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Reflecting input received in EFRAG's comment letter Issues Paper

Objective

- 1 The purpose of this paper is to discuss how the input received in response to EFRAG's draft comment letter ('the DCL') in response to IASB's discussion paper *Business Combinations – Disclosures, Goodwill and Impairment* ('the DP').

Structure of this paper

- 2 This is structured as follows. First, the suggestions in relation to questions 2 – 14 in the DP are presented and then the suggestions in relation to Question 1 is presented.

Question 2 - The strategic rationale and management's objectives for an acquisition

- 3 The answer to Question 2 in the DCL includes the following sections:
 - (a) Introductory remarks
 - (b) Are the financial statements the right place for these disclosures?
 - (c) Would disclosure requirements resolve investors' need for better information on the subsequent performance of an acquisition?
 - (d) The specific disclosure proposals
 - (e) Basing the information provided on the information the entity's CODM reviews
 - (f) Commercial sensitivity
 - (g) Constraints that could affect an entity's ability to disclose the proposed information
- 4 The comments received and suggested changes are presented below for each of these sub-sections ((c) and (d) are combined and no comments are made for (a)).
Are the financial statements the right place for these disclosures?

The DP

- 5 The DP present the view that information about the strategic rationale, objectives and related targets for an acquisition is not forward-looking information. The information reflects management's target at the time of the acquisition.
- 6 The DP also present the view that companies should be required to disclose information about the strategic rationale, objectives and related targets in the financial statements. The DP states that not all companies produce a management commentary and not all management commentaries may be available to investors on the same terms as the financial statements. The DP expresses the view that all companies should provide this information on the same terms.

The DCL

- 7 The DCL consults on whether the information suggested information should be presented in the financial statements or in the management commentary. The DCL presents arguments in favour and against both alternatives.

Amendments to the DCL

- 8 The EFRAG Secretariat suggests the following amendments based on the input received:
- (a) The CL should state that the information on the strategic rationale should be disclosed in the notes to the financial statements. An entity can choose whether to present in the management commentary (if the entity would prepare a management commentary) or in the financial statements the information about the management's objective of an acquisition and the subsequent fulfilment of these objectives. If the information is placed in the management commentary, reference to the information in the management commentary should be included in the financial statements.
 - (b) Audit issues should be discussed by the audit profession to find the best way to solve the issues.

- 9 The reasons for the suggestions of the EFRAG Secretariat (and the reasons for not proposing other suggestions are included below).

Reasons for suggestions

- 10 At its 3 December 2020 meeting, EFRAG considered the input from outreach activities and a survey to preparers.
- 11 EFRAG TEG also noted that academic research indicates that placement of information matters. It is not only because it is audited but because users take the information in the financial statements more into account. In addition, management commentary might not be audited or to a lower degree.
- 12 At the same time, feedback from users, including when discussing with the Intangibles User Panel about better information on intangibles, shows that users consider as equally informative the information presented in management commentary, investors' presentations and earnings' announcements.
- 13 When comparing the presentation in the notes with the presentation on the management commentary, one should consider that presentation in the management commentary is voluntary in nature, so it will not provide for a comparable solution to the existing users' need to receive information about the subsequent performance of an acquisition.
- 14 From the survey of preparers, EFRAG conducted it appears that there is a preference among preparers to place the information in the management commentary instead of the financial statements. However, it appears that it is particularly the information about synergies and the objectives of a business combination (particularly, the assessment of whether these have been met) that is considered to be better placed in the management commentary.
- 15 At the 3 December 2020 EFRAG TEG meeting, some EFRAG TEG members considered that information related to the subsequent performance of an acquisition and forward-looking information should be included in the management commentary since it was conceptually more suitable. However, the view was also presented that the information should be included in the financial statements because, when information was spread over several places, it was less accessible to users.
- 16 The comment letters received express a general concern that the financial statements are not the right place for the disclosures although an enforcer prefers

all the information to be provided in the financial statements (but could also accept this could be by cross reference in order to avoid duplication). Three respondents from the financial sector note that providing the information outside the financial statements would reduce the risk of litigations based on the information.

- 17 Based on the input listed above, the EFRAG Secretariat suggests that the strategic rationale should be disclosed in the notes to the financial statements. An entity can choose whether to present in the management commentary (if the entity would prepare a management commentary) or in the financial statements the information about the management's objective of an acquisition and the subsequent fulfilment of these objectives. If the information is placed in the management commentary, reference to the information in the management commentary should be included in the financial statements (such an approach was also suggested by an association of auditors in a comment letter and is used in IFRS 7 *Financial Instruments – Disclosures*). EFRAG notes that an alternative could be to include the requirement in the Management Commentary practice statement. Under such an approach a general requirement to provide information about material acquisitions (and not only the acquisitions of businesses) could be introduced, as some find it illogical to only provide information on acquisitions of businesses and not on major asset deals or step ups. The EFRAG Secretariat, however, does not suggest such an approach as entities do not have to follow the guidance included in practice statements. If EFRAG TEG would also consider that disclosures should be provided for other acquisitions, the EFRAG Secretariat assesses that this could be done by amending other standards (for example, IAS 16 *Property, Plant and Equipment* or IAS 38 *Intangible Assets*). However, the EFRAG Secretariat considers that this would be outside the scope of this project.
- 18 At the 3 December 2020 EFRAG TEG meeting, one EFRAG TEG member noted that, if a cross-reference to the management commentary was included, this information would also have to be audited. However, another EFRAG TEG member noted that the issue of whether or not the information should be audited should not affect EFRAG's decision. Financial reporting requirements should not be based on audit requirements, it should be the other way around according to one EFRAG TEG member.
- 19 One respondent suggests that the IASB consults with the International Auditing and Assurance Standards Board (IAASB) to obtain input on the best way to solve the issue of auditability regarding many of the proposed disclosure that will be difficult to audit or it would be difficult to obtain adequate audit evidence. The EFRAG Secretariat would suggest including a similar comment that the audit issues should be discussed by the audit profession to find the best way to solve the issues.
- 20 The suggestions of the EFRAG Secretariat are reflected in the section: 'Are the financial statements the right place for these disclosures?' in the proposed comment letter.

'Would disclosure requirements resolve investors' need for better information on the subsequent performance of an acquisition?' and 'The specific disclosure proposals'

The DP

- 21 The DP suggests that an entity can stop monitoring whether the objectives of an acquisition have been met after two years, without disclosing this.

The DCL

- 22 The DCL discusses whether the DP would solve users' need for better information on acquisitions. EFRAG agrees with the DP that the information should be based on what is monitored internally. However, EFRAG also shares the concern expressed in the DP about the verifiability and notes that the disclosures would not

be particularly useful to assess reported goodwill. The DCL also noted that some of the requirements need clarification.

- 23 The DCL states that it should be disclosed if an entity stops monitoring whether the objectives of an acquisition have been met within the first three years following the acquisition.

Amendments to the DCL

- 24 The EFRAG Secretariat suggests the following amendments based on the input received:
- (a) The CL would provide an additional example illustrating that the proposals in the DP are not completely clear (an example in which an entity might have to disclose its complete budget) and in relation to that state that when clarifying the requirements, the IASB should have in mind that it would not seem to be appropriate to introduce a mandatory disclosure requirement that a reporting entity is not monitoring acquisitions while in reality it does but in a way which is aligned with its business approach and its organisational strategy and that an entity cannot reasonably be required to disclose all the information that the CODM reviews. However, the latter issue should be balanced against that of providing complete information
 - (b) State in the CL that it would be necessary to test the usefulness of the clarified disclosures with users based on 'real life' examples.
 - (c) Include in the CL an acknowledgement that the information suggested would not be sufficient to confirm whether the price of an acquisition was reasonable and whether an acquisition has been successful (because unforeseen events happen). However, the disclosure could form the basis for the entity providing further explanations about why the fact that, for example, objectives have not been met does not mean that an acquisition has not been a success and what unforeseen circumstances have played a role.

Reasons for suggestions

- 25 At its 3 December 2020 EFRAG TEG meeting, EFRAG TEG members considered whether the practical issues with providing the information would result in the information not being useful in practice.
- 26 The EFRAG Secretariat noted that users have been stating that they lack information to assess business combinations. It may be difficult to present other information that would be as relevant for this purpose as the information suggested in the DP. The 'other alternative information', the EFRAG Secretariat could consider could be useful for this purpose would be (financial) information about the acquired entity, that would allow users to better assess whether too much has been paid for the acquired entity (compared with the acquired entity's standalone value).
- 27 EFRAG TEG members agreed that information about the objectives of an acquisition and whether they have been met would result in useful information. Two EFRAG TEG members indicated that, while in principle these disclosures were useful, they have to be tested in practice. One EFRAG TEG member noted that whether or not the information would be useful would depend on the how the requirements are worded in practice. In that regard the EFRAG Secretariat also notes that there are some unclarity about the disclosure requirements. For example, one respondent notes that it is unclear how long the disclosure relating to the subsequent results of an acquisition should be provided. In the view of the EFRAG secretariat it appears from the DP that the information should be provided as long as it is monitored by the management. However, the EFRAG Secretariat considers that the DP is not clear on when it can be said that the effect of an acquisition is monitored. For example, it is unclear whether an entity would have to provide disclosures in the following case:

The entity acquires a business based on some expectations on, for example, profitability. The business becomes part of a business line (including several other businesses). A budget is made for the entire business line every year and the performance of the business line compared with the budget is monitored by the CODM every year. It is unclear whether in this case the budget for the entire business line would be covered by the requirements and should thus be disclosed every year.

