others noted that goodwill should not be ignore as it represents money invested on which the entity needs to earn a return. User feedback indicated that goodwill:

a) Should be subject to impairment testing;

b) Could be amortised to relieve some pressure or for practical reasons;

c) Should not be subject to either depreciation or impairment testing;

d) Should be amortised or written off against equity at acquisition to avoid double counting;

e) Should be on the balance sheet and not written off against equity. Stewardship principle would not be met as management is responsible for shareholders’ money including goodwill; and

f) Is both rational and irrational: the irrational part, i.e., the overpayment, should be impaired immediately whilst the remainder should be amortised or impaired depending on its composition.

Qualitative comments in favour of amortisation

184 Goodwill is becoming economically more relevant and therefore might have more extreme effects. Impairments are larger and more cyclical which can cause negative shocks. Internal conflicts of interest (renumeration, reputation, earnings management) might prevent recognising impairments, especially in countries with

lower enforcement in place. Valuation models can be tweaked to provide the "number". Therefore, goodwill should be amortised for practical reasons as it was demonstrated that impairment tests had failed due to conflicts of interest inherent in the test.

185 During the 9 November 2020 webinar a user noted that although there is not strong view, he supports the idea that goodwill should be amortised. The reasons for this are that valuation multiples of companies would be more comparable; that currently the only way to remove goodwill from the balance sheet is through impairments (there is a perception of failure and this is not necessarily always the case so there should be another way of removing goodwill from the balance sheet); and that amortisation would reduce the probability of inflating book values. However, he recognised that it would be complex to determine the useful life of goodwill. He also stated that he did not believe he would add back goodwill amortisation expenses when calculating performance measures and, as such, doubted that investor would do so either. Therefore, he considered that amortisation expenses would be part of recurring EPS. Finally, he expressed the view that providing information about the age of goodwill could be theoretically useful. However, he was uncertain about how he would use this information.

186 During an EFRAG user panel meeting one user favouring amortisation noted that he would not miss the impairment test disclosures included in the notes as these are either useless because not all assumptions are included or overly optimistic. He also noted that he would not add the amortisation costs back as this represents the cost of the cash flows delivered by the synergies. The focus should not be on what the analysts do as they add other costs and not just the cost of amortising goodwill. Nevertheless, a user panel member provided the view that a majority of this group was in favour of retaining the impairment only model.

187 During a closed meeting with a user organisation, most user were in favour of reintroducing amortisation. Some of these users consider that the impairment only approach can force bankruptcy of companies. There might be an overpayment of dividends (no sufficient equity for a necessary impairment). Another example, in a downturn situation of the economy a major impairment might force problems. Another user, while considering that conceptually and for stewardship purposes the impairment test makes more sense, acknowledges that amortisation is safer. Disclosures around the impairment test will not compensate this.

188 During a closed meeting with a user organisation, the majority of the users participating were in favour of reintroducing amortisation. The users provided the following views:

a) Goodwill represents the expected future profitability in addition to the profitability of the rest of other assets. From a stewardship perspective, this over-profitability would be assessed when amortised. There would be a link between the cash flows (payment for the goodwill) and the income statement (amortisation);

b) There is already evidence on the expected future profitability (goodwill) but there is no information on the timeline. With amortisation, this timeline will be more noticeable;

c) Valuation multiples of companies would be more comparable;

d) Amortisation is supported because impairment test does not work; and

e) Goodwill impairment model is conceptually correct as it represents payments for future cash flows. It represents the value created by the acquired subsidiary and can be sold later (as part of the subsidiary's value). Goodwill cannot be replaced, therefore, amortisation is conceptually incorrect.

Qualitative comments in favour of impairment only model

189 During an EFRAG user panel meeting one user argued that goodwill is a number which provided a balance in the accounting for an acquisition where it is assumed that management has not destroyed value. He shared the view that goodwill is not an asset but, in most cases, represented the perpetuity of the business and that, therefore, amortisation did not provide any information whereas impairment testing did. He also considered that the impairment test would allow you to have some governance robustness to ensure that management is tested to see if the results meet the expectations that existed at the time of the acquisition.

190 A user expressed the view that goodwill should not be amortized. Amortisation does not indicate anything and is ignored by many analysts. On the other hand, impairment test indicates that something needs to be further investigated. An impairment does not necessarily have to be because of a bad management. The reason of the impairment should accordingly be disclosed. However, if goodwill were to be amortised, impairment would be less likely to happen and, accordingly, bad management would be more difficult to detect. From a stewardship assessment perspective, impairment only is accordingly preferable to an amortisation approach.

191 Impairment only model enables users to differentiate between successful managers and unsuccessful ones. It is also valuable to know when goodwill is impaired because it implies that the business is worth less.

Qualitative comments in favour of other approaches

192 Users referred to the character and development of goodwill. After several years this number becomes meaningless. Some users advised that the purest solution was to take all goodwill against equity. A user suggested this approach especially for financial institutions where goodwill is already deducted from CET1. This user also noted that, on the contrary, badwill is recognized in equity through profit and loss, being, therefore, aligned to the information that banking industry provide to financial regulators. One user suggested that as cash flows materialised it is effectively recognised in profit or loss. One stated that as there was limited support from users for this approach, it is acceptable to have goodwill amortisation as a compromise.

193 One user suggested a component approach based on wasting and non-wasting assets. It was suggested that there was irrational goodwill, which was the overpayment that should be written off immediately, and rational goodwill, which were synergies that had a limited life and should be amortised. The portion representing growth assets should be subject to impairment. It would be very helpful to have the proportion of goodwill by age disclosed as well as the gross goodwill number in terms of the total in cost of past acquisitions. Goodwill provided an indication of the type of return on acquisitions management had achieved in the past so that it could be modelled in the future.

Reintroduction of amortisation – potential useful life

194 During the 9 November 2020 webinar a user noted that if goodwill amortization was reintroduced, it would be complex to determine the useful life of goodwill.

195 During a closed meeting with a user organisation, a user highlighted that the difficulty in determining the useful life should not be a reason not to reintroduce amortisation. Another user noted that business plans made at acquisition date could be used as a basis to determine the useful life and the amortisation period. A different user expressed the view that subjectivity and difficulty of determining the amortisation period is not just related to goodwill but to all assets. However, a reasonable estimate can always be made.

Age of goodwill

196 A user favouring the reintroduction of amortisation stated as well that if it was not reintroduced, the age of the goodwill should be disclosed.

Auditors

197 Most auditors favour the reintroduction of amortisation. The arguments are as follows:

a) Pragmatic reasons in order to release pressure from the financial system. They consider that the current impairment test model is not working as it should. One added, it will not resolve the issues related to the implementation of the impairment test but will make them less severe.

b) Some consider that there is new evidence to support the reintroduction of goodwill amortisation, such as

   i. The continuous growth of goodwill on companies' balance sheets;

   ii. The decline in the business cycle over the last 10 or 15 years; and

   iii. The fact that many constituents in their feedback to the PIR have raised the “too little too late” concern.

198 Another auditor expressed the view that the amortisation period would be arbitrary and that users generally ignore the amortisation expense. He also highlighted the importance of coordinating this issue with the FASB as amortisation is seen by many as a potential issue in terms of the level-playing field in the M&A market. However, another auditor indicated that goodwill impairment testing provides the business with the opportunity annually to review the model, cash flows and assumptions. Also, although users do not take it into account, it provides more useful information than the amortisation.

199 One auditor expressed the view that goodwill is an accounting bubble that created capital that did not exist, and he would offset it against retained earnings. If, as a consequence of the pandemic, companies faced booking operating losses and the need to impair goodwill then some capital in the balance sheet would not be there when needed. For this reason, goodwill was not an asset for Solvency II.

200 One auditor at the Italian outreach event considered that the impairment only approach resulted in an improvement of market transparency regarding, for example, the performance of a business. He commented that goodwill is a real asset, and its consumption is not easy to be measured. He also considered that reintroducing the amortisation would not provide users with relevant information and would bring judgment when coming to the determination of the useful life of goodwill.

