Business Combinations: Disclosures, Goodwill and Impairment
Overview of Feedback Received

Objective

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

Outreach activities completed until 30 October 2020

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

(a) Field test with one preparer (conducted by the IASB);

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

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

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

(e) Webinars[2] on 16 October and 23 October 2020. The former was a joint EFRAG and IASB event whereas the latter was focussed on constituents in Denmark.

3 This paper also benefits from the results of 14 surveys completed by preparers on the topic, although not all the questions were necessarily answered. For the demographic and background information about the survey respondents, please refer to Appendix 1.

Remaining outreach activities

4 Further outreach events planned for November 2020 include:

(a) A webinar focussed on the needs of users;

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

[2] *Improving information regarding business combinations and subsequent accounting for goodwill – Which Way to Go?* on 16 October 2020 jointly hosted by EFRAG and the IASB as well as *Joint outreach event on Business Combinations: Disclosures, Goodwill and Impairment,* 23 October 2020, jointly hosted by EFRAG, the IASB and FSR – Danish Auditors & DI Confederation of Danish Industry

(b) webinars focussed on constituents in Germany, Italy, Norway and Portugal;

(c) Further interviews and field tests with preparers; and

(d) Additional preparers' surveys.

5 This feedback will be supplemented by comment letters to be received on EFRAG's DCL. The closing date for comments is 30 November 2020.

Structure of the paper

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

Contents

Improving disclosures about acquisitions

Strategic rationale for an acquisition and subsequent performance[3]

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

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

9 The result of the polling question during the two webinars (with EFRAG/IASB joint event and with Danish constituents) show that the majority of the respondents agree with the usefulness of the proposed disclosures:

Will the IASB's proposed disclosure of management's objectives for an acquisition and subsequent disclosures about whether an acquisition is meeting those objectives provide useful information to assess management's stewardship?	**Yes** 65%	**No** 35%
Of which: preparers	*12%*	*20%*
Of which: users	*15%*	*-*
Of which: auditors	*12%*	*9%*
Of which: regulators	*15%*	*-*

The results further show that all of the academics and many of the other participants also responded 'Yes'. However, some of the total respondents who answered 'Yes', note that the cost of preparing this information would outweigh its benefits.

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

The IASB proposes to provide information (strategic rationale, objectives of an acquisition and subsequent performance) based on the information the entity's chief operating decision maker (board of directors or similar) ('CODM') monitors. Do you think this is the right level?	**Yes** 61%	**No** 39%
Of which: preparers	*19%*	*12%*
Of which: users	*11%*	*-*
Of which: auditors	*12%*	*19%*
Of which: regulators	*11%*	*-*

[3] Question 2 of the IASB's DP

Do you think that it is possible to disclose information on the achievement of the targets initially defined at acquisition date and of expected synergies, without triggering commercial sensitivity?	**Yes** 14%	**Maybe** 49%	**No** 37%
Of which: preparers	-	*9%*	*19%*
Of which: users	*2%*	*5%*	*2%*
Of which: auditors	*4%*	*23%*	*9%*
Of which: regulators	*7%*	*5%*	*2%*

Do you agree with the IASB's proposal to present the proposed information in the notes to the financial statements?	**Yes** 34%	**No** 45%	**Other** 21%
Of which: preparers	*2%*	*16%*	*10%*
Of which: users	*5%*	*4%*	-
Of which: auditors	*10%*	*19%*	*5%*
Of which: regulators	*10%*	*2%*	*2%*

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

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

<u>Preparers</u>

a) Sensitivity of information

12 Feedback received by preparers show that preparers have strong concerns about commercial sensitivity of the proposed disclosures. Main arguments shared by preparers include the following:

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

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

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

(d) If disclosed, the objectives for an acquisition could put an entity in a worse position in future transactions.

(e) One preparer was concerned that the proposal could discourage entities from entering into acquisitions, and it could result in a slow-down of M&A activities.

13 The preliminary results of the survey, based on 9 responses received to date (refer to paragraph 3), show that the disclosure requirements that mostly trigger commercial sensitivity are the following (responses to the survey are given based on a scale from “0 – Not Confidential” to “4 – Strictly confidential”):

(a) Information on synergies (a more detailed analysis is provided at paragraph 47) with an average score of 3,6;

(b) Information about whether the acquisition has met the expected objectives, with an average score of 3,3; and

(c) Information to help investors to understand the benefits that a company’s management expected from an acquisition when agreeing the price to acquire a business, with a score of 3,1.