- 28 The EFRAG Secretariat suggests amending the DCL to reflect that it is unclear how all the requirements should be interpreted (the example has been included in the section 'The specific disclosure proposals') and that it would be necessary to test the usefulness of the clarified disclosures with users based on 'real life' examples.
- 29 In this regard (in relation to the example provided above in paragraph 27), a respondent also notes that it would not seem to be appropriate to introduce a mandatory disclosure requirement that a reporting entity is not monitoring acquisitions while in reality it does but in a way which is aligned with its business approach and its organisational strategy. While another notes that when an acquisition is material to an entity, a respondent thinks that an entity cannot reasonably be required to disclose all the information that the CODM reviews.
- 30 The EFRAG Secretariat suggests adding a comment to the example, that when clarifying the requirements, the IASB should have in mind that it would not seem to be appropriate to introduce a mandatory disclosure requirement that a reporting entity is not monitoring acquisitions while in reality it does but in a way which is aligned with its business approach and its organisational strategy and that an entity cannot reasonably be required to disclose all the information that the CODM reviews. However, the latter issue should be balanced against that of providing complete information.
- 31 Two respondents consider that the IASB should require minimum disclosures such as estimates of consolidated revenues, operating profits, cost savings, net earnings and balance sheet items such as consolidated debt and ROCE, information about the estimated payback period, the expected profit arising from the integration of the new business(es) and the expected integration costs.
- 32 The EFRAG Secretariat notes that business combinations are made for various and different reasons and it could therefore be difficult to require standard information. For example, if the objective of an acquisition is to prevent a competitor from buying the business, it may be difficult to provide information about an estimate pay-back period. The EFRAG Secretariat accordingly suggests not to ask for minimum disclosures in EFRAG's comment letter.
- 33 One respondent notes that the information will not be comparable between entities. The EFRAG Secretariat agrees with this. However, it notes that that seems to be unavoidable as entities could have different objectives of an acquisition. The EFRAG Secretariat thus suggests not to reflect this comment in its comment letter. This is also consistent with the response from a user association that states that "Acquisitions' objectives are different and therefore comparability is not a key point."
- 34 Several respondents note that it is not possible to isolate and measure the initial objectives without taking into account operational issues (e.g. IT systems) or that information about the performance of an acquired business might not be possible because they are integrated in the existing business. It is the interpretation of the EFRAG Secretariat that an entity should only provide the information it already prepares to monitor an acquisition. Accordingly, it should not isolate and measure the initial objectives without taking operational issues into account, unless this is already done internally for monitoring the acquisition.
- 35 The EFRAG Secretariat agrees with the comment made in comment letters and at interviews with preparers that unexpected things occur and the new disclosure

requirements will thus not be sufficient to confirm whether the price of an acquisition was reasonable and whether an acquisition has been successful. However, the EFRAG Secretariat considers that the disclosure could form the basis for the entity providing further explanations about why the fact that, for example, objectives have not been met does not mean that an acquisition has not been a success and what unforeseen circumstances have played a role. The EFRAG Secretariat suggests including this reasoning in EFRAG's comment letter.

- 36 The EFRAG Secretariat notes that comment letters from users confirmed input received from the EFRAG User Panel and from other input received from users. In principle, users find the information useful, but are concerned about what information entities in practice will provide. In the comment letter from one user organisation, it seems as if information on how the financial statement figures will be affected would seem most useful. The EFRAG Secretariat, however, assesses that entities would be very reluctant to provide information on how a business combination will affect line items in the profit or loss account. For cost/benefit reasons, the EFRAG Secretariat accordingly suggests not including such a proposal in EFRAG's comment letter.
- 37 One respondent suggested that only metrics that can be measured (and audited) with sufficient reliability should be within the scope for quantitative disclosures. The EFRAG Secretariat notes that in relation to the disclosures of the objective of an acquisition, the figures that would be reported are figures that are used internally to monitor the business. It could therefore be assumed that the metrics would be measured with sufficient reliability. The EFRAG Secretariat accordingly suggests not including this comment in relation to Question 2. However, the comment could be relevant in relation to Question 4 on the information on synergies.
- 38 One respondent agrees with the DP that an entity can stop monitoring whether the objectives of an acquisition have been met after two years, without disclosing this.
- 39 The EFRAG Secretariat notes that in its interviews with preparers, different answers were presented, and the time it takes to integrate a business varies. However, it was noted that sometimes it would take more than two years. In a comment letter from an association of users, it is noted that experience indicates that a company might take between two years and 3 years to fully integrate an acquisition. The EFRAG Secretariat thus suggests not to amend EFRAG's response that an entity should disclose if it stops monitoring an acquisition before three years after the year of the acquisition (instead of the two years suggested in the DP). No information has been received that such a disclosure should be costly for preparers.
- 40 Another respondent] thinks that an entity should stop providing disclosures about whether it is meeting its objectives only when the synergies expected to derive from the acquisition have been realised or when those objectives have been abandoned. The EFRAG Secretariat notes that this could result in the management would be required to provide disclosures it is difficult to provide because of restructurings. In addition, for the assessment of the management's stewardship the information may not be relevant as the management could have changed by that time. The EFRAG Secretariat accordingly suggests not including this comment in EFRAG's comment letter.

Basing the information provided on the information the entity's CODM reviews

The DP

- 41 The DP suggested that the information provided should be based on the information the chief operating decision maker ('the CODM') monitors.

The DCL

- 42 The DCL stated that the information should be based on what is monitored at a lower level.

Amendments to the DCL

- 43 The EFRAG Secretariat suggests the following amendments based on the input received:
- (a) Amend the CL to state that if an acquisition is material, information about it should be provided based on the information used to monitor the acquisition internally by the relevant decision maker. The relevant decision maker may correspond to the CODM or to a lower level, depending on the entity's strategy and organisation.
 - (b) State in the CL that in case the company undertakes many small acquisitions (as part of an overall strategy) which are monitored together and are material for the assessment of stewardship the IASB should consider whether these should be included in the scope of the proposals, and if so, how they could be included.

Reasons for suggestions

- 44 At its 3 December meeting EFRAG TEG noted that during outreach activities, EFRAG received limited support for its proposal. It was often suggested that the information should be based on what is monitored by the CODM or by using a general materiality threshold. EFRAG TEG noted that basing the information on the information monitored by the CODM could result in not so material information should sometimes be disclosed.
- 45 Some EFRAG TEG members agreed to consider the relevant decision maker as the reference person for disclosures (it may correspond to the CODM or to a lower level). One member suggested including an explanation of the approaches and rationale in the comment letter. Another member added that the materiality of a transaction and not the level of monitoring was important.
- 46 Responses in comment letters on this issue are mixed. An association of users specifically supports the view expressed in the DCL, but there is a significant portion supporting the CODM level suggested in the DP, but also some suggesting a lower level. It is mentioned that a benefit of basing the information on a lower level is the better alignment with the level at which the impairment test is performed.
- 47 Therefore, the EFRAG Secretariat proposes that if an acquisition is material, information about it should be provided based on the information used to monitor the acquisition internally by the relevant decision maker. The relevant decision maker may correspond to the CODM or to a lower level, depending on the entity's strategy and organisation.
- 48 In case the company undertakes many small acquisitions (as part of an overall strategy) which are monitored together and are material for the assessment of stewardship the IASB should consider whether these should be included in the scope of the proposals, and if so, how they could be included. In this regard, in order to avoid entities having to disclose information about future acquisitions (which would be commercially sensitive) the EFRAG Secretariat suggests specifying that an entity would not have to make disclosures about intended future acquisitions when describing the objectives of the acquisitions.
- 49 The EFRAG Secretariat considers that such an approach could, to some extent, address both the concern of those fearing that information that is not material would have to be disclosed and those concern about insufficient information being provided if it would be based on what the CODM monitors.
- 50 The EFRAG Secretariate notes that one respondent considers that at least some key disclosures should be required for all the acquisitions which generate a material amount of goodwill, regardless of whether they are monitored by the CODM. However, the EFRAG Secretariat notes that 'key disclosures' would be difficult to

define as the purpose of acquisitions can be very different. The EFRAG Secretariat accordingly suggests not included that proposal.

Commercial sensitivity

The DP

- 51 The DP presented the view that commercial sensitivity is not a sufficient reason to prevent disclosure of information that investors need.

The DCL

- 52 The DCL noted that a balance needed to be struck between providing users with useful information and providing commercial sensitive information.

Amendments to the DCL

- 53 The EFRAG Secretariat requests the input of EFRAG TEG on how the DCL should be amended on this issue.

Different suggestions

- 54 At its 3 December 2020 EFRAG TEG meeting, EFRAG TEG members were split on how to deal with commercial sensitivity. Some did not think that there should be included guidance on this issue. Others thought that commercial sensitivity should be taken into consideration. It was therefore agreed to consider two alternatives:
- (a) Not considering commercial sensitivity;
 - (b) Including a comment that the IASB should consider how to address commercial sensitivity and provide examples of different paths it could consider (without presenting a position on this). One of the paths that could be considered was term a 'comply or explain plus' approach. Under this approach an entity that would not provide information because the information would be considered commercial sensitive would have to provided other information. Another approach mentioned was that the IASB should amend its disclosure requirements so that commercial sensitive information would not be disclosed.
- 55 At outreach activities commercial sensitivity was mentioned as an issue, for external and internal reasons. Similarly, most respondents also considered it to be an issue. Even a user organisation has replied that it would support a 'disclose or explain' approach. However, there were different views on how often the requirements proposed could result in commercial sensitive information being disclosed.
- 56 Some respondents also mentioned that the disclosure requirements could put them in a disadvantageous position compared with companies applying another GAAP.
- 57 As a general remark, a user organisation provided in its comment letter information that would be useful on an acquisition. This list included: clear information about the price; information about what has been bought and better stub period disclosure (i.e. the period after the last audited balance sheet but before the date of first consolidation by the new owner. This period is usually not visible, and investors should be informed if any unusual accounting events have occurred in this period, such as asset impairments, changed creditor terms, debt drawdown, altered contract provisions etc. In our experience, stub periods are sometimes used for creative accounting).
- 58 If EFRAG TEG would choose the approach explained in paragraph 54(b) above, the EFRAG Secretariat suggests:
- (a) Including that entities may be particularly reluctant to disclose commercial sensitive information if this information is not disclosed by entities applying other requirements for financial reporting (see paragraph 56 above); and

- (b) Including the information mentioned in paragraph 57 above as an example of information the IASB could consider requiring under a 'comply or explain plus' approach or as alternatives to the information suggested by the IASB.

59 In the outlined draft comment letter, the suggestion described in paragraph 54(b) is reflected in the section 'Commercial sensitivity' in the response to Question 2. If EFRAG TEG would choose the approach in paragraph 54(a) this section would be removed (and the references to commercial sensitivity in other parts of the comment letter would also be removed).

Questions for EFRAG TEG

- 60 Which of the approaches mentioned in paragraph 54 would EFRAG TEG prefer?
- 61 If EFRAG TEG would prefer the approach mentioned in paragraph 54(b), does EFRAG TEG agree with the recommendations in paragraph 58 and how the response has been reflected in the recommended comment letter in the section 'Commercial sensitivity'?

Constraints that could affect an entity's ability to disclose the proposed information

The DP

62 The DP asked constituents whether there are any constraints in jurisdictions that could affect a company's ability to disclose the proposed information.

The DCL

63 The DCL stated that is not aware of any constraints within the European Economic Area that could affect an entity's ability to disclose the information proposed in the DP and a question to constituents was included.