Other stakeholders

201 In a CFSS meeting, some standard setters indicated that in their jurisdiction there was strong support for goodwill amortisation. Some of them pointed out the peculiarities of this asset and the convenience of amortisation to reduce it. A different national standard setter stated, in a closed meeting, that a change is not justified as it has not been demonstrated that the impairment test does not work. In his group there is a majority for keeping the impairment-only model, however, differences were narrow. They also indicated that there are no new arguments on whether goodwill is a wasting asset or not. Assembled workforce could be a wasting asset, but many other parts probably not. On the ‘age of goodwill’ they consider this information easy to be provided but it loses its relevance and reliability as time passes (when entering into restructurings or selling parts of CGUs).

202 An enforcer prefers the reintroduction of amortisation as the current impairment test model has failed. Although goodwill is not a wasting asset, it would reduce the continuing increase in the amount of goodwill recognised on companies' balance

sheets. However, he also recognised that there would be possible areas of debate, such as the amortisation period.

203 From a valuation perspective, goodwill contains important assets which are not wasting in nature (i.e., company's reputation, assembled workforce, going concern value). Therefore, amortisation would not be based on a sound understanding of the useful life of the underlying components and would not be helpful in understanding the value creation process of a company.

204 Research proves that goodwill is perceived as an asset as there is a positive relation between equity market values and reported goodwill. Research also shows that its value increased after the adoption of the impairment-only model. From an academic perspective, reintroducing goodwill amortisation can have the following consequences:

a) There is some evidence that goodwill amortisation might understate the goodwill value decline as perceived by stock markets;

b) Concerns that it would bring additional area of judgment, such as the determination of the amortisation period;

c) Users would lose useful information inherent in the impairment test;

d) Amortising goodwill will result in less useful information as the economic meaning of it is unclear, especially with linear amortisation.

205 Another academic highlighted that the amortisation of goodwill may not be a solution and that a high-level disclosure related to the impairment test should be developed while ensuring comparability.

<u>All stakeholders</u>

Componentisation[8]

206 As shown in the table below most of the stakeholders do not prefer the componentisation approach. The majority of the stakeholders answered 'No' for practical reasons since it would be judgemental, too costly and many answered that it would not be possible to divide goodwill into components.

Do you think that goodwill should be divided into components and the components that do not have an indefinite life should be amortised? *(63 responses)*	**Yes** 32%	**No** 68%
Of which: preparers	*5%*	*11%*
Of which: auditors	*14%*	*33%*

207 As shown in paragraph 157, during polling most respondents indicated that goodwill is not a wasting asset or that it corresponds to a mix between wasting and non-wasting elements.

208 During the 9 November 2020 webinar a preparer expressed the view that goodwill contains many elements. The business value is the core component of it but not necessarily the higher portion of its value. Other elements composing goodwill are, for example, the assembled workforce. It would be very complex asking entities to split goodwill into several components and treat them differently. It would involve a significant level of subjectivity. Furthermore, she noted the lack of existing models that could help in breaking-down goodwill components. In the same event, one user highlighted the complexity of goodwill's componentisation except for the 'technical

[8] Appendix 2 includes a summary of previous FASB considerations on the ccomponentisation approach.

goodwill' component. He considered useful to have specific rules for technical goodwill as this is a recurring cost and should be part of the amortisation.

209 During a closed meeting with preparers from a specific industry, they shared the views that separating goodwill into different components would be an interesting approach but difficult and costly. A preparer highlighted that this approach should be investigated further and might be combined with the research project on intangibles.

210 A preparer during the Italian outreach event commented that, despite being a residual concept, he considered goodwill as a mixture of components. Some of them (i.e. customers list) have been captured by the standards, while some others are still not appropriately considered. It may include some technical components (related to deferred tax items) that are often significant in cases where an entity operates in countries with aggressive tax frameworks. He then considered that it would be important to better understand which are the components of goodwill on a case by case basis and apply specific considerations to each of these components.

211 During an interview a preparer indicated that the composition of goodwill depends on each transaction and that some components are considered wasting, such as the workforce while others have a long life, such as reputation or synergies. Componentisation would be possible but would open many questions such as the identification of the components, the different useful lives, the impairment tests for each component, which would bring many complexities. They are a resourceful company and do not believe they would be able to do it on their own so they cannot even imagine smaller companies. All in all, the cost of implementation would be much higher than the benefits. In respect of having a different treatment only for technical goodwill, which arises from the tax impact of differences between fair values and book values, although they do not have a clear view, they consider that it could make sense. In other interviews preparer indicated that it would be difficult to identify individual components of goodwill and assign a value to each of them and that, although initially it might make sense, it would add complexity. Another preparer noted that identifying components in an accurate basis would be extremely judgmental.

212 In a CFSS meeting one of the standard setters expressed the view that for those components of goodwill that were clearly identifiable it made sense to amortise them because their value would diminish over time.

213 During an EFRAG user panel meeting one user shared the concern that pursuing the component approach may lead to a situation where, as for intangibles that are separate from goodwill, this approach would not be relevant to users, would be highly inaccurate and would provide no information.

Question 8 - Total equity excluding goodwill[9]

214 Several preparers agreed with EFRAG's response since it was an irrelevant disclosure to make. One preparer indicated that it would not provide a good message and that investors can do that calculation easily. However, a user did not understand the negative position of EFRAG since research aggregators were already providing the equity of the companies excluding goodwill and some of the ratios used by analysts also exclude it.

215 During a closed meeting with a user organisation, some users did not support presentation of equity excluding goodwill.

216 A standard setter also disagrees with presenting total equity excluding goodwill and even questions the calculation since it would not be possible for users to ascertain which part of the goodwill corresponds to non-controlling interests.

[9] Question 8 of the IASB's discussion paper

Questions for EFRAG TEG

217 Does EFRAG TEG have comments or questions on this summary?

Questions 9 to 11 - Simplifying the impairment test[10]

Question 9 - Indicator-only approach

218 There is divergence in stakeholders' views regarding the IASB's proposal to remove the requirement to perform a quantitative impairment test every year and to require a quantitative impairment test only when there is an indication of impairment.

219 The table below summarises the responses of participants to a polling question on the indicator-only approach during the webinars:

Should the IASB adopt an indicator-only approach, removing the requirement to perform an annual quantitative test? *(168 responses)*	**Yes** 40%	**No** 60%
Of which: preparers	*14%*	*7%*
Of which: auditors	*15%*	*27%*

The majority of the users who participated to the polling question responded 'No'. The majority of the regulators and almost all the academics responded 'No'. For the majority of 'no' voters the reasons relate to both a loss in robustness of the test as well as auditors lacking prior year results for comparative purposes.

220 The majority of the participants of the joint outreach events who disagreed with the adoption of the indicator-only approach based their view on both of the arguments below:

a) The over-optimism could increase as auditors or regulators will have no comparison to impairment tests prepared in previous years; and

b) The complex test would become significantly less robust if companies do not perform an impairment test regularly due to a decline in expertise. This could reduce the effectiveness of the impairment test and the confidence in its reliability.

The participants who just referred to one of the above arguments, were almost equally divided between argument a) and argument b).

221 The webinar also provided insight in the views of participants relating to the use of disclosures on subsequent performance of an acquisition as a triggering event:

Could the IASB's proposed disclosures on the subsequent performance of an acquisition help to better identify triggering events for a potential impairment of goodwill? *(84 responses)*	**Yes** 65%	**No** 35%
Of which: preparers	*15%*	*12%*
Of which: auditors	*24%*	*13%*

All of the users and academics who participated responded 'Yes'. The regulators responded almost equally 'Yes' and 'No'. However, many of the respondents who

[10] Questions 9 – 11 of the IASB's discussion paper

responded ‘Yes’, argue that such disclosure should not be required for confidentiality reasons.

Preparers

222 A clear majority of the preparers who participated as panellists at webinars and those in meetings/interviews agreed with the adoption of the indicator-only approach for impairment testing where the available headroom is sufficiently large. They argued that performing the quantitative impairment test will not result in an impairment loss when sufficient headroom is available. Therefore, resulting in more costs without adding value.

