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Dear Sir or Madam,

On behalf of the Austrian Financial Reporting and Auditing Committee (AFRAC), the privately organised standard-setting body for financial reporting and auditing standards in Austria, we appreciate the opportunity to comment on IASB's discussion paper (DP) *Business Combinations – Disclosures, Goodwill and Impairment*.

Principal authors of this comment letter were Klemens Eiter, Christian Höllerschmid, Aslan Milla, Stefan Maxian, Dominik Permanschlager, Gerhard Prachner, Anita Seiwald and Guido Sopp. The professional background of the authors is heterogeneous and includes academics, preparers, auditors, enforcers and users, in order to assure a balanced Austrian view on the DP.

Kind regards,

Romuald Bertl
Chairman

GENERAL REMARKS (AND ANSWER TO QUESTION 1)

The impairment-only approach was adopted in 2004 and has been effective now for almost 15 years. During this period accounting researchers and users of financial statements gained a lot of experience. Many empirical studies show that absolute amounts of goodwill, the goodwill per company and the implicit lifetime of goodwill increase very fast. The implicit lifetime of goodwill in several studies reaches 100 years and more. On the other hand, empirical evidence reveals that the association between the goodwill and the firm value and the value-relevance of goodwill decrease rapidly.

This is in line with the observations of auditors, preparers and users that in many cases goodwill represents synergies and excess earnings that decline over time and can only be realised over a limited time period.

For the purpose of this comment letter, we performed a survey among ÖVFA and CFA members (Austrian analysts and investors) in November 2020. Its findings correspond to these observations. The respondents cover a representative share of the capital market users in Austria. 72% of the respondents answered that in their opinion goodwill decreased over time. In background interviews users furthermore stated that they believe that the relevance of goodwill decreased over time and they expressed their concerns about goodwill amounts being overstated. As a consequence, goodwill is generally not used for company analyses, except in specific industries (e.g., start-ups, health care).

The results of the user survey and the empirical studies strongly suggest that goodwill is a wasting asset.

Based on this understanding, Austrian analysts and investors do not only adjust balance sheet figures, but often also the impact of impairments on performance measures/P&L. This is also due to the potential of discretionary earnings management in impairment tests. Empirical research studies also provide evidence that the impairment-only approach offers a wide range of discretion for goodwill accounting that can be utilized for earnings management. Austrian users share this view. In the survey they clearly expressed their opinion about the discretionary use of impairments, especially in cases of CEO changes.

Based on these results, AFRAC believes that the impairment-only approach does not provide sufficiently faithful and decision-useful information. Because goodwill wastes over time, it is constantly (and often fast) consumed and is replaced by internally generated goodwill that is not related to the initial business combination and should not be recognised. This internally generated goodwill shields the entity against impairment, even if the acquired goodwill is impaired. We acknowledge that the IASB discussed a headroom approach, but this is not a practical solution.

Goodwill includes, among others, synergies and excess earnings that are consumed and realised over time. Faithful representation requires this consumption to be reflected in P&L. **Hence, AFRAC strongly supports reintroducing the amortisation of goodwill.** The amortisation will also reduce management discretion and hold management accountable for acquisitions to generate profits and recover the expense related to synergy/goodwill consumption. This view is also supported by the Austrian users we surveyed. 68% of the analysts and investors stated to prefer goodwill amortisation over the current impairment-only approach.

Concerning the length of the useful life in the amortisation approach, AFRAC suggests to introduce a rebuttable presumption of a maximum of 10 years. In general, the length of the amortisation period should be based on the expected period of consuming the benefits of a business combination, e.g., the expected period in which the acquirer expects to earn excess return as compared to the theoretical case of a standalone business. However, a default period or cap provides simplicity, increases the comparability across companies and reduces costs. Based on experience, 10 years are an appropriate upper bound for realising the benefits of a business combination. This maximum of a 10-year period is also used in other standards, e.g., the EU accounting directive. A period of up to 10 years was also proposed by the vast majority of users of the recent Austrian survey. However, there may be situations in which entities can demonstrate that a longer time period is appropriate. Therefore, this presumption of ten years should be rebuttable. In the case of a longer period, we propose that the entity is subject to annual impairment tests in order to avoid the risk of overstating goodwill.

