

## **Business Combinations: Disclosures, Goodwill and Impairment**

# **Feedback to respondents – EFRAG Final Comment Letter**

**February 2021**

This Feedback Statement has been compiled by the EFRAG Secretariat to summarise the main comments received by EFRAG on its Draft Comment Letter and explain how those comments were considered by EFRAG during its technical discussions leading to the publication of its final comment letter. The content of this Feedback Statement does not constitute any form of advice or opinion and does not represent the official views of EFRAG or any individual member of the EFRAG Board or EFRAG TEG.

**Summary of contents**

Introduction .....2  
 Objective of this feedback statement .....2  
 Background to the DP .....2  
 EFRAG’s draft comment letter .....3  
 Outreach activities .....4  
 Preparer outreach .....4  
 Comments received from respondents .....5  
 EFRAG’s final comment letter .....5  
 Detailed analysis of issues, comments received, and changes made to EFRAG’s final comment letter .....7  
 Question 1 – Objective of the project .....7  
 Question 2 – Strategic rationale for an acquisition and subsequent performance .....9  
 Question 3 – Disclosure objectives ..... 18  
 Question 4 - Synergies and additional major classes of liabilities .....20  
 Question 5 – Pro forma information .....25  
 Question 6 – Improvements to the impairment test .....28  
 Question 7 – Amortisation of goodwill .....33  
 Question 8 – Total equity excluding goodwill .....37  
 Question 9 – Indicator-only approach .....38  
 Question 10 – Other simplifications to the impairment test .....40  
 Question 11 – Further simplifications to the impairment test .....42  
 Question 12 – Intangible assets .....44

Question 13 – Convergence with US GAAP .....46  
 Question 14 – Other comments .....48  
 Appendix 1: List of respondents .....50

**Introduction**

**Objective of this feedback statement**

EFRAG submitted to the IASB its Final Comment Letter on the Discussion Paper DP 2020/1 *Business Combinations – Disclosures, Goodwill and Impairment* (‘the DP’) on 28 January 2021. This feedback statement summarises the main comments received by EFRAG on its Draft Comment Letter (‘DCL’) and explains how those comments were considered by EFRAG during its technical discussions leading to the publication of EFRAG’s Final Comment Letter.

**Background to the DP**

On 19 March 2020, the IASB published the DP where it includes proposals how to provide better information about acquisitions and improve the accounting for goodwill.

The objective of the DP was to explore whether companies could, at a reasonable cost, provide investors with more useful information about the acquisitions those companies make. Better information would help investors assess the performance of companies that have made acquisitions. Better information would also be expected to help investors more effectively hold a company’s management accountable for management’s decisions to acquire those businesses.

The IASB DP was open for comments until 31 December 2020.

Further details about the IASB’s project are available on the IASB [website](#).

### **EFRAG’s Draft Comment Letter**

EFRAG published its DCL on the proposals on 28 May 2020 which was open for comments until 30 November 2020. In its DCL, EFRAG did not express a position regarding reintroduction of goodwill amortisation or whether no major changes to the current accounting for goodwill are justified. EFRAG was requesting views from its constituents. In its DCL, EFRAG supported the objective of the DP to explore whether companies could, at a reasonable cost, provide investors with more useful information about the acquisitions those companies make. This position was based on the feedback from users about the lack of sufficient information to assess acquisitions that were presented in the financial statements.

EFRAG considered that a cause of the shortcomings in the current accounting for goodwill resulted from goodwill being a mixture of many different elements. It is a residual, that requires indirect testing for impairment which allows for shielding and the inability to monitor the components subsumed in goodwill. However, EFRAG noted that the proposals did not aim at addressing, through disclosure or enhancement of the impairment model, shortcomings in goodwill accounting, so while the proposals addressed some current shortcomings, room for improvement remained.

In its DCL, EFRAG had not yet formed a view on whether the proposals in the DP, as a package, would meet the objectives of the DP. EFRAG acknowledged that information about the strategic rationale and management’s objectives for an acquisition as well as subsequent disclosures whether the acquisition would be meeting those objectives would be useful. However, EFRAG noted some

practical issues of these disclosures, both to ensure the sufficiency and relevance of the information and that the benefits would outweigh the cost. EFRAG noted some of the proposed quantitative information would be based on management expectations and would often be non-GAAP measures. EFRAG accordingly asked constituents whether some of the information would be better placed in the management commentary rather than in the notes of the financial statements. This also applied for the disclosures suggested on expected synergies. EFRAG also asked constituents for information on whether the proposed disclosures could require commercially sensitive information to be disclosed.

EFRAG considered that presentation of the amount of total equity excluding goodwill on the balance sheet would result in confusion.

EFRAG supported in its DCL including disclosure objectives in IFRS 3 as suggested in the DP if non-GAAP measures should be included in the notes of financial statements. If the IASB, after considering the various arguments in favour and against, would propose (allowing) some of the disclosures to be provided in the management commentary, this should be reflected in the wording of the disclosure objectives suggested to be included in IFRS 3.

EFRAG acknowledged that like the IASB, in the past, it was unable to make the impairment test more effective. However, to remediate some of the shortcomings of the impairment model, EFRAG considered the guidance on goodwill allocation to cash generating units, in general and with disposals, could be improved. In addition, EFRAG assessed that the impairment test information could be enhanced to reduce the shortcomings of the impairment test. EFRAG sought inputs on disclosure proposals to mitigate the risk of management over-optimism. While EFRAG appreciated the IASB’s attempts to simplify the impairment test, EFRAG expressed reservations about introducing an indicator-only approach.

EFRAG supported the removal of the prohibition on including cash flows arising from a future uncommitted restructuring or improving or enhancing the asset’s performance in IAS 36 *Impairment of Assets*. It also supported the removal of the requirement to use pre-tax inputs and pre-tax discount rates to calculate value in use.

EFRAG stated that the IASB should consider the concerns of investors who want to compare companies that grow by acquisitions more easily with those that grow organically and therefore, start a project on IAS 38 *Intangible Assets*. EFRAG questioned the usefulness of subsuming some intangible assets should be subsumed into goodwill. Instead, EFRAG suggested initiating and awaiting the outcome of the broader project on IAS 38, which could be informed by EFRAG’s pro-active work on better information on intangibles.

Finally, EFRAG did not consider that its answers depended on consistency with US GAAP but acknowledge that the IASB outcome could be influenced by the FASB’s current work.

### **Outreach activities**

After the publication of its DCL, EFRAG organised a programme of outreach events and stakeholder meetings in partnership with other organisations, including the IASB. EFRAG organised and participated in the following outreach events:

- *Improving information regarding Business Combinations: Disclosures and subsequent accounting for Goodwill – which way to go?* - joint webinar with the IASB on 16 October 2020. The feedback statement can be accessed [here](#).
- *Business Combinations: Disclosures, Goodwill and Impairment* – joint webinar with FSR, DI and the IASB on 23 October 2020. The feedback statement can be accessed [here](#).

- *Changes to the Accounting for Business Combinations: Disclosures, Goodwill and Impairment: Reflections from Norway* – joint webinar with the NASB, the NFF and the IASB on 9 November 2020. The feedback statement can be accessed [here](#).
- *What are the views of users? Business Combinations: Disclosures, Goodwill and Impairment* – joint webinar with EFFAS, ABAF/BVFA and the IASB on 12 November 2020. The feedback statement can be accessed [here](#).
- *Outreach events on the IASB’s DP Business Combinations – Disclosures, Goodwill and Impairment*. Joint webinars with the ASCG on 2 November 2020 and 20 November 2020.
- *Business Combinations: Disclosures, Goodwill and Impairment – perspectives from Portugal* – joint webinar with CNC, OROC, the OCC and the IASB on 24 November 2020. The feedback statement can be accessed [here](#).
- *IASB’s Discussion Paper Business Combinations – Disclosures, Goodwill and Impairment* – joint webinar with the OIC and IFRS Foundation on 25 November 2020.

### **Preparer outreach**

EFRAG issued a survey to preparers of financial statements and arranged interviews with preparers. IASB staff was invited to participate in these interviews and EFRAG staff was similarly invited to attend a field test organised by the IASB with an EU preparer.

The interviews covered 15 EU preparers and the survey for preparers was completed by 30 EU preparers.

The survey is available on EFRAG’s [website](#).

The purpose of the preparer outreach was to identify issues related to the proposals of the DP. Mainly issues for which input was sought

in EFRAG’s DCL on the proposed disclosures and goodwill were addressed.

### **Comments received from respondents**

In addition to outreach activities, EFRAG received and considered 26<sup>1</sup> comment letters from respondents. These comment letters are available on the EFRAG [website](#). A list of respondents is provided in Appendix 1.

The comment letters received came from national standard setters, business associations, professional organisations, users’ representatives and listed companies.

### **EFRAG’s final comment letter**

EFRAG submitted its final comment letter to the IASB on 28 January 2021.

Compared to the DCL, EFRAG developed or modified some of its views, including the following:

- The comment letter noted that many respondents did not regard the proposals as a package but rather as largely independent of each other. The DCL did not include a comment on this.
- The DCL asked for constituents’ input on whether some of the proposed disclosures would be better placed in the management commentary. Based on the input received, the comment letter noted that the IASB should further examine whether some of the disclosures should rather be included in the management commentary. When doing so, the IASB

should take into account both the arguments that some of the proposed information would rather belong to the management commentary as well as the concerns and practical issues that would be related to allowing the information to be provided in the management commentary.

- The DCL asked for constituents’ input on whether some of the requested information would be commercially sensitive to provide. Based on the input received, the comment letter noted that some of the proposed information would be considered commercially sensitive. Although the hurdle should be high, EFRAG concerned that it should be possible for entities not to present commercially sensitive information. EFRAG noted that entities may find it particularly harmful if they would have to provide sensitive information that their competitors reporting under another GAAP would not have to disclose.
- In its DCL EFRAG asked for input related to the assessed reliability of the suggested information. Based on the input received, the comment letter noted in relation to the proposed disclosures on synergies in the DP that for the benefits of these disclosures – for which reliability would depend on the specific circumstances – to outweigh the costs, it may be necessary to introduce some flexibility in relation to when/how quantitative information should be presented.
- In its DCL EFRAG asked for constituent’s input on possible proposals to mitigate the risk of management over-optimism in the impairment test of goodwill. Based on input received, the comment letter suggested such disclosure proposals.

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<sup>1</sup> 30 comment letters were received. Four of those comment letters, received after the end of the comment period and after the approval of the final position by EFRAG TEG, could not be considered by EFRAG TEG when recommending the final position to EFRAG Board.

