Deutsches Rechnungslegungs Standards Committee e.V.

Accounting Standards Committee of Germany

91. Sitzung IFRS-FA am 19.10.2020
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Mr Hans Hoogervorst
Chairman of the
International Accounting Standards Board
Columbus Building
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Berlin, XX December 2020

Dear Hans,

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

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

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

However, we think that the initial core problem of the IASB´s research project, i.e. ensuring a robust impairment test and timely impairments of goodwill in response to the ongoing criticism of *too little, too late*, has hardly been addressed and therefore not been solved and thus continues to exist.

Further, we observed that even during the Covid-19-pandemic, no significant impairments were recognised, which we interpret as an indication that the impairment test does not function properly. We think the IASB should take this as an opportunity to fundamentally question how the subsequent accounting for goodwill should be modelled.

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

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

Yours sincerely,

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Appendix – Answers to the questions in the DP

Question 1

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

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

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

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

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

While we agree that the proposed disclosures could provide users with more useful information about acquisitions, we also agree with the preliminary view of the IASB that a significant improvement to the effectiveness of the impairment test is not feasible. This assessment, though, leads us to the conclusion that the initial core problem of the IASB´s research project, i.e. ensuring a robust impairment test and timely impairments of goodwill in response to the ongoing criticism of *too little, too late*, has hardly been addressed and therefore not been solved and thus continues to exist. In our view, only the reintroduction of amortisation (so far rejected by the IASB) could represent a significant improvement (see our answers to Questions 6 and 7).

Regarding the proposed disclosures, we think that it could be difficult to solve the issue of the confidentiality and sensitivity of the information, as we recognise that there may be an area of conflict between information that is of interest to the user but is classified as confidential by the company.

Additionally, the IASB is of the opinion that the required disclosures are objectives and not forecasts and therefore cannot be classified as forward-looking information in the jurisdictions in which they are made. We think that the distinction between objectives and forecasts may require a legal assessment, answering whether information about management´s objectives for an acquisition along with detailed targets could be considered as forward-looking information (see our answer to Question 2).

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

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

Having said that, we think that information about the progress and success of business combinations logically may better be provided in the management report. As the group management report in Germany is audited as rigorously as the financial statements, we would not have a problem with a relocation of this information to the management report. We do understand, however, that the IASB has to take several jurisdictions into consideration and, therefore, cannot provide for that. It could, nevertheless, be deliberated again whether references from the financial statement to the management report may be helpful.

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

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

Question 2

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

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

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

(i) A company should be required to disclose information about the strategic rationale and management's (the chief operating decision maker's (CODM's)) objectives for an acquisition as at the acquisition date (see paragraphs 2.8–2.12). Paragraph 7 of IFRS 8 *Operating Segments* discusses the term 'chief operating decision maker'.

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

(iii) If management (CODM) does not monitor an acquisition, the company should be required to disclose that fact and explain why it does not do so. The Board should not require a company to disclose any metrics in such cases (see paragraphs 2.19–2.20).

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

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

(vi) If management (CODM) changes the metrics it uses to monitor whether the objectives of the acquisition are being met, the company should be required to disclose the new metrics and the reasons for the change (see paragraph 2.21).

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

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

(e) Paragraphs 2.29–2.32 explain the Board's view that the information setting out management's (CODM's) objectives for the acquisition and the metrics used to monitor progress in meeting those objectives is not forward-looking information. Instead, the Board considers the information would reflect management's (CODM's) targets at the time of the acquisition. Are there any constraints in your jurisdiction that could affect a company's ability to disclose this information? What are those constraints and what effect could they have?

The ASCG considers the objective of the proposals to be understandable and welcome, as they address the questions of whether the investment made with the acquisition was worthwhile and whether management created added value for the company and its shareholders. These questions are difficult to answer on the basis of the information available to date. On the basis of the proposals, companies would be forced to think about suitable measures and information.