If the amortisation approach will be adopted, AFRAC proposes to restrict impairment tests to "triggering events", as the risk of overstatement will be significantly reduced by amortisation and it will only be necessary to address specific circumstances by indicating impairment requirements. The additional costs of annual impairment tests would outweigh their benefits. If the IASB will not decide to introduce amortisation, the impairment-only approach should include the requirement of annual impairment tests (in addition to impairment tests carried out based on triggering events), as we considered annual impairment tests as part of the package when the IASB introduced the impairment-only approach.

Regarding the **additional disclosure requirements** for acquisitions, AFRAC recommends to **limit these to qualitative information about the strategic rationale for undertaking an acquisition.** AFRAC does not support the introduction of the disclosure of quantitative metrics about the subsequent performance of an acquisition. These are non-GAAP measures, which lack comparability across companies, may be forward-looking and commercially sensitive. Practical experience suggests that quantitative information on expected synergies from combining operations is subject to a high degree of judgement and, therefore, lacks verifiability. We note that the results of our user survey suggest support for additional disclosures about the performance of the acquisition. However, in background interviews, users confirmed that the relevance of information is specific to the entities and the acquisition. Hence, we believe this information should be better placed in the management commentary. Furthermore, we refer to "information overload" and to the "disclosure problem" that may be increased by additional disclosures.

AFRAC does not support the introduction of new models for accounting the goodwill, such as a headroom approach. We agree that it is not possible to eliminate the shielding effect from the impairment test. The impairment test should rather be improved or simplified. We agree to remove the restrictions in IAS 36 that prohibit companies from including cash flows from future uncommitted restructuring or asset enhancements. However, this removal would require additional guidance to assure reliability and alignment with IAS 37.

AFRAC also supports allowing the use of post-tax discount rates and cash flows. The use of pre-tax discount rates leads to artificial calculations. In this regard, we also recommend an update of

the guidance, e.g., based on the Educational Material for IFRS 13.

AFRAC supports developing further improvements of the impairment test. Mainly, this could be achieved by providing more guidance on how to calculate the necessary inputs for the impairment test. This would include adding guidance on the difference between entity-specific inputs used in value in use and market-participant inputs used in fair value less costs of disposal.

AFRAC agrees that the IASB should not change the PPA to include certain intangibles identified in a business combination in goodwill, because there is a well-established PPA practice which is generally accepted and understood by preparers and users. However, if amortisation of goodwill will be reintroduced, the assessment of whether the useful life of intangible assets identified in the PPA is finite or indefinite will become more relevant and, considering that the identification and the valuation of intangible assets like trademarks and brands are subject to a high degree of judgement, rules need to ascertain that this assessment cannot be used for earnings management.

SPECIFIC REMARKS

Question 2: Paragraphs 2.4–2.44 discuss the Board's preliminary view that it should add new disclosure requirements about the subsequent performance of an acquisition.

Do you think those disclosure requirements would resolve the issue identified in paragraph 2.4—investors' need for better information on the subsequent performance of an acquisition? Why or why not?

AFRAC generally agrees the requirement to disclose the primary reasons for an acquisition with a requirement to disclose

- the strategic rationale for undertaking an acquisition; and
- management's objectives for the acquisition at the acquisition date.

This information should be given on a qualitative basis in the notes.

AFRAC disagrees to provide such information and the information on the subsequent performance of an acquisition on a quantitative basis in the financial statements. AFRAC believes that the information about whether the original objectives of an acquisition have been met becomes less relevant as time passes. These metrics are difficult to audit, since they can be very subjective. Overall, we believe that such information should, therefore, be better placed in the management commentary and not in the notes. Furthermore, we also point out that it may be difficult, for practical reasons, to monitor whether the objectives of an individual acquisition have been met, as the acquired business may already have been integrated in the reporting group or may have been allocated to different business units and, therefore, may have become indistinguishable from the rest of the acquiring company's business.

Moreover, we consider this information to be commercially sensitive and forward-looking. Overall,

these additional metrics are non-GAAP measures and should, therefore, be placed in the management commentary. That is also necessary, as these metrics are difficult to audit, since they can be very subjective.

