Discussion Paper (*"DP" thereafter*) DP/2020/1 Business Combination – Disclosures, Goodwill and Impairment, issued by the IASB on 19th March 2020

Background

The IASB concluded that it would not be possible to make the impairment test significantly more effective and after no compelling evidence that including some intangible assets in goodwill save costs (but could increase the pressure on the impairment test for goodwill), the IASB decided, in July 2018, to refocus the objectives of the project. Thus, the IASB decided to develop the following project objectives:

(i) Identifying disclosures to enable investors to assess management's rationale for the business combination; and whether the subsequent performance of the acquired business, or combined business, meets expectations set at the acquisition date (A).

(ii) Exploring whether to simplify the accounting for goodwill by permitting an indicator-only approach to determine when an impairment test is required; and/or reintroducing amortisation of goodwill (B).

(iii) Exploring whether to improve the calculation of value in use by permitting cash flow projections to include future restructurings and future enhancements to an asset and the use of post-tax inputs in the calculation of value in use (C).

A. Disclosure

- IASB proposes to enhance the disclosure objectives and requirements in IFRS 3 Business Combinations to improve the information provided to investors about an acquisition and its subsequent performance.

In the DP IASB proposes that a company should be required:

a) to disclose information about the strategic rationale and management's (the chief operating decision maker's (**CODM**'s)) objectives for an acquisition as at the acquisition date;
b) information about whether it is meeting those objectives;
c) information management uses to monitor the subsequent performance of an acquisition;
d) if management (CODM) does not monitor an acquisition, the company should be required to disclose that fact and explain why it does not do so;

If management (CODM) changes the metrics it uses to monitor whether the objectives of the acquisition are being met, the company should be required to disclose the new metrics and the reasons for the change.

The IASB has concluded that the benefits of providing that information would exceed the costs of providing it

***EFRAG position*:** EFRAG supports the objective of the DP to explore whether companies can, at a reasonable cost, provide investors with more useful information about the acquisitions those companies make. Similar to what is reflected in the DP, it is our understanding from discussions with users of financial statements that they do not think that sufficient information to assess acquisitions is currently presented in financial statements. It is therefore important to address this issue.

EFRAG states that information about the strategic rationale and management's objectives for an acquisition as at the acquisition date and subsequent disclosure about whether an acquisition is meeting those objectives would be useful. However, EFRAG notes that there would be some practical **issues** to consider in relation to those disclosures, both to ensure that users receive sufficient and relevant information and that the costs of preparing/disclosing the information would not outweigh the benefits.

In this regard EFRAG notes that **some of the quantitative information suggested** is based on management expectations and would **often be non-GAAP measures**. **EFRAG has not yet formed a view on whether placing this information** in the notes of the **financial statements**, as opposed to placing it in the **management commentary**, would be preferable.
Among other things, it might be difficult to audit the information if Standards do not provide guidance on how the non-GAAP metrics should be determined.

EFRAG understands that the purpose of the suggested disclosures is to provide information about the success (or failure) of an acquisition. The purpose is thus not to provide information about reported goodwill. It could, of course, have been beneficial if the information on the success of an acquisition, in the case that it would involve a substantial amount of goodwill, could also be used to assess the reported goodwill figures.
In relation to the reported goodwill figures, a side-effect of the proposal could, however, be that the level at which an acquisition is monitored would be an indication of the level at which goodwill should be tested for impairment. The new disclosure requirement could offer an anchor point for the level at which goodwill should be allocated to cash-generating units. EFRAG thus recommends that the IASB explores the possibility of including, in the guidance on the allocation of goodwill to cash-generating units included in IAS 36, an expectation that the goodwill impairment test would be done at the level at which an entity monitors whether an acquisition is meeting its objectives.

UniCredit position
UniCredit supports the IASB's proposal to provide a disclosure about the management' strategic rationale for the business combination at the acquisition date. Therefore, in line with IFRS 3, UniCredit agrees to disclose information about the primary reasons and business rationale for an acquisition.