Amendments to the DCL

64 EFRAG has not received any replies stating that there would be constraints that could affect an entity's ability to disclose the information proposed. The EFRAG Secretariat accordingly suggests not amending the answer on this issue provided in the DCL.

Other issues

65 Additional issues were raised in comment letters to EFRAG. The paragraphs below explain why the EFRAG Secretariat does not suggest including these in EFRAG's CL.

66 Two respondents from the financial sector note that in regulated industries users would already receive sufficient information that would enable them to assess whether an acquisition is successful. The requirements would accordingly add unnecessary costs. The EFRAG Secretariat, however, notes that for international standards to be beneficial for users, it would be beneficial that all companies applying those standards provide the same information irrespectively of the other filings these entities are doing based on local or regional legislation. The EFRAG Secretariat accordingly suggests not reflecting this comment in EFRAG's comment letter.

67 One respondent believes that the IASB should further explore whether failure to meet the reported objectives should be linked to, and have an effect on, the impairment testing. If objectives are not met, there could be a rebuttable presumption of impairment (under an impairment only model). The EFRAG Secretariat notes that it is difficult to introduce a rebuttable presumption of impairment as this could mean that an impairment loss would be recognised even if the value in use would exceed the recoverable amount. To rebut the presumption could be burdensome, as the unit of account for goodwill relates after the acquisition

to the allocation level according to IAS 36 paragraph 80. Goodwill could be allocated to different cash generating units. The EFRAG Secretariat only considers that the fact that the objectives have not been met would be an indication of an impairment. The EFRAG Secretariat accordingly proposes not to include this comment in EFRAG's comment letter.

- 68 One respondent notes the potential difficulties for entities to communicate on a change in their metrics. Users may interpret such a change as an acknowledgement of a subpar performance, a strategic shift or management's uncertainty. Management could obviously give background information about the reasons underlying this change. The EFRAG Secretariat considers the concern to be valid, but is not able to provide any further directions for the IASB. Accordingly, the EFRAG Secretariat suggests not including the comment in EFRAG's comment letter.

Questions for EFRAG TEG

- 69 Does EFRAG TEG agree with the suggestions included in paragraphs 8, 24, 43, 64, 68?
- 70 Does EFRAG TEG consider that there are other comments that should be reflected in EFRAG's comment letter?

Question 3 – Disclosure objectives

The DP

- 71 The DP proposes, in addition to proposed new disclosure requirements, proposals to add disclosure objectives.

The DCL

- 72 The DCL supported the introduction of the disclosure objectives, should the proposed information be included in the notes to the financial statements.

Amendments to the DCL

- 73 The EFRAG Secretariat suggests amending its answer to reflect that some of the information can also be provided in the management commentary. In addition, the EFRAG Secretariat suggests that the objectives should focus more on the objectives of an acquisition rather than the benefits that a company expects.

Reasons for suggestions

- 74 In its response to the DP, EFRAG was unsure whether the financial statements were the right place for the disclosures. The answer was based on the assumption that it was. Following the suggested amendments to the answer to Question 2, the EFRAG Secretariat suggests making consequential amendments to the answer to Question 3.
- 75 A respondent agrees with the objectives but considers that an alternative approach to this issue should be considered in relation to highly regulated sectors, such as the banking sector. At present, banks inform about the management's specific objectives for an acquisition to the market as at the acquisition date. The requirement to include that information in the notes of the financial statements would, according to the respondent, provide limited benefits and would increase costs. The EFRAG Secretariat, considers that for international standards to be beneficial for users, it would be beneficial that all companies applying those standards provide the same information irrespectively of the other filings these entities are doing based on local or regional legislation.

- 76 4 respondents support the objective. However, the one of these notes that the disclosure objectives appear to focus on the benefits 'expected from an acquisition when agreeing the price to acquire a business' where, instead of focusing the disclosures should be on governance and accountability. This includes providing information to understand the objective of an acquisition and how that is being met which is useful for users. The EFRAG Secretariat considers this comment to be valid and accordingly suggests stating in EFRAG's response that the disclosure objective should focus on the objectives of an acquisition (which includes the benefits expected) rather than just on the benefits expected.

Questions for EFRAG TEG

- 77 Does EFRAG TEG agree with the suggestions included in paragraph 73?
- 78 Does EFRAG TEG consider that there are other comments that should be reflected in EFRAG's comment letter?

Question 4 – Synergies, liabilities arising from financing activities and defined benefit pension liabilities

Synergies

The DP

- 79 The DP proposes that companies should be required to disclose, in the year an acquisition occurs, some detailed information about synergies (i.e. a qualitative description, when they are expected to be realized, their estimated amount or range of amount and the estimated cost or range of cost to achieve them).
- 80 Such a proposal is aimed to address investors' concern that the current requirement for a company to provide a qualitative description of the factors that make up goodwill often results in generic descriptions that are not useful.

The DCL

- 81 The DCL considered that the suggested disclosures could be useful. However, EFRAG stated that it had not yet formed a view about whether the proposed disclosures should be placed in the financial statements or in the management commentary. EFRAG also mentioned some reservations about the practical aspects and the costs-benefits balance of the proposed disclosures.
- 82 EFRAG also considered that the proposed disclosures could be helpful if provided for other elements of goodwill and that a different type of materiality thresholds could be introduced for the information on synergies.

Amendments to the DCL

- 83 The EFRAG Secretariat suggests that, similar to the proposals discussed in Question 2 (see paragraph 8(a)), an entity would be able to choose whether to present in the financial statements or in the management commentary the proposed information about synergies. If the information is placed in the management commentary, reference to the information in the management commentary should be included in the financial statements.
- 84 The EFRAG Secretariat also suggests mentioning potential challenges expected when providing quantitative information on synergies. Among others, it recommends including suggestion to the IASB to further clarify how they consider the disclosures to be provided, and what 'synergies' encompass.

Reasons for suggestions

- 85 Reasons underlying the suggestions on the appropriate placement for the information are similar to those summarised from paragraphs 10 to 20.
- 86 Specifically, on synergies, 83% of the respondents to the preparers' survey preferred proposed disclosures to be included in the management commentary mainly due to inherent complexities in preparing the information (see paragraphs 123 - 125).
- 87 The same preference was reflected in the comment letters received. Both preparers and standard setters considered the management commentary, that is the document where management would naturally describe its strategies and objectives, as the most appropriate place for the proposed disclosures (that mainly consists of management views, assumptions and strategies).
- 88 At the 3 December 2020 meeting, some EFRAG TEG members considered impracticable, or at least highly difficult, to provide the proposed quantitative disclosures. In particular, while this information is generally expected to be available as part of the M&A process, it would be difficult to have it translated into a meaningful accounting number.
- 89 The above argument was also supported by the majority of preparers and standard setters providing their comment letters, while an auditor suggested that preparers should be exempted to provide the expected amounts of synergies (and costs to be incurred for their achievement) if such information has not been gathered through the M&A process.
- 90 However, two other TEG members considered that most of the information is already available at the acquisition date in a reliable shape as part of the due diligence process, especially when subjected to an extensive internal scrutiny by the entity's governing body.
- 91 A comment letter received from a user organisation stressed the importance for investors to have quantitative information about revenues and cost synergies.
- 92 The EFRAG Secretariat believes that the proposed requirements should be flexible and based on a qualitative level, or on high-level quantitative only, unless the information are easily available to preparers as part of their M&A processes. If not collected as part of the due diligence process, the information could be also deemed to be less relevant in the context of a specific acquisition, or more complex to be reliably determined, so it would risk resulting in boiler-plate information.
- 93 At the 3 December 2020 meeting, one TEG member added that it was not only purely a question of measurement, but also about the synergies currently not being clearly defined.
- 94 The above argument has also been mentioned in three comment letters, that highlighted that there is not a single definition on the concept of synergy and guidance how it should be estimated. Increasing the comparability between companies will therefore be more complex to achieve. One of these respondents suggested that the IASB clarifies the intended basis of the information to be disclosed: a standardised approach or a management approach. If a standardized approach is followed, requirements should be as specific as possible, including:
- (a) defining 'synergies'
 - (b) specifying whether 'estimated amount or range of amounts of the synergies' relates to synergies in total or to each type of expected synergy
 - (c) clarifying if a detailed pattern of synergy realisation by type (or in total) or simply a timeframe by type (or in total) should be disclosed.

In addition, the respondent considers that it should be clarified whether the disclosures should be based on management's synergy expectations in the deal process or after closing of the transaction.

- 95 The EFRAG Secretariat considers that it could be useful if the IASB would further clarify how they consider the disclosures to be provided, and what 'synergies' encompass. The EFRAG Secretariat accordingly suggests amending EFRAG's comment letter on this issue. However, the EFRAG Secretariat considers that it appears from the DP that the synergies that are proposed information are those anticipated as of the date of the transaction as the disclosure requirements are suggested under the heading 'Factors that make up goodwill'.

Information for other elements of goodwill and a different materiality threshold

The DP

- 96 While the IASB considered that it would continue to require companies to provide a qualitative description of other factors that make up the goodwill recognised, the proposed extensive disclosures only focus on synergies (refer to paragraph 79).
- 97 The DP requires the information to be provided for all acquisitions with material expected synergies.

The DCL

- 98 The DCL considered that the proposed information could be also provided for other elements that constitute goodwill.
- 99 If such additional requirement at paragraph 98 would not be introduced, the EFRAG preliminary position was that a different materiality threshold should be set for the information on synergies so that it would be provided in a manner that could provide users with information about the size of the remaining parts of goodwill.

Amendments to the DCL

- 100 The EFRAG Secretariat suggests confirming the preliminary view that similar disclosures for other components of goodwill could equally provide useful information.
- 101 The EFRAG Secretariat also suggest confirming that a different materiality threshold should be set for information on synergies compared to the one currently provided in the DP.
- 102 No changes compared to the preliminary positions are accordingly suggested on this issue.

Reasons for suggestions

- 103 Many of the standard setters and regulators providing comment letters supported EFRAG preliminary view that similar disclosures for other components of goodwill could equally provide useful information. Some of them considered that businesses can be acquired by management for several reasons beyond synergies, such as the increase of market share or product development/research, access to technologies, etc. Accordingly, synergies are not always the main objective for management to acquire businesses and therefore these proposals will not always be helpful to hold management accountable for the acquisition.
- 104 The above argument was also included in a comment letter received from a preparers' organisation.
- 105 One other standard setter considered that restricting the scope of disclosures to synergies may also prevent the information to meet users' needs regarding goodwill analysis.