In summary, AFRAC agrees to the purpose of providing the strategic rationale for undertaking an acquisition and management's objectives for the acquisition at the acquisition date. However, AFRAC does not support the disclosure of additional metrics for the subsequent performance of an acquired entity.

Question 3: Paragraphs 2.53–2.60 explain the Board's preliminary view that it should develop, in addition to proposed new disclosure requirements, proposals to add disclosure objectives to provide 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; and**
- **the extent to which an acquisition is meeting management's (CODM's) objectives for the acquisition.**

AFRAC believes that the disclosure of forward-looking information and the expectations from an acquisition do not meet the general purpose of accounting. The purpose of accounting is to accumulate and report on financial information about the performance, financial position and cash flows of a business at the reporting date and not at a date in the future.

Therefore, AFRAC does not support the development of proposals to add disclosure objectives to provide additional forward-looking information as they are described in par 2.53–2.60.

Question 4: Paragraphs 2.62–2.68 and paragraphs 2.69–2.71 explain the Board's preliminary view that it should develop proposals:

- **to require a company to disclose:**
  - **a description of the synergies expected from combining the operations of the acquired business with the company's business;**
  - **when the synergies are expected to be realised;**
  - **the estimated amount or range of amounts of the synergies; and**
  - **the expected cost or range of costs to achieve those synergies; and**
- **to specify that liabilities arising from financing activities and defined benefit pension liabilities are major classes of liabilities.**

Do you agree with the Board's preliminary view? Why or why not?

AFRAC disagrees with the Board's preliminary view. Practical experience suggests that quantitative

information on expected synergies from combining operations is subject to a high degree of judgement and, therefore, lacks verifiability. The information is commercially sensitive, forward-looking and does not justify the high efforts and costs necessary for its preparation. Moreover, the information can be difficult to audit.

However, AFRAC agrees to require a specification of the major classes of liabilities (liabilities arising from financing activities and defined benefit pension liabilities).

Question 5: 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.

Paragraphs 2.82–2.87 explain the Board's preliminary view that it should retain the requirement for companies to prepare this pro forma information.

AFRAC believes that such pro forma information in general could be helpful, since it can provide information on the non-organic growth of the business. The pro forma information is only hypothetical. There are practical problems and diversity in how the pro forma information is calculated. This impairs the meaningfulness and comparability of this disclosure. Therefore, AFRAC does not support retaining this disclosure requirement but considers post-acquisition disclosures as more useful.

IFRS 3 also requires companies 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.

Paragraphs 2.78–2.81 explain the Board's preliminary view that it should develop proposals:

- **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.**
- **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.**

Concerning the disclosure of performance figures for the acquired business after the acquisition date, AFRAC agrees that this information may be helpful for users and in the current form of reporting it is in general easily available and not subject to significant judgement. We support the proposal to replace the term 'profit or loss' by the term 'operating profit' as defined in the ED General Presentation and Disclosure. This will reduce diversity in practice, but it is conditional on the introduction of a definition of 'operating profit or loss' in IFRS, which we generally support. However, the adjustment of the operating profit for acquisition-related transaction and integration costs will introduce judgement with

regards to the items that can be included in this adjustment and, thus, will impair the comparability and reliability of this disclosure. In AFRAC's opinion, the adjustment for acquisition-related transaction and integration costs should, therefore, be eliminated.

AFRAC, however, does not support the additional requirement that companies should disclose the cash flow from operating activities. This measure does not only include many discretionary decisions, but we also consider the usefulness of the sole cash flow figure to be very limited. Moreover, the calculation of the cash flow from operating activities is complex and costly, especially, if the acquired business has already been fully integrated.

<u>Question 6</u>: As discussed in paragraphs 3.2–3.52, the Board investigated whether it is feasible to make the impairment test for cash-generating units containing goodwill significantly more effective at recognising impairment losses on goodwill on a timely basis than the impairment test set out in IAS 36 Impairment of Assets. The Board's preliminary view is that this is not feasible.