14 Apart from commercial sensitivity, one preparer during the webinar on 16 October 2020 noted that disclosures about synergies can also have organisational impact. Disclosure of sensitive information related to potential restructurings of the entity’s labour force should be avoided

15 The proposal to disclose information about the strategic rationale and management’s objectives for an acquisition as at the acquisition date is considered confidential but scored relatively low in the survey (average score of 2,4 based, again, on a scale from “0 – Not Confidential” to “4 – Strictly confidential). Furthermore, feedback received from other outreach activities showed that preparers consider that they already provide the proposed information to investors through press releases, analyst presentations and other means.

b) Level of information to be provided - CODM

16 Feedback received from preparers showed wide agreement for the IASB’s proposals that required disclosures should be based on the information reviewed by the entity’s Chief Operating Decision Maker (‘CODM’). Main arguments of preparers are the following:

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

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

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

17 Based on the above, the majority of the preparers do not favour the EFRAG’s proposal to base the information on a lower level than what the CODM reviews.

c) Feasibility

18 Preparers have mixed views about the feasibility of providing information under the proposed disclosures requirements. Some participants in the survey and the field test reported that they are already providing a significant part of the information included in the IASB’s proposal (refer to paragraph 15). However, others reported specific issues that make the proposed disclosures complex:

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

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

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

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

19 The preliminary results of the survey confirmed this as 64% of the respondents (11 responses) stated that the proposed disclosures are not feasible. There is an additional concern about the high degree of discretion by preparers would lead to a lack of comparability.

d) Management commentary or notes to the financial statements

20 Feedback received mostly shows a strong preference to placement within management commentary by preparers. This is due to the fact that the disclosures would be prepared based on non-GAAP measures, consisting of management views and assumptions, and involving forward-looking information, all resulting in complexity in terms of auditability.

21 However, the preliminary results of the survey show that preparers' views differ depending on the specific disclosure proposal. In particular:

(a) 75% of preparers (8 responses) would prefer the information about subsequent performance of an acquisition and level of achievement of expected objectives to be in the management commentary; but

(b) 56% of preparers (9 responses) consider it more appropriate that the information about the strategic rationale of an acquisition is placed in the financial statements.

22 One preparer prefers the disclosures to be outside of both the financial statements and management commentary. Even in the case of management commentary, there would be some level of external scrutiny from the auditors on the information. This information is fully based on internal rules and guidelines rather than on a recognised framework. Accordingly, as this entity is currently providing disclosures to investors in other presentations and would prefer for this to continue.

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

23 Comments in paragraphs 18(a) and 18(b) are also relevant to the proposed disclosure if management ceases to monitor an acquisition before the end of the second full year after the year of acquisition. Preparers generally agree that a "two-year basis" may sometimes not be relevant. This is either due to an intense integration of the acquired business just after the acquisition or because an acquisition may need a significantly longer period of time to achieve the expected benefits.

Users

24 Users consider the proposed disclosures useful to hold management accountable for its decisions and actions.

25 One user agreed with preparers' position about the focus of the disclosures only on the material acquisitions, or acquisitions of very material individual assets. He contend that disclosures of minor acquisitions would not add value for users (as argued by preparers in paragraph 16(b)).

26 However, users' views diverged from preparers' (see paragraph 18) with regard to the disclosures on the subsequent performance of acquisitions. Some are interested in comparing the expected objectives and subsequent performance of an acquisition under different metrics (i.e. turnover was expressly mentioned).

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

28 Users favour the information being in the financial statements and being audited.

Auditors

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

30 Auditors agreed that some of the proposed disclosures could be provided within the financial statements and could be audited. However, considering its nature, some of the information might be better placed in the management commentary as it involves management analysis and perceptions and, as such, is not always verifiable. To include or audit forward-looking information in itself might not be an issue for the audit, but the new disclosures include management perception of the results and the management expectations about a particular business combination which raise audit issues. This is consistent with the views of preparers in paragraphs 13 and 14. However, the requirements around management commentary is currently voluntary. To require disclosing such information requires more field tests to assess the practicality.