- 106 Few instances from comment letters also evidenced concerns that providing the disclosures on some of the other components of goodwill may be challenging, as well as in relation to the costs-benefits relationship.
- 107 The EFRAG Secretariat still believes that the relevance of synergies and/or other components that make up goodwill depends on the specific circumstances. For example, an insurance company participating in EFRAG's survey to preparers considered the penetration of new market as one of the key drivers for an acquisition. Furthermore, a software provider mentioned technologies and future technologies as a driver as well. On that basis, the objective of providing information that gives investors with better information of why a company paid the price it did for the acquired business can be only achieved by requiring companies to provide information about all the material elements of goodwill on a case-by-case basis.
- 108 The EFRAG Secretariat also still believes that, if the same requirement would not be proposed for other components of goodwill, a different materiality threshold should be set for information on synergies compared to the one currently provided in the DP. That would be mainly aimed to capture into the disclosure requirements circumstances where a range of synergies may not be material when reported in isolation, but the goodwill itself was material for the price paid for the acquired business. In such circumstances, it would provide investors with useful information about the size of remaining parts of goodwill, such as intangible assets that do not qualify for separate recognition.
- 109 A comment letter received from an enforcer suggested that the IASB could explore whether it would be appropriate to require issuers to disclose information relating to amounts of goodwill which are *individually* non-material but collectively material.
- 110 Some comment letters expressed the view that synergies should only be disclosed for acquisitions monitored by the CODM. In this regard, a better alignment of these proposals was suggested to avoid a loss of consistency in the information communicated as a whole.
- 111 The EFRAG Secretariat does not see any reason why synergies should only be disclosed for those acquisitions monitored by the CODM. The disclosure requirements suggested in the DP that relate to what the CODM monitors are also based on the specific information the CODM is monitoring. The requirement on synergies is a specific requirement – and does not relate to whether the CODM is monitoring these or not. The requirement is an attempt to provide information on what goodwill consists of, and not primarily whether an acquisition has been successful or not. The EFRAG Secretariat accordingly does not suggest including this comment in EFRAG's comment letter.

Practicability and cost/benefit aspects

The DP

- 112 The DP acknowledged that stakeholders are concerned that synergies are often difficult to be quantified. However, it expects that management would have already made an estimate of the expected synergies in agreeing the price for an acquired business.
- 113 The DP also considered the information to have limited commercial sensitivity and not being forward-looking information.

The DCL

- 114 The DCL questioned whether the benefits of providing the disclosures on synergies would outweigh the costs. EFRAG also welcomed further assessments of the practicability of the requirements, including the information would be reliable, auditable and commercial sensitive.

- 115 In relation to commercial sensitivity, in the overall Section 2, the DCL noted that a balance needed to be struck between providing users with useful information and providing commercial sensitive information.

Amendments to the DCL

- 116 The EFRAG Secretariat requests the input of EFRAG TEG on how the DCL should be amended regarding the commercial sensitivity of proposed disclosures on synergies (see paragraphs 60 - 61 above).
- 117 The EFRAG Secretariat suggests mentioning that the proposed disclosure would be beneficial for investors in a manner that would outweigh costs, provided that the required information is already available to the entity as part of the M&A process. If not, flexibility should be given to entities to limit the disclosures to qualitative or high-level information only. As already proposed in paragraph 84, the EFRAG Secretariat suggests commenting that further clarification on how the IASB considers the disclosures to be provided, and what 'synergies' encompass, should be included.

Reasons for suggestions

- 118 The commercial sensitivity issue has been discussed, both at the 3 December 2020 EFRAG TEG meeting and during outreach events, in the context of the overall disclosures proposals included in the Section 2 of the DP.
- 119 Specifically on synergies, outreach events showed that preparers reported a general consensus about the expected synergies on revenues being highly sensitive from a commercial point of view. While some others considered that they are already disclosing information to the market about cost synergies (not in the financial statements but instead through presentations and press releases), cost synergies may also trigger confidentiality issue especially under an internal perspective (i.e. synergies achieved by part of the workforce becoming redundant).
- 120 However, users' feedback from both the outreach events and the comment letter showed that, even if recognising the need to find an appropriate balance between investor needs and preparers willingness to disclose this information, they considered companies often leveraging the caption of "sensitiveness" to avoid providing information that in fact is not that sensitive.
- 121 The EFRAG Secretariat believes that this issue should be considered in the context of the commercial sensitivity of the overall disclosure requirements discussed in the Section 2 of EFRAG's Draft Comment Letter. Therefore, proposals and underlying reasons for suggestions are those included at paragraphs from 54 to 59. In particular, the EFRAG Secretariat requests the input of EFRAG TEG on how the DCL should be amended on this issue.
- 122 Under a cost-benefit perspective, some of the TEG Members at the 3 December 2020 meeting considered most of the required information to be easily available to an entity as a result of the M&A process. This information is also subject to an extensive level of internal scrutiny, and then it is deemed to be produced in a way that would be reliable and auditable.
- 123 However, some others considered that, even when available, it would be difficult to have it translated into a meaningful accounting number. It was also recognised that management might be reluctant to accept the responsibility of providing this information, as well as the complexity of its quantification leading to concern on the auditability.
- 124 Preparers providing feedback through the survey and other outreach events broadly considered the proposed disclosure, when considered under a quantitative perspective, to trigger a significant technical complexity, incremental costs and to involve an undue level of management responsibility (in line with some of the other disclosures requirements proposed in the DP). However, users considered this

information as one of the most relevant in a business combination that currently lack of enough disclosures to investors.

- 125 Comment letters received mostly showed the same positions. Preparers broadly considered that the information to be provided are forward-looking in nature, consists of projections, estimates and management assumptions, are difficult to be subjected to an audit and trigger incremental costs and management risks that outweigh benefits. Users opined some of the arguments raised by preparers for the disclosures being considered as too complex (i.e. the lack of available data due to quick integration of the existing business), as well as they confirmed it is urgent that users would be provided with this information to assess the contribution of the combined entity to the total value of the business.
- 126 Comment letters showed more balanced views from standard setters, regulators and auditors. While most of them recognised the relevance of the proposed information, only few respondents considered it as triggering additional costs that would outweigh benefits. However, many of them considered that the disclosure would be limited to qualitative information. One respondent suggested that a preparer would be required to disclose the full information only if it has been gathered in the deal process and, as such, it would be easily available.
- 127 The EFRAG Secretariat believes that the proposed information is beneficial for investors, and these benefits are generally considered to outweigh costs. However, as already stated in paragraph 92, the proposed requirements should be flexible and based on qualitative information, or on high-level quantitative information, unless the information are easily available to preparers as part of their M&A processes.
- 128 One comment letter included suggestion that the IASB would consider proposing disclosures of subsequent changes in the initial synergy expectations. The EFRAG Secretariat notes that information about this will be provided (indirectly) if the CODM monitors synergies. If the CODM does not monitor synergies, the EFRAG Secretariat considers that the information might be considered useful, but:
- (a) It would also result in an additional cost for preparers;
 - (b) It would not any longer explain factors that goodwill consists of (as although the synergies would decrease goodwill might not because of shielding and headroom);
 - (c) It would conflict with the view of EFRAG that the disclosures of a success of an acquisition should be based on what the management of the entity is monitoring.

The EFRAG Secretariat accordingly suggests not including this comment in EFRAG's comment letter.

Liabilities arising from financing activities and defined benefit pension liabilities

The DP

- 129 The DP proposed to specify that liabilities arising from financing activities and defined benefit pension liabilities are major classes of liabilities.

The DCL

- 130 The DCL supported the IASB's proposal.

Amendments to the DCL

- 131 The EFRAG Secretariat considers that no changes are needed to its preliminary position.

Reasons for suggestions

- 132 Most of the respondents across all categories of constituents supported the proposal as providing useful information to investors and being easily available to preparers.
- 133 Few respondents expressed some concerns on the proposal:
- (a) In some jurisdictions, defined benefit plans are being phased out, and liabilities are normally settled as part of the acquisition; and
 - (b) It would result in a duplication of information to be provided, as similar requirements are already embedded in other IFRS Standard (i.e. IAS7.44B; IAS19).
- 134 The EFRAG Secretariat suggests not including this comment in EFRAG's comment letter based on the following reasons as in cases where these liabilities are settled as part of the acquisitions, they would not be recognised and therefore no disclosures would be necessary. However, in many jurisdictions, they may not be phased out.
- 135 The EFRAG secretariat agrees with the argument in the DP that, based on current requirements, the proposed information is not separately disclosed, when material, for each single acquisition.

Questions for EFRAG TEG

- 136 Does EFRAG TEG agree with the suggestions included in paragraphs 83 - 84, 100 - 102, 117 and 131 and how these have been reflected in the proposed comment letter?
- 137 Does EFRAG TEG consider that there are other comments that should be reflected in EFRAG's comment letter?

Question 5 – Pro forma information

The DP

- 138 The DP proposed:
- (a) To replace the term 'profit or loss' in paragraph B64(q) of IFRS 3 with the term 'operating profit before deducting acquisition-related costs and integration costs'.
 - (b) To add a requirement to disclose cash flows from operating activities of the acquired business after the acquisition date, and of the combined business on a pro forma basis for the current reporting period.

The DCL

- 139 The DCL supported retaining the requirement to disclose pro forma information, to the extent practicable and replacing the term 'profit or loss' with 'operating profit before deducting acquisition-related costs and integration costs'. It was suggested to provide a principles-based definition for the new concepts of 'acquisition-related' and 'integration cost'.
- 140 The DCL did not support the IASB proposal to provide information for cash flows from operating activities as the usefulness of this information would be very limited.
- 141 The DCL questioned whether it would be more useful to present as pro forma information further modified figures than 'operating profit before acquisition-related transaction and integration costs' which would also exclude the effects of the purchase price allocation (revaluations to fair value of the assets and liabilities of the acquired entity).

Amendments to the DCL

- 142 The EFRAG Secretariat suggests the following amendments based on the input received:
- (a) Including a reference to paragraph 53 of IFRS 3 Business Combinations when asking for guidance on what constitute 'acquisition costs'.
 - (b) Adding as an argument for not supporting that cash flows from operating activities should not be provided, that the information would not be relevant for the financial sector.
 - (c) Removing the suggestion in the DP that entities should present further modified figures that in addition to excluding acquisition-related transaction and integration costs would also exclude the effects of the revaluations to fair value.

Reasons for suggestions

Should pro forma figures be provided?