Since AFRAC strongly supports the reintroduction of the amortisation approach, the introduction of the headroom approach is only of limited relevance. In this regard, we agree that it is not possible to eliminate shielding from the impairment test. Existing models should be rather improved or simplified. For example, further guidance could be given for the organisational level at which goodwill is allocated – this could reduce shielding to a certain extent and could reduce the judgment currently allowed in allocating goodwill to CGUs. Enhancing the guidance or rules on the reallocation of goodwill amongst CGUs would also improve usefulness.

<u>Question 7</u>: Paragraphs 3.86–3.94 summarise the reasons for the Board's preliminary view that it should not reintroduce amortisation of goodwill and instead should retain the impairment-only model for the subsequent accounting for goodwill.

AFRAC supports the reintroduction of the amortisation approach of goodwill. It considers the goodwill to be a <u>wasting asset</u> and, therefore, it should be amortised over its useful lifetime.

The impairment-only approach was introduced in 2004 and has been effective now for almost 15 years. During this period accounting researchers and users of financial statements also gained a lot of experience and extensive evidence indicates that this model does not work as intended by the IASB. Several studies and reports (e.g., by ESMA) state that the impairment-only model is not working as assumed by the IASB, and impairments recognized are generally criticized to be "*too little, too late*".

1) **Empirical studies show that goodwill is a wasting asset**

For instance, *Bugeja* and *Gallery* (2006) **find evidence** that the **value relevance of purchased goodwill declines as it ages.** Their results show that goodwill acquired in the observation year and in each of the previous two years is positively associated with firm value, but **there is no significant**

association with goodwill acquired more than two years before. The absence of a significant relationship between the market value of equity and the goodwill acquired more than two years before **suggests that older goodwill is not considered to be an asset by investors, or that it is already wasted.**

In a similar study based on European data, *Ojala* et al (2007) show that **the value relevance of goodwill is more pronounced in the case of shorter amortisation periods**. They conclude that the **goodwill amortisation practice does provide relevant information for investors**, provided that amortisation periods are sufficiently short in order to better reflect the economic life of the underlying asset.

Recent studies investigating goodwill in financial statements suggest that the impairment-only model does not reflect the economic life of goodwill. *Patloch-Kofler and Roider* (2020) calculate the implicit lifetime of a goodwill accounted for according to the impairment-only model of companies listed on the **STOXX Europe 600 between 2010 and 2018**. They find that the **implicit lifetime did not only dramatically increase since the abandonment of the amortisation approach,** but also that the **implicit lifetime of goodwill accounts for approx. 103 years in 2018. In 2010, the approx. implicit lifetime of goodwill was just 38 years. This represents an increase of 271% within 9 years.**

These results are in line with those in a paper by the ASBJ and HKICPA Staff (ASAF meeting, April 2020, AP 1A) based on more than 1,000 listed companies that constitute the S&P 500, S&P Europe 350, the Nikkei 225 and the Hang Seng Composite Index of Hong Kong covering main capital markets worldwide analysing goodwill and impairment for the timeframe from 2014 to 2018. This research paper **indicates an implicit lifetime of 122 years for US, 78 years for Europe and 64 years for Hong Kong and Japan**. From 2014 to 2018 goodwill per company increased by 45% for US, 26% for Europe, 60% for Hong Kong and 74% for Japan. 18.8% of the US companies and 10.1% of the EU companies show goodwill that exceeds 100% of their net assets, 41.1% of the US companies and 33.8% of the European companies show goodwill that exceeds 50% of their net assets.

This study also corroborates a previous study done by *Cappel and Hartmann* (2018). They find that the value relevance of **goodwill in the German DAX30-companies has been steadily increasing from 2008 to 2016.** They calculate the proportional goodwill to total assets and find that goodwill **increased by a total of 60.1% from 125 billion Euros to 200 billion Euros**.

To sum up, **empirical studies show that goodwill generally, goodwill per company and the implicit lifetime of goodwill are increasing very fast. The implicit lifetime of goodwill** in several studies reaches **100 years and more.** On the other hand, **empirical evidence shows** that the **association between goodwill and firm value and the value relevance of goodwill is decreasing very fast.**

This is consistent with the **observations of auditors, preparers and users** that in many cases **goodwill represents synergies and excess earnings that decline over time and can only be realised within a limited time period**.