- The DCL did not include a position related to the issue on whether amortisation of goodwill should be reintroduced. Instead, input was sought from constituents on this issue. Based on this input, EFRAG’s comment letter acknowledged the conceptual and practical arguments for both the impairment-only model and reintroduction of amortisation and noted that more and more voices were raised in favour of the latter mainly for practical reasons. However, considering that an accounting policy should only be changed if it would provide reliable and more relevant information, EFRAG suggested the IASB to further explore improvements to the existing impairment test and any cost and consequences of reintroducing amortisation (including how to determine the useful life, amortisation method, the impairment test to be applied under the amortisation model and transitional provisions which should be regarded as a package).

## Detailed analysis of issues, comments received, and changes made to EFRAG’s final comment letter

**EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments**

**EFRAG’s response to respondents’ comments**

### Question 1 – Objective of the project

### EFRAG final position

#### *Proposals in the DP*

Paragraph 1.7 of the DP indicates that the IASB’s overall objective is to explore whether companies can, at a reasonable cost, provide investors with more useful information about the acquisitions those companies make. Better information would help investors assess the performance of companies that have made acquisitions. Better information would also be expected to help investors more effectively hold a company’s management to account for management’s decisions to acquire those businesses.

The IASB considers that its preliminary views included throughout the DP are interconnected and form a package. If this package of preliminary views were implemented, the IASB would meet the objectives of the project.

#### *EFRAG’s tentative position*

EFRAG supported the objective of the DP to explore whether companies can, at a reasonable cost, provide investors with more useful information about the acquisitions those companies make. EFRAG’s understanding was that users of financial statements did not think that sufficient information to assess acquisitions was currently presented in financial statements. It was therefore important to address this issue.

EFRAG noted that the proposals in the DP did not aim at addressing, through disclosure or enhancement of the impairment model, shortcomings in goodwill accounting. Accordingly, the proposals would

Considering the feedback received, EFRAG maintained its initial position supporting the overall objective of the DP and considering that the DP did not aim at addressing shortcomings in goodwill accounting.

EFRAG noted that a significant number of constituents did not consider the proposals as a package. In relation to the consideration of the IASB’s preliminary views as a package, therefore EFRAG did not agree that the DP was a package of proposals, but rather considered it a series of proposals that could be considered independently. EFRAG suggested that the IASB could first introduce swiftly the simplifications to the impairment test, as these proposals were the least controversial (proposals on post-tax inputs and cash flows from future restructurings and asset enhancements including guidance on the latter). The IASB could then consider other proposals over a longer period as these might take a longer period to implement.

In addition, EFRAG asked the IASB to consider commercial sensitivity of the disclosure proposals and whether significant transactions out of the scope of IFRS 3 could be addressed in another standard.

**EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments**

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address some current shortcomings, but would leave room for improvement in this area.

EFRAG’s view on whether the proposals in the DP, as a package, met the objectives of the DP, would only be provided after receiving inputs from its constituents.

*Respondents’ comments*

A significant number of constituents considered the proposals not as a package, with several distinguishing between disclosures and subsequent accounting for goodwill. Some respondents considered that the concerns around the accounting for goodwill had not been addressed. A few respondents were unconvinced that the benefits of that package would exceed its costs and considered that part of the information would be commercially sensitive.

In addition, there were concerns that the project only focused on acquisitions and excluded many significant transactions where holding management to account for its decision was equally important. Management used resources of investors and should be held to account for it. Examples such as asset deals or a step acquisitions (no goodwill but excess payment through equity) were provided. The IASB could accordingly consider whether it should address the issue more broadly than by considering amendments to IFRS 3 *Business Combinations* only.

**EFRAG’s response to respondents’ comments**

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**EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments**

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**Question 2 – Strategic rationale for an acquisition and subsequent performance**

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*Proposals in the DP*

The DP proposed that:

- 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.
- IFRS 3 requires a company to disclose the primary reasons for an acquisition. This disclosure requirement may result in companies providing some information about management’s objectives, but, according to the DP, this information is unlikely to be specific enough to form the basis of the information that would help investors to assess the subsequent performance of the acquisition.
- 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, rather than on metrics prescribed by the IASB.
- 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. A company would not be required to disclose any metrics in such cases.

**EFRAG’s response to respondents’ comments**

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**EFRAG final position**

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Considering the feedback received, EFRAG decided mainly to retain its initial position and to add the concerns in relation to commercial sensitivity, placement of information and cost benefit issues.

Based on the feedback received, EFRAG considered that the proposed disclosure requirements could result in useful information to assess business acquisitions. However, for the requirements to be most useful, the information should be provided for all material acquisitions based on the information that the relevant decision-maker monitors. While EFRAG considered the information could be useful, it had some practical concerns including what information would be provided. In its final comment letter EFRAG also requested the IASB to further examine whether some information might be better provided in the management commentary instead of in the financial statements. In that regard, EFRAG noted that the information would be based on management expectations and would refer to non-GAAP indicators. However, EFRAG would also have reservations about allowing entities to present the information in the management commentary by either including the requirements in the management commentary practice statement or allowing entities to provide the information in the management commentary by cross reference. EFRAG also noted that the IASB would have to consider how to avoid entities having to disclose commercially sensitive information. EFRAG thus disagreed that commercial sensitivity would never be a reason to prevent disclosure of information that investors would find useful. EFRAG noted that the

## **EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments**

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- A company should be required to disclose the information about whether it is meeting those objectives for as long as its management (CODM) continues to monitor the acquisition to see whether it is meeting its objectives.
- 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.
- 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.

According to the DP, the fact that the required information can be commercially sensitive to provide is not a sufficient reason to prevent disclosure of information that investors need.

### *EFRAG’s tentative position*

In its DCL, EFRAG considered that the proposed disclosure requirements could result in useful information to assess business acquisitions. However, for the requirements to be most useful, the information to be provided should not only be based on what information the CODM monitors. While EFRAG considered the information could be useful, it had some practical concerns including what information would be provided. In its DCL, EFRAG had not yet formed a view, and consulted its constituents, on whether it is practical and appropriate to disclose the proposed information in the financial statements instead of providing the information as part of the management commentary as the information is based on management expectations and referred to non-GAAP indicators. EFRAG

## **EFRAG’s response to respondents’ comments**

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proposed disclosures would not resolve the issues related to current goodwill accounting

### *Summary of how EFRAG considered the views of respondents in arriving at this final position*

Based on the comments received from constituents, EFRAG developed or modified its view (as stated in the DP) in relation to:

- Including the proposed information in the management commentary.
- How to take into account that some of the proposed information might be commercially sensitive.
- What the information to be provided should be based on.
- The clarity of the suggestions and other issues.

### *Including the proposed information in the management commentary*

EFRAG noted the comments made by some respondents who considered the disclosures to be forward-looking and argued that the information would belong to the management commentary. EFRAG also understood that some considered that placing the information in the management commentary would reduce the risk of litigations based on the information. From the survey EFRAG conducted with preparers, EFRAG understood that the concern was primarily related to the disclosures on the (specific) objectives of an acquisition and whether these objectives have been met and less related to the disclosures on the strategic rationale of a business combination. EFRAG also understood that at least some users of financial statements would be indifferent about whether the information is placed in the financial statements or the management commentary.

## **EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments**

supported conducting additional activities to understand the issue related to commercial sensitivity. Also, EFRAG noted that the proposed disclosures will not resolve the issues related to current goodwill accounting.

### *Respondents’ comments*

#### *Input received through outreach*

Views of constituents on the IASB’s proposals regarding disclosures were relatively similar to the observations included in EFRAG’s DCL. That is, in principle, much of the suggested information would be useful for users but there are potential issues with:

- Faithful representation (e.g., it can be difficult to provide estimations of synergies and in order not to disclose commercially sensitive information, some information may not be disclosed, or boilerplate disclosure will be provided).
- Some of the information is commercially sensitive.
- The information may be difficult to audit.

Discussions have also been on whether some of the information should be presented in management commentary. In a survey for preparers, particularly information on synergies and whether objectives have been met was considered to be better placed in, for example, the management commentary.

#### *Input received through comment letters*

Almost all preparers had concerns with the proposed disclosures or asked to review the usefulness of the current disclosures first. One preparer agreed to disclose information about the primary reasons and business rationale for an acquisition. In contrast, users supported the proposed

## **EFRAG’s response to respondents’ comments**

At the same time, however, EFRAG had reservations about allowing the information to be placed in the management commentary taking into account that:

- The practice statement Management Commentary does not provide mandatory guidance. Accordingly, if the IASB included the guidance in the practice statement, the proposed disclosures might not be provided by many entities. In addition to resulting in relevant information not always being provided, it could result in a level playing field issue.
- Under an approach by which the disclosures would be required by IFRS 3 but could be provided in the management commentary by cross reference, many of the issues identified by those suggesting the disclosures to be provided in the management commentary may not be solved and such an approach could result in confusion about what information belongs to the financial statements. The benefits of the approach could be that it would limit the size of the financial statements, but such an objective may become less relevant as financial information is provided digitally.

EFRAG thus considered that the IASB should further examine whether some of the disclosures would be better provided in the management commentary, taking into account both the concerns about including some of the proposed information in the financial statements and the concerns related to allowing the information to be provided in the management commentary. In addition, the IASB should further analyse the disclosures proposed to differentiate between those that relate to accounting disclosures required for a complete set of IFRS information from those that result from management expectations or strategy,

## **EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments**

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improved disclosures. From users it was noted that for investors it is fundamental that companies provide useful information to (1) accurately analyse the value of the acquisition, (2) the resulting value of the entity and (3) to understand the amount of the recognised goodwill.

Messages from standard setters were mixed. Some standard setters noted that the proposed disclosures would be of limited use. Others thought the disclosures would be useful. Two standard setters argued from a different angle. While agreeing to or welcoming the objective of the disclosures, they either encouraged the IASB to perform extensive field testing, reach out to stakeholders and then significantly reconsider its proposals or suggested substantiating, amending and clarifying the disclosure objective.

Auditors and regulators agreed with enhancing the information provided to investors about the subsequent performance of an acquisition.

On the proposals to disclose the strategic rationale and management’s (CODM’s) objectives for an acquisition at the acquisition date, a preparer provided explicit support for the disclosure. One preparer noted that information relating to the material acquisitions are often already provided by press releases.

Users generally agreed with a requirement to provide this information. Auditors and regulators also expressed support.

Most standard setters generally agreed with the requirements to disclose the strategic rationale for undertaking an acquisition and management’s objectives for the acquisition.

One preparer noted that the requirement to state why the entity does not monitor an acquisition seemed to be an attempt to force entities to disclose the metrics it uses by the method of “naming and shaming”. In

## **EFRAG’s response to respondents’ comments**

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included not as a disclosure requirement but as a best-practices guidance.

*How to take into account that some of the proposed information might be commercially sensitive*

EFRAG noted the concerns of constituents that the information required by the proposals could result in companies having to disclose information they would consider commercially sensitive. EFRAG agreed that this could be the case when it:

- Would require an entity to disclose “a secret strategy”.
- Would provide information on how much the entity is willing to pay for possible future targets, when an entity has a strategy to make many acquisitions within a limited time period.