However, we consider the gathering of the necessary information for the proposed disclosures to be difficult. Particularly in the regularly observable cases of an integration of the acquired company into the acquirer and the restructuring of a group, which also can take place at a later date. While the explanations in the DP give the impression that integrations are rather the exception, the ASCG considers them to be the rule, e.g. to achieve synergies. For this reason, we believe that the disclosures on subsequent performance should focus more strongly on the combined business; we therefore suggest amending and clarifying the disclosure objective. In general, we are of the opinion that it would be more helpful to further substantiate the basic disclosure objectives and to require and focus less on specific disclosures.

We agree with the requirement to disclose the proposed information for as long as its management continues to monitor the acquisition to see whether it is meeting its objectives. The ASCG discussed whether it would be beneficial to require a list (either permanently or for

a defined period of time) of all acquisitions not or no longer monitored. Ultimately, we do not attribute an information benefit to such a list and therefore support the one-off disclosures envisaged by the IASB, if management does not monitor an acquisition or stops monitoring whether those objectives are being met before the end of the second full year after the year of acquisition. We also support the disclosures required in the event of subsequent changes to the metrics used for monitoring purposes.

Regarding the requirement that the information provided should be based on the information and the acquisitions a company´s CODM reviews, we question whether focussing on the information monitored by the CODM constitutes the appropriate level. By analogy to the management approach used for segment reporting in IFRS 8, the DP proposes to base the information for the intended disclosures on metrics that are monitored by the CODM. We note that the CODM often only monitors the largest acquisitions, especially in large groups and conglomerates, so that in this case information on further significant acquisitions would not be disclosed, which would not be sufficient. This also applies to small acquisitions, which are not significant individually, but in aggregate could add up to a relevant amount. Since quite a few acquisitions are not monitored by the CODM, we believe that reference should rather be made to the highest level at which the acquisition is monitored individually.

Another possibility would be the development of materiality criteria specifically for the disclosure of information on acquisitions. The ensuing challenge would be to define a suitable threshold (*substantial*, *significant, major* or something similar), as we consider the generally applicable materiality thresholds as too low.

With regard to the confidentiality and sensitivity of the information, we recognise that there may be an area of conflict between information that is of interest to the user but is classified as confidential by the company. However, the disclosures proposed by the IASB should be retained, as they could improve the information on the subsequent performance of an acquisition.

While the IASB is of the opinion that the required disclosures are objectives and not forecasts and therefore cannot be classified as forward-looking information in the jurisdictions in which they are made, we point out that a valid statement of objectives may also require a plausible presentation of the expected way of achieving these objectives. Therefore, we deem a legal assessment, if information about management´s objectives for an acquisition along with detailed targets could be considered as forward-looking information, to be difficult.

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

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

Question 3

Paragraphs 2.53–2.60 explain the Board's preliminary view that it should develop, in addition to proposed new disclosure requirements, proposals to add disclosure objectives to provide information to help investors to understand:

- the benefits that a company's management expected from an acquisition when agreeing the price to acquire a business; and
- the extent to which an acquisition is meeting management's (CODM's) objectives for the acquisition.

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

We agree and support the motivation for and the aim of the proposed disclosure objectives.

As already stated in our answer to Question 2, we are of the opinion that it would be more helpful to further substantiate the basic disclosure objectives and to require and focus less on specific disclosures. We think that the proposed disclosures regarding the subsequent performance of an acquisition could provide additional value to investors and other stakeholders.

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

Question 4

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

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

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

We agree that these disclosures may contribute to a better assessment of whether the acquisition was successful and whether the purchase price paid was appropriate.

However, we acknowledge that there are certain difficulties (e.g. the existence of multicausal effects, such as revenue synergies) in determining the disclosures, but nevertheless deem this

to be preferential compared to the alternatives of no information on synergies or only boilerplate information.

On the part of the investors, there is an understandable interest in this information. Therefore, we consider the proposed requirements to be useful. However, we suspect that these disclosure requirements - also due to the sensitivity of the information - could be prepared rather vaguely.

Nevertheless, the proposed disclosures may provide additional relevant information and thus offer added value to the user.

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

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

Question 5

IFRS 3 *Business Combinations* requires companies to provide, in the year of acquisition, pro forma information that shows the revenue and profit or loss of the combined business for the current reporting period as though the acquisition date had been at the beginning of the annual reporting period.

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

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

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

IFRS 3 also requires companies to disclose the revenue and profit or loss of the acquired business after the acquisition date, for each acquisition that occurred during the reporting period.

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

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

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

With regard to the usefulness of pro forma information, we observed that the demand for such information is low and comparability across entities impaired – due to the fact that they are not prepared in a uniform manner. Nevertheless, we think that the requirement for pro forma information should be retained, though comparability should be improved, as pro forma information is indeed used by preparers, if such disclosure helps conveying significant information to users.

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

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

We also support the proposed additional requirement to disclose cash flows from operating activities of the acquired business after the acquisition date, and of the combined business on a pro forma basis for the current reporting period.

Question 6

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

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

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

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

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

We agree that the impairment test set out in IAS 36 *Impairment of Assets* has not met the expectations placed in it, namely to recognise impairment losses on goodwill on a timely basis. We would even go a step further and hold the opinion that this is not feasible either, as the basic concept of the impairment test and the wording of the standard are not designed to signal

whether an acquisition was successful or not, which is what some stakeholders have apparently hoped for.

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

Notwithstanding our agreement with the analysis, we do not agree with discharging the responsibility for the appropriate execution of impairment tests on auditors and regulators, as is expressed several times in the DP. To us, this is not an acceptable solution to the problem identified. In our view, the primary responsibility does not rest with auditors and regulators, but rather with the standard-setter in developing requirements that meet the test of demonstrating that they are capable of being applied faithfully and appropriately. To us, the current Covid-19 pandemic provides for a classic scenario where we would have expected entities to incur impairments due to the economic downturn. However, no significant impairments can be observed, which we interpret as an indication that the impairment test does not function properly as it fails to recognise impairments on a timely basis. We believe that the IASB would therefore be better advised to take on the challenge and think about suitable alternatives, rather than to hold on to an accounting construct that has proven not to be effective when it matters.

When deliberating 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 more timely basis than the impairment test set out in IAS 36 *Impairment of Assets*, we also considered the requirements in German GAAP. The corresponding requirements are set out in GAS 23 *Accounting for Subsidiaries in Consolidated Financial Statements* and provide for a (renewed) consolidation at the time the impairment test is carried out to arrive at a quasi-implied fair value of goodwill as the test's point in time. Since the implied fair value of the goodwill had already been discussed several times by the IASB and the FASB as a conceptually valid alternative, but always been rejected as not being viable, we point at the simplifications codified in GAS 23 for the Board's consideration.

However, GAS 23 is aimed at a different group of companies than IAS 36 (in the sense of smaller companies, less manpower, less efficient systems, less complex acquisitions) and takes this into account by approximating the fair value of goodwill and any necessary write-downs (impairments). Applying this approach does not result in an exact calculation of the impairment amount, but rather in the best-possible approximation.

The requirements of GAS 23 read as follows: [ggf. als Appendix]

128.

The amount of the write-down is calculated by comparing the carrying amount of the goodwill of a subsidiary recognised at the reporting date with the current value of the subsidiary's goodwill measured as at the same date. The current value of goodwill shall be calculated at a conceptual level by referring to the following model:

Fair value of the parent entity's investment in the subsidiary
less: Proportionate fair value of the subsidiary's net assets […]
= Current value of goodwill

129.
For simplification, the amount of the write-down can be determined by comparing the fair value of the investment in the subsidiary with the total of the carrying amount of the net assets of the subsidiary in the consolidated financial statements and the net carrying amount of goodwill. Regardless of whether this comparison produces a positive or a negative difference, entities are additionally encouraged to examine whether material hidden reserves and liabilities that require a change in the amount of the write-down have arisen since the date of initial consolidation.

130.
Any non-controlling interest in the fair value of the subsidiary and in the goodwill shall also be recognised. The calculations shall be adjusted appropriately, where necessary.

131.
If the calculated write-down exceeds the carrying amount of goodwill, the carrying amount of goodwill shall be written down to a nominal amount (memorandum item). Provisions in the amount of the remaining negative difference may not be recognised.

132.
If goodwill was allocated to individual or several lines of business (see paragraph 85ff.), the determination of the amount of the write-down of goodwill as described above shall be broken down accordingly, with the necessary modifications.

B38.
The calculation model set out in paragraph 128 serves to ensure the precise calculation of any write-down and is therefore regarded as conceptually accurate. However, this calculation may involve considerable effort because, in addition to the fair value of the parent entity's investment in the subsidiary, which may, for example, be the income capitalisation value of the subsidiary, the proportionate fair value of the subsidiary's net assets […] also has to be determined.

B39.
In light of this, paragraph 129 describes a simplified alternative approach, which also results in a step-wise approximation of the detailed calculation of the fair value of goodwill. This is designed to ensure firstly that the entity is not required to make comprehensive calculations if the indications of impairment do not materialise under closer inspection. Secondly, it simplifies overall the calculation of the amount of the write-down, whereby any existing lack of precision can be consciously accepted based on cost-benefit considerations. The step-wise approach also considers the fact that the detailed calculation of the amount of any write-down is of considerable importance if goodwill has a very long useful life, in particular

because in such cases, substantial new hidden reserves or liabilities may be created since the date of initial consolidation.

B40.
The simplified calculation in accordance with paragraph 129 compares the fair value of the investment with the aggregate carrying amounts of the subsidiary's net assets, including the carrying amount of goodwill. In contrast to the precise calculation in accordance with paragraph 128, this means that hidden reserves and liabilities of the subsidiary are not recognised (in the first instance) because capturing them comprehensively is considered to be complex. Any negative consolidation difference arising can then be recognised as a write-down.

B41.
If there are substantial hidden reserves and/or liabilities at the subsidiary that were created since the date of initial consolidation, entities are encouraged to include them in the calculation of the amount of the write-down, meaning that the calculation at least starts approximating the precise approach. Hidden reserves increase the amount of the write-down, while hidden liabilities reduce it.

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

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

Question 7

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

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

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

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

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

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

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

The ASCG disagrees with the IASB´s preliminary view that it should not reintroduce amortisation of goodwill and instead should retain the impairment-only model for the subsequent accounting for goodwill. Our assessment is not based on any new arguments, as we firmly believe that all arguments have been on the table for long and have already been exchanged numerous times. As we see it, both, the impairment-only approach as codified in IFRS 3, and the amortisation approach are not perfect models but conventions for the subsequent accounting for goodwill. This is also due to the fact that goodwill is a unique asset that cannot be completely and faithfully depicted for under either approach. Further, we believe that different people hold strong views and put forward valid arguments for and against either model.

However, in practice, we observe that the fight over the most appropriate accounting method seems largely outcome-driven, rather than conceptual. A few years back, companies that grew organically favoured an amortisation approach, mainly to save cost on a burdensome impairment test; conversely, companies that grew through acquisitions almost unanimously favoured an impairment-only model as they were reasonably satisfied that they could avoid high amortisation charges to goodwill (and impairment charges as well). That being said, we observe a noticeable shift among companies in our jurisdiction over the last three years, as several companies with significant goodwill-to-equity ratios are now in favour of an amortisation approach. The main reasons cited include the perceived lack of control over that asset and the uncertainty in the timing of any impairments, coupled with the pro-cyclicality of the impairment-only approach, which these companies perceive as a risk that is hard to manage.

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

reliably either. Additionally, such an approach would significantly increase the complexity and the subjectivity of the subsequent accounting for goodwill.

The decision for one of the two methods under consideration is therefore the determination of an accounting convention. As stated in our answer to Question 6, the current Covid-19 pandemic provides for a classic scenario where we would have expected entities to incur impairments due to the economic downturn. However, no significant impairments can be observed, which we interpret as an indication that the impairment test does not function properly as it fails to recognise impairments on a timely basis. Due to this and the other identified limitations of the impairment-only approach (see our answer to Question 6) we think that the IASB likely will not be able to design an improved impairment test. Consequently, we think that the existing accounting convention (i.e. the impairment-only approach) is no longer advantageous.

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

With regard to the details of amortisation, we would favour the specification of a maximum useful life and, thus, also a maximum amortisation period of ten years with a straight-line amortisation pattern, both possibly as a rebuttable presumption, so that shorter amortisation periods or different amortisation patterns would also be feasible if companies could demonstrate their appropriateness. This may be particularly relevant for industries with fast-changing business models.

As we acknowledge that valid arguments for both methods exist, we discussed whether the introduction of an accounting option between amortisation and the impairment-only approach should be pursued. Ultimately, we rejected this option due to the resultant lack of comparability between the companies and the impracticality of a reconciliation of the amounts to their respective alternative.

In summary, we concede that we did not identify any new arguments for or against amortisation or the impairment-only approach. However, our re-evaluation of the arguments already known leads us to a different assessment than when the impairment-only approach was introduced. Due to the limits of the impairment-only approach identified over time and the assessment – in light of the lack of impairments in the context of the Covid-19 pandemic - that a balance sheet item of this sizable amount should not remain almost unadjusted in the balance sheet in the long term, the ASCG, on balance, is in favour of reintroducing amortisation.

Question 8

Paragraphs 3.107–3.114 explain the Board's preliminary view that it should develop a proposal to require companies to present on their balance sheets the amount of total equity excluding goodwill. The Board would be likely to require companies to present this amount as a free-

standing item, not as a subtotal within the structure of the balance sheet (see the Appendix to this Discussion Paper).

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

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

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

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

Question 9

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

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

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

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

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

This proposed simplification of the impairment test is counterintuitive to the underlying criticism of *too little, too late* regarding the recognition of impairments. We think that reintroducing amortisation would likely reduce the magnitude of impairments and could therefore take some pressure off the impairment test, making this simplification more viable. However, if the impairment-only approach was retained, we think that the mandatory annual impairment test should be maintained in order to preserve a robust impairment test.

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

In our view, though, the suggested reduction of cost due to less frequent calculations of the recoverable amount is outweighed by a loss of continuity and a slower acquisition of knowledge

as to how to perform impairment tests, if preparers only occasionally attend to the quantitative impairment test.

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

Question 10

The Board's preliminary view is that it should develop proposals:

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

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

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

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

We support the proposed removal of the restriction in IAS 36 that prohibits companies from including some cash flows in estimating value in use (cash flows arising from a future uncommitted restructuring or from improving or enhancing the asset's performance) as well as the proposed permission to use post-tax cash flows and post-tax discount rates in estimating value in use, as we think that the current IAS 36 guidance pertaining to the calculation of the value in use does not seem appropriate.

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

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

Question 11

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

(a) Should the Board develop any of the simplifications summarised in paragraph 4.56? If so, which simplifications and why? If not, why not?

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

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

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

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

Question 12

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

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

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

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

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

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

Conceptually, we think that identifiable intangible assets acquired in a business combination should be recognised separately. We also see an increasing importance of intangible assets, especially for acquisitions in the new economy. In our view, there is already a lack of

information and transparency regarding the value drivers of companies in those industries (i.e. with regard to intellectual property), which would be further exacerbated by including identifiable intangible assets acquired in a business combination in goodwill. This would also be contrary to the frequent calls to improve financial reporting by providing more information about intangible assets that are increasingly important in modern economies. Therefore, we consider the separate accounting of intangible assets as having a very high information value.

We think that the additional inclusion of intangible assets acquired in a business combination in goodwill might be up for consideration only in case of a reintroduction of amortisation of goodwill.

However, we concede that for pragmatic reasons, relief could alternatively be considered for intangible assets that are similar to goodwill.

By way of example, the corresponding requirements of German GAAP, namely GAS 23 *Accounting for Subsidiaries in Consolidated Financial Statements,* read:

> *53.*
> *Benefits that are similar to goodwill do not meet the recognition criteria for the existence of an asset and may not therefore be recognised separately in the consolidated balance sheet. Such items shall be recognised in the consolidated balance sheet as a component of purchased goodwill.*

Additionally, GAS 23.52 provides that assets or liabilities that cannot be measured reliably shall not be recognised separately.

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

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

Question 13

IFRS 3 is converged in many respects with US generally accepted accounting principles (US GAAP). For example, in accordance with both IFRS 3 and US GAAP for public companies, companies do not amortise goodwill. Paragraphs 6.2 - 6.13 summarise an Invitation to Comment issued by the US Financial Accounting Standards Board (FASB).

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

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

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

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

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

Question 14

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

We do not have any other comments.