Deutsches Rechnungslegungs Standards Committee e.V.

Accounting Standards Committee of Germany

ASCG • Joachimsthaler Str. 34 • 10719 Berlin

IFRS Technical Committee

Phone: +49 (0)30 206412-12

E-Mail: info@drsc.de

Berlin, 28 December 2020

Mr Hans Hoogervorst
Chair of the
International Accounting Standards Board
Columbus Building
7 Westferry Circus / Canary Wharf
London E14 4HD

Dear Hans,

IASB Discussion Paper DP/2020/1 *Business Combinations – Disclosures, Goodwill and Impairment*

On behalf of the Accounting Standards Committee of Germany (ASCG) I am writing to comment on the Discussion Paper DP/2020/1 *Business Combinations – Disclosures, Goodwill and Impairment* issued by the IASB on 19 March 2020 (herein referred to as 'DP').

We welcome the opportunity to comment on the DP proposals and appreciate the IASB's effort to improve and to simplify the impairment test as well as to provide users with more useful information about acquisitions.

Regarding the proposed disclosures, we think that they are capable of providing more useful information to investors and, therefore, of increasing the information value of the financial statements. However, we think that it could be difficult to solve the issue of confidentiality and sensitivity of the information, as we recognise that there may be an area of conflict for information that is of interest to the user but is classified as confidential by the company. Therefore, we suggest developing overarching, principle-based disclosure objectives in conjunction with (limited) disclosure requirements for core information. Further, we note that the IASB's expectation that much of the required information is already available to companies is too optimistic and that the underlying assumptions do not adequately reflect the complexity of corporate structures and many of the acquisitions occurring in practice.

Our main criticism, though, relates to our observation that the initial core problem of the IASB's research project, i.e., ensuring a robust impairment test and timely impairments of goodwill in response to the ongoing criticism of *too little, too late* has hardly been addressed and not been solved; it therefore continues to exist.

Contact:
Joachimsthaler Str. 34
D-10719 Berlin
Phone: +49 (0)30 206412-0
Fax: +49 (0)30 206412-15
E-Mail: info@drsc.de

Bank Details:
Deutsche Bank Berlin
IBAN-Nr.
DE26 1007 0000 0070 0781 00
BIC (Swift-Code)
DEUTDEBBXXX

Register of Associations:
District Court Berlin-Charlottenburg, VR 18526 Nz
President:
Prof Dr Andreas Barckow
Executive Director:
Prof Dr Sven Morich

In our view, the current Covid-19 pandemic provides for a classic scenario where we think that the current impairment model does not meet the expectation of users, regulators, and other stakeholders. We would have expected entities to incur impairments due to the economic downturn. However, the conceptual design of the current impairment model, and various factors that influence the recoverable amount, lead to crises not being reflected in a timely manner, as significant impairments would only occur in situations that severely threaten a CGU's business model and therefore, significantly affect the terminal value in the impairment test. We think the IASB should take this as an opportunity to fundamentally question how the subsequent accounting for goodwill should be modelled.

We concede that most technical arguments for or against amortisation or the impairment-only approach have been on the table for long and have already been exchanged numerous times. However, our re-evaluation of the arguments already known, and our observations lead us to a different assessment than when the impairment-only approach was introduced – namely that:

- the terminal value is the main factor when determining whether or not there is a need for an impairment and
- the current impairment model does not meet the expectations of users, regulators, and other stakeholders with regard to recognising impairments on a timely basis.

This is also due to the fact that goodwill is a unique asset that can neither be fully accounted for by the amortisation nor by the impairment-only approach. In our opinion, the impairment-only approach merely represents an accounting convention that may be superior conceptually yet is only but one reasonable alternative and one that leads to the well-known accounting problems due to the lived practice in performing an impairment test. Therefore, we are convinced that the problems could be better solved by reintroducing an amortisation model.

Our responses to the questions of the DP are laid out in the appendix to this letter. If you would like to discuss our comments further, please do not hesitate to contact Peter Zimniok (zimniok@drsc.de) or me.

Yours sincerely,

Sven Morich

Executive Director

Appendix – Answers to the questions in the DP

Question 1

Paragraph 1.7 summarises the objective of the Board's research project. Paragraph IN9 summarises the Board's preliminary views. Paragraphs IN50–IN53 explain that these preliminary views are a package and those paragraphs identify some of the links between the individual preliminary views.

The Board has concluded that this package of preliminary views would, if implemented, meet the objective of the project. Companies would be required to provide investors with more useful information about the businesses those companies acquire. The aim is to help investors to assess performance and more effectively hold management to account for its decisions to acquire those businesses. The Board is of the view that the benefits of providing that information would exceed the costs of providing it.

(a) Do you agree with the Board's conclusion? Why or why not? If not, what package of decisions would you propose and how would that package meet the project's objective?

(b) Do any of your answers depend on answers to other questions? For example, does your answer on relief from a mandatory quantitative impairment test for goodwill depend on whether the Board reintroduces amortisation of goodwill? Which of your answers depend on other answers and why?