EFRAG noted that many current requirements, could have the same effect. For some companies, the profit margin appearing in the statement of financial performance could thus be commercially sensitive. EFRAG, however, also noted that entities seem to be most reluctant to provide commercially sensitive information that is forward looking and if disclosing the information is considered to provide a commercial disadvantage compared to entities preparing financial information under another set of requirements. If the proposed information was to be provided, a balance therefore needed to be struck. EFRAG thus decided to disagree with the DP that commercial sensitivity could never be a reason to prevent disclosure of information that investors would find useful. However, EFRAG suggested that the IASB’s proposal should include a ‘high threshold’ for entities that do not disclose information due to commercial sensitivity to avoid that less commercially sensitive information is also not disclosed.

## **EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments**

the view of the respondent an entity should be allowed to state that it is monitoring the acquisition but that for reasons of confidentiality and commercial sensitivity it chooses not to disclose the metrics.

One standard setter agreed with the proposal to disclose how management (CODM) monitors and measures the acquisition is at an appropriate level of details. The metrics disclosed will give investors relevant information about how management monitors and follow up an acquisition and about how well a company is managed. With regards to quantitative disclosure requirements on such metrics the IASB should emphasise that only metrics that can be measured (and audited) with sufficient reliability should be within the scope for quantitative disclosures.

Users thought that specific information will provide a better base for understanding and valuing the entity. Hence, companies should provide metrics that are relevant for investors such as estimates of consolidated revenues, operating profits, cost savings, net earnings, balance sheet items such as consolidated debt and ROCE (return on capital employed). Other type of non-financial information such as (combined) market share and/or other information (e.g., number of retail stores if that is the case) would also be helpful. Users agreed with EFRAG’s comments regarding the subsequent monitoring of the performance of an acquisition. They dissented with the DP’s argument that an entity cannot provide information because the acquired business is integrated.

In the view of a regulator a company should stop providing disclosures about whether it is meeting its objectives only when the synergies expected to derive from the acquisition have been realised or when those objectives have been abandoned (which in their view corresponds to the time when an acquired business is fully integrated into the acquiring business).

## **EFRAG’s response to respondents’ comments**

EFRAG accordingly suggested the IASB to address the issue of commercially sensitivity. In its final comment letter EFRAG provided suggestions for different approaches the IASB could investigate. One approach mentioned was a ‘disclose or explain’ approach under which an entity does not disclose specified information, if disclosing the information would seriously harm the entity’s possibilities to achieve the expected objectives (or by other means result in a significant unfavourable position for the entity). This approach would be similar to the approach included in paragraph 92 of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. Under a ‘disclose or explain’ approach, the IASB would have to consider how the approach should be applied when some information might be commercially sensitive while others might not to avoid that, for example, only the ‘good’ information is disclosed.

Another approach, the IASB could consider in the case an entity would not provide the required disclosures, would be to either require entities to determine the additional information it would need to meet the disclosure objectives or to specify alternative information to allow users making some assessment of the management’s decisions to acquire a business. Based on input from users, EFRAG suggested that such information could be:

- Clear information about the price (including non-cash transfers such as new shares in the acquirer issued to the vendor and assets injected by the acquirer into the new entity if the vendor retains a stake);
- Information about what has been bought (e.g., financial information relating to the acquired business – including



## **EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments**

Some preparers noted that if the disclosures would be required, they should be based on the information and the acquisitions a company’s CODM reviews. Other preparers asked for further field tests to obtain further evidence on whether these proposals would work in practice or noted the information should remain rather qualitative and materiality criteria should be considered.

Two standard setters suggested to consider a lower management level – at least in some cases - as the threshold for monitoring the acquisitions (e.g., the level at which goodwill is being monitored internally) and disclose metrics used by this lower management. On the other hand, one standard setter emphasized that the disclosures should be built on management’s metrics provided to the CODM for relevance and cost/benefit trade-off reasons. Another one supported 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.

In the regulators’ view at least some key disclosures should be required for all the acquisitions which generate a material amount of goodwill, regardless of whether they are monitored by the CODM.

All preparers had concerns with the commercial sensitivity of the information, just like most of the standard setters.

Users understood that companies cannot provide commercially sensitive information but noted that companies under the caption of “sensitiveness” in many cases do not provide information that in fact is not that sensitive. They agreed with EFRAG’s comments that a balance should be reached.

Also, auditors suggested to find a balance between the benefits to investors and the commercial sensitivity of these disclosures. On the

## **EFRAG’s response to respondents’ comments**

information from the last audited balance sheet to the date of first consolidation by the new owner).

In its final comment letter, EFRAG mentioned the IASB could also consider to only require disclosure of information that would not be commercially sensitive.

*What the information to be provided should be based on*

EFRAG only received limited support for its proposal that the information provided should be based on a lower level of monitoring than the CODM level. Constituents often suggested that the information should be based on the CODM level of monitoring or by using a general materiality threshold. EFRAG noted that basing the information on the information monitored by the CODM could result in not so material information could sometimes be disclosed.

EFRAG considered that if an acquisition is material, information about it should be provided. This information should then be based on the information used to monitor the acquisition internally by the relevant decision maker. This relevant decision maker could correspond to the CODM, but could also be a lower level, depending on the entity’s strategy and organisation.

EFRAG considered that such an approach could, to some extent, address both the concern of those fearing that information that is not material would have to be disclosed and the concerns about insufficient information being provided if it would be based on what the CODM monitors.

EFRAG acknowledged that there would be advantages of referring to the information used by the CODM, as this term is already defined in IFRS 8 *Operating Segments*. However, EFRAG considered that it

## **EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments**

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contrary, a regulator thought that generally commercial sensitivity is not a valid reason for not informing investors.

Only a few participants (preparers and standard setters) opined that information established or generated at the time of the acquisition is forward-looking by nature, even though it was determined in the past. The quantified expected outcomes from an acquisition are necessarily projections into the future of what management expects from the transaction in terms of profitability, etc. Consequently, the IASB should accept that this information is of the nature of a projection into the future.

One standard setter pointed out that a valid statement of objectives may also require a plausible presentation of the expected way of achieving these objectives. Therefore, they deemed a legal assessment difficult, whether information about management’s objectives for an acquisition together with detailed targets could be considered as forward-looking information. In order to find a universally applicable suitable solution, the IASB might consider whether information classified as forward-looking in a particular jurisdiction should not be subject to mandatory disclosure for companies in that jurisdiction.

Almost all preparers disagreed with including all of the proposed information in the notes of the financial statements – instead the information should be provided in the management commentary - from a cost/benefit perspective. They did not share the view that it would be more useful, relevant or reliable if audited. One of them noting that putting the information in the management commentary would not make such a big difference.

Users noted that currently, information about the business strategy is included in the management commentary. They added that reliability and auditability of the information in M&As should not depend on the

## **EFRAG’s response to respondents’ comments**

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should also be possible to define ‘the relevant decision maker’ level on which the disclosures on the success (or failure) of acquisitions should be based.

EFRAG also decided to add that in the case the company undertakes many small acquisitions (as part of an overall strategy) which are monitored together and are material for the assessment of stewardship the IASB should consider whether these should be included in the scope of the proposals, and if so, the IASB should consider how they could be included. In this regard, in order to avoid entities having to disclose information about future acquisitions (which would be commercially sensitive) the EFRAG specified in its response that an entity would not have to make disclosures about intended future acquisitions when describing the objectives of the acquisitions.

EFRAG noted that a respondent considered that at least some key disclosures should be required for all the acquisitions which generate a material amount of goodwill, regardless of whether they are monitored by the CODM. However, EFRAG noted that ‘key disclosures’ would be difficult to define as the purpose of acquisitions can be very different.

### *The clarity of the suggestions and other issues*

EFRAG noted that users have been stating that they lack information to assess business combinations. It may be difficult to present other information that would be as relevant for this purpose as the information suggested in the DP. EFRAG agreed with the DP that information about the objectives of an acquisition and whether they have been met would result in useful information. However, EFRAG noted that while in principle these disclosures were useful, they have to be tested in practice as whether or not the information would be useful would depend on the how the requirements would be worded in practice. In

### **EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments**

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circumstances. As the process of consolidation develops new or different information might appear but the information disclosed should be reliable.

One preparer noted that many acquisitions are based on cost synergies. However, tracking these cost savings along the subsequent periods after the acquisitions for the purpose of a disclosure may be difficult, unreliable and thus irrelevant for the users.

Most standard setters noted the information is difficult to audit or creates auditability issues. One of them thought that the verifiability of the information supporting the proposed disclosures is a real practical issue. Many of the metrics the CODM uses may be non-financial (such as market shares) and, if having a financial nature, may not be defined by IFRS Standards. In addition, part of the information an entity would disclose would reflect management’s expectation and thus, be forward-looking in nature.

Some standard setters noted the information provided by the companies will be more useful or relevant and/or reliable if it is audited. One standard setter thought it would be possible to prepare the information in a manner that would make it possible to audit.

### **EFRAG’s response to respondents’ comments**

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that regard EFRAG also noted its outreach activities had shown that there were some unclarity about the disclosure requirements. For example, EFRAG considered that the DP was not clear on when it can be said that the effect of an acquisition is monitored. For example, if an acquired business can be said to be monitored if the business line in which it will be part of is monitored. If the proposals would mean that an acquisition is monitored in that case, it would mean that an entity would have to provide the information it uses to assess the performance of the business line. EFRAG noted that this could result in an entity having to disclose all the information that the CODM (or other relevant decision maker) reviews and EFRAG did not think this was appropriate. On the other hand, if the IASB’s intention is that an entity would not monitor an acquisition if it monitors it as part of a business line, EFRAG agreed with the comment of a respondent that it would not be appropriate to require the entity to state that it is not monitoring the acquisition.

EFRAG noted that a few respondents considered that the IASB should require minimum disclosures such as estimates of consolidated revenues, operating profits, cost savings, net earnings and balance sheet items such as consolidated debt and ROCE, information about the estimated payback period, the expected profit arising from the integration of the new business(es) and the expected integration costs.

However, EFRAG noted that business combinations are made for various and different reasons and it could therefore be difficult to require standard information. For example, if the objective of an acquisition is to prevent a competitor from buying the business, it may be difficult to provide information about an estimate pay-back period.

EFRAG also noted that a respondent had noted that the information would not be comparable between entities. EFRAG agreed with this.



**EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments**

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**EFRAG’s response to respondents’ comments**

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However, it noted that that seems to be unavoidable as entities could have different objectives of an acquisition. In this regard, EFRAG also noted the response from a user association stating that “Acquisitions’ objectives are different and therefore comparability is not a key point.”

EFRAG noted that several respondents commented that it is not possible to isolate and measure the initial objectives without taking into account operational issues (e.g., IT systems) or that information about the performance of an acquired business might not be possible because they are integrated in the existing business. However, it was the interpretation of EFRAG that an entity should only provide the information it already prepares to monitor an acquisition.