31 Feedback from two auditors show that they do not always consider the CODM to be the most appropriate level. Some auditors reported that the level at which the success of an acquisition is monitored could sometimes be lower (i.e. when an entity acquired a complex conglomerate monitored by the CODM on an aggregate basis).

32 Another auditor agreed with preparers' concerns over commercial sensitivity. Balance between the needs of users and information that preparers are not willing to disclose is needed to determine the right level of granularity of information.

Other stakeholders

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Expected benefits when agreeing the price to acquire a business[4]

37 Stakeholders’ views on the overall disclosure requirements are the same as in paragraphs 12 to **Error! Reference source not found.** above. Some specific comments are provided here.

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

[4] Question 3 of the IASB’s DP

39 Another preparer agreed and added that the transaction price is the result of negotiations between the two parties and does not necessarily express the expected amount of benefits and synergies.

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

41 Finally, if the disclosures should be provided, 75% of the respondent to the preparers' survey (6 out of 8 respondents) prefers this information to be included in the management commentary.

Nature, timing and amount of expected synergies[5]

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

Preparers

43 While comments reported from paragraph 12 to **Error! Reference source not found.** directly apply also to the proposed disclosures on synergies, some preparers added some other specific comments.

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

45 A preparer reported that they have tried in the past to measure cost synergies, but the results were not useful for management of the business. He mentioned that they do not set a specific synergies target, and that synergies are not monitored as envisaged in the IASB's DP.

46 Concerns expressed at paragraph 18(b) also apply to synergies. Some preparers indicated that synergies can often materialise in the long term and generally do not provide measurable benefits in the initial phase of an acquisition. It would be then complicated to assess whether benefits expected from synergies are met at an earlier stage.

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

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

49 Finally, if the disclosures should be provided, 75% of the respondent to the preparers' survey (8 responses) expressed their preference to have this information included in the management commentary.

[5] Question 4 of the IASB's DP

Users

50 While comments reported from paragraph 24 to 28 also apply directly to the proposed disclosures on synergies, some users reported the following specific comments during EFRAG working group meetings and closed events held:

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

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

51 A user expressed concern about the level of detail included in the proposed requirements, as the disclosures could potentially result in boiler-plate information.

Auditors

52 Comments by auditors reported from paragraphs 29 to 32 directly apply also to the proposed disclosures on synergies.

Other stakeholders

53 Comments by other stakeholders reported at paragraphs 33 and 34 also apply directly to the proposed disclosures on synergies.

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

Enhancing current IFRS 3 disclosure requirements[6]

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

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

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

Preparers

58 Preparers do not support the proposals reported in paragraph 55. The main reported arguments include the following:

(a) The notion of ‘acquisition-related transaction costs’ and ‘integration costs’ is currently undefined and unclear: it could potentially lead to inconsistent outcomes; and

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

59 Preparers also do not support the proposal reported in paragraph 56, as in their view it could be complex to prepare and would not add meaningful information to investors.

60 This is also in line with the preliminary responses to the preparers’ survey about the usefulness, the complexity and the incremental costs of the proposals. The

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

preliminary results show that the proposal to disclose operating profit or loss before acquisition-related transaction and integration costs and cash flow from operating activities after the acquisition date:

(a) Has a limited usefulness, with an average score of 1,4 on a scale from "0 – Not useful" to "3 – Useful" (based on 7 respondents);

(b) Is considered potentially costly, but scored relatively low in the survey (average score of 2,8 on a scale from "0 – Not costly" to "4 – Highly costly" and based on 9 respondents); and

(c) Is considered potentially complex but scored relatively low in the survey (average score of 2,7 on a scale from "0 – Not Complex" to "4 – Very complex" and based on 9 respondents).

61 Furthermore, for pro-forma information with the acquisition date presumed to have been at the beginning of the annual reporting period, responses show the following:

(a) The information has a partial usefulness with an average score of 1,7 on a scale from "0 – Not useful" to "3 – Useful" (based on 7 respondents):

(b) It would imply high incremental costs, with an average score of 3,3 on a scale from "0 – Not costly" to "4 – Highly costly" and based on 9 respondents;

(c) It would be considered highly complex, with an average score of 3,3 on a scale from "0 – Not Complex" to "4 – Very complex" and based on 9 respondents.