We do not wholly agree that the package of preliminary views would, if implemented, meet the objective of the project.

While we agree that the proposed disclosures could provide users with more useful information about acquisitions, we also agree with the preliminary view of the IASB that a significant improvement to the effectiveness of the impairment test is not feasible. Although certain improvements are possible through additional disclosures and changes in the calculation of value in use (see our answer to Question 10), it seems impossible to simplify the impairment test and at the same time make it more rigid, as these objectives are conflicting. This assessment leads us to the conclusion that the initial core problem of the IASB's research project, i.e., ensuring a robust impairment test and timely impairments of goodwill in response to the ongoing criticism of *too little too late* has hardly been addressed and not been solved, so that it continues to exist. In our view, the reintroduction of goodwill amortisation (so far rejected by the IASB) constitutes a more worthy alternative to pursue (see our answers to Questions 6 and 7).

Regarding the proposed disclosures, we think that it could be difficult to solve the issue of confidentiality and sensitivity of the information, as we recognise that there may be an area of conflict for information that is of interest to the user but is classified as confidential by the company. Therefore, we suggest developing overarching, principle-based disclosure objectives in conjunction with (limited) disclosure requirements for core information (see our answers to Question 2 and Question 3).

Additionally, the IASB is of the opinion that the required disclosures are objectives and not forecasts and therefore cannot be classified as forward-looking information in the jurisdictions in which they are made. We think that the distinction between objectives and forecasts may require a legal assessment, answering whether information about management's objectives

for an acquisition together with detailed targets could be considered as forward-looking information (see our answer to Question 2).

Further, we note that the IASB's expectation that much of the required information is already available to companies is too optimistic and that the underlying assumptions do not adequately reflect the complexity of corporate structures and many of the acquisitions occurring in practice.

However, we concede and agree that the existing disclosures do not adequately satisfy the interest of users as to whether an acquisition was successful. The proposed disclosures could provide more useful information to investors and therefore increase the information value of the financial statements.

Having said that, we think that, from a German perspective, information about the progress and success of business combinations may better be provided in the management report. Our preference for locating such information in management report over the notes is based on the objective of the document – namely, to provide information from a management's point of view over a longer term than is the case with the financial statements. Further, as the group management report in Germany is audited with the same level of assurance as the financial statements, we would expect the same degree of robustness. We do understand, however, that the IASB does not have a mandate to develop a fully-fledged standard for the management report. Therefore, our favoured solution would be to allow references from the notes to the management report, as plenty of relevant information on acquisitions is already provided there and as such references are already permitted in other cases, too (e.g., risk disclosures per IFRS 7).

Considering the other topics raised in the DP, we disagree with the proposal to require companies to present the amount of total equity excluding goodwill on their balance sheet. IASB ED/2019/7 *General Presentation and Disclosure* already proposes the disclosure of goodwill as a separate line item on the balance sheet, which, in our opinion, creates sufficient transparency.

Further, if the impairment-only approach was retained, we think that the mandatory annual impairment test should be maintained to preserve the knowledge about the impairment test methodology.

Additionally, we think that in case of a reintroduction of amortisation of goodwill and for pragmatic reasons, granting relief from separating intangible assets from goodwill could be considered for intangible assets that are similar in nature to goodwill. While this approach would likely reduce the information value, we think it could be viable nonetheless, as the costs of subsequent measurement (i.e., valuation) would exceed the benefit of separating these intangibles, especially when their useful life is similar to the amortisation period of goodwill.

Finally, we would also like to point out that the interaction of IFRS 3 *Business Combinations*, IAS 36 *Impairment of Assets* and IAS 38 *Intangible Assets* is highly important. In this context, the reintroduction of amortisation could also help to reduce the controversy over related topics (particularly regarding disclosures and intangible assets).

Regarding the IASB's question whether any of our answers depend on answers to other questions, we refer to our answer to Question 9 regarding the relief from a mandatory quantitative impairment test, as well as to our answer to Question 12 regarding the inclusion of some intangible assets in goodwill.

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.

(a) 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?

(b) Do you agree with the disclosure proposals set out in (i)–(vi) below? Why or why not?

(i) A company should be required 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 (see paragraphs 2.8–2.12). Paragraph 7 of IFRS 8 *Operating Segments* discusses the term 'chief operating decision maker'.

(ii) A company should be required to disclose information about whether it is meeting those objectives. That information should be based on how management (CODM) monitors and measures whether the acquisition is meeting its objectives (see paragraphs 2.13–2.40), rather than on metrics prescribed by the Board.

(iii) 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. The Board should not require a company to disclose any metrics in such cases (see paragraphs 2.19–2.20).

(iv) A company should be required to disclose the information in (ii) for as long as its management (CODM) continues to monitor the acquisition to see whether it is meeting its objectives (see paragraphs 2.41–2.44).

(v) If management (CODM) stops monitoring whether those objectives are being met before the end of the second full year after the year of acquisition, the company should be required to disclose that fact and the reasons why it has done so (see paragraphs 2.41–2.44).

(vi) 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 (see paragraph 2.21).