EFRAG agreed with the comment made in comment letters and at interviews with preparers that unexpected things occur, and the new disclosure requirements would thus not be sufficient to confirm whether the price of an acquisition was reasonable and whether an acquisition has been successful. However, EFRAG considered that the disclosure could form the basis for the entity providing further explanations about why the fact that, for example, objectives have not been met does not mean that an acquisition has not been a success and what unforeseen circumstances have played a role.

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## EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments

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### Question 3 – Disclosure objectives

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#### *Proposals in the DP*

The DP proposes to add further disclosure objectives that require companies 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 management’s (CODM’s) objectives for a business combination are being met.

#### *EFRAG’s tentative position*

In its DCL EFRAG supported the introduction of the disclosure objectives, should the proposed information be included in the notes to the financial statements.

#### *Respondents’ comments*

##### *Input received through outreach*

If the disclosures should be provided, 80% of the respondents to the preparers’ survey preferred this information to be included in the management commentary.

##### *Input received through comment letters*

Almost all preparers agreed with the usefulness of providing this information to investors but almost all of them also raised concerns at the same time.

One respondent, however, considered that an alternative approach to this issue should be considered in relation to highly regulated sectors, such as the banking sector. The respondent noted that banks already communicate the management’s specific objectives for an acquisition to

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## EFRAG’s response to respondents’ comments

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### EFRAG final position

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In its final comment letter, EFRAG supported the introduction of the disclosure objectives, however, would the IASB propose that some of the information could be provided in the management commentary, it should be specified that the objectives apply to the information provided in both the financial statements and the management commentary.

#### *Summary of how EFRAG considered the views of respondents in arriving at this final position*

EFRAG noted that generally respondents supported including the disclosure objectives, but some had concerns with the disclosures required. EFRAG considered these concerns when replying to the specific disclosure proposals.

As noted in the answer to Question 2, EFRAG considered that the IASB should further examine whether some of the disclosures would be better provided in the management commentary. If the IASB would propose (allowing) entities to present the information in the management commentary EFRAG considered that it should be specified that the objectives would apply to the information provided in both the financial statements and in the management commentary.

EFRAG noted the suggestion that an alternative approach to this issue should be considered in relation to highly regulated sectors, such as the banking sector. EFRAG, however, considered that for international standards to be useful for users, it would be beneficial that all companies applying those standards provide the same information irrespectively of the other filings these entities are doing based on local or regional legislation.

the market as at the acquisition date. The requirement to include that information in the notes of the financial statements would, according to the respondent, provide limited benefits to users and would increase costs for preparers.

Several national standard setters considered the objectives to be useful. Two of them agreed in principle with broadening the existing disclosure requirements but asked first to seek feedback on disclosure objectives or to better substantiate them.

A regulator agreed with the IASB preliminary view that it should develop, in addition to the proposed new disclosure requirements, proposals to add disclosure objectives to provide information to help investors to understand the benefits a company's management expects from an acquisition and the extent to which an acquisition is meeting the CODM's objectives.

## **EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments**

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### **Question 4 - Synergies and additional major classes of liabilities**

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#### *Proposals in the DP*

The IASB DP proposes 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.
- The expected cost or range of costs to achieve those synergies.

Also, the DP proposes to specify that liabilities arising from financing activities and defined benefit pension liabilities are major classes of liabilities.

#### *EFRAG’s tentative position*

In its DCL EFRAG considered that the suggested disclosure requirements on synergies could provide useful information. Similar disclosures for other components of goodwill could equally provide useful information. However, EFRAG questioned whether the information should be provided in the financial statements and whether the benefits of providing the disclosures on synergies will outweigh the costs. EFRAG was therefore seeking inputs from constituents on costs. EFRAG supported separate disclosure of liabilities arising from financing activities and defined benefit pension liabilities acquired as part of an acquired business.

#### *Respondents’ comments*

In the preparers’ survey, EFRAG issued to collect input for its comment letter, 83% of the respondents, preferred the proposed disclosures on synergies to be included in the management commentary mainly due to

## **EFRAG’s response to respondents’ comments**

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### **EFRAG final position**

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Considering the feedback received, EFRAG decided mainly to retain its initial position and to address some practical issues to consider in relation to those disclosures like cost benefit issues, commercial sensitivity and placement of information.

In its comment letter to the IASB, EFRAG considered that the suggested disclosure requirements on synergies could provide useful information. Similar disclosures for other components of goodwill could equally provide useful information. EFRAG considered that the benefits of providing the disclosures on synergies would outweigh the costs provided that the information would already be available to an entity as a result of the M&A process or by other internal sources. If it would not be the case, EFRAG suggested that a higher flexibility would be given to entities to limit the disclosures to qualitative information only. In order to increase comparability between entities, EFRAG suggested the IASB to further clarify how they considered the disclosures to be provided, and what ‘synergies’ would encompass. EFRAG also considered that the IASB should further examine whether the disclosures would be better provided in the management commentary, taking into account both the concerns about including some of the proposed information in the financial statements and the concerns related to allowing the information to be provided in the management commentary. Similar to disclosures on management objectives for an acquisition and its subsequent performance, EFRAG noted that the IASB would have to consider how to avoid entities having to disclose commercially sensitive information. EFRAG thus disagreed that commercial sensitivity would never be a reason to prevent disclosure of information that investors

## **EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments**

inherent complexities in preparing the information. This preference was also reflected in the comment letters received. Both preparers and standard setters considered the management commentary, that is the document where management would naturally describe its strategies and objectives, as the most appropriate place for the proposed disclosures (that mainly consists of management views, assumptions and strategies).

The majority of preparers and standard setters submitting a comment letter raised concerns about the difficulties related to providing the proposed quantitative disclosures. An auditor suggested that preparers should be exempted to provide the expected amounts of synergies (and costs to be incurred for their achievement) if such information has not been gathered through the M&A process.

A user organisation stressed the importance for investors to have quantitative information about revenues and cost synergies.

Some comment letters highlighted that there was not a single definition on the concept of synergy and guidance how it should be estimated. Increasing the comparability between companies will therefore be more complex to achieve. One of these respondents suggested that the IASB should clarify the intended basis of the information to be disclosed: a standardised approach or a management approach. In addition, the respondent suggested to clarify whether the disclosures should be based on management’s synergy expectations in the deal process or after closing of the transaction.

Many of the national standard setters and regulators providing comment letters supported EFRAG preliminary view that similar disclosures for other components of goodwill could equally provide useful information. Some of them considered that businesses can be acquired by management for several reasons beyond synergies, such as the increase

## **EFRAG’s response to respondents’ comments**

would find useful. EFRAG supported separate disclosure of liabilities arising from financing activities and defined benefit pension liabilities acquired as part of an acquired business.

*Summary of how EFRAG considered the views of respondents in arriving at this final position*

EFRAG considered the comments related to the commercial sensitivity of the information provided and whether the information on synergies should/could instead be provided in the management commentary. For these issues, EFRAG assessed that its response to these issues under Question 2, would also apply in this case – and for the same reasons.

Considering the comments on the difficulties related to providing the information, EFRAG noted that the proposed information about synergies would provide investors with useful information. However, from a cost-benefit perspective, EFRAG considered that the benefits would outweigh the costs only if the required information is already available to the entity as part of the M&A process or other internal sources. That condition would also affect the reliability and the auditability of the information that will eventually be reported.

EFRAG noted that the reliability and auditability would depend on the circumstances. In some circumstances, when the synergies are the key driver of an acquisition, the required information could be easily available to entities. In addition, the information could often be subjected to an extensive level of internal scrutiny by the entities’ governing bodies and, as such, could be deemed to be produced in a way that would be reliable and auditable. Furthermore, the proposed requirements indicated that range of amounts could alternatively be disclosed, and it would allow preparers to maintain quantitative information at a broader level only. However, in some other

## **EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments**

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of market share or product development/research, access to technologies, etc. Accordingly, synergies are not always the main objective for management to acquire businesses and therefore these proposals will not always be helpful to hold management accountable for the acquisition.

The above argument was also included in a comment letter received from a preparers’ organisation.

Another standard setter considered that restricting the scope of disclosures to synergies may also prevent the information to meet users’ needs regarding goodwill analysis.

Few instances from comment letters also evidenced concerns that providing the disclosures on some of the other components of goodwill may be challenging, as well as in relation to the cost-benefit relationship.

Some comment letters expressed the view that synergies should only be disclosed for acquisitions monitored by the CODM. In this regard, a better alignment of these proposals was suggested to avoid a loss of consistency in the information communicated as a whole.

Outreach events showed that some preparers were concerned about the expected synergies on revenues being highly sensitive from a commercial point of view. While some others considered that they were already disclosing information to the market about cost synergies (not in the financial statements but instead through presentations and press releases). It was also noted that information about cost synergies could trigger confidentiality issue especially under an internal perspective (i.e., synergies achieved by part of the workforce becoming redundant).

However, users’ feedback from both the outreach events and the comment letters showed that, even if recognising the need to find an

## **EFRAG’s response to respondents’ comments**

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circumstances, this information would be difficult to translate into a meaningful accounting number. EFRAG accordingly suggested that in those cases some flexibility should be provided to entities to limit the disclosures to qualitative information only.

If not collected as part of the due diligence process, the information could be also deemed to be less relevant in the context of a specific acquisition, or more complex to be reliably determined, so it would risk resulting in boiler-plate information.

EFRAG agreed with the comments that there is not a single definition on the concept of synergy and guidance how it should be estimate. Accordingly, EFRAG included in its final comment letter a request to the IASB to provide a list of synergies and further clarify the proposed requirements including a specification of whether ‘estimated amount or range of amounts of the synergies’ relates to synergies in total or to each type of expected synergy; and a clarification if a detailed pattern of synergy realisation by type (or in total) or simply a timeframe by type (or in total) should be disclosed.

EFRAG noted the support for its preliminary view that similar disclosures for other components of goodwill could equally provide useful information.

EFRAG considered that the relevance of synergies and/or other components that make up goodwill depends on the specific circumstances. For example, an insurance company participating in EFRAG’s survey to preparers considered the penetration of new market as one of the key drivers for an acquisition. Furthermore, a software provider mentioned technologies and future technologies as a driver as well. On that basis, the objective of providing information that gives investors with better information of why a company paid the price it did



## **EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments**

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appropriate balance between investor needs and preparers willingness to disclose this information, preparers were, in the views of users, often leveraging the caption of “sensitivity” to avoid providing information that in fact is not that sensitive.

Preparers feedback through the survey and other outreach events broadly considered that proposed disclosure, under a quantitative perspective, would trigger significant technical complexity, incremental costs and involve an undue level of management responsibility (in line with some of the other disclosures requirements proposed in the DP). However, users considered this information as one of the most relevant in a business combination that currently lacks enough disclosures to investors.