AFRAC's strong view is that **disregarding these empirical results and observations** and continuing **not to amortise goodwill but instead account for it indefinitely fails to** meet the basic requirement

of **providing relevant information** that is useful for economic decision-making.

2) Recent user survey considers goodwill to be a wasting asset

In November 2020, the Austrian ÖVFA and CFA conducted a survey among their members at the request of AFRAC. The 39 participating analysts and investors represent a significant share of the capital market users in Austria.

72% of the respondents answered that in their opinion goodwill is diminishing over time. In background interviews users furthermore stated that they believed that the relevance of goodwill decreased over time and expressed their concerns about goodwill amounts being overstated. As a consequence, goodwill is generally excluded from their company analyses, except for specific industries (e.g., start-ups, health care). Austrian analysts and investors do not only adjust balance sheet figures, but often also impairment impacts on performance measures in the P&L. This is also due to discretionary earnings management (see item 3) below).

The results of this survey are in line with the findings in the empirical studies (see above) and the view of Austrian prepares and auditors that goodwill is a wasting asset.

3) Impairment-only approach is used for earnings management

Many empirical studies deal with the question whether the impairment-only approach is amenable to earnings management.

For instance, *Malijebtou et al* (2017) investigate how reporting incentives influence firms' accounting choices when they are required to use IAS 36 to account for goodwill impairment. They **examine the earnings management motives** associated with the decision and the magnitude of goodwill impairment losses reported by French firms following the adoption of IFRS on purchased goodwill in 2005. **Their results show that the decision to record goodwill impairment losses is driven by CEO change and financial crisis motives**. In addition, their **findings indicate a significant link between the magnitude of annual goodwill impairment losses and firms' incentives to understate them**. They suggest that French firms record higher annual goodwill impairment losses to **meet earnings management incentives linked to CEO change, earnings smoothing, big bath accounting and financial crisis.** In this context, they **reveal managers' opportunistic behaviour in the medium to long term**, which suggests the discretionary use of the annual goodwill impairment test under IAS 36.

AbuGhazaleh et al (2011) find **similar evidence**, using a sample of 528 firm-year observations drawn from the **top 500 U.K. listed firms** for the years 2005 and 2006. In contrast to the IASB's contention that the impairment-only approach will improve the accounting treatment of goodwill and will provide users with more useful and value-relevant information regarding the underlying economic value of goodwill, empirical results reveal that **managers exercised discretion** in the reporting of goodwill impairments following the adoption of IFRS 3. Specifically, goodwill impairments are more likely to be associated with recent CEO changes, income smoothing and "big bath" reporting behaviours.

Glaum et al (2018) corroborate these findings. They investigate **a comprehensive sample of stock-**

listed firms from 21 countries and conclude the following: Though the timeliness of goodwill impairments and the degree to which goodwill impairment decisions are influenced by incentives depend on the strength of national accounting and auditing enforcement systems, goodwill impairment decisions still leave room for managerial discretion and are, thus, **to some degree influenced by managerial and firm-level incentives, such as CEO reputation concerns and by management's preferences for smooth earnings.**

To sum up, **empirical research studies provide evidence that the impairment-only model offers a wide range of discretionary powers for goodwill accounting that is often – at least to some extent – utilized for earnings management**.

This view is shared not only by AFRAC members, but also by Austrian users. In the recent survey (see item 2) above) they expressed their opinion about the discretionary use of impairments, especially in cases of CEO change.

4) Conclusion on empirical studies and user survey: Impairment-only does not provide faithful and decision useful information

Based on the results of the empirical studies and the recent survey AFRAC believes that the impairment-only approach does not provide faithful information.

As goodwill is wasting over time, it is constantly (and often fast) consumed and is replaced by internally generated goodwill that is not related to the initial business combination and should not be recognised. This internally generated goodwill shields the entity against impairment even if the acquired goodwill is impaired.

Goodwill includes, among others, synergies and excess earnings that are consumed and realised over time and faithful representation requires this consumption to be reflected in P&L. Hence, AFRAC strongly supports reintroducing the amortisation of goodwill. The amortisation will also reduce management discretion and hold management accountable for acquisitions to generate profits and recover the expense related to synergy/goodwill consumption.