(c) Do you agree that the information provided should be based on the information and the acquisitions a company's CODM reviews (see paragraphs 2.33–2.40)? Why or why not? Are you concerned that companies may not provide material information about acquisitions to investors if their disclosures are based on what the CODM reviews? Are you concerned that the volume of disclosures would be onerous if companies' disclosures are not based on the acquisitions the CODM reviews?

(d) Could concerns about commercial sensitivity (see paragraphs 2.27–2.28) inhibit companies from disclosing information about management's (CODM's) objectives for an acquisition and about the metrics used to monitor whether those objectives are being met? Why or why not? Could commercial sensitivity be a valid reason for companies not to disclose some of that information when investors need it? Why or why not?

(e) Paragraphs 2.29–2.32 explain the Board's view that the information setting out management's (CODM's) objectives for the acquisition and the metrics used to monitor progress in meeting those objectives is not forward-looking information. Instead, the Board

considers the information would reflect management's (CODM's) targets at the time of the acquisition. Are there any constraints in your jurisdiction that could affect a company's ability to disclose this information? What are those constraints and what effect could they have?

The ASCG considers the objective of the proposals understandable and welcomed, as the proposals address the questions of whether the investment made with the acquisition was worthwhile and whether management created value for the company and its shareholders. However, several of these questions are difficult to answer on the basis of the information and the IT environment available to entities to date. On the basis of the proposals, companies would certainly have to think thoroughly about suitable measures and information.

We consider the gathering of the necessary information for the proposed disclosures to be difficult. This is particularly true for the regularly observable cases where the acquired company is fully integrated into the business of the acquirer and where a group is restructured, which also can take place later. While the explanations in the DP give the impression that integrations are rather the exception, the ASCG considers them to be the rule, e.g., to achieve synergies. For this reason, we believe that the metrics used by companies to monitor whether the objectives of the acquisition are being met, will, in practice, focus more strongly on the combined business; we therefore suggest substantiating, amending, and clarifying the disclosure objective in this regard.

We agree with the requirement to disclose the proposed information for as long as its management continues to monitor the acquisition to see whether it is meeting its objectives. The ASCG discussed whether it would be beneficial to require a list (either permanently or for a defined period of time) of all acquisitions not or no longer monitored. Ultimately, we do not attribute an information benefit to such a list and therefore support the one-off disclosures envisaged by the IASB if management does not monitor an acquisition or stops monitoring whether those objectives are being met before the end of the second full year after the year of acquisition. We also support the disclosures required in the event of subsequent changes to the metrics used for monitoring purposes.

We agree that the information provided should be based on the information and the acquisitions a company's CODM reviews. In reaching this conclusion, we questioned whether focussing on the information monitored by the CODM constitutes the appropriate level. By analogy to the management approach used for segment reporting in IFRS 8, the IASB proposes to base the information for the intended disclosures on metrics that are monitored by the CODM. We note that the CODM often only monitors the biggest acquisitions, especially in large groups and conglomerates, so that in this case information on further significant acquisitions would possibly not be disclosed. This might also apply to small acquisitions, which are not significant individually, but in aggregate could add up to a relevant amount. Since, conceivably, quite a few acquisitions are not monitored by the CODM, we explored whether reference could rather be made to the highest level at which the acquisition is monitored individually. Ultimately, we were concerned that this alternative threshold might be too low. To counteract this, such a reference could be linked to an additional materiality threshold. However, if a materiality threshold (e.g., 'significant') were to be implemented, an undefined legal concept would be introduced, whereas we consider the established CODM approach from IFRS 8 to be more objective. As a result, we support the CODM approach for pragmatic reasons and due to the lack of a superior, sufficiently objectifiable alternative, even though not

every significant transaction is likely to be reported at the CODM level. Additionally, we think it would be helpful to define the term 'monitoring'.

Concerning the IASB's question regarding commercial sensitivity, we recognise that there may be an area of conflict for information that is of interest to the user but is classified as confidential by the company. We think that this may be particularly problematic for companies in industry sectors with a strong focus on research & development. Therefore, and due to the existing legal uncertainty as regards forward-looking information, we see the risk of some disclosure requirements being met rather vaguely. Additional specific disclosure requirements should therefore not be developed; we would favour substantiating overarching, principle-based disclosure objectives instead. Although this gives management a certain amount of leeway over the information to be disclosed, it is nevertheless considered the best possible alternative, as it enables companies to disclose appropriate and relevant company specific information. However, the specific disclosures already proposed by the IASB should be retained as core information, as they could improve the information on the subsequent performance of an acquisition.

While the IASB is of the opinion that the required disclosures are objectives and not forecasts and, therefore, cannot be classified as forward-looking information in the jurisdictions in which they are made, we point out that a valid statement of objectives may also require a plausible presentation of the expected way of achieving these objectives. Therefore, we deem a legal assessment difficult, whether information about management's objectives for an acquisition together with detailed targets could be considered as forward-looking information. While we consider the proposed information to be desirable, we note that there are jurisdictions where such information is subject to specific legal requirements; therefore, we doubt that a universally suitable solution is feasible.