Comment letters received mostly showed the same positions. Preparers broadly considered that the information to be provided would be forward-looking in nature, would consist of projections, estimates and management assumptions, would be difficult to audit and would trigger incremental costs and management risks that outweigh benefits. Users, however, noted that the information provided would be important.

Comment letters showed more balanced views from standard setters, regulators and auditors. While most of them recognised the relevance of the proposed information, only few respondents considered it as triggering additional costs that would outweigh benefits. However, many of them considered that the disclosure would be limited to qualitative information. One respondent suggested that a preparer would be required to disclose the full information only if it has been gathered in the deal process and, as such, it would be easily available.

One comment letter included suggestion that the IASB would consider proposing disclosures of subsequent changes in the initial synergy expectations.

## **EFRAG’s response to respondents’ comments**

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for the acquired business can be only achieved by requiring companies to provide information about all the material elements of goodwill on a case-by-case basis.

EFRAG also considered that, if the same requirement would not be proposed for other components of goodwill, a different materiality threshold should be set for information on synergies compared to the one currently provided in the DP. That would be mainly aimed to capture into the disclosure requirements circumstances where a range of synergies may not be material when reported in isolation, but the goodwill itself was material for the price paid for the acquired business. In such circumstances, it would provide investors with useful information about the size of remaining parts of goodwill, such as intangible assets that do not qualify for separate recognition.

When considering the comments that synergies should only be disclosed for acquisitions monitored by the CODM, EFRAG did not see any reason why synergies should only be disclosed for those acquisitions monitored by the CODM. It noted that the disclosure requirements suggested in the DP that related to what the CODM monitors were also based on the specific information the CODM would be monitoring. The requirement on synergies was a specific requirement – and did not relate to whether the CODM was monitoring the synergies or not. The requirement was an attempt to provide information on what goodwill consists of, and not primarily whether an acquisition has been successful or not. Accordingly, EFRAG did not include this comment in its comment letter.

On the comment that the IASB should consider proposing disclosures of subsequent changes in the synergy expectations, EFRAG noted that information about this would be provided (indirectly) if the CODM (or

**EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments**

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Most of the respondents across all categories of constituents supported the proposal to specify that liabilities arising from financing activities and defined benefit pension liabilities are major classes of liabilities.

**EFRAG’s response to respondents’ comments**

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other relevant decision maker) would monitor synergies. If the CODM would not monitor synergies, EFRAG considered that the information might be considered useful, but:

- It would also result in an additional cost for preparers.
- It would not any longer explain factors that goodwill consists of (as although the synergies would decrease goodwill might not because of shielding and headroom).
- It would conflict with the view of EFRAG that the disclosures of a success of an acquisition should be based on what the management of the entity is monitoring.

Accordingly, EFRAG decided not to include this comment in its comment letter.

EFRAG noted the broad support for the proposal to specify that liabilities arising from financing activities and defined benefit pension liabilities and decided to also maintain its support on this issue.



## EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments

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### Question 5 – Pro forma information

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#### *Proposals in the DP*

The DP explained that the requirement of IFRS 3 B64(q) to prepare pro forma information and to disclose the revenue and profit or loss of the acquired business after the acquisition date should be retained. The DP proposed:

- 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 IASB 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.

#### *EFRAG’s tentative position*

In its DCL EFRAG supported retaining the requirement to disclose pro forma information, to the extent practicable, and replacing the term ‘profit or loss’ with ‘operating profit before deducting acquisition-related costs and integration costs’. It was suggested to provide a principles-based definition for the new concepts of ‘acquisition-related’ and ‘integration cost’.

## EFRAG’s response to respondents’ comments

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### EFRAG final position

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Considering the feedback received, EFRAG decided to maintain its position and to add additional explanations and arguments for its position and not to add a suggestion to present further modified figures as pro forma information.

In its final comment letter, EFRAG suggested that the IASB should provide a principles-based definition for the new concepts of ‘acquisition-related’ and ‘integration cost’ to be used in preparing the pro forma information. EFRAG agreed with replacing ‘profit or loss’ with ‘operating profit before acquisition-related transaction and integration costs’ for both the pro forma information and information about the acquired business after the acquisition date. EFRAG disagreed with providing similar information for cash flows from operating activities.

#### *Summary of how EFRAG considered the views of respondents in arriving at this final position*

In response to the comments that the current information on pro forma figures was not useful, EFRAG noted that the DCL acknowledged that the information was ‘hypothetical information’ but argued that the information was useful as trend information about an entity’s financial performance would be important for users. EFRAG agreed that there were practical problems related to preparing the information and acknowledged that the issue on the pro forma figures had not resulted in most feedback from users. The latter could indicate that it was not considered to be the most important information for users. EFRAG, however, noted that there had been some comments from users on the issue and that EFRAG in the DCL argued why the information was

## **EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments**

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The DCL did not support the IASB proposal to provide information for cash flows from operating activities as the usefulness of this information would be very limited.

The DCL questioned whether it would be more useful to present as pro forma information further modified figures than ‘operating profit before acquisition-related transaction and integration costs’ which would also exclude the effects of the purchase price allocation (revaluations to fair value of the assets and liabilities of the acquired entity).

### *Respondents’ comments*

Some respondents did not think the current requirements on providing pro forma information should be maintained as the information was not used or was not useful as it was hypothetical and related with practical problems.

One respondent considers that the pro forma information should be limited to those acquisitions monitored by the CODM.

Input received from outreach activities and the comment letters received expressed mixed views on whether the term ‘profit or loss’ should be replaced with ‘operating profit before deducting acquisition-related costs and integration costs’. Some of those disagreeing with the proposal noted the absence of definitions of the proposed figures.

The views on the need for additional guidance on the preparation of pro forma information were split. Some respondents asked for more guidance on how to prepare pro forma figures. However, other respondents noted that the information would be non-GAAP information and, as such, subject to judgement. Some were concerned that additional guidance would disrupt current practices, but some mentioned that the disclosure of the basis of preparation might already improve the usefulness of the

## **EFRAG’s response to respondents’ comments**

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useful. EFRAG accordingly maintained the position expressed in the DCL that the information should be provided (unless impracticable).

EFRAG did not agree with the comment that the pro forma information should be limited to those acquisitions monitored by the CODM (see EFRAG’s response to Question 2).

EFRAG noted the mixed views on whether the term ‘profit or loss’ should be replaced with ‘operating profit before deducting acquisition-related costs and integration costs’. EFRAG observed that some preparers supported the proposal, although one organisation of preparers preferred to allow entities to present what they think is the most appropriate. The proposal was supported by some standard setters, but other standard setters were concerned that the change would not be applied consistently. In that regard, EFRAG noted that some principle-based guidance should be provided on what to consider as acquisition or integration costs and that the current ‘profit or loss’ figure was also not (always) considered to be the ‘profit or loss’ as calculated under IFRS. In addition, some of the complications (for example, related to financing costs) with calculating the ‘profit or loss’ figure would be removed when basing the information on the operating profit or loss. EFRAG accordingly maintained its support for replacing the term ‘profit or loss’ with ‘operating profit before deducting acquisition-related costs and integration costs’.

EFRAG agreed with the respondents who noted that the pro forma figures would be non-GAAP measures and, accordingly, would be subject to judgement. In addition, in some jurisdictions detailed guidance on the preparation of such information was provided by other authorities and organisations, for example, by stock exchanges. Accordingly, EFRAG did not consider that it should be a priority for the

### **EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments**

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information. Others suggested guidance about the objectives for the information. The IASB was also recommended to leverage current European market regulations in this regard.

One respondent noted that ‘acquisition-related costs’ were well-defined in paragraph 53 of IFRS 3.

Input received from outreach activities mainly confirmed the view expressed in EFRAG’s DCL that pro forma information on cash flows from operating activities would not be particularly useful (without further information on working capital, which could be costly to prepare). A couple of respondents providing comment letters to EFRAG considered that the information would be useful, but more respondents thought that it would not be useful and costly to prepare. However, some of these respondents came from the financial sector (in which cash flow information is of limited use). One respondent considered that the information could be useful, but it would be costly to prepare.

The input received during outreach activities did not support the proposal in EFRAG’s DCL to provide further modified figures than ‘operating profit before acquisition-related transaction and integration costs’ which would also exclude the effects of the purchase price allocation (revaluations to fair value of the assets and liabilities of the acquired entity). Very limited feedback was received in comment letters on this issue. One respondent noted that to increase the comparability and understandability it might be useful to prepare the pro forma information without the effects of the purchase price allocation. However, this required significant changes in the current principles for business combinations in IFRS 3.

### **EFRAG’s response to respondents’ comments**

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IASB to develop guidance on how to build pro forma measures. However, EFRAG suggested that the IASB provides a principles-based definition for the new concepts of ‘acquisition-related’ and ‘integration cost’ to help enhance comparability of the information. In addition, similar to some of the respondents, EFRAG would support entities providing explanations about the judgement applied in the preparation of the pro forma information.

EFRAG agreed with the comment that ‘acquisition-related costs’ are defined in IFRS 3, and accordingly decided to reflect this in its comment letter.

Based on the input received on the usefulness of providing information on cash flows from operating activities, EFRAG decided to maintain the position in its DCL , that this information should not be provided.

As the proposal included in EFRAG’s DCL to provide further modified figures than ‘operating profit before acquisition-related transaction and integration costs’ did not receive support from constituents, EFRAG decided not to include this proposal in its final comment letter to the IASB.

## **EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments**

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### **Question 6 – Improvements to the impairment test**

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#### *Proposals in the DP*

In the DP, the IASB investigates 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. The IASB’s preliminary view is that it is not feasible. The two main reasons for concerns about the possible delay in recognising impairment losses on goodwill are management overoptimism and the ‘shielding effect’.

#### *EFRAG’s tentative position*

In its DCL, EFRAG agreed with the main reasons identified (management overoptimism and the ‘shielding effect’). EFRAG shared the IASB’s reservations on the possibility to develop a different and more effective impairment approach. However, EFRAG considered that, without putting into question the fundamentals of the impairment model in IAS 36, there were collateral areas of possible improvements. EFRAG suggested that the guidance on goodwill allocation (including reallocation when reorganising) to cash generating units was discussed and possibly amended to improve how the test was applied in practice. In addition, better disclosures of estimates used to measure recoverable amounts of cash generating units containing goodwill could supplement the improvements to goodwill allocation guidance. EFRAG sought constituents’ inputs on possible disclosure proposals to mitigate the risk of management over-optimism.

#### *Respondents’ comments*

*Input received through outreach*

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## **EFRAG’s response to respondents’ comments**

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### **EFRAG final position**

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Considering the feedback received, EFRAG mainly maintained its initial position and decided to add to its initial response, the proposal for further disclosures to address management overoptimism, a request to explore better guidance for the identification of triggering events and a request to develop additional guidance on what is a "reasonable and supportable" cash flow projection.