223 The survey research results show that many respondents expect significant cost savings and a few respondents expect significant cost savings. Two preparers during interviews noted that business plans that are used as input for the impairment test and the impairment test itself still needs to be prepared regularly for internal purposes. Other mentioned that each disinvestment require to prepare a valuation. The survey research also assessed the costs and complexities triggered by the alternative approaches proposed by the IASB’s Discussion Paper (par. 4.25). The results show that respondents consider all options to be averagely complex and costly compared to the current requirement.

224 In addition, the survey research results are in line with the feedback in paragraph 229 showing that the majority of the respondents will continue performing the quantitative test either to be able to document to auditors and other stakeholders the lack of occurrence of impairment indicators and for internal/managerial reasons. The approach and arguments in paragraph 228 are also confirmed by the survey research results where almost all respondents agreed that the indicator-only approach would not simplify the impairment test. Further background can be found at paragraphs from 69 to 78 in the Agenda Paper '*04-05 Results from surveys and interviews’* of 3 December 2020 TEG meeting.

225 Another preparer emphasised during an interview that the triggers must be very robust and a complete list of triggers is necessary. Specific trigger for goodwill should be in place as these can be different compared to triggers for intangible assets.

226 One preparer explained during the API meeting on 19 October 2020 that triggers are already monitored and applied for interim periods and could also be applied to year-end making it less costly and aligning with US GAAP. Another preparer agreed and added that disclosing sensitivity analysis regularly, is more useful than a yearly quantitative impairment test. Users will be able to use the sensitivity analysis for future value assessments. However, further guidance on triggers will be necessary.

227 Another preparer from the banking sector explained during an interview that the annual impairment test is too costly and goodwill in general is less relevant for them since the regulatory ratio’s exclude the goodwill figures. The preparer also confirmed that they never receive comments or questions from investors on the goodwill or goodwill impairment.

228 Nevertheless, some of these preparers shared the following restrictions and consequences of the indicator-only approach:

a) The indicator-only approach will not be a solution for the ‘too little too late’ issue since the result of the indicator-only approach and the quantitative impairment test will not be different.

b) The quality of the quantitative impairment test will diminish if the test is not performed regularly. Another preparer confirmed during a closed event on 1 December 2020 that changes in teams will result in the loss of experiences. However, the majority of the respondents to the survey research disagree with this statement. The majority of the respondents who agreed with this statement did not think that a requirement to perform an impairment test every third year would be a possible solution to improve the robustness. Other preparers during an interview also disagreed that management skills will significantly deteriorate when impairment test is not performed regularly as the impairment test model is already in place and only variables are collected and updated. Another preparer explained during an interview that for the current impairment test a lot of information is gathered from different departments that are challenged internally. The internal review of the assessment of the triggers would be much difficult as the available information would be less.

c) The annual quantitative impairment test supports managers with monitoring and discussing the developments in the value of a company.

d) One preparer was concerned about pricing for acquisitions and opportunistic behaviour. In his industry (Software) US companies seems to be willing to pay higher prices. He was referring to the 2-step approach under US GAAP. As he was not aware of any major impairment after acquisition but was clearly worried about the value of the business compared to the price paid. A trigger only approach might not be enough for a certain period after acquisition. Goodwill might accumulate.

e) Two other preparers during a closed meeting on 1 December 2020 and during the Portuguese outreach event on 24 November 2020 commented that the indicator-only approach will not necessarily result in a simplification or reduced cost. When the conclusion on some triggers is questioned, further analysis might be necessary to quantify and substantiate the conclusion. It might be easier to perform the quantitative impairment test in that case. This is supported by another preparer who explained during an interview that for the current impairment test a lot of information is gathered from different departments that are challenged internally. The internal review of the assessment of the triggers would be much difficult as the available information would be less.

f) Two preparers commented during the outreach event on 24 November 2020 that using indicators would be judgemental not resulting in an improvement.

229 Other preparers (automotive industry, banking sector, insurance industry, and telecommunication industry) indicated during interviews that they will continue performing the annual quantitative impairment test even if the indicator-only approach is adopted, for the following reasons:

a) The annual quantitative impairment test is embedded in the governance structure of the organisation - requested by and used to provide assurance to management;

b) The annual quantitative impairment test is required for preparing the statutory accounts under local GAAP as the cash generating units belong to legal entities; and

c) The annual quantitative impairment test enables the organisation to respond quickly to triggering events since the impairment test and the data of previous periods are readily available.

230 During the German outreach events on 2 and 20 November 2020 one preparer explained that a valuation and therefore the quantitative impairment will still be required in case of a disposal. Another preparer added that the indicator-only approach would be a real relieve for smaller companies.

231 One preparer during an interview agreed with the benefits of removing the requirement to perform the quantitative impairment test annually, but at the same time was comfortable with the current test and finds the current framework balanced.

232 The IASB discusses in its DP alternative approaches to perform the quantitative impairment test the first few years after a business combination or once in three years. A majority of the respondents to the survey research stated that these alternatives are not difficult to apply but costly. One preparer explained during the API meeting on 19 October 2020 that his business already applies the indicator-only approach to fixed assets and performs the quantitative impairment test every three or four years, confirming the practicability.

233 One preparer emphasised that, even though they preferred the indicator-only approach when sufficient headroom is available, they disagree with the package as a whole. They specifically have concerns about the other proposed disclosures on subsequent performance of business combinations as discussed in section 'Improving disclosures about acquisitions' in this paper.

Auditors

234 Two out of three auditors who expressed their view during the EFRAG FIWG meeting on 5 October 2020 do not support the indicator-only approach using the following arguments:

a) The indicator-only approach would make management over-optimism even more prevalent;

b) Performing the quantitative impairment test regularly increases the robustness and discipline;

c) Regularly exposing auditors and regulators to the complexities of impairment testing increase their experience and knowledge;

d) The quantitative impairment test is not the largest cost for multinationals in fulfilling reporting requirements; and

e) The indicator-only approach should only be considered if amortisation of goodwill is introduced and the useful life limited.

235 One of the auditors during the EFRAG FIWG meeting supported the indicator-only approach, but identified the following consequences and pre-conditions:

a) Increased pressure on the indicators and therefore the need to determine a more robust set of indicators in IAS 36.

b) Additional disclosure requirements relating to the indicator assessment to reduce the potential for over-optimism.

Alternatively, the auditor opted for an annual mandatory quantitative test, unless specific conditions are met, for example the availability of sufficient headroom.

236 This view including the alternative approach were shared by the auditor during the 16 October 2020 webinar because the indicator-only approach could be cost-saving and more practical. At the same time, the indicator-only approach could potentially exacerbate management over-optimism and the subjectivity of the impairment test. However, he stated that if the indicator-only approach is implemented, the indicators must be very robust. The auditor panellist noted that additional disclosure comparing the market capitalisation and the carrying amount of the CGU would help in testing management's assumptions. At the same webinar, the investor panellist disagreed with comparing market capitalisation to carrying amounts in the financial statements. Management often argue that the market capitalisation cannot be compared with the financial statements as there is not necessarily a correlation between the two.

237 One auditor at the Italian outreach event did not support the indicator-only approach, as the current impairment test model is already encountering some practical issue and did not always ensure a timely recognition of impairment losses. He found it quite contradictory compared to the overall objective of the Discussion Paper. Furthermore, in case the indicator-only approach would be reintroduced, the

impairment indicators currently provided in the accounting standards should be improved.

Users

238 In general, users question the effectiveness of the indicator-only approach in practice since the judgment shifts from the quantitative test to the qualitative indicators. They express the need for more clarification and guidance on the triggers.

239 One user at the API meeting on 7 October mentioned that there will not be a comprehensive list of indicators. Additionally, the level of management judgment would increase, especially in cases where it would be reasonable to conduct an impairment test, but no triggers has been hit. Another user explained during the webinar on 9 November 2020 that it is difficult to define a triggering event.

240 During the IAWG meeting on 15 October 2020, one member agreed with the concerns summarised in the EFRAG DCL relating to the indicator-only approach. Another member highlighted that the indicator-only approach could reintroduce the ‘cliff risk’ from the users’ point of view.

241 One user, during the webinar on 16 October 2020, noted that the more complex an impairment model is, the easier for management it will be to use it in their own favour. He linked the proposed disclosures to monitor the subsequent performance of an acquisition and stated that the disclosed objectives and metrics could be used as impairment triggers.