In addition to the questions raised, we would like to submit the following additional points as regards this chapter. While the verifiability and auditability of the proposed disclosures may also prove difficult (e.g. with regard to possible revenue synergies), we acknowledge that other discretionary values and disclosures have to be determined and audited as well. Additionally, many of the relevant issues may arise in a similar way when executing and verifying an impairment test. Therefore, this argument would not be decisive for us.

Furthermore, we point out that the intended disclosures primarily relate to the performance of the actual transaction. When assessing the success of an acquisition, however, other – e.g., originally strategic - objectives can also play a decisive role but may be difficult to quantify in subsequent years. In addition, a comparison of what the performance would have been without the acquisition would be necessary. While these factors may limit the usefulness of the proposed disclosures, we nevertheless think that the proposed disclosures could provide additional value to investors and other stakeholders.

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.

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

We agree with the Board's preliminary view and support the motivation for and the aim of the proposed disclosure objectives.

As already stated in our answer to Question 2, we are of the opinion that it would be helpful to further substantiate the basic disclosure objectives. We suggest developing overarching, principle-based disclosure objectives in conjunction with (limited) disclosure requirements for core-information. Although this gives management a certain amount of leeway over the information to be disclosed, it is nevertheless considered the best possible alternative, as it enables companies to disclose appropriate and relevant company specific information. In this regard, we think that the proposed disclosures on the subsequent performance of an acquisition could provide additional value to investors and other stakeholders and should therefore be core information.

Similarly, adding disclosure objectives aimed at providing users with information on the benefits that a company's management expected from an acquisition when agreeing on the price to acquire a business and on the extent to which an acquisition is meeting management's (CODM's) objectives for the acquisition could help in identifying and preparing useful information.

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?

We agree that these disclosures may contribute to a better assessment of whether the acquisition was successful and whether the purchase price paid was appropriate, even though we acknowledge that there are certain difficulties (e.g., the existence of multicausal effects, such as revenue synergies) in determining the disclosures. However, we deem this to be preferential to the alternatives of no information on synergies or only boilerplate information.

On the part of the investors, there is an understandable interest in this information. Therefore, we consider the proposed requirements to be useful. However, we suspect that these disclosure requirements may be prepared rather vaguely – which may, at least in part, be due to the sensitivity of the information. Nevertheless, the proposed disclosures may provide additional relevant information and thus offer added value to the user.

We would like to add that the situation is similar to the disclosure of company-specific key figures (non-GAAP measures). Although this might impair comparability and give management a certain amount of leeway over the information to be disclosed, it is nevertheless considered the best possible alternative.

Lastly, we support the separate disclosure of the amount of liabilities from financing activities and defined benefit pension liabilities, as the data is readily available and could be helpful to users.

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.

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

(b) Should the Board develop guidance for companies on how to prepare the pro forma information? Why or why not? If not, should the Board require companies to disclose how they prepared the pro forma information? Why or why not?

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.

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

With regard to the usefulness of pro forma information, we observed that the demand for such information is low and comparability across entities impaired – due to the fact that they are not prepared in a uniform manner. Nevertheless, we think that the requirement for pro forma information should be retained, though limited to transactions that are monitored by the CODM,

as pro forma information is indeed used by preparers, if such disclosure helps conveying significant information to users.

Regarding a possible improvement in comparability, we do not think that there is a necessity for the IASB to develop additional guidance for the preparation of pro forma information. Instead, we favour a disclosure requirement that asks companies to disclose how they prepared the pro forma information, i.e., which accounting policies have been applied in preparing the pro forma information.

We generally support the change of the term *profit or loss* to *operating profit before deducting acquisition-related costs and integration costs* used in IFRS 3.B64(q). However, and in accordance with IASB ED/2019/7 *General Presentation and Disclosures*, the wording should be refined to *operating profit or loss before deducting acquisition-related costs and integration costs*. Furthermore, we think that it would be helpful to preparers and users if the IASB defined the terms *acquisition-related costs* and *integration costs*.

While we also generally support the proposed additional requirement to disclose cash flows from operating activities of the acquired business after the acquisition date, and of the combined business on a pro forma basis for the current reporting period, we were informed by some companies that this information cannot currently be obtained from their IT systems and would therefore have to be compiled manually and probably at a high cost. Whilst we believe this information to be useful, we are concerned that it can be obtained reliably and at reasonable costs, especially as and when the integration of the acquired company progresses. Accordingly, this requirement should be limited to transactions that are monitored by the CODM, to ensure that only the most significant information is reported.

Question 6

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.

(a) Do you agree that it is not feasible to design an impairment test that is significantly more effective at the timely recognition of impairment losses on goodwill at a reasonable cost? Why or why not?

(b) If you do not agree, how should the Board change the impairment test? How would those changes make the test significantly more effective? What cost would be required to implement those changes?

(c) Paragraph 3.20 discusses two reasons for the concerns that impairment losses on goodwill are not recognised on a timely basis: estimates that are too optimistic; and shielding. In your view, are these the main reasons for those concerns? Are there other main reasons for those concerns?