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

63 In the survey, 88% of preparers (8 responses) considered that additional guidance is not required as this is not a reason for the 'too little too late' problem.

<u>Other stakeholders</u>

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

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

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

(a) The proposal would trigger incremental costs and complexities;

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

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

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

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

Questions for EFRAG TEG

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

Goodwill impairment and amortisation

Goodwill impairment[7]

69 In general, a small majority of the stakeholders agree with the IASB's preliminary conclusion that it is not feasible to design a different impairment test that is more effective. The following table shows the results of the relevant polling question during the two webinars:

The IASB's preliminary view is that it is not feasible to design a different test that is significantly more effective at recognising losses on a timely basis at a reasonable cost. Should the IASB consider addressing the shielding effect improving guidance on the allocation and reallocation of goodwill to CGUs?	**Yes** 45%	**No** 55%
Of which: preparers	*9%*	*23%*
Of which: auditors	*15%*	*9%*
Of which: other	*21%*	*23%*

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

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

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

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

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

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

	Preparers	Auditors	Other	Total
All of the proposed disclosures requirements	4%	13%	15%	32%

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

Only one of the proposed disclosure requirements	13%	11%	14%	38%
None of the proposed disclosure requirements	13%	5%	12%	30%
Total	30%	29%	41%	100%

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

a) Allocation and reallocation

Preparers

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

72 For the result of polling during outreach events please see paragraph 82 above. A majority of the preparers voted that the guidance should not be adjusted.

73 In the survey replies received to date, this is not considered to be the reason for the perceived failure of the impairment testing of goodwill (7 out of 8).

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

75 During an interview, a preparer mentioned that goodwill might be allocated to a higher CGU level to cover synergies as well. The goodwill impairment test might be prepared on a higher level compared to which management monitors KPIs of the acquisition.

76 During an outreach event, a different preparer noted that it was not necessary to develop additional guidance.

b) Management over-optimism

Preparers

77 Preparers have some reservations about the proposed disclosures. The polling result during the webinars (see paragraph 70) show that the majority considers some of the proposals or all of them as being useful to address over-optimism. A minority considers it not useful to introduce such guidance.

78 In the survey preparers assess the difficulty in including the disclosures referred to in paragraph 70 as well as their reluctance. In the replies received to date (8) they consider the ‘back-testing’ disclosure to be the most difficult (4,1 out of 5) while the disclosure of current cash flows to be the least (3,5). They are also more reluctant to disclose the cash flows of the period (4,5) than the other disclosures (4,1). From the surveys received, it seems that they are more reluctant to include the information than the difficulty of obtaining it. Additionally, a preparer provided the following qualitative comments:

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

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

79 During the 16 October 2020 webinar, a preparer agreed with the disclosures a) and c) referred to in paragraph 70 to provide more discipline. Additionally, he suggested that over-optimism should have consequences e.g. by shortening the planning period before going into the terminal value. He also considered that Improving transparency requirements on the objectives of an acquisition do not help in identifying triggering events for a potential goodwill impairment as they have been designed for other purposes.

Users

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

81 Further outreach to users will take place in the middle of November 2020 (Outreach event and User Panel).

Auditors

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

83 One auditor agrees with the academic research results showing correlation between the identification of key audit matters and the quality and quantity of disclosures as explained in paragraph 89. He also emphasised the importance of informing stakeholders that the objective of impairment tests is not to measure the subsequent performance of a business. He added that over-optimism can be (partially) addressed by improving the disclosure requirements or the level of allocation of goodwill to CGUs. For example, similarly to US GAAP or as suggested by EFRAG with one level below segment level by default. He also explained that the risk of failure is not linear over time (gradual decline) but can result in a sudden deterioration and significant impairment losses.

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

Other stakeholders

85 A national standard-setter agreed with EFRAG that there are different options for improving the impairment test while ensuring that the costs do not outweigh the benefits.