242 One user referred to the information value of disclosures provided with the annual impairment test. The disclosures help to value the business. Such information value would be lost when applying an indicator only approach.

243 An analyst explained during the webinar on 12 November 2020 that the cost of performing the annual impairment test is not necessarily always high. The analyst argued that large cap companies have sufficient resources and information to perform the test annually, but small cap companies might have less resources and would benefit more from performing the impairment test less regularly.

244 Another user at the same webinar suggested to stop the impairment test since it does not provide any information and indicated that in that case the indicator-only approach would at least provide some information about triggering events and management assessments which could help with over-optimistic assumptions. One user disagreed with the indicator-only approach as it would weaken the impairment test. Another user, shared the same view and stated that the indicator-only approach could provide more incentives to management interpretation and subjectivity.

Other stakeholders

245 Other stakeholders confirm the usefulness of the information disclosed as part of the quantitative impairment test. These would disappear with an indicator-only approach.

246 From an academic perspective, research shows the following importance of the goodwill impairment test and relating disclosures:

a) Financial markets have a negative response to impairment losses;

b) Following an impairment loss announcement, companies experience lower analyst forecast accuracy and higher analyst forecast dispersion;

c) Prospective information disclosed on goodwill impairment is negatively associated with the cost of equity, and as such having a direct impact on the funding; and

d) Increased level of disclosure transparency decreases disagreement among analysts and between analysts and managers about the impairment of goodwill and the underlying earnings forecast.

Accordingly, the annual impairment test brings the advantage of informing users about the evaluation trend for goodwill. This makes it easier for users to identify opportunistic use of goodwill impairment by managers.

247 During the German outreach event on 2 and 20 November 2020 one academic and auditor added that it is conceptually not possible to not perform the quantitative impairment test and that it enables opportunistic behaviour.

248 One regulator sees the indicator-only approach as contradiction of the overall purpose of the project as it enlarges the scope of management judgment and makes it more difficult to recognise an impairment. The expected cost savings will not outweigh the related decrease in the robustness of the impairment test.

249 According to the valuer panellist at the 16 October webinar improvements to the robustness of indicators are required for both external and entity-related indicators. The valuer also considers that defining more specific indicators would not be costly. An example of an entity-related indicator could be the comparison between the expected internal rate of return and the entity's cost of capital. Another example could be the use of KPI's as disclosed at acquisition date as an indicator. Another valuer emphasised during the API meeting of 19 October 2020 that a checklist-mentality should be avoided, thereby confirming the need for more robust and entity-specific indicators.

250 According to the CFSS, the indicator-only approach should only be considered if the amortisation of goodwill is reintroduced. The indicator-only approach would be disadvantageous with an impairment-only approach. One CFSS member confirmed the concerns already expressed by auditors and preparers relating to the loss of expertise when the test is not performed regularly.

Question 10/11 - Further simplifications

Remove restriction to include cash flows relating to future uncommitted restructurings and enhancements of assets

251 In general, stakeholders agree with removing the restriction to include cash flows relating to future uncommitted restructurings and enhancements of assets in the value in use ('VIU') calculation. The following specific arguments are used by some stakeholders:

a) Auditor - The data used in the impairment test will be more closely aligned with the internal business plans and management information thereby reducing the cost of preparing impairment test; and

b) Standard setter - Adjusting the internal business plans to exclude these cash flows leads to an oversimplification of the impairment test. The positive impact of these restructurings and enhancements would already be taken into account when agreeing the acquisition price, in particular when acquisitions aim to increase market share. Excluding these cash flows could lead to unjustified impairment losses.

c) User - The current restrictions place the VIU in between the maintenance cash flows and the growth rate of the discounted cash flow-method, making it artificial and complex.

252 The table below summarises the responses of participants to a polling question on the removal of restrictions relating to cash flows during the webinar on 9 November 2020:

Would value in use estimates improve if cash flows from future uncommitted restructurings or enhancements to asset performance are included in the estimate? *(32 responses)*	**Yes**	**No**
	88%	12%

Of which: preparers	*28%*	*3%*
Of which: auditors	*47%*	*3%*

All the users agreed and the academics voted equally 'Yes' and 'No'. The 'No' voters argued that it will result in over-optimism and will contribute even further to the ineffectiveness of the goodwill impairment test. The 'Yes' voters argued that the value in use will be more aligned with the fair value less costs to sell measurement and will result in less costs as the information is used for internal purposes. The majority of the 'Yes' voters argued that additional guidance is necessary relating to the conditions to include these cash flows in order to avoid over-optimism.

253 The participants of the German outreach event on 2 and 20 November 2020 agreed with the proposed simplifications relating to the VIU calculation.

<u>Preparers</u>

254 A narrow majority of respondents to the survey disagree with the statement that including cash flows from future asset enhancements will lead to unjustifiable optimistic input. A narrow majority also do not find it necessary to have additional guidance on when to include restructuring cash flows in the VIU calculation. The respondents who did not agree, find it necessary to set a threshold and the majority suggest this to be the 'highly probable' threshold. One preparer confirmed that more guidance to include these cash flows is preferred to increase the objectiveness. Many respondents to the survey affirmed that other cash flows should also be considered to be included. Some of these respondents considered that it should be based on individual management judgment necessary to reflect individual facts and circumstances. Some others expressly mentioned the investments to be made to increase the production capacity, even in case projects are not finally approved.

255 One preparer during the API meeting on 19 October agreed with including these cash flows as it aligns more with the income approach that can be used to determine the fair value and it is difficult to exclude these cash flows from current reports. Given that the fair value definition allowed the use of the income approach, it was unnecessary for companies to have to distinguish between different approaches.

256 Other preparers stated during an interview and during the Portuguese outreach event on 24 November that including these cash flows allows the use of readily available management information in the value in use calculation. This was confirmed by one of the panellists during the webinar on 9 November 2020, however the preparer noted that these cash flows need to be mature and well documented as for any other assumption in the impairment test. A preparer at a closed event on 1 December 2020 also agreed with removal of these restrictions as it allows to use readily available internal information. Another preparer supported the removal of the restrictions, but did not expect significant cost-savings.

257 One preparer during the Italian outreach event supported the proposal.

<u>Other stakeholders</u>

258 At the webinar on 12 November 2020 one user noted that the simplifications relating to allowing certain cash flows brings the value in use closer to fair value, one way to simplify the test would be to go to "higher of" the two.

259 However, one auditor commented that uncommitted asset enhancements are more subject to judgment. Therefore, it would be more robust if it were part of the overall planning process and had been scrutinised by those charged with governance.

260 One auditor during the Italian outreach event supported the proposals, as the issue is very frequently encountered in practice. He expressed the opinion that, based on

this change and jointly with the use of post-tax measures, the result would be an alignment of the VIU with a FV configuration.

261 One CFSS member agreed with the reduction of costs but did not expect it to make the test significantly more robust.

Remove restriction to apply post-tax cash flows and discount rates

262 In general, stakeholders also agreed with the use of post-tax cash flows and post-tax discount rates in estimating VIU.

Would value in use estimates improve if post-tax cash flows and discount rates (compared to only pre-tax inputs allowed currently) are allowed in the estimate? *(30 responses)*	**Yes** 87%	**No** 13%
Of which: preparers	*27%*	*0%*
Of which: auditors	*47%*	*7%*

All the users agreed and the academics voted equally 'Yes' and 'No'. Almost all 'Yes' voters agreed that post-tax cash flows and post-tax discount rates are available and observable leading to reduced cost of executing the value in use calculation. Few of 'Yes' voters argued that the double counting risk from temporary differences which was the reason to introduce the requirement to use pre-tax information is still available when pre-tax information is used.

263 The participants of the German outreach event on 2 and 20 November 2020 agreed with the proposed simplifications relating to the post-tax cash flows and discount rate.

264 The majority of the respondents to the survey state that permitting post-tax discount rates and cash flows will reduce the complexity of the impairment test. Many of the respondents also believe that it will also reduce the cost. The majority of the respondents also believed that the proposed change would not trigger a risk of impairment losses going undetected due to double counting of tax cash flow in the estimation of the value in use. One preparer stated during an interview that their current software can cope with both pre-tax and post-tax numbers.