- 143 The EFRAG Secretariat notes that some respondents do not think the current requirements on providing pro forma information should be maintained. These respondents argue that the information is not used or is not useful as it is hypothetical and related with practical problems.
- 144 The DCL acknowledges that the information is 'hypothetical information' but argues that the information is useful as trend information about an entity's financial performance is important for users. The EFRAG Secretariat agrees that there are practical problems related to preparing the information and acknowledges that the issue on the pro forma figures has not been the issue that has resulted in most feedback from users. The latter could indicate that it is not considered to be the most important information for users. The EFRAG Secretariat, however, notes that there have been some comments from users on the issue and that EFRAG in the DCL argues why the information is useful. The EFRAG Secretariat accordingly suggests maintaining the position expressed in the DCL that the information should be provided (unless impracticable).
- 145 One respondent considers that the pro forma information should be limited to those acquisitions monitored by the CODM. As the EFRAG Secretariat suggests that the information that would be disclosed should not be based on what the CODM monitors, it follows that the EFRAG Secretariat would also not suggest reflecting this comment.

Guidance on how to prepare pro forma figures

- 146 Some respondents ask for more guidance on how to prepare pro forma figures. However, as noted in the DCL, and also noted by a respondent, the information would be non-GAAP information and, as such, subject to judgement.
- 147 An alternative to providing more guidance on how the information should be prepared, that is mentioned by some respondents, is to require entities to disclose the methods they apply. The EFRAG Secretariat notes that the DCL similarly suggests the IASB to ask entities to provide explanations about the judgement applied in the preparation of the pro forma information.

Operating profit before deducting acquisition-related costs and integration costs

- 148 At its 3 December 2020 meeting, it was noted that not much input had been received from outreach activities on whether the term 'profit or loss' should be replaced with 'operating profit before deducting acquisition-related costs and integration costs'.
- 149 The comment letters received express mixed views. The EFRAG Secretariat notes that some preparers support the proposal, although one organisation of preparers

prefers to allow entities to present what they think is the most appropriate. The proposal is supported by some standard setters, but other standard setters are concerned that the change will not be applied consistently. In that regard, the EFRAG Secretariat notes that EFRAG in its comment letter suggests that some principle-based guidance is provided on what to consider as acquisition costs or integration costs and that the current 'profit or loss' figure is also not (always) considered to be the 'profit or loss' as calculated under IFRS. In addition, some of the complications (for example, related to financing costs) with calculating the 'profit or loss' figure would be removed when basing the information on the operating profit or loss. The EFRAG Secretariat accordingly suggests maintaining the position in the DCL that EFRAG supports replacing the term 'profit or loss' with 'operating profit before deducting acquisition-related costs and integration costs'.

- 150 One respondent notes that 'acquisition-related costs' are well-defined in paragraph 53 of IFRS 3. The EFRAG Secretariat suggests including a reference to that paragraph when EFRAG asks for guidance on what constitute 'acquisition costs'.

Cash flows from operating activities

- 151 Based on the input received from outreach activities EFRAG TEG decided preliminary at its 3 December 2020 meeting to retain the view that pro forma information on cash flows from operating activities would not be particularly useful (without further information on working capital, which could be costly to prepare).
- 152 A couple of respondents considered that the information would be useful, but more respondents thought that it would not be useful and costly to prepare. However, some of these respondents came from the financial sector (in which cash flow information is of limited use). One respondent considered that the information could be useful, but it would be costly to prepare.
- 153 Based on this input, the EFRAG secretariat suggests maintaining the position that the information would not be particularly useful and adding as an argument for not supporting that cash flows from operating activities should not be provided, that the information would not be relevant for the financial sector.

Further modified figures

- 154 At its 3 December 2020 meeting, EFRAG TEG discussed the feedback received from outreach activities in response to its proposal to present as pro forma information further modified figures than 'operating profit before acquisition-related transaction and integration costs' which would also exclude the effects of the purchase price allocation (revaluations to fair value of the assets and liabilities of the acquired entity). The input received did not support such a requirement and the EFRAG Secretariat suggested not to include this proposal in EFRAG's final comment letter.
- 155 In line with this one EFRAG TEG member suggested that the proposal to exclude the effects of the revaluations to fair value from pro forma information could be applied on the voluntary basis when entity considers relevant.
- 156 Very limited feedback has been received in comment letters on this issue. One respondent notes that to increase the comparability and understandability it might be considered by the IASB to prepare the pro forma information without the effects of the purchase price allocation. However, this requires significant changes in the current principles for business combinations in IFRS 3.
- 157 The EFRAG Secretariat accordingly suggests removing the suggestion from the DP.
- 158 Four respondents agree to replace the metric profit or loss with operating profit as ultimately defined by the standard following from the ED *General Presentation and Disclosure* whilst one disagrees.

- 159 A few comment letters commented on the exclusion of acquisition-related and integration costs with two disagreeing with the proposal given the absence of definitions and two respondents agreeing with the proposal subject to guidance.
- 160 The views on the need for additional guidance on the preparation of pro forma information was split: four to four. Some are concerned that additional guidance would disrupt current practices but some mention that the disclosure of the basis of preparation may already improve the usefulness of the information. Others suggest guidance about the objectives for the information. The IASB is also recommended to leverage current European market regulations in this regard.
- 161 Four respondents (like the DCL) disagree with the usefulness of the proposed cash flow metric with two respondents considering that it would help users in their cash flow analysis.

Questions for EFRAG TEG

- 162 Does EFRAG TEG agree with the suggested amendments proposed in paragraph 142 and how these have been reflected in the proposed comment letter?
- 163 Does EFRAG TEG consider that other comments should be reflected in EFRAG's comment letter?

Question 6 – Improving the impairment test

The DP

- 164 The IASB is investigating whether it is feasible to make the impairment test for cash-generating units containing goodwill significantly more effective at recognising impairment losses on goodwill on a timely basis. The IASB's preliminary view is that it is not feasible. The two main reasons for concerns about the possible delay in recognising impairment losses on goodwill are management overoptimism and the 'shielding effect'.

The DCL

- 165 EFRAG had reservations on the possibility to develop a different and more effective impairment approach. However, EFRAG believed that there were areas of improvements such as the guidance on goodwill allocation to CGUs and better disclosures on estimates. EFRAG agreed with the reasons for concerns about the possible delay in recognising impairment losses on goodwill identified by the IASB.

Amendments to the DCL

- 166 Based on the inputs received the EFRAG Secretariat suggests:
- (a) retaining the position reflected in the DCL on the guidance to allocate goodwill to the cash generating units.
 - (b) Include disclosures suggested by EFRAG in its DCL acknowledging that there could be some implementation issues and reflecting the main concerns raised by constituents so that the IASB could further explore. Suggest the IASB whether additional disclosure requirements to those of paragraph 134 of IAS 36 can be added or how paragraph 134 of IAS 36 can be adjusted. In addition or as an alternative to the proposed disclosures to make the overoptimism transparent, suggest the IASB to develop additional guidance on what is a "reasonable and supportable" cash flow projection (IAS 36 paragraph 33).
 - (c) Include suggestions for the IASB to explore whether guidance for identification of impairment testing trigger events could be improved, especially if the indicator only approach is adopted.

Reasons for suggestions

- 167 At its 3 December 2020 EFRAG TEG meeting, EFRAG TEG members agreed to retain the current proposals included in the DCL regarding the improvement on the guidance to allocate goodwill to the cash generating units and on the improvement on disclosures subject to the commercial sensitivity matter discussed in paragraphs 51 to 59 of this paper.
- 168 The feedback obtained from outreach events differ mainly between preparers and other respondents like users, auditors and standard setters or regulators. While preparers are mainly reluctant to improve the guidance on allocation or reallocation of goodwill and to provide additional disclosures, such proposals were appreciated by other groups of respondents. A few constituents highlighted that impairment test could be improved through better guidance and transparency on triggering events.
- 169 A majority of the comment letters received from constituents agrees with EFRAG that the guidance on the allocation and reallocation of goodwill in CGUs could be improved as this could reduce shielding to a certain extent and reduce the judgment currently allowed in (re) allocating goodwill to CGUs. Comment letters do not broadly support the adoption of additional disclosure requirements to reduce the risk of management over-optimism. Those in favour of additional disclosures suggest that the IASB explore additional disclosures mainly on assumptions used in cash flow estimates.
- 170 Two comment letter indicates that the IASB could investigate providing further disclosure requirements in addition to those in paragraph 134 of IAS 36. Improvements on assumptions such as terminal values and the growth rate used in the projected period on which cash flow projections are based, are explicitly mentioned. Another comment letter requires similar to a panellist during a Webinar more guidance on what is a "reasonable and supportable" cash flow projection (IAS 36 paragraph 33). It explicitly seeks guidance on matters such as expected link between cash flow predictions and external evidence, expected link between capital expenditures and revenues or margin forecasts, the types of risk that should be included in the discount rate and how to reflect the less optimistic scenarios in cash flow predictions.
- 171 A majority of the constituents involved in the various outreach events and providing comment letters consider too optimistic estimates as one of the main reasons for not recognising impairment losses on goodwill on a timely basis. Therefore, the EFRAG Secretariat considers appropriate to evaluate the introduction of disclosure requirements as an alternative to mitigate this issue. During the various outreach events some constituents (mainly preparers) argued that these disclosures would be costly to prepare as well as commercial sensitive information. In addition, the 'back-testing' disclosure suggested by EFRAG in its DCL could lead to wrong messages, if forecasts are not reached. Acknowledging that some of these disclosures might have implementation issues, we consider that the IASB should explore the disclosures alternative to reduce the risk of management over-optimism. In relation to the proposal from a constituent of obtaining additional guidance on what is a "reasonable and supportable" cash flow projection (IAS 36 paragraph 33) we consider that it merits to explore as long as the principle-based approach of the standards is not compromised.
- 172 The EFRAG Secretariat considers that the IASB should explore improvements on the guidance for identification of impairment testing trigger events such as a more granular set of indicators or the requirement to disclose the assessment made by the company that results in the impairment test not being performed if the indicator only approach is adopted.