86 An enforcer agreed with EFRAG's view that the allocation of goodwill should take place at the lowest possible level to reduce the shielding effect. He also expressed the view that there is potential for improvement related to paragraph 33 of IAS 36 as it is difficult to determine whether assumptions are reasonable given the lack of disclosures at CGU level. In this regard, he suggested that the IASB include additional guidance relating to the reasonableness and supportability of

assumptions. The operating cycle of a business may be insightful, e.g. by using an average cash flow level since entities often use the highest cash flow level reached after the planning period to calculate the terminal value. Furthermore, he suggested that more guidance to ensure consistency between assumptions used in the impairment test calculation: growth rate, risk rate, interest rate, inflation rate.

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

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

89 Academic research indicates that goodwill impairment is considered complex and at the discretion of management. There is evidence of the opportunistic use of the impairment test, both from a timing and value perspective. Research also indicate that monitoring and oversight have a positive impact on enhancing the quality of the impairment test and the related disclosures. This suggests that the issue around the over-optimism is indeed an application issue where the solution may lie with auditors and regulators. Another study showed that identifying the impairment testing as a key audit matter improved the quality and quantity of the relating disclosures.

Potential reversal of impairment

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

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

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

Amortisation[8]

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

Are you in favour of reintroduction of amortisation of goodwill?	**Yes**	**No**

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

	83%	17%
Of which: preparers	*22%*	*3%*
Of which: auditors	*20%*	*7%*

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

Preparers

92 As shown above, during polling preparers were in favour of reintroducing amortisation.

93 During the outreach activities referred to in paragraph 2 preparers provided mixed views on whether goodwill amortisation should be reintroduced.

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

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

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

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

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

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

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

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

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

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

96 As to whether goodwill is a wasting asset as asked in EFRAG's DCL, a majority of respondents of the survey consider goodwill to be a wasting asset (5 out of 9) while some consider it partially so (3 out of 9). However, there are mixed views as to whether goodwill is a real economic asset (5 out of 9) or an accounting construct (4 out of 9).

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

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

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

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

d) Comparability with other accounting standards that apply amortisation such as Japanese GAAP. If amortisation were to be reintroduced, a majority of preparers consider that the useful life of the goodwill would have to be the best estimate of the management limited by a cap. However, some others consider that it should be a default period with the possibility of using a different number of years when justified. There are some concerns expressed in relation to the useful life. During the webinar on 23 October 2020, a preparer expressed concern that the determination of the useful life of goodwill would outweigh the benefits of introducing amortisation and that different amortisation periods would affect comparability.

98 If amortisation of goodwill were to be reintroduced, most preparers consider that impairment test should only be performed if there are impairment indicators.

99 A majority of the respondents of the survey consider that the cost of disclosing information about the “age” of goodwill would be minimal (5 out of 9). Some consider that it would be moderate (3 out of 9). Regardless of the election of the impairment only model or the amortisation, a preparer noted that disclosing information on the “age” of goodwill is very useful as it will help users to assess the success of acquisitions.

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

<u>Users</u>

101 Users of financial statements propose different approaches. However, many consider that goodwill is not particularly useful. User feedback indicated that goodwill:

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

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

c) Is becoming economically more relevant and therefore might have more extreme effects. Impairments are larger and more cyclical which can cause negative shocks. Internal conflicts of interest (renumeration, reputation, earnings management) might prevent recognising impairments, especially in countries with lower enforcement in place. Valuation models can be tweaked to provide the “number”. Therefore, goodwill should be amortised for practical reasons as it was demonstrated that impairment tests had failed due to conflicts of interest inherent in the test;

d) Could be amortised to relieve some pressure;

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

f) Enables users to differentiate between successful managers and unsuccessful ones. It is also valuable to know when goodwill is impaired because it implies that the business is worth less.

102 Users referred to the character and development of goodwill. After several years this number becomes meaningless. Some users advised that the purest solution was to take all goodwill against equity. One user suggested that as cash flows materialised it is effectively recognised in profit or loss. One stated that as there was limited support from users for this approach, it is acceptable to have goodwill amortisation as a compromise.