265 The preparers during the API meeting on 19 October 2020, three preparers during the Portuguese outreach event on 24 November 2020 and one preparer during a closed event on 1 December 2020 supported the use of post-tax inputs as these are more readily available. During an interview, one of these preparers added that the nominal tax rate needs to be used when post-tax cash flows are applied to avoid the use of a zero rate when previous losses are applicable. The preparers that are interviewed agreed that it would simplify the impairment test. One of them mentioned that it would increase the relevance as these items are already factored into the price agreed when acquiring a business. It would also contribute to reduce the gap between trading multiples and the results from the impairment test. One preparer noted that auditors already allow the application of adjusted post-tax cash flows and discount rates. A panellist (preparer) during the webinar on 9 November 2020, had concerns on the complexity regardless of pre- or post-tax information is used due to the use of nominal values instead of fair values. The panellist suggested that this point should be discussed when IAS 12 is reviewed.

266 One user at the API meeting on 19 October 2020 also supported the proposal to allow post-tax figures as preparers conduct post-tax evaluation. Furthermore, both pre-tax and post-tax are expected to have the same outcome since the implied tax-rate is derived by considering the post-tax outcome. The user explains that post-tax figures will not lead to under-recognition of impairments because companies already estimated their tax rates which would be applicable to their cash flows in the following years.

Using one model to calculate recoverable amount

267 At the API meeting on 19 October the appropriateness of the fair value less cost of disposal and the VIU has been discussed. The members expressed the following views:

a) User – Goodwill consists of the consideration paid beyond the value of the assets of a business. Therefore, it is counterintuitive to apply fair value when goodwill is an accounting construct with an entity-specific value. Even the fair value of a CGU would be hypothetical, because selling the whole CGU is not realistic. The user prefers the VIU to determine the recoverable amount.

b) Valuer – The restrictions of IAS 36 on cash flows is confusing. US GAAP is more straightforward accounting only for the fair value. The valuer preferred the fair value less cost of disposal as the VIU could lead to overly optimistic forecasts. He acknowledged that market information is not always observable, and in those cases, entities need to estimate, document and explain market assumptions used in the fair valuation.

c) Preparer – Noted that fair value is considered a transaction-based value and not a model-derived value (VIU), the latter depending on entity-specific assumptions. Applying entity-specific assumptions simpler than estimating market assumptions. However, in some cases he agreed that fair value is more appropriate. He added that goodwill can only tested in conjunction with other assets, which makes it impossible to apply the fair value to goodwill.

Other proposals to further simplify the impairment test

268 One standard setter suggested an additional proposal to further simplify the impairment test by permitting cash outflows related to the lease liability (IFRS 16 Leases) in the VIU calculation. In France, local GAAP already permits including the cash flows from lease liabilities in the impairment test. A further simplification could be to clarify the inclusion or not of lease liabilities in the CGU and the impact on the cash flows to be included in the impairment test.

269 The participants of the German outreach event on 2 and 20 November 2020 agreed with the IASB's view that there are no further simplifications possible.

Questions for EFRAG TEG

270 Does EFRAG TEG have comments or questions on this summary?

Question 12 - Intangible assets[11]

271 In general, stakeholders agreed with the preliminary views of EFRAG and the IASB not to develop proposals that allow some intangible assets to be included in goodwill.

272 The participants of the German outreach event on 2 and 20 November 2020 noted that goodwill can consist of different underlying assets and therefore separate recognition could be useful.

<u>Preparers</u>

273 Respondents to the survey research see benefits in recognising intangible assets acquired in a business combination separately from goodwill but find it very complex and costly.

274 The preparers expressing their views during the API meeting on 19 October, confirmed the benefits of separately recognising intangible assets. One of these preparers added during an interview that some intangibles, like customer

[11] Question 12 of the IASB's discussion paper

relationships, are complex to capture and value, therefore adding to the carrying amount of goodwill would be favoured.

275 A preparer during an interview explained that separate recognition provides information on what the entity paid for in the acquisition distinguishing between the payment for the business and future benefits. Another preparer mentioned during an interview that currently, they recognise brands separately and do not find it costly. The usefulness of separate recognition is confirmed by a third preparer during an interview. Another preparer supported the current approach of separate recognition and explained that they obtain the fair value from an external party. Lastly, a preparer mentioned that intangibles are separately recognised and amortised if it is a wasting asset and if it is not wasting it is added to the carrying amount of goodwill.

<u>Users</u>

276 The users who expressed their views during the API meeting on 19 October, also confirmed the usefulness of separate recognition of intangible assets. One user preferred separate recognition of intangible assets to clearly convey a company's rationale behind an acquisition. Other users noted that some intangible assets like customer lists could be eligible to be included as part of goodwill and some not.

277 On the other hand, the users who expressed their views during the User Panel meeting on 19 November 2020 agreed in general that the separate recognition of acquisition related intangible assets, not being goodwill, involves a lot of judgment and complexity. Therefore, it is considered to have limited value. One of these users opted for immediate standard-setting measures during a closed User event on 3 December 2020. According to him, currently, the separate recognition of intangibles is used by companies to bring the goodwill number down and amortise the intangible asset, which results in reducing the equity and increasing the return on capital.

278 At the User Panel meeting on 19 November 2020, one member opted for simplifying the approach to acquisition related intangible assets by applying the regular recognition criteria to these intangible assets which makes it more difficult to separately recognise. Another member explained that in practice the acquisition price actually relates to expected future cashflows instead of paying, for example, for specific customer contracts, meaning that it is more appropriate to present it as goodwill. One member noted that the cash flows from the intangible assets often cannot be identified separately from the cash flows from the general business. He argued that intangible assets should only be separately recognised if its cash flows can be identified separately. He added that in his experience intangible assets are never sold separately, but always sold together with the goodwill, confirming that separate recognition is not appropriate.

279 Another user commented that there is no reason to change the current approach on intangible assets and no reason to review IAS 38 during the closed user event on 3 December 2020.

<u>Other stakeholders</u>

280 One auditor at the FIWG meeting on 5 October 2020 responded that if amortisation of goodwill is reintroduced, including intangibles in goodwill will result in even more frontloading of the amortisation expense. Another auditor at the IAWG meeting on 15 October also supported separate recognition of intangible assets since it maintains the accounting experience which is built in the last 20-30 years around acquisitions.

281 One of the auditors who expressed their view during the FIWG meeting on 5 October 2020 agreed with the need to address the accounting for intangibles separately during the agenda consultation of the IASB (agreeing with EFRAG proposal in DCL).

282 During the IAWG meeting on 15 October one academic noted that intangible assets have some importance to investors. Intangibles can be amortised while goodwill cannot under current requirements. The academic agreed with the current requirement to separately recognise intangible assets from goodwill.

Question 13 - Convergence with the FASB[12]

283 The participants of the German outreach event on 2 and 20 November 2020 supported the convergence with the FASB however noted that it should not be an overarching principle.

Preparers

284 All of the preparers who expressed their view during the Business Europe meeting on 22 September 2020 favour a convergence between the IFRS Standards and US GAAP. According to one of these preparers, divergence could lead to complex reconciliations by investors to cope with fundamental differences in the treatment of goodwill leading to confusion. Another preparer at the API meeting on 19 October agreed with convergence, but not as the main goal.

285 During an interview, one preparer had strong concerns that divergence will create competitive disadvantage where a preparer carries-out a significant portion of its business in the US.

286 One preparer mentioned in an interview that in practice having different accounting requirements between the two legislations could result in an unlevelled playing field when competitors price an acquiree. However, theoretically, if both amortisation and impairment test are performed well the total impact of both should be the same when an impairment occurs. Another preparer explained during an interview that reintroducing amortisation will not have an effect on acquisition prices unless amortisation was deductible and generated a tax shield and the accounting between the jurisdictions differ. Lastly, one preparer stated that reintroducing amortisation will have a negative impact on the acquisition prices and the number of transactions. The preparer added that competitive disadvantage might occur for companies that are required to amortise compared to companies that are required to apply the impairment test.

287 One respondent to the survey agreed with the statement that convergence with US GAAP should prevail over more relevant and/or reliable information. Information is expected to be more useful if there is convergence between the IFRS Standards and US GAAP.

Users

288 In general, users agreed at the IAWG meeting on 19 October that convergence is important but the clarity of IFRS standards is more important.

Auditors

289 During the EFRAG FIWG meeting, one auditor agreed that alignment with the FASB is important to ensure a leo field. However, convergence should not be the main goal of the project.

Standard setter

290 One standard setter agrees with EFRAG’s position that convergence should be aimed for but should not be a pre-condition for an IFRS. The IFRS standards should be developed based on inputs from all stakeholders. Any convergence issues should be discussed at the end of the process.

[12] Question 13 of the IASB’s discussion paper

Questions for EFRAG TEG

291 Does EFRAG TEG have comments or questions on this summary?

High-level summary

292 An overview of the feedback so far in comparison to the DP and EFRAG DCL:

Topic	DP	EFRAG DCL	Feedback received
Improving disclosures about acquisitions			
• Strategic rationale and objectives for acquisition • Based on information received by… • Location	Proposed CODM FS	Agrees A level lower than CODM Undecided	• Significantly mixed views: Preparers generally concerned about commercial sensitivity and feasibility. Others support the proposals. • Preparers: CODM. Users: mixed. Auditors: mostly CODM • Preparers and auditors: forward-looking information in management commentary; rest in FS. Users: FS
Disclose if cease monitoring after two years	Proposed	Disagrees, should be three years	Preparers: Not a relevant lapse of time due to either integration or longer time needed to achieve objectives. NSS: some are concerned for the feasibility of the disclosure based on integration. In one case, mixed views within jurisdiction have been reported.
Expected benefits	Proposed	Agrees	Preparers: may impact competitiveness
Whether acquisition is meeting the objectives	Proposed	Agrees	Preparers: disagree with proposals generally. Users consider very useful
Synergies • Description • Expected timing • Expected amount or range	Proposed	Agrees	Preparers: difficult to estimate, may be longer term in nature, impact of planned disposals. Management commentary. Users: very important NSS: other components such as work force and skills not addressed
Enhancing current IFRS 3 disclosure requirements			
Pro-forma information • Guidance? • Replace ‘Profit or loss’ with ‘operating profit before acquisition-related transaction and integration costs’ • Operating cash flows	Retain Proposed Proposed	Principles for new concepts Agrees Disagrees	• Preparers: No further guidance required • Preparers: No, undefined terms Auditors: Complex • Disagree
Goodwill impairment and amortisation			
Effectiveness of current impairment test (allocation and reallocation)	No change proposed	Agrees, but guidance on allocation of goodwill to CGUs and alignment with expected benefits	Preparers: majority no further guidance; some consider EFRAG suggestions as useful (partly depends how rebuttable presumption can be rebutted) Users: Mixed views (partly because whether can this solve the problem?) Auditors: A majority agree with better guidance. Balance between doing several tests and avoiding impairment due to shielding

			Others: Some agreement
Effectiveness of current impairment test (management over-optimism)	No change proposed	Agrees, but several disclosures were proposed to address management over-optimism	Preparers: per polling questions – majority considers these disclosures would be useful. Survey responses - consider disclosures to be commercially sensitive and difficult to implement. Users: Important to improve disclosures Auditors: A majority consider that these disclosures could provide discipline. Reconciliation of market cap to book value might help.
Amortisation of goodwill	No	Not yet a view	Strong support for reintroduction Few discussed a component approach
Presentation of equity before goodwill	Proposed	Disagrees	Mixed views, but limited feedback
Simplifying the impairment test			
Indicator-only approach	Proposed	Disagrees unless with goodwill amortisation	Mixed views with some more support from preparers and opposition from users and auditors in general.
Simplifications of VIU calculation: • Post-tax inputs • Restructurings • Enhancements to assets	Proposed	Agree, but additional guidance for restructuring cash flows	Agreement with post-tax inputs Preparers support other changes with other stakeholders less positive.
Additional simplifications: • Guidance inputs for FVLCD • One method only • Testing at reportable segments	No change proposed	Agrees, but further guidance on allocation of goodwill to CGUs	Mixed views on using one-method only. User prefers VIU, valuer prefers FVLCD and preparer suggests both could be applicable depending on the specific circumstances. No input on other items.
Intangible assets			
Inclusion of intangibles in goodwill	No	Proposed for second phase of project with revision of IAS 38	Most agree with IASB proposal; some auditors support EFRAG about phase two.
Convergence with FASB			
Convergence of IFRS Standards with USGAAP	Requests input	EFRAG view not dependent on convergence but IASB's view could be influenced by FASB's current work	Almost all support convergence but not main goal.

293 Inputs received in response to questions from either the IASB or EFRAG:

Questions to constituents in DCL	**Feedback received**
Preparers: Concerns about stating that not monitoring an acquisition?	
Commercial sensitivity	Significant concerns
Preparers: How costly would it be for you to prepare the information? Would you have concerns about the reliability of the information?	Given lack of common approach or methodology for synergies could impair comparability.

Preparers: Are there any legal constraints to disclosing information?	To have lawsuits as a consequence of giving the disclosures was expressed several times.
Preparers: Can you remove from KPIs the effects of the PPA[13]?	Can be very complex and costly
Preparers: Costs relating to including cash flows from operating activities in pro-forma information. Would this be feasible if business is fully integrated with no separate accounts?	Would not be feasible and it is often the case.
Should impairments be reversed - specifically for those in the interim financial statements?	Polling question during the Danish outreach event: Majority should not be allowed.
New evidence to support goodwill amortisation?	Continuously growing goodwill balances; Covid-19 and lack of impairments.
Users: would goodwill amortisation be added back?	Maybe, one provided the message the standard setter should not care. Users do that with other costs as well depending on the understanding of the business.
Age of goodwill: useful and feasible?	Mainly supported (limited feedback), some preparers highlighted moderate costs with others consider it to be insignificant. Large groups with regular disposals and reallocations will not be able to provide the information.
Indicator-only approach: reduction in confidence and other implications? Would there be significant cost savings?	Preparers: survey indicates insignificant savings Overall: concerns about reduction in know-how/ increase of overoptimism and some concern about missing information
Concerns on use of post-tax inputs?	None identified, but one preparer asked for guidance
Intangibles: benefits/concerns of including in goodwill?	No benefits identified, few users referred to missing reliability for separate recognised intangibles
Importance of convergence with US GAAP in this debate	Mixed views: concerns about level-playing field; secondary objective, i.e., not most important

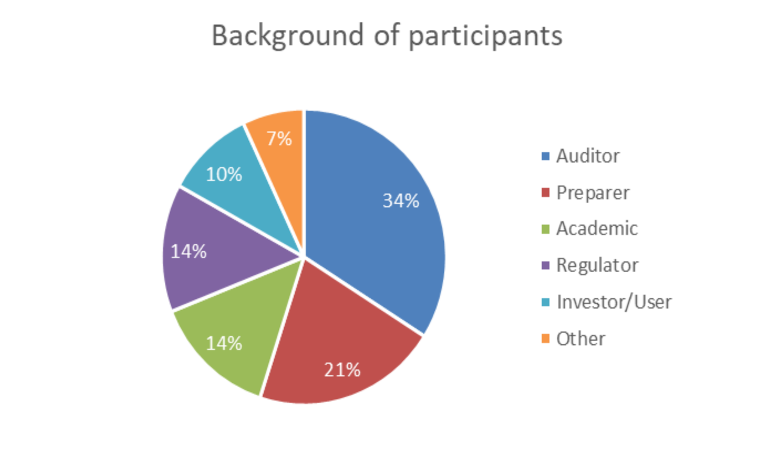
Questions for EFRAG TEG

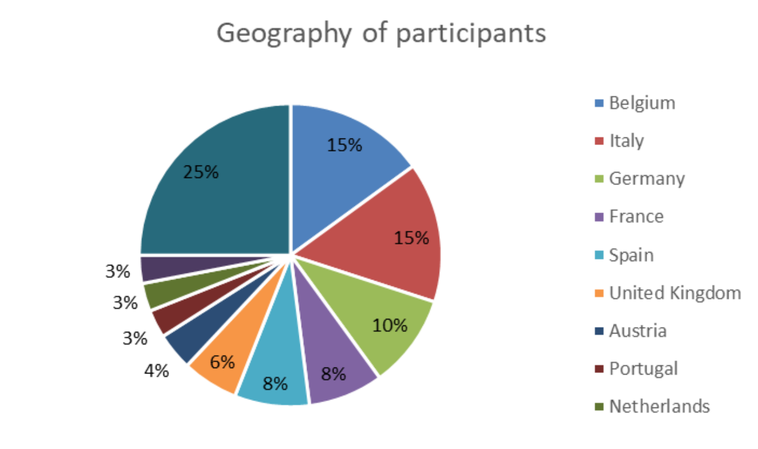
294 Does EFRAG TEG have comments or questions on this summary?

[13] Purchase Price Allocation done on acquisition and includes items such as recognition of intangibles not previously recognised by the acquiree or other fair value adjustments to the assets and liabilities of the acquiree.

Appendix 1: Profile of webinar attendees

For the event on 16 October 2020, the following reflects the profile of participants:





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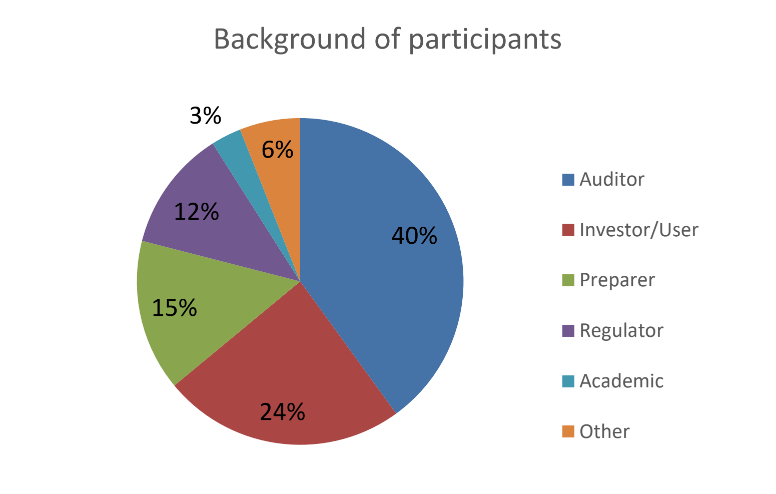
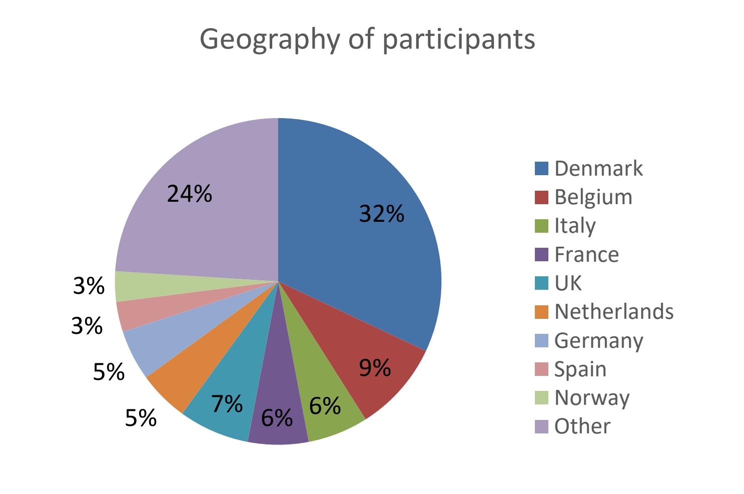
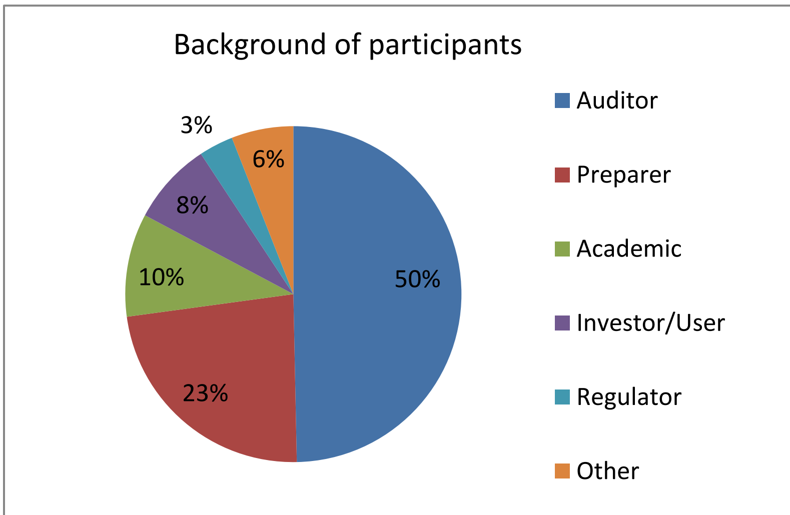
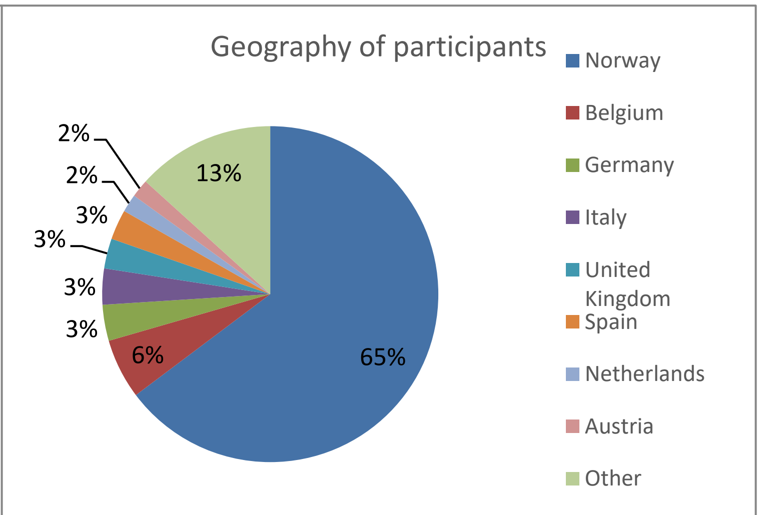


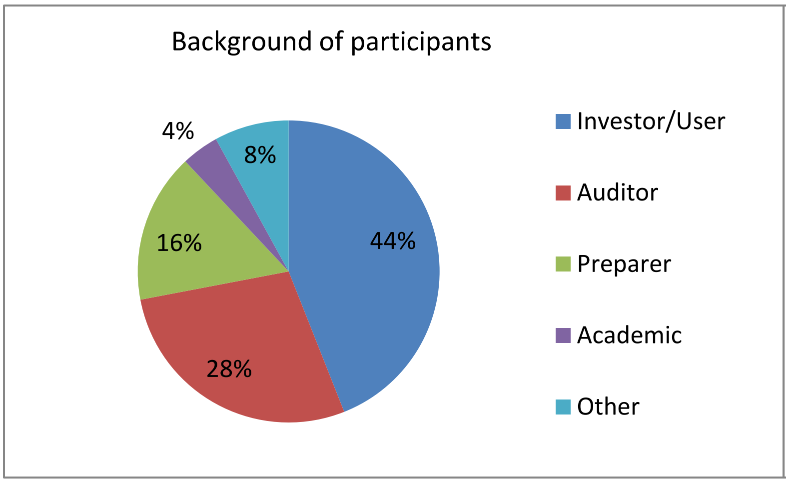


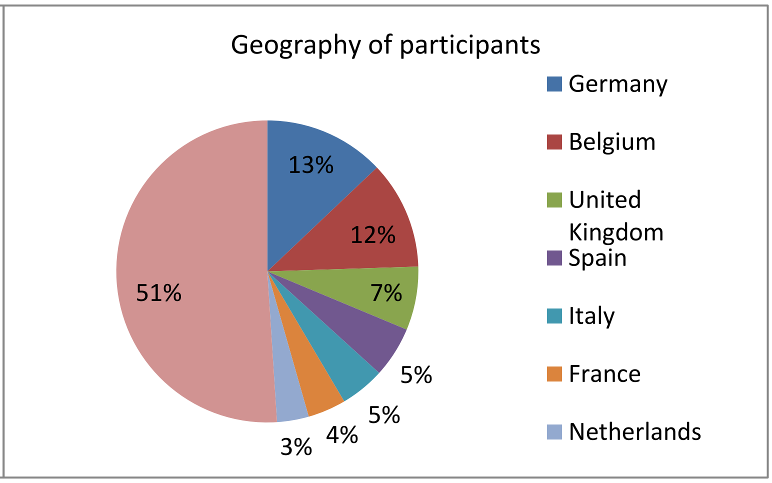
The following reflects the profile of participants at the webinar on 9 November 2020:



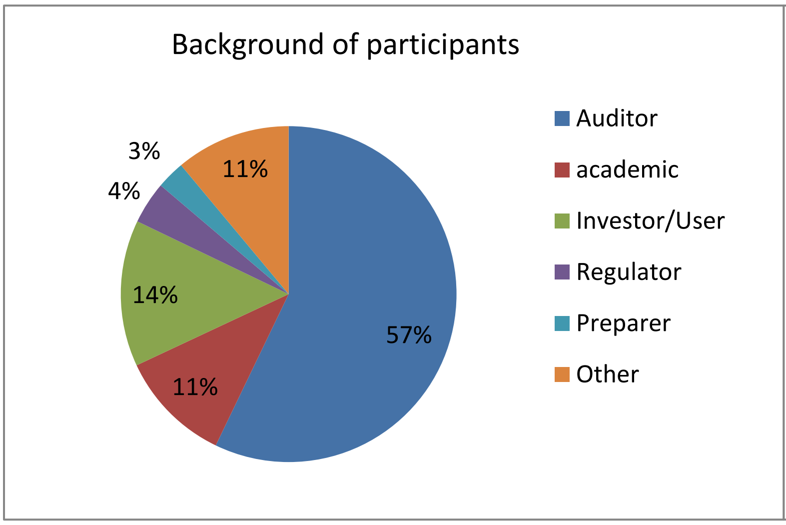


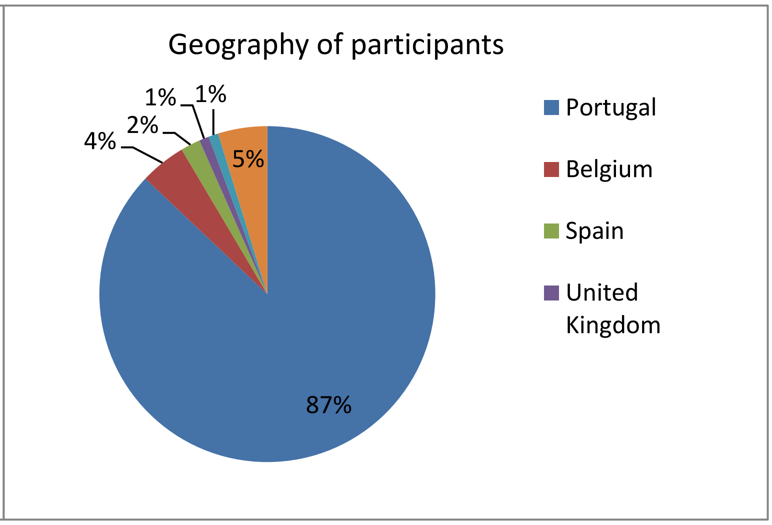
The following reflects the profile of participants at the webinar on 12 November 2020:





The following reflects the profile of participants at the webinar on 24 November 2020:





Appendix 2: Previous FASB consideration on componentisation approach

295 This appendix provides a summary of the FASB's considerations relating to the componentisation approach of goodwill as presented in the Exposure Draft *Business Combinations and Intangible Assets – Accounting for Goodwill* ('ED'), issued on 7 September 1999 and revised on 14 February 2001. This revision included the significant decision to change the accounting for goodwill from an amortisation to an impairment-only approach. The summary given in this appendix relates to the revised ED.

296 The 1999 ED included a breakdown of goodwill in the following components:

(a) Component 1—The excess of the fair values over the book values of the acquired entity's net assets at the date of acquisition.

(b) Component 2—The fair values of other net assets that were not recognised by the acquired entity for the following reasons:

i. as they failed to meet the recognition criteria (perhaps because of measurement difficulties),

ii. the recognition was prohibited, or

iii. because the entity concluded that the costs of recognising them separately were not justified by the benefits.

(c) Component 3—The fair value of the "going concern" element of the acquired entity's existing business. This represents the ability of the established business to earn a higher rate of return on an assembled collection of net assets than would be expected if those net assets had to be acquired separately. That value stems from the synergies of the net assets of the business, as well as from factors related to market imperfections. Such factors include the ability to earn monopoly profits and barriers to market entry—either legal or because of transaction costs—by potential competitors.

(d) Component 4—The fair value of the expected synergies from combining the acquiring entity's and acquired entity's net assets and businesses. Those synergies are unique to each combination, and different combinations would produce different synergies and, hence, different values.

(e) Component 5—Overvaluation of the consideration paid by the acquiring entity stemming from errors in valuing the consideration tendered. Although the purchase price in an all-cash transaction would not be subject to measurement error, the same may not necessarily be said of a transaction involving shares of the acquiring entity's stock. For example, if the number of shares being traded daily is small relative to the number of shares issued in the combination, imputing the current market price to all of the shares issued to affect the combination may produce a higher value than those shares would produce if they were sold for cash and the cash then used to affect the combination.

(f) Component 6—Overpayment or underpayment by the acquiring entity. Overpayment might occur, for example, if the price is driven up in the course of bidding for the acquired entity, while underpayment may occur in the case of a distress sale or fire sale.

297 The FASB noted that the following components are conceptually not part of goodwill:

a) Component 1 as it reflects gains that were not recognised by the acquired entity on its net assets.

b) Component 2 as it reflects intangible assets that might be separately identified and recognised.

c) Component 5 as it is a measurement error.

d) Component 6 as it represents a loss (overpayment) or a gain (underpayment).

298 The FASB noted that the following components are conceptually part of goodwill and consider them “core goodwill”:

a) Component 3 as it reflects the excess assembled value of the acquired entity’s net assets. It represents the pre-existing goodwill that was either internally generated by the acquired entity or acquired by it in a prior business combination.

b) Component 4 as it reflects the excess assembled value that is created by the combination, which reflects the synergies that are expected from combining their businesses.

299 The FASB acknowledged that, as a practical matter, it is not possible to separate the components as listed in paragraph 297 that are not conceptually part of goodwill, given the current state of art of measurement and given the fact that the fair values of some tangible and intangible assets cannot be measured reliably. As the 1999 Exposure Draft proposed, the FASB calls for efforts to avoid subsuming the fifth component into the amount initially recognised for goodwill and includes provisions for eliminating the fifth and sixth components by testing goodwill for impairment.

300 The 1999 ED noted that, conceptually, some of what is recognised as goodwill may have an indefinite useful economic life that could last as long as the business is considered a going concern. However, the FASB concluded that some of what is recognised as goodwill might have a finite useful economic life partly because goodwill is measured as a residual and may include components (representing assets or elements of assets) that are wasting assets and therefore should be amortised. Prior to issuing the 1999 ED, the FASB considered the component approach that would have required amortisation of the wasting portion of goodwill and non-amortisation of the nonwasting portion (that is, the portion with an indefinite useful economic life). However, the FASB concluded that segregating the portion of recognised goodwill that might not be a wasting asset from the portion that is a wasting asset would not be practicable.

301 The revised 2001 ED changed the measurement criteria for intangible assets that are acquired in a business combination. Previously, intangible assets that could not be reliably measured should be recognised as part of goodwill, but with the revision only intangible assets that do not have an underlying contractual or other legal base or are not capable of being separated and sold, transferred, licensed, rented, or exchanged be recognised as part of goodwill. It is noted that this revision would result in including intangible assets as part of goodwill that are more “goodwill like” in nature – that is, of the type that can be renewed of regenerated. Another consequence of the revision would be that the portion of recognised goodwill that might be wasting would be smaller. Thus, the FASB considered non-amortisation of all goodwill as potentially more appropriate in this case.