#### *Summary of how EFRAG considered the views of respondents in arriving at this final position*

Considering the feedback received, EFRAG decided to maintain its reservations on the possibility to develop a different and more effective impairment approach. EFRAG also believed that, without putting into question the fundamentals of impairment in IAS 36, there were collateral areas of possible improvements. EFRAG anticipated that the benefits of exploring these enhancements may be justified irrespective of the eventual reintroduction of amortisation.

Based on the feedback received, EFRAG also retained the position reflected in its DCL on the suggested improvements to the guidance on goodwill allocation to the cash generation units and on subsequent reallocation of goodwill to mitigate a potential factor to the perceived ineffectiveness of the impairment test in practice. EFRAG understands that the current guidance might not be fully reflective of the intended benefit for which the entity paid the purchase price and might provide room for opportunistic behaviour.

In addition, EFRAG decided to propose to the IASB disclosures suggested in its DCL as alternatives that could help for a better

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## **EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments**

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‘Shielding effect’ and management overoptimism were confirmed as problems during the outreach.

In relation to the improvements of the guidance on goodwill allocation to cash generating units and possible amendments to improve how the test was applied in practice, the feedback obtained from outreach events differed mainly between preparers and other respondents like users, auditors and standard setters or regulators. While preparers were mainly reluctant to improve the guidance on allocation or reallocation of goodwill, such proposals were appreciated by other groups of respondents.

In relation to the proposed disclosures to mitigate management overoptimism the polling results obtained during the various webinars showed that the majority of constituents consider some of the proposals or all of them as being useful to address over-optimism. However, some preparers had reservations as these disclosures could trigger commercial sensitivity.

A few constituents highlighted that impairment test could be improved through better guidance and transparency on triggering events.

A panellist during a webinar expressed the view that there was potential for improvement related to paragraph 33 of IAS 36 as it was difficult to determine whether assumptions were reasonable given the lack of disclosures at CGU level. He suggested that the IASB could include additional guidance relating to the reasonableness and supportability of assumptions.

### *Inputs received through comment letters*

Constituents tended to agree that it would not be feasible to design a significantly more effective impairment test at a reasonable cost.

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## **EFRAG’s response to respondents’ comments**

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transparency of the estimates made or their achievements. However, EFRAG acknowledged that there could be some implementation issues and reflected the main concerns raised by constituents so that the IASB could further explore. The reason is that EFRAG after considering the feedback received did not agree with the conclusion in the DP that management over-optimism is best addressed by auditors and regulators, not by changing IFRS Standards. Auditors and regulators might not be able to have better knowledge about the business development than management, and therefore they might not replace the estimations made by management with their own estimations. So additional disclosures to make management overoptimism transparent are considered useful. Emphasis should be given to the assumptions taken to reach and to estimate the terminal value.

EFRAG noted from the feedback received that some respondents provided the view that improvements on the guidance for identification of impairment testing trigger events would help to recognise impairment losses on goodwill on a timely basis. Also, an increase in the transparency of the assessments made by management to determine whether there were indications of impairment, would enable users to gain a better understanding of the company and its risks. These disclosures would be of greater relevance if the indicator-only approach were adopted.

EFRAG also considered that there was merit in exploring whether additional guidance that reduces the existing subjectivity in reasonable and supportable cash flow projection (paragraph 33 of IAS 36) could be developed. The already existing guidance in IFRS 9 *Financial Instruments* could serve as a basis.

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### **EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments**

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A majority of preparers regarded current impairment test as satisfactory. Opposite to that, most of the rest of constituents agreed that the impairment test was not working properly and considered that too optimistic estimates and ‘shielding effect’ were the main reasons for not recognising impairment losses on goodwill on a timely basis.

Preparers considered that management over-optimism or any lack of discipline should be addressed by the auditors and not by increasing the disclosure burden. Most of auditors and regulators that provided a response did not share the IASB’s view that over-optimism should only be dealt with by auditors and regulators because different aspects of over-optimistic estimates are also the responsibility of preparers. In addition, there was information asymmetry between the parties which usually does not allow enforceable corrections to a business plan beyond technical or obvious mistakes.

The few preparers that provided a response did not support the suggestion made by EFRAG that the guidance on the initial allocation of goodwill to CGUs as well as the guidance on the reallocation of goodwill based on the relative value approach should be further developed. They noted that current IAS 36 guidelines enabled entities to use the judgement they deemed relevant to enable a faithful representation of the transaction.

On the other hand, most of the other constituents agreed with EFRAG that the guidance on the allocation and reallocation of goodwill in CGUs could be improved as this could reduce shielding to a certain extent and reduce the judgment currently allowed in (re) allocating goodwill to CGUs. In this regard, they suggested developing application guidance on the requirements in paragraphs 80-87 of IAS 36 and exploring requiring entities to make more granular allocations of goodwill.

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### **EFRAG’s response to respondents’ comments**

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EFRAG decided not to include some other suggestions made by constituents due to limited feedback or because some of the suggestions implied shift toward disruptive approaches that are not currently considered by EFRAG.

**EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments**

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In addition, a few constituents considered that entities should be more transparent in allocating the goodwill over the different segments which would facilitate users to understand and better assess the shielding effect.

In relation to provide additional disclosures to mitigate the risk of management over-optimism mixed views were provided. Some constituents did not support the specific disclosures proposed by EFRAG to mitigate the risk of management over-optimism. They argued that these disclosures were difficult to prepare and highly sensitive and that implementation issues should be addressed by better application rather than by standard setting. They also noted that assumptions related to the period for which management had projected cash flows and the ‘back-testing’ disclosure could lead to wrong messages, should forecast not be reached, and that disclosures such as the current level of cash flows to allow users to model the future performance themselves was not appropriate, as external users would always miss some additional information to complete their projections in a reliable manner. In contrast, some other constituents considered that disclosing additional information about the cash flow estimates would be relevant and useful, especially on how entities estimate terminal values. They also noted that disclosing ‘back-testing’ information would improve transparency and it could also serve to make assumptions more realistic.

Constituents also suggested other improvements which ranged from enhancements of the current impairment model to the introduction of disruptive approaches. Those ones related to the current impairment model were:

- (a) rename the impairment test to refer instead to ‘a cash generating unit carrying value test’ as this name better reflect what is being tested under the current impairment model;

**EFRAG’s response to respondents’ comments**

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**EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments**

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- (b) provide further guidance on the notion of ‘largely independent’ cash flows and providing more guidance on what is a “reasonable and supportable” cash flow projection (IAS 36 paragraph 33);
  - (c) disclose a reconciliation between Market Value of a CGU containing goodwill and/or the sum of the CGU containing goodwill with the book value of the net assets or the sum of the recoverable amounts to overcome management over-optimism.
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**EFRAG’s response to respondents’ comments**

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## EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments

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### Question 7 – Amortisation of goodwill

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#### *Proposals in the DP*

In its DP, the IASB concluded that the impairment test cannot be significantly improved at a reasonable cost and considered whether to develop a proposal to reintroduce amortisation of goodwill to take some pressure off the impairment test and to provide a simple mechanism that targets the acquired goodwill directly.

The IASB tentatively decided not to reintroduce amortisation of goodwill and instead to retain the impairment-only model for the subsequent accounting for goodwill.

#### *EFRAG’s tentative position*

In its DCL, EFRAG did not express a view on whether amortisation of goodwill should be reintroduced, in combination with an impairment requirement, or whether no major changes to the current accounting for goodwill are justified. EFRAG asked views from its constituents on the new evidence, new arguments or new assessment on the existing evidence to support a change.

#### *Respondents’ comments*

The majority of the participants in the outreach events as well as the majority of the comment letters received from national standard setters, preparers and users were in favour (or with majority of views in favour) of the reintroduction of goodwill amortisation. These respondents mainly agreed with the IASB’s view that impairment model was not working as intended and cannot be improved at a reasonable cost and therefore amortisation was a practical solution. From conceptual point of view, these

## EFRAG’s response to respondents’ comments

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### EFRAG final position

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Considering the feedback received, EFRAG acknowledged the conceptual and practical arguments for both the impairment-only model and reintroduction of amortisation and noted that more and more voices were raised in favour of the latter mainly for practical reasons. However, considering that an accounting policy should only be changed if it would provide reliable and more relevant information, EFRAG suggested the IASB to further explore improvements to existing impairment test and any cost and consequences of reintroducing amortisation (including how to determine the useful life, amortisation method, the impairment test to be applied under the amortisation model and transitional provisions which should be regarded as a package).

#### *Summary of how EFRAG considered the views of respondents in arriving at this final position*

EFRAG acknowledged the controversial nature of the question of whether the impairment-only model should be kept subject to suggested improvements or should the amortisation of goodwill be reintroduced and that many valid arguments exist in both camps.

EFRAG noted that some constituents have been always in favour of the impairment-only approach for conceptual reasons and some others in favour of amortisation. From the first group a shift can be observed. Because of this shift for practical reasons now the amortisation approach seems to have a majority in Europe.

The feedback received showed that the majority of respondents agreed with the IASB conclusion that impairment model was not working as intended and cannot be improved at a reasonable cost and considered amortisation as a practical solution. From conceptual point of view

## **EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments**

respondents considered goodwill to be (partly) a wasting asset which should be amortised to reflect its consumption.

A few respondents were in favour (or with majority of views in favour) of keeping the existing impairment model on the grounds that the impairment test was the only conceptually correct model, that problems lied within its application and that it provided relevant and useful information to users and investors. These respondents also considered that no new arguments were provided to justify a change. In their view the impairment model worked as intended and no significant facts or circumstances were identified that would lead to reconsider the conceptual argument.

A few other respondents representing preparers’, professional organisations, and national standard setter, did not express a view, mentioning that both approaches had their advantages and disadvantages and the absence of the new compelling evidence to support one of them.

One respondent proposed an accounting policy choice between amortisation and impairment options with disclosures of the rationale of this choice. Another respondent, however, advocated against such a choice as negatively impacting comparability between the entities.

The majority of proponents of amortisation suggested that the amortisation model should be accompanied by either annual quantitative impairment test or by indicator-only approach.

### *Useful life and amortisation pattern*

Many respondents suggested that management could estimate the useful life based on a goodwill consumption pattern, the payback period of the investment and the amortisation pattern - on the basis of the realisation of the expected synergies. They considered that the determination of useful life of goodwill was not more complex than for any other tangible or

## **EFRAG’s response to respondents’ comments**

those respondents considered goodwill to be (partly) a wasting asset which should be amortised to reflect its consumption.

EFRAG decided to report the observed shift to the IASB and because of the feedback that impairment model was not working as intended to request to further explore improvements to existing impairment test. In addition, any cost and consequences of reintroducing amortisation should be inquired, before deciding about a potential reintroduction of goodwill amortisation.