Other matters

- 173 A constituent comment letter suggests that components of goodwill that relates to a particular legal entity, such as deferred-tax-goodwill ("Technical goodwill") and employees should be kept at that entity level for impairment testing purposes. Another comment letter suggests that wasting components of goodwill should be identified and measured separately and thereafter de-recognised when their useful life end.
- 174 This suggestion is highly related to question number 7 of the DP and the existence of different components of goodwill (wasting or non-wasting elements) The EFRAG Secretariat considers that to the extent that goodwill componentisation is not considered in the financial statements for other purposes such as amortisation purposes or disclosures requirements, it would not merit to introduce these concepts for impairment testing purposes as it would create inconsistencies throughout the financial statements and add confusion.
- 175 A constituent comment letter considers that It would be helpful for the IASB to provide further guidance on the notion of 'largely independent' cash flows. In its view the standard does not sufficiently explain what it takes for cash flows to be independent. In addition, explaining what is meant by "benefit from synergies" and "monitoring of goodwill" would be helpful.
- 176 The EFRAG secretariat notes that in the various outreach events carried out with the different stakeholders no questions were raised about the definitions of cash generating units or about the possibility that there might be widespread delays in the recognition of impairments as a consequence of an incorrect definition of cash generating units. In relation to the "monitoring of goodwill" concept, the EFRAG Secretariat considers that it is difficult to provide further definition as each entity has its own approach to monitoring goodwill. In this regard, the EFRAG Secretariat considers not to add these suggestions to its FCL. However, during the various outreach events some constituents shared their concern about the definition of 'synergies'. As such, we may include in our FCL a suggestion for the IASB to provide a definition of 'synergies' (see question 4 of this paper).
- 177 In a comment letter from a preparer, it is indicated that paragraphs 138 to 140 and 150 of the IAS 36 basis for conclusions already provides useful guidance on the main issues with regards to the allocation and reallocation of goodwill to CGUs. The EFRAG secretariat considers that the abovementioned paragraphs do not provide information significantly different from that included in paragraphs 80 to 87 of the IAS 36.

Questions for EFRAG TEG

- 178 Does EFRAG TEG agree with the suggested amendments proposed in paragraph 166 and how these are reflected in the proposed comment letter?
- 179 EFRAG TEG requested the EFRAG Secretariat to inquire about potential disclosures to reconcile market capitalisation and the book value of net assets or the sum of the recoverable amounts? Does EFRAG TEG considers that this should be included in the FCL?
- 180 Does EFRAG TEG consider that other comments should be reflected in EFRAG's comment letter?

Question 7 – Reintroduction of goodwill amortisation

The DP

- 181 The preliminary view of the IASB is that it would not be possible to make the impairment test significantly more effective at recognising impairment losses on goodwill on a timely basis. Also, it is the preliminary view of the IASB is that it should

not reintroduce amortisation of goodwill and instead should retain the impairment-only model for the subsequent accounting for goodwill.

The DCL

182 In its DCL EFRAG did not form a view on whether amortisation of goodwill should be reintroduced, in combination with an impairment requirement, or whether no major changes to the current accounting for goodwill is justified. EFRAG was seeking views from constituents regarding new evidence, new arguments or new assessment on the existing evidence to support a change.

183 EFRAG also questioned if reporting the age of goodwill would be considered useful.

Amendments to the DCL

184 The EFRAG Secretariat requests the input of EFRAG TEG on how the DCL should be amended on this issue.

Different suggestions

185 A majority of participants in EFRAG's outreach events as well a majority of comment letters received have been in favour of reintroduction of amortisation of goodwill.

186 The respondents agreed with the IASB conclusion that impairment model was not working as intended and cannot be improved at a reasonable cost, thus amortisation was considered a practical solution. From conceptual point of view respondents considered goodwill to be a wasting asset which should be amortised to reflect its consumption.

187 The amortisation would also provide a mechanism to eliminate increasing goodwill balances from the balance sheet, that, as some argue, do not reflect the incremental value of the acquired business a couple of years after acquisition. It would avoid the volatility in profit or loss caused by impairment charges.

188 Some of the respondents acknowledged that both approaches had their advantages and disadvantages and absence of the new compelling evidence to support one of them.

189 A few respondents, mostly user organisations, were in favour of keeping the existing impairment model on the grounds that the impairment test was the only conceptually correct model, that problems lied within its application and that it provided relevant and useful information to users and investors. These respondents also noted that no new arguments were provided to justify a change. In their view the impairment model worked as intended and no significant facts or circumstances were identified that would lead to reconsider the conceptual arguments.

190 There was also a proposal of accounting policy choice between amortisation and impairment model and the proposals against such a choice as negatively impacting comparability between the entities.

191 The EFRAG Secretariat considered the variety of responses received with the arguments for and against the reintroduction of amortisation and concluded that, although amortisation model has arguably less strong conceptual basis compared to impairment-only model, it does have significant advantages in terms of simplifications of goodwill accounting, addressing 'too little too late issue', improving comparability between entities growing organically and by acquisition, absence of procyclical effects.

192 The reintroduction of amortisation will take pressure away from the impairment test and would allow to simplify and improve it as described in EFRAG's response to the Question 6 above. Many respondents suggested that amortisation of goodwill should be accompanied by either an indicator-only impairment model or by annual quantitative impairment test. Such approach would be consistent with the current accounting for other intangible assets.

- 193 The EFRAG Secretariat doubts that an impairment-only model could be significantly improved at a reasonable cost and that proposed new disclosure requirements would be sufficient to address all the identified shortcomings.
- 194 Feedback received suggested that management could estimate the useful life based on a goodwill consumption pattern or the payback period of the investment and the amortisation pattern - on the basis of the realisation of the expected synergies. The rebuttable presumption of 10 years amortisation period in line with EU Accounting Directive can be used, if the useful life cannot be reliably estimated in particular circumstances. Straight-line amortisation could be used as a pragmatic, transparent and cost-effective solution.
- 195 EFRAG received mixed feedback on whether the new MPM will be created to add back goodwill amortisation expense and on the usefulness of providing the age of goodwill.
- 196 The EFRAG Secretariat also acknowledges arguments supporting the impairment-only model, such as that goodwill is non-wasting asset and an indicator for the value of the future free operating cash flows and future economic benefits, some of which can have indefinite lives (like access to markets for example). It is part of "invested capital" and determines whether a reporting entity is profitable or not.
- 197 The impairment test holds management to account, better reflects the economic reality and the stewardship and accountability objective of financial reporting whereas an amortisation charge is an arbitrary value which has no value relevance and will be ignored by investors.
- 198 It should be noted that the cost of changing the existing model is likely to be high and the cost-benefit analysis of the switch to amortisation should be carried out before making a decision. The transitional arrangements such as retrospective or prospective application should be discussed.
- 199 The detailed responses can be found in the Comment Letter Analysis paper.
- 200 Therefore, the EFRAG Secretariat proposes to EFRAG TEG to consider two options of a response to this controversial question:
- Option 1 – If not possible to improve impairment test – choose amortisation*
- 201 EFRAG acknowledges the conceptual and practical arguments for both the impairment-only model and the reintroduction of amortisation and notes that more and more voices are raised in favour of the latter. However, acknowledging conceptual strength of the impairment model, EFRAG suggests the IASB further explore improvements to existing impairment test. Should the IASB reach a conclusion that the proposed improvements could not address the identified existing shortcomings of the impairment model at a reasonable cost, EFRAG is of view that the amortisation of goodwill should be reintroduced. The amortisation should be accompanied by the indicator-only impairment model.
- Option 2 – Choose amortisation*
- 202 EFRAG acknowledges the conceptual and practical arguments for both the impairment-only model and the reintroduction of amortisation and notes that more and more voices are raised in favour of the latter. EFRAG agrees with the IASB conclusion that the existing impairment test cannot be significantly improved at a reasonable cost and considers that the proposed new disclosure would not be sufficient to address the identified shortcomings. Therefore, EFRAG is of view that the IASB should consider the reintroduction of goodwill amortisation as a simple, transparent and cost-effective solution. The amortisation should be accompanied by the indicator-only impairment model.

Question to EFRAG TEG:

- 203 Would you recommend for consideration to the EFRAG Board Option 1 or Option 2? Or would you request the EFRAG Secretariat to change the papers to Option 3 to retain the impairment-only approach because there was no compelling new evidence to introduce a change? Could you please explain why?
- 204 Do you agree with the comments in relation to useful life if amortisation is reintroduced (estimation with a cap)?
- 205 Do you consider that EFRAG should propose the IASB any transitional requirements or leave this for the phase of the project as that was not specifically addressed during outreach?

Question 8 – Total equity excluding goodwill subtotal

The DP

- 206 The DP suggests presenting total equity excluding goodwill as a free-standing item on the statement of financial position.

The DCL

- 207 In its DCL EFRAG did not support this proposal.

Amendments to the DCL

- 208 At its 3 December EFRAG TEG meeting, EFRAG TEG supported the direction suggested by the EFRAG Secretariat, which was to maintain the position expressed in the DCL but reflect the comment of a national standard setter questioning the usefulness of such a disclosure where some of the goodwill relates to that of the non-controlling interests.
- 209 As it appears from the comment letter analysis, most respondents have a similar view as the view expressed in the DCL. The EFRAG Secretariat accordingly suggests reflecting the preliminary position reflected in paragraph 208 above in the comment letter recommended for the EFRAG Board.

Questions for EFRAG TEG

- 210 Does EFRAG TEG agree with the suggestion included in paragraph 209?
- 211 Does EFRAG TEG consider that there are comments that should be reflected in EFRAG's comment letter?

Question 9 – Indicator-only approach

The DP

- 212 The DP proposes to remove the requirement for a company to perform an annual impairment test for cash-generating units containing goodwill if there is no indication that the cash-generating units may be impaired. This proposal would also apply to intangible assets with indefinite useful lives and intangible assets not yet available for use.

The DCL

- 213 The DCL disagrees with the introduction of an indicator-only approach unless goodwill amortisation is reintroduced.

Amendments to the DCL

- 214 The EFRAG Secretariat suggests retaining the position reflected in the DCL on the indicator-only approach.

Reasons for suggestions

- 215 The feedback from outreach activities shows that stakeholders have a mixed view relating to the indicator-only approach with, in general, more support from preparers and opposition from users and auditors. In the survey, the majority of preparers indicate insignificant savings when following the indicator-only approach. Overall, there are concerns about the reduction in know-how relating to the quantitative test in these circumstances, in addition to concerns of users that would not benefit any more from information that they consider useful.
- 216 At its 3 December 2020 EFRAG TEG meeting, EFRAG TEG members agreed to retain the current proposals in the DCL regarding the indicator-only approach.
- 217 The feedback in the comment letters received are in line with the feedback from outreach events.
- 218 The majority of the comment letters, mostly from auditors and national standard setters, do not support the indicator-only approach because it reduces the robustness of the test, increases management judgment and does not significantly reduce cost. The majority of the respondents who do not support the indicator-only approach would do so if amortisation of goodwill was reintroduced. Some of the respondents suggest enhancing the current relief in paragraph 99 of IAS 36 *Impairment of Assets* as an alternative to the indicator-only approach.
- 219 The comment letters in favour of the indicator-only approach, mostly from preparers, argue that the quantitative impairment test does not add value when significant headroom is available. Some respondents also request additional guidance on the identification and use of indicators if the indicator-only approach is introduced.
- 220 The EFRAG Secretariat notes that the feedback received from stakeholders supports the current proposal in EFRAG's DCL. Therefore, the EFRAG Secretariat proposes to retain EFRAG's current position on the indicator-only approach in its DCL.