On the contrary, UniCredit is concerned that the provision of information about the performance of an acquired business might not be possible and, in any case, may lack informative value. Based on past experience, we note that the purchased businesses have always been integrated in the existing ones, both in terms of management and in terms of performance evaluation.
As purchased assets and liabilities are mixed and managed together with existing ones, in order to produce together an unitary economic result, the provision of information about the performance of the purchased business would not be possible nor it would provide significant information. This obviously would occur unless the purchased business constitutes a specific CGU.
Useful information about the subsequent performance of the business combination is provided in the segment reporting and through the impairment of goodwill. We are aware that such information mixes the performance of the existing business with the performance of the purchased one, but in our opinion this circumstance cannot be avoided for the reasons mentioned above.
Furthermore, UniCredit argues that it is not clear for how long the disclosure relating to the subsequent results of an acquisition should be provided.
Finally, as far as the disclosure position is concerned, UniCredit considers that it should not be reported in the financial statements, but only in the management report, because the disclosure comes from management assumptions. It is worth noting that the management report is not regulated by accounting standards.

A.1 IFRS 3 Business Combinations requires companies to provide, in the year of acquisition, pro forma information that shows the revenue and profit or loss of the combined business for the current reporting period as though the acquisition date had been at the beginning of the annual reporting period; and to disclose the revenue and profit or loss of the acquired business after the acquisition date, for each acquisition that occurred during the reporting period.

IASB's preliminary view: (i) to replace the term 'profit or loss' with the term 'operating profit before acquisition-related transaction and integration costs' for both the pro forma information and information about the acquired business after the acquisition date. Operating profit or loss would be defined as in the Exposure Draft General Presentation and Disclosures; (ii) to add a requirement that companies should disclose the cash flows from operating activities of the acquired business after the acquisition date, and of the combined business on a pro forma basis for the current reporting period.

EFRAG position: EFRAG suggests that the IASB provides a principles-based definition for the new concepts of 'acquisition-related' and 'integration cost' to be used in preparing the pro forma information. EFRAG **agrees** with replacing 'profit or loss' **with 'operating profit before acquisition-related transaction and integration costs**' for both the pro forma information and information about the acquired business after the acquisition date. EFRAG **disagrees** with **providing similar information for cash flows from operating activities.**

UniCredit Position

UniCredit supports the EFRAG's position and its considerations about the pro forma information, in particular it agrees with replacing "profit or loss" with "operating profit before acquisition-related transaction and integration costs" and disagrees with providing similar information for cash flows from operating activities.

It is worth noting that, as specified above, UniCredit does not support the proposal to provide information related to the acquired business after the acquisition date.

B. Goodwill & impairment

There are shortcomings in how goodwill is accounted for, in detail main causes of the issues are:

- the goodwill is composed by a mixture of elements;
- the goodwill is not tested for impairment directly but only indirectly through the test of CGU to which is allocated.

Similar to the IASB, EFRAG had in the past tried, but was not able, to design the impairment test in a manner that would be more effective. However, in order to remediate some of the shortcomings of the current impairment model in practice, EFRAG considers that the guidance on how goodwill is allocated to cash generating units, in general and in case of disposals, can be improved. In addition, EFRAG assesses that better information related to the impairment test could be provided. These initiatives could potentially reduce the shortcomings of the impairment test. In addition, EFRAG seeks constituents' inputs on possible disclosure proposals to mitigate the risk of management over-optimism. EFRAG appreciates the IASB's attempts to simplify the impairment test. However, EFRAG has reservations about introducing an indicator-only approach.

IASB promotes discussion about the impairment only approach model and amortisation of goodwill.

Both methods of accounting for goodwill—impairment-only and amortisation with impairment—have limitations.

Overall, the IASB concluded it did not have compelling evidence that it should permit or require some identifiable intangible assets to be included in goodwill. Thus, the IASB's preliminary view is that it should not make any changes. Indeed, it is not feasible to design a different impairment test that is significantly more effective than the impairment test in IAS 36 at recognising impairment losses on goodwill on a timely basis at a reasonable cost.

EFRAG position: EFRAG has not yet formed 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 has reservations about an indicator-only approach, as it would expose to a risk to an even lower users' reliance on the results of the impairment test. This could potentially accentuate the 'too little too late' issue and could result in a further loss of information on governance and management stewardship of capital employed (if the 'too little too late' issue is accentuated, it reduces the value of the information these impairment losses provide).