This view is also supported by the Austrian users we surveyed. 68% of the analysts and investors stated to prefer goodwill amortisation over the current impairment-only approach.

5) Amortisation and useful life

The amortisation approach requires that goodwill should be amortised in a systematic way. It may not be easy to determine the appropriate useful life. In general, the length of the amortisation period should be based on the expected period of consuming the benefits of a business combination, e.g., the expected period in which the acquirer expects to earn excess return as compared to the theoretical case of a standalone business. For practical reasons, AFRAC suggests to define a default period or cap. Such an approach provides simplicity, increases the comparability across companies and reduces costs. Specifically, we suggest applying a rebuttable presumption for the useful life of goodwill of a maximum of 10 years. Based on experience, this is an appropriate upper limit for realising the benefits of a business combination and a maximum 10-year period is also used in other standards,

e.g., in the EU accounting directive. A period of up to 10 years was also proposed by the vast majority of users of the recent Austrian survey.

However, there may be exceptional situations in which entities can demonstrate that a longer time period is appropriate and the presumption is rebutted. These exceptional situations may rely on the estimated lifetime of the business model of the acquisition, which has to be taken into account. However, AFRAC considers requiring an annual impairment test in case of rebutting the useful life of 10 years and choosing a longer useful life. In this case, we propose that the entity is subject to annual impairment tests over the whole amortisation period.

Question 8: Paragraphs 3.107–3.114 explain the Board's preliminary view that it should develop a proposal to require companies to present on their balance sheets the amount of total equity excluding goodwill. The Board would be likely to require companies to present this amount as a free-standing item, not as a subtotal within the structure of the balance sheet (see the Appendix to this Discussion Paper).

AFRAC disagrees with the explicit disclosure of the total equity excluding goodwill. Stakeholders are able to compute the amount easily. Thus, this would not provide any additional information and could raise (legal) questions for financial agreements including financial covenants. Moreover, this kind of presentation would result in the fundamental question whether goodwill was an asset. We believe that the proposal in the ED General Presentation and Disclosure requiring goodwill to be presented as a separate line item on the balance sheet is appropriate.

Question 9: Paragraphs 4.32–4.34 summarise the Board's preliminary view that it should develop proposals to remove the requirement to perform a quantitative impairment test every year. A quantitative impairment test would not be required unless there is an indication of impairment. The same proposal would also be developed for intangible assets with indefinite useful lives and intangible assets not yet available for use.

AFRAC recommends the reintroduction of the amortisation approach, and if it is accepted, an annual impairment test should not be required. Impairment tests carried out based on "triggering events" are sufficient, as the risk of overstatement will be significantly reduced by amortisation and it will only be necessary to address specific circumstances indicating impairment. The costs of annual impairment tests would outweigh their benefits.

However, if the IASB were to decide *not* to introduce amortisation, the impairment-only approach should include the requirement of annual impairment tests (in addition to impairment tests carried out based on triggering events), as we considered annual impairment as part of the package when the IASB introduced the impairment-only approach.

<u>Question 10</u>: The Board's preliminary view is that it should develop proposals:

- **to remove the restriction in IAS 36 that prohibits companies from including some cash flows in estimating value in use—cash flows arising from a future uncommitted restructuring, or from improving or enhancing the asset's performance (see paragraphs 4.35–4.42); and**
- **to allow companies to use post-tax cash flows and post-tax discount rates in estimating value in use (see paragraphs 4.46–4.52).**

The Board expects that these changes would reduce the cost and complexity of impairment tests and provide more useful and understandable information.

AFRAC agrees with the IASB's assessment of the benefits related to the removal of the restriction in IAS 36 that prohibits companies from including cash flows arising from uncommitted restructuring or from asset enhancements. Although it is conceptually not in line with the idea of determining the value in use of existing assets, it is practicable. The benefit of this proposal is that the forecasted cash flows are more aligned with the forecast used by management for business purposes, which eliminates the differences between different types of restructurings, such as on the one hand operational enhancements arising from continuous improvements that are already included in the cash flows to determine the value in use, and on the other hand more structural changes to the business which currently need to be excluded.