(d) Should the Board consider any other aspects of IAS 36 in this project as a result of concerns raised in the Post-implementation Review (PIR) of IFRS 3?

We believe that the impairment test set out in IAS 36 *Impairment of Assets* has not met the expectations placed in it, namely, to recognise impairment losses on goodwill on a timely basis.

We would even go a step further and hold the opinion that this is not feasible either, as the basic concept of the impairment test and the wording of the standard are not designed to signal whether an acquisition was successful or not – which is what some stakeholders have apparently hoped for.

In our view, the main reasons for the delayed recognition of impairments – estimates that are too optimistic and shielding – were correctly identified by the IASB. Academic research gathered in the Post-implementation Review of IFRS 3 suggests that management estimates and forecasts tend to be too optimistic. The regularly observable implementation of the impairment test at the level of aggregated cash-generating units (often at the highest permitted aggregation level of the operating segment according to IFRS 8 *Operating Segments*) also leads to the shielding effects identified. This could be countered by requiring the tests to be performed at a lower level, but this would likely necessitate significantly higher costs and effort, which in turn could lead to a different assessment of cost versus benefit in a renewed analysis. Additionally, tax effects could also cause both the creation of goodwill and the subsequent shielding against impairments (tax shield).

Notwithstanding our agreement with the analysis, we do not agree with discharging the responsibility for the appropriate execution of impairment tests on auditors and regulators, as is expressed several times in the DP. To us, this is not an acceptable solution to the problem identified. In our view, the primary responsibility does not rest with auditors and regulators, but rather with the standard-setter in developing requirements that meet the test of demonstrating that they are capable of being applied faithfully and appropriately.

To us, the current Covid-19 pandemic provides for a classic scenario where users, regulators, and other stakeholders would have expected entities to incur impairments due to the economic downturn, wherever the strategic business model has been significantly affected or is in need of an overhaul. Due to the conceptual design of the current impairment model, however, the terminal value is the main factor when determining whether there is the need for an impairment. Furthermore, various factors (e.g., optimistic management estimates, perpetuity considerations, going concern premise, CGU considerations, shielding, substitution of goodwill, entity specific expectations regarding value in use) aid an ‘optimistic’ terminal value. As a result - and precisely because the current impairment test works as envisaged - there will be no significant impairments, as long as the terminal value is not significantly affected. This leads to crises not being reflected in a timely manner, as significant impairments would only occur in situations that severely threaten a CGU’s business model. Hence, we think that the current impairment model does not meet the expectations of users of the financial statements, regulators, and other stakeholders with regard to recognising impairments on a timely basis. We believe that the IASB would therefore be better advised to take on the challenge and think about suitable alternatives, rather than to hold on to an accounting construct that has proven not to be effective when it matters.

The ASCG agrees with the IASB that it is not feasible to make the impairment test for cash-generating units containing goodwill significantly more effective at recognising impairment losses on goodwill on a timelier basis than the impairment test set out in IAS 36 *Impairment of Assets*, particularly under cost-benefit considerations. Disclosures alone, however, do not represent a significant improvement. The initial core problem of the IASB’s research project, i.e. ensuring a robust impairment test and timely impairments of goodwill in response to the

ongoing criticism of too little too late, has hardly been addressed and therefore continues to exist.

Nevertheless, even in the event of the reintroduction of amortisation of goodwill, it would still be necessary to test for (unforeseen) impairments. If the existing impairment test was to be used for this purpose, the existing unsolved problems mentioned above would persist. We suggest the IASB consider a different approach with a simpler yet still justifiable methodology, especially if a relatively short amortisation period were to be implemented. We may refer to requirements in German GAAP, which are set out in GAS 23 *Accounting for Subsidiaries in Consolidated Financial Statements* and provide for a (renewed, simplified) consolidation at the time the impairment test is carried out.

The key logic of that test borrows on the same rationale as for implied goodwill, but uses a simplified methodology: Under German GAAP, the amount of the write-down can be determined by comparing the fair value of the investment in the subsidiary with the total of the carrying amount of the net assets of the subsidiary in the consolidated financial statements and the net carrying amount of goodwill. Regardless of whether this comparison produces a positive or a negative difference, entities are additionally encouraged to examine whether material unrecognised reserves and liabilities that require a change in the amount of the write-down have arisen since the date of initial consolidation. We would be happy to explain the rationale in more detail should the IASB wish to consider this alternative.

In summary, the ASCG concludes that the basic concept of the impairment test cannot be further improved, due to the system-immanent degrees of freedom and judgement, without incurring considerable costs (especially on the part of preparers). We therefore agree with the preliminary view of the IASB that a significant improvement to the effectiveness of the impairment test is not feasible. Although minor improvements are possible through additional disclosures and changes in the calculation of value in use (see our answer to Question 10), it seems impossible to simplify the impairment test and at the same time make it more rigid, as these objectives are conflicting.