Questions for EFRAG TEG

- 221 Does EFRAG TEG agree with the suggestion included in paragraph 214?
- 222 Does EFRAG TEG consider that there are comments that should be reflected in EFRAG's comment letter?

Question 10 – Other simplifications of the impairment test

The DP

- 223 The DP proposes to remove from IAS 36 the restriction on including cash flows arising from a future restructuring to which a company is not yet committed or from improving or enhancing an asset's performance.
- 224 The DP proposes to remove the explicit requirement to use pre-tax cash flows and pre-tax discount rates in estimating value in use.

The DCL

- 225 The DCL supports the IASB's proposal to remove the restriction in IAS 36 that prohibits companies from including cash flows arising from a future uncommitted restructuring, or from improving or enhancing the asset's performance. However, additional guidance would be required on when to include restructuring cash flows in the calculation.
- 226 The DCL supports the IASB's proposal to remove the explicit requirement to use pre-tax inputs and pre-tax discount rates to calculate value in use.

Amendments to the DCL

- 227 The EFRAG Secretariat suggests the following amendments based on the input received:
- (a) Add that the IASB should clarify that capacity investments are included in the asset enhancements;
 - (b) Remove the suggestion that additional guidance would be required on including the cash flows from uncommitted future restructurings and asset enhancements; and
 - (c) Add that the IASB should provide clarification on the alignment of the use of post-tax cash flows with IAS 12 *Income Taxes* regarding the impact of deferred tax assets from carrying forward tax losses.

Reasons for suggestions

- 228 The feedback from outreach events shows that most preparers agree with the proposal to remove the restrictions on including cash flows arising from a future uncommitted restructuring and from asset enhancements. Overall, a minority of stakeholders disagree as they are concerned that the test would be less robust with these changes.
- 229 The feedback from outreach events shows that almost all stakeholders agree with the proposal to remove the restriction to use post-tax cash flows and post-tax discount rates in the VIU calculation.
- 230 At its 3 December 2020 EFRAG TEG meeting, EFRAG TEG members discussed whether additional guidance is necessary to include cash flows from future uncommitted restructurings and asset enhancements:
- (a) One EFRAG TEG member supported additional guidance as it would improve comparability. However, other EFRAG TEG members commented that it was difficult to set a threshold;
 - (b) One EFRAG TEG member noted that these cash flows have relatively less impact on the valuation, compared to for example the assumptions relating to the terminal value, reducing the need to set a threshold; and
 - (c) Another EFRAG TEG member suggested that the IASB should clarify if capacity investments are included in the asset enhancements.
- 231 The feedback received from comment letters is in line with the feedback received from the outreach events. In addition, many comment letters, mostly from preparers and national standard setters, request additional guidance to clarify which cash flows can be included and to determine a threshold. Some comment letters consider current requirement in IAS 36 requiring reasonable and supportable assumptions sufficient.
- 232 One comment letter from a regulator states that the IASB's proposal may be conceptually problematic as the impairment test is required to test the value of the asset at the reporting date. By including uncommitted material restructurings, enhancements or improvements, the value of that asset is not tested at the reporting date, but it would be the value of a possible altered asset or group of assets at a future date. Planned improvements and enhancements may give rise to assets that would be separately recognised in the future in accordance with the appropriate standard (e.g., IAS 16). These future assets, once they are acquired, would be subsequently subject to measurement themselves (i.e., impairment testing).
- 233 Almost all comment letters support the use of post-tax input in the VIU calculation. Some respondents require additional guidance on alignment with IAS 12 *Income Taxes* regarding the impact of deferred tax assets from carrying forward tax losses.

- 234 The EFRAG Secretariat notes the feedback regarding the request for additional guidance and considers the current requirements in IAS 36 sufficient. Paragraph 33 of IAS 36 requires the cash flow projections to be based on reasonable and supportable assumptions that represent management's best estimate of the range of economic conditions that will exist over the remaining useful life of the asset. It also states that the cash flow projections should be based on the most recent financial budgets/forecasts approved by management. The EFRAG Secretariat considers the required governance around the budgeting and forecasting process to be sufficient to ensure reasonable and supportable inputs.
- 235 The EFRAG Secretariat also notes the feedback from the regulator relating to the conceptual misalignment. The EFRAG Secretariat agrees that the proposal would conflict with the current requirements of IAS 36. However, the EFRAG Secretariat does not consider that there would be any conceptual issues with the proposed changes. The EFRAG Secretariat notes that 1) there would then currently be conceptual issues related to 'committed restructurings' and 2) as long as the calculation includes both the cost and benefits related to an enhancement or improvement, the value could be said to reflect a value as of the reporting date. The EFRAG Secretariat does not consider the possibility of a future asset to be conceptually wrong as long as the related costs are also taken into account.
- 236 The EFRAG Secretariat therefore proposes the following amendments to EFRAG's current position in the DCL on the other simplifications of the impairment test:
- (a) Suggest that the IASB clarifies if capacity investments are included in the asset enhancements;
 - (b) Suggest removing the EFRAG's proposal that additional guidance is required to include cash flows from uncommitted future restructuring and asset enhancements; and
 - (c) Suggest that the IASB provides clarification on the alignment of the use of post-tax cash flows with IAS 12 Income Taxes regarding the impact of deferred tax assets from carrying forward tax losses.

Questions for EFRAG TEG

- 237 Does EFRAG TEG agree that the IASB should clarify that capacity investments are included in the asset enhancements? Or do you share the concern of some of the respondents?
- 238 Does EFRAG TEG agree with the other suggested amendments proposed in paragraph 227 and how these are reflected in the suggested comment letter?
- 239 Does EFRAG TEG consider that other comments should be reflected in EFRAG's comment letter?

Question 11 – Further simplifications of the impairment test

The DP

- 240 The DP concludes that it should not develop the following proposals:
- (a) Adding more guidance on the difference between entity-specific inputs used in value in use and market-participant inputs used in fair value less costs of disposal;
 - (b) Mandating only one method for estimating the recoverable amount of an asset (either value in use or fair value less costs of disposal) or requiring a company to select the method that reflects the way the company expects to recover an asset; and

- (c) Allowing companies to test goodwill at the entity level or at the level of reportable segments rather than requiring companies to allocate goodwill to groups of cash-generating units that represent the lowest level at which the goodwill is monitored for internal management purposes.

The DCL

- 241 EFRAG supports the IASB's preliminary view to not develop the above proposals apart from further guidance on allocating goodwill to cash-generating units as discussed in paragraph 165 (refer to that section for an analysis of the feedback received and proposed amendments to the EFRAG's comment letter relating to further guidance on allocation of goodwill).

Amendments to the DCL

- 242 Based on the input received, the EFRAG Secretariat suggests adding to its CL that the IASB should provide guidance/simplifications by stating that the carrying amount of lease liabilities and cash outflows relating to lease liabilities should be included in the value in use calculation.

Reasons for suggestions

- 243 The feedback received from outreach events show that there are mixed views on the use of one method for determining the recoverable amount of a CGU – a user prefers value in use and a valuer prefers fair value less costs of disposal.
- 244 At its 3 December 2020 EFRAG TEG meeting, EFRAG TEG members agreed to retain the current proposals in the DCL regarding further simplifications to the test.
- 245 Based on the comment letters received, many respondents support the IASB's preliminary view that no further simplifications need to be developed and are in particular opposed against using a single method for the recoverable amount.
- 246 Few respondents request in their comment letters further guidance on including the carrying amount of lease liabilities and cash outflows relating to the lease liability under IFRS 16 *Leases* when calculating the VIU, to avoid divergence in practice.
- 247 The EFRAG Secretariat therefore proposes to retain EFRAG's current position on the further simplifications of the impairment test and add a suggestion to EFRAG's comment letter that the IASB provides guidance on including the carrying amount of lease liabilities and cash outflows relating to the lease liability in the value in use calculation.

Questions for EFRAG TEG

- 248 Does EFRAG TEG agree with the suggested amendments proposed in paragraph 242 in relation to leases and how these are reflected in the suggested comment letter?
- 249 Does EFRAG TEG consider that other comments should be reflected in EFRAG's comment letter?

Question 12 – Intangible assets

The DP

- 250 The DP concludes that it should not develop a proposal to change the recognition criteria for identifiable intangible assets acquired in a business combination.

The DCL

- 251 The DCL considered it necessary that investors are able to compare companies that grow by acquisitions more easily with those that grow organically. Therefore, the

DCL recommended that the issue on whether some intangible assets could be included in goodwill should be considered in a second phase of the project together with a revision of IAS 38.

Amendments to the DCL

- 252 Based on the input received, the EFRAG Secretariat does not propose any amendments to the position expressed in the DCL.

Reasons for suggestions

- 253 Based on the feedback received during outreach events, most of the stakeholders support the conclusion in the DP to not develop a proposal to change the recognition criteria for identifiable intangible assets acquired in a business combination. Some stakeholders support the DCL to review the recognition criteria together with a review of IAS 38 in a second phase of the project.
- 254 At its 3 December 2020 EFRAG TEG meeting, EFRAG TEG members agreed to retain the current proposals in the DCL regarding the recognition criteria for intangible assets acquired in a business combination.
- 255 The feedback in the comment letters received are generally in line with the feedback received from the outreach events. The majority of the respondents support the proposal to not develop requirements to add intangible assets acquired in a business combination to the carrying amount of goodwill. The main argument is that it provides useful information regarding the consideration paid for the acquisition and in line with the increasing importance of intangibles in contemporary economies. Nonetheless, most of the respondents acknowledge the challenges relating to the subjectivity and complexity of valuation, however these can be overcome.
- 256 Many respondents support a dedicated and comprehensive review project on IAS 38 *Intangible Assets*, but some respondents urge for a narrow-scoped review on short-term instead of waiting for a review of IAS 38.
- 257 The EFRAG Secretariat notes that in general separate recognition is supported by constituents. The EFRAG Secretariat would accordingly not suggest EFRAG to propose any changes to the current requirements in the short run. On the other hand, the EFRAG Secretariat would also expect that constituents might reconsider their position after a thorough and general consideration on how to account for intangible assets. Accordingly, the EFRAG Secretariat considers that it would be useful to consider the current guidance following a broader project on IAS 38 instead of a narrow-scoped amendment that might need to change when reviewing IAS 38.
- 258 The EFRAG Secretariat therefore proposes to retain EFRAG's current position on recognition criteria for identifiable intangible assets acquired in a business combination in its DCL.