In its comment letter, EFRAG also acknowledged the arguments supporting the impairment-only model, such as goodwill being a non-wasting asset and an indicator for the value of the future free operating cash flows and future economic benefits, some of which could have indefinite lives, and that the impairment test holds management to account, better reflects the economic reality and the stewardship and accountability objective of financial reporting.

EFRAG also noted that the cost of changing the existing model could be high and the cost-benefit analysis of the switch to amortisation should be carried out before making a decision. The transitional arrangements such as retrospective or prospective application should also be discussed.

In addition, EFRAG highlighted that impairments might be triggered for different reasons. Therefore, impairment testing remains relevant even if amortisation would be reintroduced. Thus, improvements to the impairment testing remain relevant and necessary.

### *Could amortisation help to solve the “too late” problem?*

EFRAG also noted that the amortisation may indirectly contribute to avoid everlasting goodwill. Irrespective of the conceptual merits of the amortisation, a systematic path of reduction through amortisation expenses would result in the progressive derecognition of goodwill.

## EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments

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intangible asset and could be revised if circumstances change. They also suggested that accounting standard could set a predetermined maximum as a rebuttable presumption (e.g., 10 years as in the EU accounting directive), if the useful life cannot be reliably estimated in particular circumstances.

Several suggestions were made on the amortisation pattern: from straight-line to declining balance as well as that this period should not be arbitrary and should be capped.

The respondents also asked to specify transition requirements concerning prospective or retrospective application, should the IASB decide to go for amortisation.

*Under the impairment-only model, are companies adding back impairment losses in their management performance measures (MPM)?*

The feedback received suggested that impairment losses were often added back by the analysts.

Slight majority of respondents considered that if the amortisation would be reintroduced the amortisation expense would be treated by the analysts in the same way as impairment losses.

However, some respondents thought that fewer users would adjust out an amortisation expense than the current goodwill impairment charge. This is because the periodic amortisation expense would reflect the cost connected to a wasting asset (goodwill), while currently the impairment charge is not considered to be part of the performance result for the period.

## EFRAG’s response to respondents’ comments

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### *Useful life and amortisation pattern of goodwill*

Based on the feedback received, EFRAG provided several suggestions. For example, management could estimate useful life based on a goodwill consumption pattern, the payback period of the investment or on a multiple such as price / current earnings (or price / expected earnings). The amortisation pattern could also be estimated on the basis of the realisation of the expected synergies. EFRAG noted, that the determination of useful life of goodwill is not more complex than for many other tangible or intangible asset and could be revised if circumstances change. The accounting standard could set a predetermined maximum as a rebuttable presumption (e.g., 10 years as in the EU accounting directive), if the useful life cannot be reliably estimated in particular circumstances and could, particularly when useful life cannot be reliably estimated, include a cap for any estimation to be made. Straight-line amortisation could be used as a pragmatic, transparent and cost-effective solution, but other amortisation methods (e.g., declining balance) could also be considered.

*Is acquired goodwill distinct from goodwill subsequently generated internally in the same cash-generating units?*

EFRAG did not change its response as a result of consultation and considered that for accounting purposes, distinguishing acquired goodwill from subsequently generated internally goodwill is not possible.

*Under the impairment-only model, are companies adding back impairment losses in their management performance measures (MPM)?*

Based on the feedback received and recent studies on the use of alternative performance measures, EFRAG observed that one of the most frequent items that companies remove from their profit or loss

**EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments**

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*Age of goodwill*

Respondents considered this information to be useful, especially if the IASB decides not to reintroduce amortisation.

One respondent disagreed because in his view it would be misleading, where useful lives cannot be determined.

**EFRAG’s response to respondents’ comments**

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when illustrating the “normal” or “recurring” net result is the impairment loss on goodwill.

In its response, EFRAG highlighted that a slight majority of respondents consider that financial analysts would likely add amortisation expense back, in the same way it is currently done for impairments.

*Age of goodwill*

To reflect the feedback received EFRAG proposed that the IASB considers the disclosure of the age of goodwill where possible without undue cost or effort if it decides not to reintroduce the amortisation of goodwill.

**EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments**

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**Question 8 – Total equity excluding goodwill**

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*Proposals in the DP*

The DP proposed that companies should present on their balance sheets the amount of total equity excluding goodwill.

*EFRAG’s tentative position*

EFRAG’s DCL did not support the IASB’s proposal.

*Respondents’ comments*

The input received at outreach activities and from comment letters generally supported the position expressed in EFRAG’s DCL.

**EFRAG’s response to respondents’ comments**

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**EFRAG final position**

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In its comment letter to the IASB, EFRAG maintained its position and did not support the IASB’s proposal to require companies to present on their balance sheets the amount of total equity excluding goodwill.

*Summary of how EFRAG considered the views of respondents in arriving at this final position*

Considering that generally the input received from comment letters and outreach activities supported the view expressed in the DCL, EFRAG maintain the view of its DCL.

## **EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments**

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### **Question 9 – Indicator-only approach**

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#### *Proposals in the DP*

The IASB proposed to remove the requirement for a company to perform an annual impairment test for cash-generating units containing goodwill if there is no indication that the cash-generating units may be impaired. This proposal would also apply to intangible assets with indefinite useful lives and intangible assets not yet available for use.

#### *EFRAG’s tentative position*

In its DCL EFRAG expressed reservations regarding introduction of an indicator-only approach as it had the potential to further delay the recognition of goodwill impairment losses and put more pressure on the qualitative assessment. Furthermore, useful information produced by the impairment test would also be lost. The potential for cost reduction could be considered by leveraging what was already in IAS 36 paragraph 99. These views were equally valid for other intangible assets.

#### *Respondents’ comments*

##### *Input received through outreach*

The feedback from outreach activities showed that stakeholders have a mixed view relating to the indicator-only approach with, in general, more support from preparers and opposition from users and auditors. In the survey, the majority of preparers indicated insignificant savings when following the indicator-only approach. Overall, there were concerns about the reduction in know-how relating to the quantitative test in these circumstances, in addition to concerns of users that would not benefit any more from information provided by a quantitative impairment test that they considered useful.

## **EFRAG’s response to respondents’ comments**

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### **EFRAG final position**

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Based on the feedback received, EFRAG maintained its initial position and expressed reservations about the introduction of an indicator-only approach based on the same considerations as in its DCL. EFRAG did not support the approach in connection with the impairment-only model.

#### *Summary of how EFRAG considered the views of respondents in arriving at this final position*

EFRAG has considered the feedback received from constituents which were in line with its position in the DCL. Based on the input received EFRAG has emphasised in the final position that the indicator-only approach was not supported in connection with the impairment-only model.

**EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments**

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*Input received through comment letters*

The majority of the comment letters, mostly from auditors and national standard setters, did not support the indicator-only approach based on the following main arguments:

- It reduces the robustness of the test.
- It increases management judgment.
- It does not significantly reduce costs.

The majority of the respondents who did not support the indicator-only approach would do so if amortisation of goodwill was reintroduced. Some of the respondents suggested enhancing the current relief in paragraph 99 of IAS 36 as an alternative to the indicator-only approach.

The comment letters in favour of the indicator-only approach, mostly from preparers, argued that the quantitative impairment test does not add value when significant headroom is available. Some respondents also requested additional guidance on the identification and use of indicators if the indicator-only approach were introduced.

**EFRAG’s response to respondents’ comments**

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**EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments**

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**Question 10 – Other simplifications to the impairment test**

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*Proposals in the DP*

The IASB proposes to remove from IAS 36 the restriction on including cash flows arising from a future restructuring to which a company is not yet committed or from improving or enhancing an asset’s performance.

The IASB also proposes to remove the explicit requirement to use pre-tax cash flows and pre-tax discount rates in estimating value in use (VIU).

*EFRAG’s tentative position*

In its DCL EFRAG supported the IASB’s proposal to remove the restriction in IAS 36 that prohibits companies from including cash flows arising from a future uncommitted restructuring, or from improving or enhancing the asset’s performance. However, additional guidance would be required on when to include restructuring cash flows in the calculation.

EFRAG also supported the IASB’s proposal to remove the explicit requirement to use pre-tax inputs and pre-tax discount rates to calculate value in use.

*Respondents’ comments*

*Input received through outreach*

The feedback from outreach events showed that most preparers agree with EFRAG’s tentative position.

A minority of stakeholders disagreed with the removal of the restriction on certain cash flows as they were concerned that the test would be less robust with these changes.

**EFRAG’s response to respondents’ comments**

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**EFRAG final position**

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Considering the feedback received, EFRAG supported the IASB’s proposal to remove the restriction in IAS 36 that prohibits companies from including cash flows arising from a future uncommitted restructuring, or from improving or enhancing the asset’s performance. However, additional clarification would be required on whether cash flows from capacity investments were included in the asset enhancements.

EFRAG supported the IASB’s proposal to remove the explicit requirement to use pre-tax inputs and pre-tax discount rates to calculate value in use. However, additional clarification would be required on the alignment with IAS 12 *Income Taxes*.

*Summary of how EFRAG considered the views of respondents in arriving at this final position*

EFRAG noted the feedback regarding the request for additional guidance and considers the current requirements in IAS 36 sufficient in line with the view of most of the respondents.

EFRAG considered the required governance around the budgeting and forecasting process to be sufficient to ensure reasonable and supportable inputs. Therefore, EFRAG removed the statement that additional guidance is required to include these cash flows from its comment letter. However, EFRAG included the request for additional clarification on cash flows from capacity investments.



**EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments**

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*Input received through comment letters*

The feedback received from comment letters was in line with the feedback received from the outreach events.

Almost all stakeholders supported the simplifications as it is expected to lower the cost and complexity.

Some stakeholders did not support this simplification relating to the removal of the restriction to use cash flows arising from future uncommitted restructurings of from improving or enhancing an asset’s performance as they were concerned that the test could become less robust and could increase the shielding effect. Many stakeholders requested additional guidance on how and when to include these cash flows in the VIU calculation. The stakeholders particularly requested clarification on whether cash flows from capacity investments were included in the asset enhancements.

Some respondents suggested additional guidance and clarification on the alignment with IAS 12 *Income Taxes* in relation to the treatment of deferred tax assets.

**EFRAG’s response to respondents’ comments**

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EFRAG also noted the feedback regarding the alignment with IAS 12 and included it in the final comment letter.

## **EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments**

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### **Question 11 – Further simplifications to the impairment test**

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#### *Proposals in the DP*

The IASB concludes to not develop the following proposals:

- 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.
- 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.
- Allowing companies to test goodwill at the entity level or at the level of reportable segments rather than requiring companies to allocate goodwill to groups of cash-generating units that represent the lowest level at which the goodwill is monitored for internal management purposes.
- Adding guidance on identifying cash-generating units and on allocating goodwill to cash-generating units.

#### *EFRAG’s tentative position*

In its DCL, EFRAG supported the IASB’s preliminary view to not develop these proposals apart from the view to not add further guidance on allocating goodwill to cash-generating units.