However, we acknowledge that the removal of these restrictions may result in an overall optimistic assessment of the future cash flows by the management. We believe that the suggested guidance in the DP is not sufficient to counterbalance over-optimism; over-optimism cannot be only addressed by auditors or regulators. Consequently, our agreement to the removal of these restrictions is conditional on introducing additional guidance when restructuring cash flows should be included in the calculation, and on aligning this guidance with IAS 37. That is, before removing the restrictions, it is necessary to specify principle-based guidance for the inclusion of cash flows arising from a future uncommitted restructuring or from improving or enhancing the asset's performance. In Austria (as well as in Germany), where cash flow models play a dominant role in the valuation practice, specific valuation guidance was developed, which is generally accepted and relevant for transaction and fair value calculation purposes and could, therefore, serve as a basis for such guidance.

Regarding the permission to use post-tax inputs in the calculation of value in use we support the IASB's proposal to remove the explicit requirement to use pre-tax inputs and pre-tax discount rates to calculate value in use due to two reasons:

First, a pre-tax discount rate may be hard to understand, since this rate is not observable in the market data and is generally not used for any other valuation purposes. Hence, the usefulness of this information is very limited and increases complexity.

Second, management usually uses post-tax discount rates that are observable and post-tax cash flows for calculating the recoverable amount and then calculates the pre-tax discount rate needed for disclosure requirements. Allowing post-tax inputs would result in a simplification and the susceptibility

to error would be further reduced.

<u>Question 11</u>: Paragraph 4.56 summarises the Board's preliminary view that it should not further simplify the impairment test.

Should the Board develop any of the simplifications summarised in paragraph 4.55? If so, which simplifications and why? If not, why not?

AFRAC supports the development of further improvements of the impairment test. Mainly, this could be achieved by providing more guidance on how to calculate the necessary inputs for the impairment test. This includes specifying several terms and definitions, like adding more guidance on the difference between entity-specific inputs used in value in use and market-participant inputs used in fair value less costs of disposal. For instance, the meaning of market-participant inputs for assets and products that are not comparable to others is unclear. The missing guidance results in many difficulties when applying IAS 36 and IFRS 13.

A further possibility for simplifying the impairment test is to improve guidance on how to calculate the discount rate. For example, the explanations on how to calculate the discount rate provided in the Educational Material for IFRS 13 (2013) are a useful guidance. We recommend updating and aligning the guidance in IAS 36 in this or other regards, e.g., the growth rate based on the Gordon growth model.

<u>Question 12</u>: Paragraphs 5.4–5.27 explain the Board's preliminary view that it should not develop a proposal to allow some intangible assets to be included in goodwill.

AFRAC agrees that the IASB should <u>not</u> develop such a proposal. AFRAC is aware of the complexity for companies to perform a PPA to account for intangible assets identified in business combinations such as customer relationships and brands separately from goodwill. Nevertheless, we notice that there is an established PPA practice, which is generally accepted and understood by preparers and users.

However, if amortisation of goodwill will be reintroduced, the assessment of whether the useful life of intangible assets identified in the PPA is finite or indefinite will become more relevant and, considering that the identification and the valuation of intangible assets like trademarks and brands are subject to a high degree of judgement, rules need to ascertain that this assessment cannot be used for earnings management.

<u>Question 13</u>: IFRS 3 is converged in many respects with US generally accepted accounting principles (US GAAP). For example, in accordance with both IFRS 3 and US GAAP for public companies, companies do not amortise goodwill. Paragraphs 6.2–6.13 summarise an Invitation

to Comment issued by the US Financial Accounting Standards Board (FASB).

Do your answers to any of the questions in this Discussion Paper depend on whether the outcome is consistent with US GAAP as it exists today, or as it may be after the FASB's current work? If so, which answers would change and why?

Convergence between US-GAAP and IFRS is an important factor. Goodwill accounting and amortisation is especially relevant for international M&A transactions and the trading of companies at capital markets. According to a CFA institute investment analysis, goodwill represents up to 40% of the equity of public companies. Therefore, US-GAAP convergence is important and the outcome of the FASB's discussion on requiring amortisation of goodwill should be taken into account in the IASB's deliberations. Ultimately, however, the main objective for standard-setting by the IASB is to adopt accounting standards for goodwill that assure most relevant and faithful financial information.

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