Given the identified limitations of the existing impairment test and considering the impossibility of significant enhancements to it, the ASCG, on balance, concludes that the reintroduction of goodwill amortisation constitutes a more worthy alternative to pursue. This would also reduce the magnitude of any necessary impairments and could therefore take some pressure off the impairment test itself.

Regarding the last part of Question 6, we did not identify any other aspects of IAS 36 that the Board should consider in this project as a result of concerns raised in the Post-implementation Review (PIR) of IFRS 3. Considering our support for the reintroduction of amortisation, though, we believe that the assumptions used for the impairment test in accordance with IAS 36 to test for (unforeseen) impairments need to be aligned with the assumptions that apply to the accounting for goodwill (e.g., if goodwill was assumed to have a finite useful life, the impairment test cannot be based on projections that run into perpetuity).

Question 7

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.

(a) Do you agree that the Board should not reintroduce amortisation of goodwill? Why or why not? (If the Board were to reintroduce amortisation, companies would still need to test whether goodwill is impaired.)

(b) Has your view on amortisation of goodwill changed since 2004? What new evidence or arguments have emerged since 2004 to make you change your view, or to confirm the view you already had?

(c) Would reintroducing amortisation resolve the main reasons for the concerns that companies do not recognise impairment losses on goodwill on a timely basis (see Question 6(c))? Why or why not?

(d) Do you view acquired goodwill as distinct from goodwill subsequently generated internally in the same cash-generating units? Why or why not?

(e) If amortisation were to be reintroduced, do you think companies would adjust or create new management performance measures to add back the amortisation expense? (Management performance measures are defined in the Exposure Draft *General Presentation and Disclosures*.) Why or why not? Under the impairment-only model, are companies adding back impairment losses in their management performance measures? Why or why not?

(f) If you favour reintroducing amortisation of goodwill, how should the useful life of goodwill and its amortisation pattern be determined? In your view how would this contribute to making the information more useful to investors?

The ASCG disagrees with the IASB'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. While we believe that most technical arguments have been on the table for long and have already been exchanged numerous times, our assessment was also strongly influenced by our observations that the terminal value is the main factor when determining whether there is a need for an impairment. We further reckon that the current impairment model does not meet the expectations of users, regulators, and other stakeholders with regard to recognising impairments on a timely basis.

As we see it, both, the impairment-only approach as codified in IFRS 3, and the amortisation approach are not perfect models but conventions for the subsequent accounting for goodwill. This is also due to the fact that goodwill is a unique asset that cannot be completely and faithfully depicted for under either approach. Further, we believe that different people hold strong views and put forward valid arguments for and against either model.

However, in practice, we observe that the fight over the most appropriate accounting method seems largely outcome-driven, rather than conceptual. A few years back, companies that grew organically favoured an amortisation approach, mainly to save cost on a burdensome impairment test; conversely, companies that grew through acquisitions almost unanimously favoured an impairment-only model as they were reasonably satisfied that they could avoid

high amortisation charges to goodwill (and impairment charges as well). That being said, we observe a noticeable shift among companies in our jurisdiction over the last three years, as several companies with significant goodwill-to-equity ratios are now in favour of an amortisation approach. The main reasons cited include the perceived lack of control over that asset and the uncertainty in the timing of any impairments, coupled with the pro-cyclicality of the impairment-only approach, which these companies perceive as a risk that is hard to manage.

To determine the appropriate subsequent accounting for goodwill, an analysis of its components (future income, synergies, etc.) would be necessary. This could theoretically lead to identifying the separate components and to allocating a portion of the purchase price to these components, which could then be accounted for separately by reflecting their respective nature. We think, however, that in most cases the necessary information would not be available in practice and estimates would therefore have to be used, as goodwill cannot be measured directly and, therefore, the individual goodwill components could probably not be measured reliably either. Additionally, such an approach would significantly increase the complexity and the subjectivity of the subsequent accounting for goodwill.

The decision for one of the two methods under consideration is therefore the determination of an accounting convention. As detailed in our answer to Question 6, the current Covid-19 pandemic provides for a classic scenario where we think that the current impairment model does not meet the expectation of users, regulators, and other stakeholders. We would have expected entities to incur impairments due to the economic downturn. However, the conceptual design of the current impairment model and various factors influencing the recoverable amount led to crises not being reflected in a timely manner. Significant impairments would only occur in situations that severely threaten a CGU’s business model and therefore significantly affect the terminal value in the impairment test. Consequently, we think that the current impairment model does not meet the expectations of users of the financial statements and other stakeholders with regard to recognising impairments on a timely basis. Due to this and the other identified limitations of the impairment-only approach (see our answer to Question 6) we think that the IASB likely will not be able to design an improved impairment test. Consequently, we think that the existing accounting convention (i.e., the impairment-only approach) can no longer be considered advantageous – regardless of its theoretical and conceptual superiority.

Instead, amortisation could represent a more pragmatic, cost-effective, and standardised convention for the subsequent accounting for goodwill. Amortisation would mitigate the effects of shielding and management over-optimism and likely reduce the magnitude of any necessary impairments and could therefore take significant pressure off the impairment test itself. Another positive aspect of the reintroduction of amortisation of goodwill would be that the impact of separating or including intangible assets with finite useful lives from or in goodwill in the context of a purchase price allocation (see our answer to Question 12) would be mitigated to some degree.

