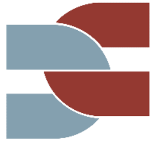

EUROPEAN ASSOCIATION OF CO-OPERATIVE BANKS
The Co-operative Difference : Sustainability, Proximity, Governance

EACB Comments

IASB's consultation on the Goodwill and Impairment

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Contact:

For further information or questions on this paper, please contact:
- Mr. Volker Heegemann, Head of Department (v.heegemann@eacb.coop)
- Mr. Anastasios Pavlos, Adviser (Anastasios.Pavlos@eacb.coop)

General comments

The members of the EACB gladly take the opportunity to comment on the IASB consultation about Goodwill and Impairment. The EACB welcomes the IASB's effort to improve the information companies provide to investors, at a reasonable cost, about the businesses those companies buy and would help to hold management to account for its decisions to acquire those businesses. However, EACB questions the feasibility of the approach outlined by the IASB from a preparer's perspective.

First, we think that the information about profitability/subsequent performance of an acquisition is highly sensitive.

While our members understand and support the aim to provide information on the strategic reasons behind acquisitions, it must be noted that the information is quite often available and widely described – at least the material one – in press releases. Instead, disclosing information in relation to the extent to which an acquisition is meeting chief operating decision maker's (CODM's) objectives, synergies and their cost is quite complex and sensitive. Should this information exist, it may not be easily available, and it implies costly operational challenges.

Besides this, we are not convinced about the relevance of including this information within the financial statements. We see it as a "management information" rather than an "accounting information". Thus, EACB believes that it should belong to the management report and not be included in the financial statements, because they represent non-GAAP indicators that will be difficult to audit. Moreover, it could create a competitive distortion between US and European entities. The US GAAP require less information than the one displayed in the Discussion Paper proposals.

The EACB strongly support the reintroduction of amortization. We believe that the goodwill is a consumable asset with a useful lifetime which ends when the expected synergies would be effective. We do consider that the amortization is the only way to show the consumption of goodwill over its useful life and prevent the entities from recognizing "internal goodwill".

Nevertheless, if the reintroduction of amortization were not to be the pursued route, the EACB strongly believes that adjustments are needed concerning the impairment Test (see Q6 for more details). Indeed, we see that the costs of performing the impairment test are significant, partly related to the complexity of IAS 36 and also to the frequency of the impairment test. EACB members believe that improvements are feasible both concerning the cost and the usefulness of the information presented in the test.

Answers to specific questions

Q.1 - Paragraph 1.7 summarizes the objective of the Board's research project. Paragraph IN9 summarizes 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 amortization of goodwill? Which of your answers depend on other answers and why?

Q.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).
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?

Q.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?

Q.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?

Q.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?

Q.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?

The EACB believes that the costs of performing the impairment test is significant and this enormous cost is partly related to the complexity of IAS 36 and also the frequency of the impairment test.
EACB members also believe that the cost is not proportionate to the importance of the information as given by financial analysts. This cost of preparing the information can be even higher in case of the medium sized entities. According to varius estimations, the cost of the calculation can be amounted to 25% – 50% of the total accounting budget and thought that medium sized entities were often not in the public spotlights, in which case the impairment test is considered an expensive administrative burden.

EACB members are also more concerned with the benefits of the information. They consider that the many assumptions used for the calculations were resulting in information that is too subjective to be useful for financial analysts.
Moreover, EACB notes that acquisition goodwill transformed into going concern goodwill a couple of years after the acquisition and from an entity's perspective there is no need to justify going concern goodwill. In general, business analysts compare operational performance expectations with the actual value of capital stakes. Information of goodwill impairment is of limited use for this assessment. Therefore, efforts in preparing goodwill impairment tests exceeded decision usefulness. Only the main drivers of the evaluation model are explained in the notes, this is not sufficient for financial analysts.

In addition, frequent impairment will likely just create noise when evaluating the performance of a business combination. The information about goodwill is not useful as it was a mixture of externally and internally generated goodwill.

As mentioned above, Goodwill is generally ignored by financial analysts. Analysts are focused on the underlying cash flow of the business. This has become more evident with the evolution of financial metrics such as tangible net asset value, which adjusted for goodwill and intangibles, and adjusted profit measures that striped out goodwill impairment and intangible amortisation.
In addition, for financial institutions, capital regulations fully deduct goodwill and intangibles from core capital as it is not considered a source of capital. Financial analysts examine other indicators to evaluate the viability of future cash flows and focus more often on short-term cash flow indications. Goodwill is often supported by long-term cash flow indicators. Different assumptions for value in use, in contrast to fair value, caused errors and puzzlement.

Finally, definition of carrying amount and recoverable amount were not fully reconcilable (e.g. deferred taxes). The relevance of the information is questionable as users did not have further insight into the basic parameters and methods used by the reporting entity

In order to reduce the cost of the impairement test the EACB believes that it can be reduced by the following steps:

a) **allowing/requiring amortisation of goodwill**. Goodwill should/could be amortised on a systematic basis and impairment test should be performed only when there would be an indication that goodwill might be impaired
b) **limiting impairment test to when there would be an indication of impairment**.
c) reducing the frequency of the impairment test;
d) **only requiring impairment test when the book value of equity compared with the market capitalisation of the company would exceed a given threshold**;
e) **introducing a less prescriptive approach**.
f) **introducing a more standardised approach** It means that that standard setters should establish a standard model for impairment testing with well-established drivers and methods
g) **clarifying the requirements**. Significant communication costs can be caused by the lack of guidance provided in IAS 36 and IFRS 13 on whether for a publicly, listed, goodwill bearing CGU the value in use could exceed the market capitalization of this cash-generating unit -CGU. The same lack of guidance existed on the issue whether the total value of all CGUs of a publicly listed entity could exceed the market capitalisation of the entity. Due to the lack of guidance these issues are often viewed differently in different countries or even by different auditors in the same country. More specific guidance by the IASB could help to reduce the time and effort required for preparing and auditing goodwill impairment tests

EACB members propose the following on how the information of the impairement test prepared could be made more useful.:

a) The total of acquired and internally generated goodwill should be disclosed as this could indicate future impairment needs.
b) The change in the value in use from one period to another should be decomposed into different significant components.
c) A hypothetical value should be derived for 'internal goodwill' (similar to the concept used under FRS 11 in the UK prior to the adoption of IFRS1). This could mitigate the problem related to the external goodwill being transformed into internal goodwill and masking the true performance and assessment of the acquired goodwill.

Q.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?

Q.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?

Q.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?
4.56

Q.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.

Q.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?

Q.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?

Q.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?

Q.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?