Moreover, EFRAG has reservations on the possibility to develop a different and more effective impairment approach. However, EFRAG believes that, without putting into question the fundamentals of impairment in IAS 36, there are collateral areas of possible improvements. EFRAG suggests that the guidance on goodwill allocation to cash generating units is discussed and possibly amended to improve how the test is applied in practice. In addition, better disclosures of estimates used to measure recoverable amounts of cash generating units containing goodwill could supplement the improvements to goodwill allocation guidance. EFRAG seeks constituents' inputs on possible disclosure proposals to mitigate the risk of management over-optimism.
EFRAG anticipates that the benefits of **exploring these enhancements** may be justified **irrespective of the eventual reintroduction of the amortisation**, as the risk of **overstating goodwill is reduced as a result of the amortisation process only several years after the initial recognition** and in this period the risk of impairment can be material.

UniCredit position

UniCredit supports the proposal to reintroduce the amortisation of goodwill. Indeed, this could simplify indirectly the impairment test.
In particular:

- *the amortisation of goodwill could reduce the volatility in profit or loss, as it reduces the risk of less predictable impairment losses;*
- *as the integration of the new business in the existing ones progresses, the synergies that the goodwill represents are progressively achieved through generation of a higher profit. Therefore, it seems reasonable to depreciate goodwill so to match revenues and expenses.*
- *the amortisation of goodwill would allow in a business combination not to recognize certain intangible assets (such as customer relationships), whose cash flows depend on similar cash flows as the goodwill and that have a finite useful life. This would simplify the impairment test as, being subsumed in goodwill, they will be tested together with the latter*
- *the depreciation of goodwill would simplify the impairment test. In fact, as goodwill is depreciated, its carrying value will be reduced. This will allow, depending on the depreciation rate used, in periods subsequent to those immediately after the Business acquisition, to de-emphasise the attention given to the goodwill, thus allowing to introduce a simplification in the goodwill impairment model, always granting compliance with IAS 36 requirements*
- *the amortisation would be more consistent with the accounting requirements for most of the other non-current assets and the amortisation would allow entities to convey information of the components of goodwill.*

On the other hand, if the amortisation of goodwill will be reintroduced, UniCredit highlights that IASB should clarify whether the useful life of goodwill will be determined by the standards or it will be defined by companies on a discretionary basis.

B.1 Presentation of Equity without goodwill

***IASB proposal*:** The IASB's preliminary view is that it should develop a proposal to help investors better understand companies' financial positions by requiring companies to present on their balance sheets the amount of total equity excluding goodwill. The IASB reached this view because it was considered that:
(a) Goodwill is different from other assets with a unique nature.
(b) Presenting this amount could help to highlight those companies for which goodwill is a significant portion of their total equity.
However, changing the structure of the financial statements to allow the presentation of this subtotal could be too disruptive. Therefore, the IASB does not intend to pursue such a change and companies would present this amount as a free-standing item.

***EFRAG position*:** does not support the IASB's proposal to require companies to present on their balance sheets the amount of total equity excluding goodwill.

UniCredit Position
UniCredit supports the EFRAG position not to change the balance sheet. However, UniCredit argues that it could be useful, only within the Illustrative Note, to show the total equity net of goodwill (even though such calculation can be made by users of financial statements with the information already provided).

C. Calculation of Value in use

IASB proposal: The IASB's preliminary view is that it should develop a proposal 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.
Because:
- Reduce cost and complexity;
- Make the impairment test less prone to error because estimates of value in use would probably be based on cash flow projections which are prepared, monitored and used internally for decision-making regularly.
- Make the impairment test easier to understand.
- Make the impairment test easier to perform and therefore could make it easier to audit and enforce.

Moreover, IASB would allow companies to use post-tax cash flows and post-tax discount rates in estimating value in use.

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

UniCredit position

Concerning the calculation of value in use, UniCredit supports the proposal to include cash flows arising from future restructuring to which the company is already committed, but it does not agree to include cash flows arising from future restructuring to which the company is not committed yet, because it could increase the subjectivity in the calculation. In this regard, UniCredit position is that generally goodwill impairment test would need to rely, as now, on plans and budget approved by the management; as far as a restructuring is foreseen in those plans then, its effects can be included in the cash flows. Otherwise, the inclusion in cash flows of restructuring initiatives that the management has not approved (and therefore the entity is not committed to) might make impairment test too much subjective, lacking documentability. Moreover, UniCredit supports the proposal to allow companies to use post-tax inputs and discount rate to calculate value in use.