Regarding the question whether companies would adjust or create new management performance measures to add back the amortisation expense, we think that no major change would probably occur, as companies that already adjust for impairment expenses or purchase price allocation-related expenses would also make adjustments for such expenses in the future.

As regards the details of amortisation, we would favour the specification of a useful life and, thus, also an amortisation period of ten years with a straight-line amortisation pattern, both as a rebuttable presumption. Provided companies could demonstrate their appropriateness, a shorter or longer amortisation period or a different amortisation pattern should be possible. This may be particularly relevant for industries with fast-changing business models (which may justify a shorter amortisation period) or industries with long-term research (justifying a longer useful life). In any case, we think that an upper limit of 20 years for the amortisation period should be specified.

As we acknowledge that valid arguments for both methods exist, we discussed whether the introduction of an accounting option between amortisation and the impairment-only approach should be pursued. Ultimately, we rejected this option, as a clear majority of our IFRS Technical Committee and of the constituents participating in the outreach events we conducted were in favour of amortization.

In summary, we concede that we did not identify any new arguments for or against amortisation or the impairment-only approach. However, our re-evaluation of the arguments already known leads us to a different assessment than when the impairment-only approach was introduced. Due to the limits of the impairment-only approach identified over time and the assessment that a balance sheet item of this sizable amount should not remain almost unadjusted in the balance sheet over the long term, the ASCG, on balance, is in favour of reintroducing amortisation.

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).

(a) Should the Board develop such a proposal? Why or why not?

(b) Do you have any comments on how a company should present such an amount?

We disagree with the proposal to require companies to present the amount of total equity excluding goodwill on their balance sheets. IASB ED/2019/7 *General Presentation* already proposes the disclosure of goodwill as a separate line item on the balance sheet, which, in our opinion, creates sufficient transparency. In addition, and notwithstanding ED/2019/7, we observed that many companies already disclose goodwill as a separate line item on the balance sheet.

The disclosure of total equity excluding goodwill, as proposed in the DP, does not offer any added value, as this amount can be readily calculated. Furthermore, such presentation may cast doubt as to whether goodwill really was an asset.

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.

(a) Should the Board develop such proposals? Why or why not?

(b) Would such proposals reduce costs significantly (see paragraphs 4.14–4.21)? If so, please provide examples of the nature and extent of any cost reduction. If the proposals would not reduce costs significantly, please explain why not.

(c) In your view, would the proposals make the impairment test significantly less robust (see paragraphs 4.22–4.23)? Why or why not?

We would support the removal of the requirement to perform a quantitative impairment test every year – notwithstanding an indication of impairment – only in case amortisation of goodwill was reintroduced by the IASB.

This proposed simplification of the impairment test is counterintuitive to the underlying criticism of *too little, too late* regarding the recognition of impairments. We believe that the reintroduction of amortisation would likely reduce the magnitude of impairments and could therefore take some pressure off the impairment test, provided the amortisation period is reasonably short, making this simplification more viable.

However, if the impairment-only approach was retained, we think that the mandatory annual impairment test should be maintained to preserve a robust impairment test.

We acknowledge that the current requirements in IAS 36 for the determination of the recoverable amount of a CGU to which goodwill has been allocated are complex and time-consuming. Therefore, we understand the intention to reduce this complexity, especially when the likelihood of impairment is remote.

In our view, though, the suggested reduction of cost due to less frequent calculations of the recoverable amount is outweighed by a loss of continuity and a slower acquisition of knowledge as to how to perform impairment tests, if preparers only occasionally attend to the quantitative impairment test.

Additionally, we think that the existing practical expedient in paragraph 99 of IAS 36 already provides relief and is indeed used by preparers in our jurisdiction. Lastly, the procedural conditions for performing the quantitative impairment test have usually already been established by the entities. Hence, we question whether performing qualitative assessments and then discussing these judgements and assessments with an auditor would truly constitute relief for entities.

Question 10

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.

(a) Should the Board develop such proposals? Why or why not?

(b) Should the Board propose requiring discipline, in addition to the discipline already required by IAS 36, in estimating the cash flows that are the subject of this question? Why or why not? If so, please describe how this should be done and state whether this should apply to all cash flows included in estimates of value in use, and why.

We support the proposed removal of 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) as well as the proposed permission to use post-tax cash flows and post-tax discount rates in estimating value in use, as we think that the current IAS 36 guidance pertaining to the calculation of the value in use does not seem appropriate.

Regarding the inclusion of cash flows from future uncommitted restructurings and asset enhancements, we believe that it does make sense to make use of internal budgets and forecasts, which take the dynamic management of the business into consideration, and to allow those effects to be incorporated in the cash flow projections that are used to determine the value in use. We would expect these budgets and forecasts to be reasonable and supportable, i.e., they would have to be reliable for market participants.