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

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

<u>Auditors</u>

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

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

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

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

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

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

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

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

<u>Other stakeholders</u>

108 In a CFSS meeting, some standard setters indicated that in their jurisdiction there was strong support for goodwill amortisation. One of the standard setters expressed the view that for those components of goodwill that were clearly identifiable it made sense to amortise them because their value would diminish over time. Some of them pointed out the peculiarities of this asset and the convenience of amortisation to reduce it. A different national standard setter stated, in a closed meeting, that a

change is not justified as it has not been demonstrated that the impairment test does not work. In his group there is a majority for keeping the impairment-only model, however, differences were narrow.

109 An enforcer prefers the reintroduction of amortisation as the current impairment test model has failed. Although goodwill is not a wasting asset, it would reduce the continuing increase in the amount of goodwill recognised on companies' balance sheets. However, he also recognised that there would be possible areas of debate, such as the amortisation period.

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

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

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

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

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

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

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

Total equity excluding goodwill[9]

113 A preparer agreed with EFRAG's response since it was an irrelevant disclosure to make. However, a user did not understand the negative position of EFRAG since research aggregators were already providing the equity of the companies excluding goodwill and some of the ratios used by analysts also exclude it.

Questions for EFRAG TEG

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

Simplifying the impairment test[10]

Indicator-only approach

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

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

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

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

Should the IASB adopt an indicator-only approach, removing the requirement to perform an annual quantitative test?	**Yes** 34%	**No** 66%
Of which: preparers	*15%*	*8%*
Of which: auditors	*7%*	*25%*

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

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

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

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

The participants who just referred to one of the above arguments, relied mostly on argument a).

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

Could the IASB's proposed disclosures on the subsequent performance of an acquisition help to better identify triggering events for a potential impairment of goodwill?	**Yes** 63%	**No** 38%
Of which: preparers	*14%*	*14%*
Of which: auditors	*20%*	*9%*

All of the users and academics who participated responded 'Yes'. The regulators responded equally 'Yes' and 'No'. However, some of the respondents who responded 'Yes', argue that such disclosure should not be required for confidentiality reasons.

<u>Preparers</u>

119 All the preparers who participated as panellists at webinars and those in meetings agreed with the adoption of the indicator-only approach for impairment testing where the available headroom is sufficiently large. They argued that performing the quantitative impairment test will not result in an impairment loss when sufficient headroom is available. Therefore, resulting in more costs without adding value. The survey research results (ten responses) show that almost all respondents expect some cost savings, however the majority expects the cost savings to be insignificant.

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

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

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

b) The quality of the quantitative impairment test will diminish if the test is not performed regularly. However, most of the respondents to the survey research (11 responses) disagree with this statement.

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

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

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

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

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

123 The approach and arguments in paragraph 122 are also confirmed by the survey research results (11 responses) where almost all respondents agreed that the indicator-only approach would not simplify the impairment test.

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

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

Auditors

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

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

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

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

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

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

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

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

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

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

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

<u>Users</u>

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

130 One user at the API meeting on 7 October mentioned that there will not be a comprehensive list of indicators. Additionally, the level of management judgment would increase, especially in cases where it would be reasonable to conduct an impairment test, but no triggers has been hit.

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

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

<u>Other stakeholders</u>

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

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

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

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

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

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

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

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

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

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

Further simplifications

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

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

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

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

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

<u>Preparers</u>

139 The majority of respondents to the survey (nine responses) disagree with the statement that including cash flows from future asset enhancements will lead to unjustifiable optimistic input. They also do not find it necessary to have additional guidance on when to include restructuring cash flows in the VIU calculation. The respondents who did not agree, find it necessary to set a threshold and the majority suggest this to be the 'highly probable' threshold.

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

<u>Other stakeholders</u>

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

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

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

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

144 Almost all of the respondents to the survey (ten responses) state that permitting post-tax discount rates and cash flows will reduce the complexity of the impairment test. Most of the respondents also believe that it will also reduce the cost, however the expected reduction is insignificant. In general, the respondents did not need any further guidance to avoid double counting of tax cash flows and did not identify other issues or risks from the use of post-tax inputs. One preparer stated during an interview that their current software can cope with both pre-tax and post-tax numbers.

145 The preparers during the API meeting on 19 October 2020 supported the use of post-tax inputs as these are more readily available. One preparer noted that auditors already allow the application of adjusted post-tax cash flows and discount rates.