## **EFRAG’s response to respondents’ comments**

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### **EFRAG final position**

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Considering the feedback received, EFRAG maintained its initial position and added a request for guidance in relation how leases are incorporated in the value in use calculation.

EFRAG supported the IASB’s preliminary view to not develop these proposals apart from the view to not add further guidance on allocating goodwill to cash-generating units. The final position was based on the same arguments as in the DCL.

#### *Summary of how EFRAG considered the views of respondents in arriving at this final position*

EFRAG acknowledged the request from respondents relating to further guidance on including lease liabilities under IFRS 16 when calculating the VIU. EFRAG identified, among others, the following two issues:

- How to take into account reinvestments in leased assets when the period for the cash flow projections exceeds the lease term.
- The possibility to include lease liabilities (and the cash outflows) in a CGU when calculating value in use. There is currently divergence in practice and preparers find it costly to separate the cash flows related to the liability from other cash flows related to the lease when the lease liability is not included in the calculation of the VIU.

Therefore, EFRAG has included a suggestion that the IASB should simplify the impairment test by stating that when calculating value in use, the lease liabilities and the related cash outflows could be included

**EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments**

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EFRAG expects that the shielding effect is greater when goodwill is allocated to groups of cash generating units containing several cash generating units.

*Respondents’ comments*

The feedback received from outreach events showed that there were mixed views on the use of one method for determining the recoverable amount of a CGU – some participants preferred value in use and others prefer fair value less costs of disposal.

Based on the comment letters received, many respondents supported the IASB’s preliminary view that no further simplifications needed to be developed and were in particular opposed to using a single method for the recoverable amount.

Few respondents requested in their comment letters further guidance on including the carrying amount of lease liabilities and cash outflows relating to the lease liability under IFRS 16 *Leases* when calculating the VIU, to avoid divergence in practice.

**EFRAG’s response to respondents’ comments**

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in the calculation of the value in use. EFRAG additionally noted that such an amendment may raise questions around the treatment of other financing activities that were similar in nature to leases and so a broader topic may need to be considered in addressing this issue.

## **EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments**

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### **Question 12 – Intangible assets**

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#### *Proposals in the DP*

The IASB concludes that it should not develop a proposal to change the recognition criteria for identifiable intangible assets acquired in a business combination.

#### *EFRAG’s tentative position*

In its DCL, EFRAG considered it necessary that investors were able to compare companies that grow by acquisitions more easily with those that grow organically. Therefore, EFRAG recommended that the issue on whether some intangible assets could be included in goodwill should be considered in a second phase of the project together with a revision of IAS 38.

#### *Respondents’ comments*

##### *Input received through outreach*

Most of the stakeholders supported the conclusion in the DP to not develop a proposal to change the recognition criteria for identifiable intangible assets acquired in a business combination. Some stakeholders supported EFRAG’s tentative position to review the recognition criteria together with a review of IAS 38 in a second phase of the project.

##### *Input received through comment letters*

The feedback from the comment letters received was generally in line with the feedback received from the outreach events. The majority of the respondents supported the proposal to not develop requirements to add intangible assets acquired in a business combination to the carrying amount of goodwill. The main argument was that it provided useful

## **EFRAG’s response to respondents’ comments**

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### **EFRAG final position**

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Based on the feedback received, supporting its initial assessment, EFRAG considered it necessary that investors were able to compare companies that grow by acquisitions more easily with those that grow organically. Therefore, EFRAG recommended that the issue on whether some intangible assets could be included in goodwill should be considered in a second phase of the project together with a revision of IAS 38.

#### *Summary of how EFRAG considered the views of respondents in arriving at this final position*

EFRAG analysed the feedback received from constituents and concluded that in general it was in line with EFRAG’s tentative position.

**EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments**

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information regarding the consideration paid for the acquisition and was in line with the increasing importance of intangibles in contemporary economies. Nonetheless, most of the respondents acknowledged the challenges relating to the subjectivity and complexity of valuation, however considered that these can be overcome.

Many respondents supported a dedicated and comprehensive review project on IAS 38 *Intangible Assets*, but some respondents urged for a narrow scope review on short-term instead of waiting for a review of IAS 38.

**EFRAG’s response to respondents’ comments**

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## EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments

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### Question 13 – Convergence with US GAAP

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#### *Proposals in the DP*

The IASB questions if stakeholder’s answers to questions in the DP would depend on whether the outcome would be consistent with US GAAP as it exists today, or as it may be after the FASB’s current work.

#### *EFRAG’s tentative position*

In its DCL EFRAG confirmed that its responses to the questions in the DP would not depend on whether the outcome was consistent with US GAAP. However, EFRAG considered that the IASB outcome could be influenced by the FASB’s current work.

#### *Respondents’ comments*

##### *Input received through outreach*

The overall view of stakeholders obtained during outreach events, was that convergence with the FASB was considered important but should not prevail over the principal objectives of the IFRS Standards. Stakeholders expressed different degrees of importance in relation to the convergence with the FASB.

##### *Input received through comment letters*

In general, the feedback from the comment letters received was in line with the feedback received from the outreach events. In addition, national standard setters, regulators and auditors put more emphasis on the convergence and proposed active coordination between the IASB and FASB.

## EFRAG’s response to respondents’ comments

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### EFRAG final position

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Based on the feedback received, supporting its initial assessment, in its comment letter EFRAG confirmed that its responses to the questions in the DP would not depend on whether the outcome was consistent with US GAAP. However, EFRAG considered that the IASB outcome could be influenced by the FASB’s current work.

#### *Summary of how EFRAG considered the views of respondents in arriving at this final position*

EFRAG acknowledged the concerns of respondents around commercial sensitivity of the proposed disclosures in the DP and noted that these could impact perceptions of a level-playing field if the FASB does not introduce similar requirements. Therefore, this point was emphasised in EFRAG’s final comment letter.



**EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments**

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In particular, many comment letters strongly requested that the IASB ensures convergence with the FASB’s position on disclosure of subsequent performance of acquisitions as divergence may result in competitive disadvantage for companies that comply with IFRS Standards. Many comment letters also requested that the IASB ensures convergence with the FASB’s position on subsequent accounting for goodwill.

**EFRAG’s response to respondents’ comments**

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## EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments

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### Question 14 – Other comments

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#### *Proposals in the DP*

The DP asks whether there are any further comments on the IASB preliminary views or whether the IASB should consider any other topics in response to its PIR of IFRS 3.

#### *EFRAG’s tentative position*

In its DCL, EFRAG noted that componentisation of goodwill and further guidance as to the allocation of goodwill to divested businesses and reorganisations should be further considered. EFRAG also sought views from its constituents on the reversals of goodwill impairments especially of those recognised in an interim period.

#### *Respondents’ comments*

There was not extensive feedback on componentisation of goodwill and views were often mixed with those opposing the idea citing concerns around reliability of such information.

On technical goodwill (goodwill generated by the recognition of deferred tax liabilities on the recognition of the fair value adjustments) there were mixed views. A few respondents did not agree that the goodwill elements should be separated. One respondent considered that the issue would be addressed by the reintroduction of goodwill amortisation and another was in favour of recognition of this technical component as a separate component of goodwill or as a separate intangible asset and would amortise it in line with the related deferred tax. The EFRAG noted, for example, in the accounting for contingent consideration, the accounting for goodwill was determined separately from the liability. Changing the

## EFRAG’s response to respondents’ comments

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### EFRAG final position

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Considering the feedback received, EFRAG in its final response considered that the DP could have included a discussion on separating goodwill into components although EFRAG noted the concerns around reliability of allocating amounts to such components. In addition, EFRAG suggested the IASB to develop more guidance on goodwill allocation to divested businesses and reorganisations and to consider the transition considerations if goodwill amortisation were reintroduced.

#### *Summary of how EFRAG considered the views of respondents in arriving at this final position*

Suggestions in the DCL were refined based on feedback received.

Considerations around transition if goodwill amortisation were to be reintroduced was included given the importance of the topic. However, reference to the reversal of goodwill impairment was removed given the mixed views and limited feedback on this.

**EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments**

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accounting for goodwill in relation to technical goodwill would put this separation in question and could create unintended consequences.

On the question of reversal of goodwill, some respondents did not support introduction of reversals of goodwill impairment. However, other respondents supported the reversal in specific circumstances. The respondents noted that it might be difficult to prove that the reversal related to the impaired goodwill and allowing a reversal for a limited period might have limited success to overcome any aversion to the recognition of impairment. Such a limited period might also become a continual discussion point for further extensions and would be arbitrary. During an outreach event a majority of participants did not support reversal of impairment.

**EFRAG’s response to respondents’ comments**

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## Appendix 1: List of respondents

**Table 1: List of respondents**

<b>Name of respondent<sup>2</sup></b>	<b>Country</b>	<b>Type / Category</b>
The European Savings and Retail Banking Group (ESBG)	Europe	Preparer organisation
UniCredit	Italy	Preparer
Accountancy Europe (AE)	Europe	Professional organisation
BNPP	France	Preparer
Insurance Europe – CFO Forum	Europe	Preparer organisation
El Instituto de Contabilidad y Auditoria de Cuentas (ICAC)	Spain	National Standard Setter
Comissão de Normalização Contabilística (CNC)	Portugal	National Standard Setter
European Federation of Financial Analysts Societies (EFFAS)	Europe	User organisation
Danish Accounting Standards Committee (DASC)	Denmark	National Standard Setter
Swedish Financial Reporting Board (SFRB)	Sweden	National Standard Setter
The Belgian Association of Financial Analysts (ABAF BVFA)	Belgium	User organisation
L'Autorité des normes comptables (ANC)	France	National Standard Setter
Austrian Financial Reporting and Auditing Committee (AFRAC)	Austria	National Standard Setter
Dutch Accounting Standard Board (DASB)	Netherlands	National Standard Setter
European Securities and Markets Authority (ESMA)	Europe	Regulator
Corporate Reporting Users' Forum (CRUF)	UK	User organisation
European Association of Co-operative Banks (EACB)	Europe	Preparer organisation
ACTEO-AFEP-MEDEF	France	Preparer organisation
Association for Financial Markets in Europe (AFME)	UK	Market organisation
Organismo Italiano di Contabilità (OIC)	Italy	National Standard Setter
Die Deutschen Versicherer (GDV)	Germany	Preparer organisation
Norwegian Accounting Standards Board (NASB)	Norway	National Standard Setter
Instituto Español de Analistas Financieros (IEAF)	Spain	User organisation
Accounting Standards Committee of Germany (ASCG/DRSC)	Germany	National Standard Setter
Institute of Chartered Accountants in England and Wales (ICAEW)	UK	Professional organisation
BusinessEurope	Europe	Preparer organisation

<sup>2</sup> Respondents whose comment letters were considered by the EFRAG Board before finalisation of the comment letter.