As regards the proposal to allow entities an election between a pre-tax or post-tax calculation, we observed that entities regularly use a post-tax basis with an additional iteration to derive the pre-tax discount rate required by IAS 36 (for disclosure purposes as no observable pre-tax interest rates are available). Therefore, we agree with the proposal to use a post-tax discount rate as an alternative to the pre-tax rate currently mandated.

We would like to point out though, that the proposed changes will lead to the value in use becoming very similar to the fair value less costs of disposal, as remaining differences mainly relate to entity-specific estimates and synergies. Therefore, the IASB may consider whether mandating only one method for estimating the recoverable amount of an asset (either value in use or fair value less costs of disposal) or requiring a company to select the method that reflects the way the company expects to recover an asset, could be pursued.

Regarding requiring discipline, we think that the impairment test is already subject to significant documentation and governance requirements, and wherever a company has a significant amount of goodwill being recognised, the item will almost certainly be a key audit matter.

Accordingly, we think that sufficient discipline is required already, as assumptions used for the impairment test must be adequately substantiated.

Question 11

Paragraph 4.56 summarises the Board's preliminary view that it should not further simplify the impairment test.

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

(b) Can you suggest other ways of reducing the cost and complexity of performing the impairment test for goodwill, without making the information provided less useful to investors?

The ASCG generally agrees with the Board's preliminary view that it should not develop proposals for the potential simplifications or guidance as set out in paragraph 4.56 of the DP.

The only simplification not pursued that may be reconsidered pertains our remark in Question 10, that the proposed changes will lead to the value in use coming very close to the fair value less cost of disposal. We would encourage the IASB to reconsider whether mandating only one method for estimating the recoverable amount of an asset (either value in use or fair value less costs of disposal) or requiring a company to select the method that reflects the way the company expects to recover an asset, could be pursued.

With regard to providing additional guidance on identifying cash-generating units and allocating goodwill that could apply to all companies, we come to the conclusion that providing additional guidance does not appear feasible due to the wide variety of companies and different acquisition specifics. Also, we could not identify other ways of reducing the cost and complexity of performing the impairment test for goodwill.

Instead, the fact that no viable options for a significant improvement to the guidance on the impairment-only approach were identified constitutes, in our view, a further argument for the reintroduction of amortisation of goodwill.

Question 12

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.

(a) Do you agree that the Board should not develop such a proposal? Why or why not?

(b) If you do not agree, which of the approaches discussed in paragraph 5.18 should the Board pursue, and why? Would such a change mean that investors would no longer receive useful information? Why or why not? How would this reduce complexity and reduce costs? Which costs would be reduced?

(c) Would your view change if amortisation of goodwill were to be reintroduced? Why or why not?

Our answer to the question whether a proposal to allow some intangible assets to be included in goodwill should be developed depends on whether the amortisation of goodwill was reintroduced or whether the impairment-only approach was retained.

Should the impairment-only approach be retained, we support the IASB's preliminary view that the recognition criteria for intangible assets acquired in a business combination should not be changed.

Conceptually, we think that identifiable intangible assets acquired in a business combination should be recognised separately. We also see an increasing importance of intangible assets, especially for acquisitions in the new economy. In our view, there is already a lack of information and transparency regarding the value drivers of companies in those industries (i.e. with regard to intellectual property), which would be further exacerbated by including identifiable intangible assets acquired in a business combination in goodwill. This would also be contrary to the frequent calls to improve financial reporting by providing more information about intangible assets that are increasingly important in modern economies. Therefore, we consider the separate accounting of intangible assets as having a very high information value.

However, we concede that in case of a reintroduction of amortisation of goodwill and for pragmatic reasons, granting relief could be considered for intangible assets that are similar to goodwill. While this approach would likely reduce the information value, we think it could be viable nonetheless, as the costs of subsequent measurement (i.e., valuation) would exceed the benefit of identifying and separately measuring these intangibles, especially when their useful life is similar to the amortisation period of goodwill.

As there is a significant risk that too many intangible assets would ultimately be included in goodwill and that this would further increase the shielding effect (see Question 6), it would be important to ringfence any potential changes.

Considering this, the ASCG deems a revision of IAS 38 *Intangible Assets* to be necessary and warranted, although not in the context of the current project. The issue of intangible assets acquired in a business combination should, however, be addressed in advance to provide relief, if necessary.

Question 13

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?

While we understand the question to be aimed at the convergence of accounting standards (IFRS and US GAAP), the ASCG thinks that the creation and maintenance of an economic level playing-field is an important (and probably more important) issue to consider.

Empirically, it can be observed that the respective method for the subsequent accounting for goodwill (amortisation or impairment-only approach) also has an influence on the purchase

price paid in acquisitions. Due to this fact, we think that the users would also be in favour of converged solutions.

The ASCG therefore is in favour of convergent standards, but less for the reason of uniform accounting standards than to ensure a level playing-field in international acquisitions.

Question 14

Do you have any other comments on the Board's preliminary views presented in this Discussion Paper? Should the Board consider any other topics in response to the PIR of IFRS 3?

We do not have any other comments.