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

Using one model to calculate recoverable amount

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

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

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

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

Other proposals to further simplify the impairment test

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

Questions for EFRAG TEG

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

Intangible assets[11]

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

151 Most of the preparers to the survey research (eight responses) see benefits in recognising intangible assets acquired in a business combination separately from goodwill but find it very complex and costly. The preparers expressing their views during the API meeting on 19 October, confirmed the benefits of separately recognising intangible assets.

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

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

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

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

Convergence with the FASB[12]

Preparers

156 All of the preparers who expressed their view during a closed meeting on 22 September 2020 favour a convergence between the IFRS Standards and US GAAP. According to one of these preparers, divergence could lead to complex reconciliations by investors to cope with fundamental differences in the treatment of

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

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

goodwill leading to confusion. Another preparer at the API meeting on 19 October agreed with convergence, but not as the main goal.

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

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

Users

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

Auditors

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

Standard setter

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

Questions for EFRAG TEG

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

High-level summary

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

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

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

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

Questions to constituents in DCL	**Feedback received**
Preparers: Concerns about stating that not monitoring an acquisition?	
Commercial sensitivity	Significant concerns
Preparers: How costly would it be for you to prepare the information? Would you have concerns about the reliability of the information?	Given lack of common approach or methodology for synergies could impair comparability.
Preparers: Are there any legal constraints to disclosing information?	To have lawsuits as a consequence of giving the disclosures was expressed several times.

Preparers: Can you remove from KPIs the effects of the PPA[13]?	Can be very complex and costly
Preparers: Costs relating to including cash flows from operating activities in pro-forma information. Would this be feasible if business is fully integrated with no separate accounts?	Would not be feasible and it is often the case.
Should impairments be reversed - specifically for those in the interim financial statements?	Was part of a polling during the danish outreach event- Majority should not be allowed.
New evidence to support goodwill amortisation?	Continuously growing goodwill balances; Covid-19 and lack of impairments.
Users: would goodwill amortisation be added back?	No inputs received yet
Age of goodwill: useful and feasible?	Generally supported (limited feedback), some preparers highlighted moderate costs with others consider it to be insignificant.
Indicator-only approach: reduction in confidence and other implications? Would there be significant cost savings?	Preparers: survey indicates insignificant savings Overall: concerns about reduction in know-how
Concerns on use of post-tax inputs?	None identified, but one preparer asked for guidance
Intangibles: benefits/concerns of including in goodwill?	No benefits identified
Importance of convergence with US GAAP in this debate	Mixed views: concerns about level-playing field; secondary objective, i.e. not most important

Questions for EFRAG TEG

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

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

Appendix 1: Demographic information about survey respondents

Background

(a) In September 2020, EFRAG launched a questionnaire for preparers with active M&A agendas or material goodwill amounts in the financial statements in order to obtain inputs on the IASB's DP as well as EFRAG's DCL.

(b) To date (28 October 2020), EFRAG has received 14 completed responses from entities located in or with activities in the EEA, however not all responses have completed all questions. This appendix provides further information as to the demographic information about survey respondents.

Information about respondents by country, sector and location of significant operations

Country	Primary sector	Responses	Location of significant operations: EEA	Oth.[14] Eur.	North America	Asia-Pacific	RoW[15]
France	Manufacturing	3	3	2	2	3	2
France	Transportation and utilities	1	1	1	1	1	1
France	Finance, insurance and real estate	2	2	2	2	2	1
	Total for France	***6***	***6***	***5***	***5***	***6***	***4***
Germany	Finance, insurance and real estate	1	1	1	1	1	1
	Italy	2	1	1			1
Switzerland	Healthcare	1	1	1	1	1	1
UK	Mining and construction	1	1				
	Total	**11**	**10**	**8**	**7**	**8**	**7**

Size of respondents

Country	Primary sector	Total assets 2019 YE: €0,5 bn - €30 bn	≥ €30 bn
France	Manufacturing	1	2
France	Transportation and utilities		1
France	Finance, insurance and real estate	1	1
	Total for France	***2***	***4***
Germany	Finance, insurance and real estate		1
Italy			2
Switzerland	Healthcare		1
United Kingdom	Mining and construction		1
	Total	**2**	**9**