Questions for EFRAG TEG

- 259 Does EFRAG TEG agree with the suggestion included in paragraph 252, not to change the comment letter?
- 260 Does EFRAG TEG consider that there are comments that should be reflected in EFRAG's comment letter?

Question 13 – Convergence with US GAAP

The DP

- 261 The DP presents a summary of the Invitation to Comment issued by the US Financial Accounting Standards Board ('FASB'). The DP asks whether stakeholder's answers to questions in the DP would depend on whether the

outcome is consistent with US GAAP as it exists today, or as it may be after the FASB's current work.

The DCL

- 262 The DCL confirmed that its responses to the questions in the DP do not depend on whether the outcome is consistent with US GAAP. However, the DCL considered that the IASB outcome could be influenced by the FASB's current work.

Amendments to the DCL

- 263 The EFRAG Secretariat therefore proposes to retain EFRAG's current position on convergence with the FASB in its DCL.

Reasons for suggestions

- 264 The overall view of stakeholders, obtained during outreach events, is that convergence with the FASB is considered important but should not prevail over the principal objectives of the IFRS Standards. Stakeholders express different degrees of importance in relation to the convergence with the FASB.
- 265 At its 3 December 2020 EFRAG TEG meeting, EFRAG TEG members agreed to retain the current proposals in the DCL regarding the convergence with the FASB.
- 266 One EFRAG TEG member suggested that the IASB should carefully consider the proposed disclosure requirements because they can put IFRS companies at disadvantage compared to the US GAAP companies, if the FASB does not require the same type of disclosures.
- 267 The feedback in the comment letters received are in line with the feedback received from the outreach events. In addition, national standard setters, regulators and auditors put more emphasis on the convergence and propose active coordination between the IASB and FASB.
- 268 Many comment letters strongly request that the IASB ensures convergence with the FASB's position on disclosure of subsequent performance of acquisitions as divergence may result in competitive disadvantage for companies that comply with IFRS Standards, which is in line with the EFRAG TEG member's comment in paragraph 266. Many comment letters also request that the IASB ensures convergence with the FASB's position on subsequent accounting for goodwill.
- 269 The EFRAG Secretariat notes the comments from stakeholders regarding their request for convergence relating to the disclosures on subsequent performance of acquisitions. In Question 2, EFRAG mentions that the lack of convergence makes preparers more reluctant to disclose commercial sensitive information and the EFRAG Secretariat suggests that the comment letter includes the view that the IASB should address the commercial sensitivity issue. The EFRAG Secretariat accordingly assesses that this comment has been addressed in the suggestions to amend the DCL proposed by the EFRAG Secretariat.
- 270 The EFRAG Secretariat also notes the comments from stakeholders regarding their request for convergence relating to the subsequent accounting for goodwill. However, the EFRAG Secretariat notes that many stakeholders prefer having divergent IFRS Standards if it is more effective compared to US GAAP.

Questions for EFRAG TEG

- 271 Does EFRAG TEG agree with the suggestion included in paragraph 263?
- 272 Does EFRAG TEG consider that there are comments that should be reflected in EFRAG's comment letter?

Question 14 – Other comments

The DP

- 273 The DP asks whether there are any further comments on the DP or whether the IASB should consider any other topics in response to its PIR of IFRS 3.

The DCL

- 274 The DCL commented that the DP should have considered componentisation of goodwill as well as further guidance as to the allocation of goodwill with divestments and reorganisations. EFRAG also sought views on the reversals of goodwill impairments especially of those recognised in an interim period.

Amendments to the DCL

- 275 On componentisation of goodwill in general, the EFRAG Secretariat proposes not to include such a suggestion in the final comment letter. On the issue of technical goodwill, the EFRAG Secretariat also suggests leaving the topic open given the mixed views.
- 276 The EFRAG Secretariat proposes to mention the considerations around transition if goodwill amortisation were to be reintroduced but proposes not to include a proposal around the reversals of goodwill impairment given the mixed views and limited feedback on this aspect.
- 277 To the other aspects in the DCL like divestments, the EFRAG Secretariat proposes not to change the comment letter.

Reasons for suggestions:

- 278 On the issue of componentisation of goodwill in general, the EFRAG Secretariat considers that significantly more work would need to be done to sensibly disentangle components from the residual that is regarded as goodwill. There are also currently no accepted valuation methodologies to measure such components reliably even if they can be identified. Therefore, such a proposal would add significant complexity without obvious benefits and being judgemental.
- 279 On the issue of technical goodwill or the goodwill generated by the recognition of deferred tax liabilities on the recognition of the fair value adjustments, two respondents do not agree that the element should be separated. Another respondent considers that the issue would be addressed by the reintroduction of goodwill amortisation and yet another is in favour of recognition as a separate component of goodwill or as a separate intangible asset this technical component and amortised it in line with the related deferred tax. One preparer indicated that technical goodwill constitutes less than 5% of their goodwill balance. The EFRAG Secretariat notes, for example, in the accounting for contingent consideration, the accounting for goodwill is determined separately from the liability. Changing the accounting for goodwill in relation to technical goodwill would call this separation in question and could create unintended consequences.
- 280 On the reversal of goodwill question, three respondents do not support introducing reversals of goodwill impairment. However, three other respondents do support the reversal of goodwill impairments in specific circumstances. It may be difficult to prove that the reversal relates to the impaired goodwill and allowing a reversal for a limited period may have limited success to overcome any aversion to the recognition of impairment. Such a limited period may also become a continual discussion point for further extensions to something which necessarily will be arbitrary. During an outreach event a majority did not support reversal of impairment (see polling result).

Questions for EFRAG TEG

- 281 Does EFRAG TEG agree with the suggestions included in paragraphs 275 and 276 and how these have been reflected in the proposed comment letter?
- 282 Does EFRAG TEG consider that there are other comments that should be reflected in EFRAG's comment letter?

Question 1 - Introduction

The DP

- 283 Paragraph 1.7 of the DP states: "The Board's overall objective is to explore whether companies can, at a reasonable cost, provide investors with more useful information about the acquisitions those companies make. Better information would help investors assess the performance of companies that have made acquisitions. Better information would also be expected to help investors more effectively hold a company's management to account for management's decisions to acquire those businesses."

The DCL

- 284 EFRAG supports and agrees with the objective of the project in its DCL. However, since it was wanting input from its constituents on aspects of the DP, it considered that it could only answer on the package as a whole after receiving such feedback.

Amendments to the comment letter

- 285 The EFRAG Secretariat proposes that the comment letter should recommend that the IASB implement speedily the proposals on post-tax inputs and cash flows from future restructurings and asset enhancements including guidance on the latter.
- 286 At the same time, within a longer time frame, the IASB should consider:
- (a) the scope of the project and whether significant transactions could be addressed in another standard such as IAS 1 *Presentation of financial statements* by requiring similar disclosures to those contemplated in IFRS 3 *Business Combinations*;
 - (b) Commercial sensitivity (including forward looking nature of some of the information) of the disclosure proposals;
 - (c) Suggestions to improve the impairment test such as further guidance about goodwill allocation and reallocation and other disclosures such as the age of goodwill.
- 287 Where the IASB considers that no further improvement is possible, goodwill amortisation should be adopted as a practical expedient.

Reasons for suggestions

- 288 At the 3 December 2020 EFRAG TEG meeting, the EFRAG Secretariat noted limited feedback related to Question 1 of the DP. However, the support for guidance about the allocation/reallocation/disposal of goodwill and disclosures to mitigate overoptimism shows that the DP has not addressed concerns about the current accounting.
- 289 While seven comment letter respondents agreed with the objective of the project, eight respondents considered the proposals not as a package with several distinguishing between disclosures and subsequent accounting for goodwill. Four respondents consider that the concerns around the accounting for goodwill has not been addressed. Two respondents are unconvinced that the benefits of that package would exceed its costs and one respondent suggested field testing to ascertain whether this is the case.

- 290 The EFRAG Secretariat notes that the response in the DCL notes that the main issues identified in the post implementation review of IFRS 3 are not addressed by the DP. Accordingly, the concern of the four respondents on the concern related to goodwill accounting is addressed by EFRAG already.
- 291 On the issue whether the benefits would exceed the costs, it is noted that some respondents particularly assessed the requirements to disclose information they consider commercial sensitive to be costly. The EFRAG Secretariat suggests addressing this issue in the proposed comment letter.
- 292 As many respondents do not consider the proposals as a package, the EFRAG Secretariat considers that the IASB could first introduce the simplifications to the impairment test considered in Question 10 of the DP. It is the assessment of the EFRAG Secretariat that these proposals are the least controversial ones and it could thus be inappropriate not to introduce these improvements as soon as possible.
- 293 In the outreach as well as in the comment letters, there were concerns that the project only focuses on acquisitions and excludes many significant transactions where holding management to account for its decision is equally important. Examples 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. The IASB could accordingly consider whether it should address the issue more broadly than by considering amendments to IFRS 3 only.
- 294 In some cases, the commercial sensitivity concerns about the proposals were mentioned here, but this is more fully addressed under Question 2 of this paper.

Questions for EFRAG TEG

- 295 Does EFRAG TEG agree with the suggestions included in paragraphs 285 - 287 and how these have been reflected in the proposed comment letter?
- 296 Does EFRAG TEG consider that there are other comments that should be reflected in EFRAG's comment letter?

Cover letter and language.

- 297 A respondent has indicated that the current wording in the cover letter should be refined, and the tone of the following expressions be reconsidered:
- (a) "there are shortcomings in how goodwill is currently accounted for";
 - (b) "goodwill is a mixture of many different elements";
 - (c) "goodwill is an accounting construct"; and
 - (d) "... for users' views that reported goodwill has limited relevance".

Proposed amendments to the comment letter

- 298 The EFRAG Secretariat proposes the following changes to the comment letter:
- (a) "some perceive shortcomings in how...." or "perceived shortcomings";
 - (b) "goodwill consists of many factors" (as per the DP paragraph 2.68);
 - (c) "some consider goodwill to be an accounting construct"; and
 - (d) "for the views of some users that ...".

Question for EFRAG TEG

- 299 Does EFRAG TEG have comments on the proposals included in paragraph 298 and how these have been reflected in the proposed comment letter?