Beyond the GAAP

Mazars' newsletter on accounting standards

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Editorial

While many were waiting, sometimes apprehensively, for the IASB's (tentative) decision on the reintroduction of goodwill amortisation, the Board held off at its September meeting, asking the staff to conduct further research on the subsequent accounting for goodwill.

Discussions on the next steps for the project on disclosures for business combinations and goodwill impairment testing, the subject of a discussion paper in March 2020, will therefore continue in the coming weeks. At this stage, it is difficult to foresee the outcome.

IFRS Highlights

IASB launches IFRS 9 post-implementation review

On 30 September 2021, the International Accounting Standards Board (IASB) published a request for information as part of the post-implementation review of IFRS 9 *Financial Instruments*. The request can be accessed here.

This review could lead the Board to issue further educational material or even to amend the standard.

The IASB has opted to take a three-step approach, starting with a review of the classification and measurement rules in IFRS 9. The reviews of impairment and hedge accounting will follow.

Everyone can now contribute to the IASB's review, bearing in mind that the deadline for comments has been set at 28 January 2022.

Update on Discussion Paper on business combinations and impairment tests

Readers will remember that the IASB published a Discussion Paper entitled *Business Combinations – Disclosures, Goodwill and Impairment* on 19 March 2020. We included a feature on the DP in the April 2020 issue of Beyond the GAAP.

The key points of the proposals were as follows:

- no plans to change the current impairment model or to return to amortisation of goodwill;
- additional disclosures would be required on the performance of the acquired business after the acquisition date, and how this compares with management's objectives;
- the information disclosed should be the same as that used by the chief operating decision maker (as defined in IFRS 8 – *Operating Segments*), as the IASB has chosen to focus on ensuring the relevance of the information (rather than comparability of metrics between different companies);
- the disclosures currently required under IFRS 3 – *Business Combinations* would be slightly altered, with additional disclosures required on cash flows from operating activities, and clarification on the issue of profit (henceforth, entities should disclose operating profit before deducting acquisition-related costs and integration costs);
- the requirement for regular annual impairment testing would be removed (an impairment test would only be carried out when there is an indication that an asset may be impaired);
- some practical expedients were proposed:
  - permitting entities to use a post-tax discount rate;
  - removing the requirement to adjust business plans where they include items relating to future restructurings or asset enhancements.

In this feature, Beyond the GAAP presents an analysis of the initial feedback received by the IASB through its outreach work, and a summary of the current progress of discussions.

Disclosures in the notes

Regarding disclosures, the most significant sticking points were as follows:

The location of disclosures

In particular, some respondents felt that disclosures on the performance of an acquisition should be presented in the management commentary.

They felt that this type of information was by its very nature best located in the management commentary (rather than in the financial statements); that this would help to address issues around the auditability of these disclosures (particularly as regards the objectives set for an acquisition); that this would also help to limit the risk of litigation (*safe harbour* protections); and finally, that it would avoid repetition of information.

In contrast, other respondents felt that the disclosures should be located in the financial statements, as the IASB has no way of requiring IFRS entities to disclose this information in the management commentary (plus, it is more user-friendly if all disclosures are presented in a single document).

The particularly sensitive nature of some information

Some respondents felt that disclosing quantified objectives set by management could provide third parties with detailed information on an entity's cost structure, how it determines its selling price or potential future restructuring plans.

However, others felt that it should be possible to provide the necessary information without any negative impact on the entity. They pointed out that press releases often contain information on strategic rationale and objectives.

A third group of respondents felt that it all depended on the level of detail of the disclosures, and that supposed concerns about commercial sensitivity were often put forward as a reason for not disclosing certain information.

The forward-looking nature of the information

Some respondents were concerned that the forward-looking nature of some information could open entities up to litigation.

However, many enforcers and standard-setters agreed with the Board that the information is historical, not forward-looking (such as the assumptions used by management at the date of the business combination).

One solution could be for the Board to require entities to either disclose the information, or else explain why the information is considered to be sensitive (an approach that is already used in IAS 37 for situations where disclosing the information would seriously prejudice the entity in the context of a dispute). Another solution could be to permit entities to present purely qualitative information.

Costs involved, practicability and relevance

In addition, most preparers felt that the potential benefits are outweighed by the costs involved in providing these new disclosures (costs of gathering and auditing the information, and costs relating to the commercially sensitive nature of the information and potential litigation arising from its forward-looking nature).

As regards integration costs, it may be difficult or even impossible to quantify these, particularly in situations where the acquired business is quickly integrated into the entity's existing activities. Moreover, it could be misleading to present information on the acquired business separately, as this would not necessarily reflect the objectives of the acquisition.

Regarding the format of the disclosures, a very large majority of respondents agreed with the IASB's preliminary decision not to specify an indicator, but instead to require entities to disclose the information that is regularly monitored by their management. Then, there were more diverse reactions on the proposal to focus on the information received by the Chief Operating Decision Maker, perhaps due to differing perceptions of the level of detail provided to this individual or body.

Disclosures on synergies were felt to be costly to prepare, commercially sensitive, and sometimes difficult to produce at all.

However, there was little objection to the proposed requirement to present disclosures on the amount of pension liabilities and financial debts acquired as part of the business.

Finally, as regards the quantified information (revenue and profit or loss) required by IFRS 3, most respondents felt that the disclosures on cash flows from operating activities would be costly to produce and not particularly useful. There was no particular objection to the proposal to define the ‘profit or loss’ as an ‘operating profit before acquisition-related costs and integration costs’.

Amortisation of goodwill

Opinions diverged significantly on this point and, in particular, there were differences by geographical region. Among users, those in Europe, Japan and Canada tended to be in favour of reintroducing amortisation, while those in the United States, the United Kingdom and Australia would prefer to retain the current system. In contrast, most preparers were in favour of reintroducing amortisation.

The comments received did not put forward any significant new conceptual arguments (or evidence), other than the fact that impairment testing is not considered to be sufficiently effective.

It should also be noted that the US accounting standard-setter, the Financial Accounting Standards Board (FASB), tentatively decided in December 2020 that it would reintroduce amortisation of goodwill on a straight-line basis over a ten-year period (unless an entity opted for a different period, in which case it would need to justify this decision, and the period would be subject to a cap that has yet to be determined). Moreover, entities would not be required to reassess the amortisation period subsequently.

The FASB justified the decision to reintroduce amortisation of goodwill on both conceptual and practical grounds.

This change of direction has led to concerns, particularly in Europe, that entities would be at a disadvantage relative to entities preparing their financial statements under US GAAP.

Goodwill impairment testing

The very large majority of respondents agreed with the IASB that it would not be possible to significantly improve the effectiveness of impairment testing without incurring undue costs.

However, various suggestions for improvements were put forward:

- regarding the risk of management over-optimism, some respondents suggested that the Board should provide guidance on consistency of assumptions (both consistency between different internal assumptions and consistency between internal assumptions and external evidence), while others suggested that a comparison between forecasts used in previous impairment testing and actual cash flows should be presented in the notes;
- regarding the risk of the shielding effect, some respondents wanted the Board to clarify what is meant by “monitoring goodwill” (which could be replaced by monitoring the acquisition), or amend the reference to operating segments under IFRS 8 (to make it clearer that this is the highest level at which goodwill may be allocated), or provide guidance on allocating goodwill to cash generating units (CGUs). In the event of a change in the reporting structure, the Board could stipulate that an entity may only change the level at which impairment testing is carried out if it can demonstrate that cash flows have in fact changed. Otherwise, the test would need to be carried out as previously, in

accordance with the former reporting structure;

- other notable suggestions included permitting entities to reverse impairment losses on goodwill, and improving the list of indicators of impairment (by adding indicators that are specific to goodwill, or indicators necessary to demonstrate that goodwill has not become impaired, etc.)

A majority of respondents supported the IASB's proposals for simplifying the impairment test. They felt that the Board should permit entities to use post-tax cash flows and post-tax discount rates and that it would be useful to remove the current restrictions on how to estimate value in use (future restructurings and asset enhancements).

In contrast, most respondents disagreed with the proposal to remove the requirement for an annual impairment test, feeling that the cost savings would not compensate for the reduction in the effectiveness and robustness of the test. However, this response was based on the IASB's current tentative decision, and could thus change if the Board ultimately decided to reintroduce amortisation of goodwill.

Other issues

Most respondents agreed that the Board should not amend the criteria for recognising intangible assets acquired in a business combination.

On this subject, it should be noted that the FASB decided in April 2021 to carry out additional research to determine whether some intangible assets should be recognised separately from goodwill (notably non-compete agreements and certain customer-related intangible assets).

Some respondents felt that, if amortisation of goodwill were to be reintroduced, the Board should review the distinction between intangible assets and goodwill (for cost/benefit reasons, as both types of assets would be amortised).

There were also some respondents (including some users) who felt that separate recognition of intangible assets does not provide useful information. Conversely, others felt that the Board should launch a wider-scope project to permit entities to recognise more intangible assets, including those generated internally (to increase comparability between entities expanding through acquisition and those focusing on internal growth).

As regards the Board's proposal that equity excluding goodwill should be presented in the statement of financial position, most respondents felt that this information was not useful (as it is easy to calculate oneself) and could potentially be misleading (as it would suggest that goodwill was not an asset).

Finally, while most respondents felt that convergence with US GAAP was desirable, there were some differences of opinion. Some respondents felt that convergence was more important than the specific outcome (i.e. whether or not amortisation was reintroduced). Others felt that convergence was desirable, but should not take precedence over the quality of IFRS financial statements.

Where are we following the recent IASB meetings?

Currently, it is extremely difficult to foresee the final outcome of the project. In particular, there is a question over whether the IASB will be influenced by the FASB's decision to reintroduce amortisation of goodwill, even though no new conceptual arguments in favour of amortisation emerged from this outreach work.

The Board's deliberations in July 2021 highlighted the fact that none of the approaches are perfect, leading some members to support the "least bad" approach. The joint meeting between the FASB and the IASB, which also took place in July, shortly after the IASB's meeting, will likely have provided the Board members with more insight into the US standard-setter's position.

Several members of the IASB said in July that they would like to be able to decide on the whole package of accounting treatment and disclosures required in the notes (while some acknowledged that disclosures in the notes are often addressed at the last minute, at the end of a project).

In practice, the staff planned to approach the subject from different angles: disclosures in the notes, the treatment of goodwill, and other topics.

As regards disclosures in the notes, the staff are to develop illustrative examples, to be tested with preparers, users, regulators and auditors, to determine whether or not the Board's demands are reasonable. In other words, the objective of these examples is to see whether the concerns expressed by some are due to second-guessing particular aspects of the Board's requirements.

This should clarify whether it is possible to retain the Board's preliminary views regarding the disclosures required on subsequent performance and synergies.

As regards the accounting treatment of goodwill, some Board members wanted the staff to work on the useful life of goodwill and the treatment of historical goodwill (and thus the potential transition between two accounting models).

As regards the useful life of goodwill, a feasibility study was proposed, focusing on the costs of determining the useful life of goodwill on a transaction-by-transaction basis; the usefulness of the information obtained; the reliability of estimates; and the merits of the various information bases suggested for calculating amortisation of goodwill.

Regarding transition, it was deemed necessary to estimate the amount of "historical" goodwill (i.e. at the date of transition to a potential new accounting model) and the impact of a change in approach on the financial statements, as well as to investigate the potential effects of the possible approaches (in terms of an entity's ability to distribute reserves, comply with banking covenants and meet the obligations of a listed company).

At the end of the July meeting, it was expected that the Board would vote in September 2021 on whether or not to reintroduce amortisation of goodwill (and whether the decision should be dependent on other aspects, such as the disclosures required in the notes, the practicalities of amortisation, or the inability to improve the effectiveness of impairment testing).

However, the Board was unable to reach a decision on this key issue in September. The Board has opted to follow the recommendations of the staff and the project will thus focus on the two key areas previously discussed, namely:

- ensuring the Board has an overview of the whole package of required disclosures (based on the Board's preliminary views, accompanied by illustrative examples); and
- carrying out additional analysis on the subsequent accounting treatment of goodwill (i.e. the feasibility of reliably assessing the

useful life of goodwill, and the practical implications of a potential change in accounting model).

These new developments raise questions over the ultimate outcome of the project, and particularly the issue of which accounting model will be chosen (impairment-only, or amortisation and impairment).

The practical implications are significant and have only become more so over time, given that impairment losses are now rarely recognised on goodwill related to acquisitions since the IASB moved away from the amortisation model. Many stakeholders will doubtless be keeping a close eye on this project.

Key points to remember

Analysis of feedback on the *Business Combinations – Disclosures, Goodwill and Impairment* Discussion Paper, published by the IASB in March 2020, has resulted in the following key findings:

- Some information is felt to be too sensitive to be included in the financial statements. Similarly, some respondents felt that disclosures on the performance of an acquisition should not be presented in the financial statements themselves.
- The feedback did not produce any significant new conceptual arguments in favour of either model for the subsequent accounting for goodwill (i.e. impairment-only or amortisation and impairment) and opinions on the subject remain highly divided.
- Respondents were strongly in favour of the Board's proposals for simplifying the impairment test for goodwill (i.e. permitting entities to use post-tax cash flows and post-tax discount rates, and removing the current restrictions on which cash flows can be used to estimate value in use).
- In contrast, removing the requirement for an annual impairment test was not felt to be a good idea, as the cost savings would not compensate for the reduction in the effectiveness and robustness of the test.
- Similarly, disclosures on synergies were felt to be costly to prepare, commercially sensitive, and sometimes difficult to produce at all.
- Finally, respondents were not convinced by the Board's proposals to require entities to present equity excluding goodwill in the statement of financial position, and to add disclosures on cash flows from operating activities to the quantitative information (revenue and profit or loss) already required for business combinations.

In addition to the issues raised by the analysis of feedback, the debate on the amortisation of goodwill seems to have been re-opened by the FASB's tentative decision in December 2020 to reintroduce amortisation. By the end of its September meeting, the IASB had still not decided whether or not to reintroduce amortisation of goodwill.

Before deciding on the future direction of the project, the Board wishes to have an overview of the whole package of required disclosures, based on its preliminary views, accompanied by illustrative examples. It has asked the staff to carry out additional analysis on the subsequent accounting treatment of goodwill (i.e. the feasibility of reliably assessing the useful life of goodwill, and the practical implications of a potential change in accounting model).

Ongoing IASB deliberations on presentation of financial statements

In September, the IASB continued its deliberations following the December2019 Exposure Draft issued with a view to the possible replacement of IAS 1 on the presentation of financial statements and the amendment of IAS 7 on the statement of cash flows.

While not all the topics on the agenda could be discussed (including the presentation of the share of net income of equity-accounted companies in the income statement), the IASB took a number of still-tentative decisions, pending overall validation of the content of the future standard.

The IASB once again considered:

- management performance measures, following its initial discussions in March 2021 and June 2021 (see Beyond the GAAP issues 153 and 156 respectively);
- the principles of aggregation and disaggregation and their application in the primary financial statements and the notes, following first redeliberations in April 2021.

Definition of management performance measures

The IASB is making gradual progress on management performance measures and is likely to require several meetings to complete its deliberations on this crucial topic (e.g. consideration of the interaction between management performance measures and segment reporting under IFRS 8).

Readers will recall that in previous meetings, the IASB confirmed that disclosures in respect of management performance measures should be made in the notes to the financial statements, and that it had no wish to extend their scope (except where a numerator or a denominator of a ratio meets the definition of a management performance measure).

In September, the IASB began work to redefine management performance measures considering the proposal in the Exposure Draft, according to which:

"Management performance measures are subtotals of income and expenses that:

a) are used in public communications outside financial statements;

b) complement totals or subtotals specified by IFRS Standards; and

c) communicate to users of financial statements management's view of an aspect of an entity's financial performance."

Many stakeholders who responded to the exposure draft viewed the concept of "public communications" in the first of these points as unclear and too broad.

The September meeting discussed this topic without asking the Board to vote on any decisions. The IASB intends to explore further how to clarify the scope of public communications, considering the objective of proposals for management performance measures and the extent to which detailed guidance is needed to meet that objective.

In future the IASB will also discuss how to clarify that an entity is not required to repeat disclosures provided in the interim financial statements in the annual financial statements or to review historical communications related to previous financial statements to identify management performance measures.

Turning to the second aspect of the definition, the IASB tentatively decided to amend the definition of management performance measures:

- to remove the reference to *complementing* totals or subtotals specified by IFRS Standards. This would be only presented in the Basis for Conclusions, to avoid creating confusion as to the IASB's intention: if the disclosures complement the information required by IFRS standards this is not in itself a criterion for identifying management performance measures; and
- to state that totals and subtotals specified by IFRS Standards are not management performance measures.

Members of the IASB also discussed item (c) above relative to the definition of management performance measures, without taking any decisions at this stage.

Principles of aggregation and disaggregation and their practical application

The IASB also continued to deliberate on the principles of aggregation and disaggregation of information in the primary financial statements and the notes, following an initial decision in April 2021 that led the Board to strengthen the principle of disaggregation of information by emphasising that a single dissimilar (non-shared) characteristic between items would be sufficient to require an entity to disaggregate information about those items if that information were material.

During the September 2021 meeting, the IASB essentially decided to explain, in the final version of the standard, that:

- the purpose of aggregation (to obtain classes of assets and liabilities, etc.) is to make information understandable;
- the requirement to disclose such classes applies to all material classes. Hence any class of aggregated items should be disaggregated if the resulting disaggregated classes provide material information. Consistent with the April decision, material classes might be identified because the items have a single dissimilar characteristic.

The IASB also tentatively decided to require an entity to explain, in qualitative terms only, how a class of items disclosed in the notes is included in line items in the primary financial statements. This information must enable users of financial statements to understand how the amounts presented in the notes relate to the line items in the primary financial statements.

Finally, the IASB tentatively decided to publish application guidance to help entities to apply the principles of aggregation and disaggregation in practice, both in the primary financial statements and in the notes.

For the primary financial statements, the IASB tentatively decided that the application guidance will state that, in general, the more diverse the items in a class (that is, the more dissimilar characteristics the items have in addition to the shared characteristics that form the basis for the class) the more likely it would be that disaggregation based on some of those dissimilar characteristics would result in a more understandable overview.

In the case of the notes, the IASB tentatively decided that the application guidance will state that, in general, the more diverse the items in a class (that is, the more dissimilar characteristics the items have in addition to the shared characteristics that form the basis for the class) the more likely it would be that disaggregation based on some of those dissimilar characteristics would result in material information.

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The drafting of the present issue was completed on 1 October 2021

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[1] Where permitted under applicable country laws

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