Accounting frameworks of respondents

	IFRS	Local GAAP	Both	No response
France	6			1
Germany			1	
Italy	1		1	2
Switzerland	1			
UK		1		
Total	**8**	**1**	**2**	**3**

[14] Non-EEA Europe
[15] Rest of the world

Goodwill KPIs as at 2019 year-end of respondents

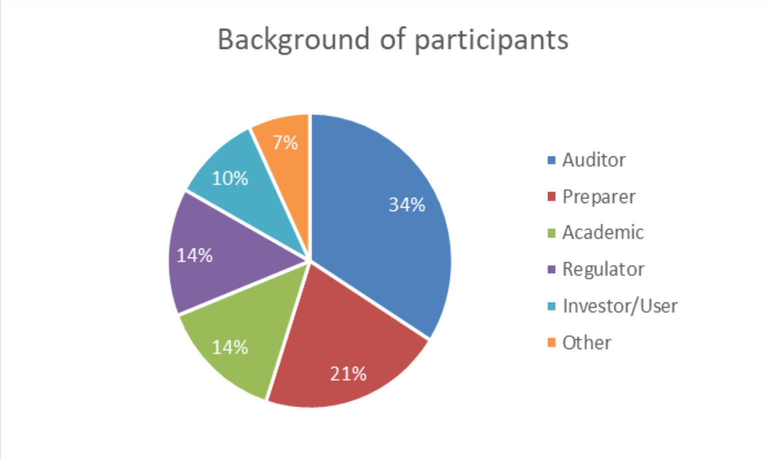
Country	Primary sector	GW/Total assets				GW/Total equity			
		< 10%	10% - 20%	20% - 50%	≥ 50%	< 10%	10% - 20%	20% - 50%	≥ 50%
France	Manufacturing	2		1		2			1
France	Transportation and utilities	1							1
France	Finance, insurance and real estate	1		1				1	1
	Total for France	***4***		***2***		***2***		***1***	***3***
Germany	Finance, insurance and real estate	1					1		
Italy		1			1	1			1
Switzerland	Healthcare		1					1	
United Kingdom	Mining and construction	1				1			
	Total	**7**	**1**	**2**	**1**	**4**	**1**	**2**	**4**

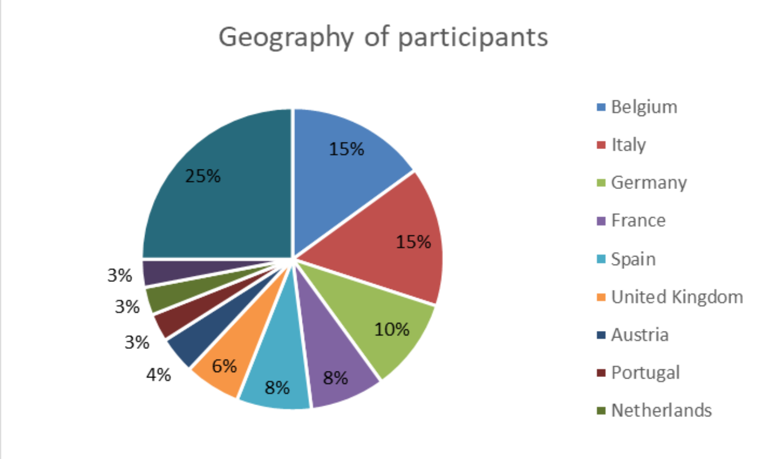
Frequency of business combinations and level of goodwill allocation of respondents

Country	Primary sector	Regular BC's?		Level of allocation of goodwill		
		Yes	No	Reporting entity level	At segment level	Below segment level
France	Manufacturing	2	1	1		2
France	Transportation and utilities	1				1
France	Finance, insurance and real estate	2			2	
	Total for France	***5***	***1***	***1***	***2***	***3***
Germany	Finance, insurance and real estate	1			1	
Italy		1	1		1	1
Switzerland	Healthcare	1			1	
United Kingdom	Mining and construction		1	1		
		8	**3**	**2**	**5**	**4**

Appendix 2: Profile of webinar attendees

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





The following reflects the profile of participants at the webinar on 23 October 2020: