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15 July 2024

602/579

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**Re.: IASB Exposure Draft: Business Combinations – Disclosures, Goodwill and Impairment – Proposed amendments to IFRS 3 and IAS 36**

Dear Mr Barckow

The IDW (Institut der Wirtschaftsprüfer in Deutschland e.V.)<sup>1</sup> would like to thank you for the opportunity to comment on the IASB's Exposure Draft (ED) "Business Combinations – Disclosures, Goodwill and Impairment – Proposed amendments to IFRS 3 and IAS 36".

In general, the IDW agrees with the IASB's objective of improving information about business combinations in IFRS financial statements. We believe that the Board's approach of balancing the need to provide information that helps users to better assess the performance of a business combination without overburdening preparers or jeopardising the success of the business combination is reasonable. Nevertheless, we have a few reservations about some of the details relating to the proposed requirements. These relate in particular to the determination of strategic business combinations, the exemption from disclosing specified information in accordance with paragraph B67D of IFRS 3 and the new disclosure requirements on the expected synergies from combining operations of

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<sup>1</sup> The IDW is a voluntary membership organisation representing the interests of the profession of public auditors in Germany and counts over 79 % of this profession as members.

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the acquiree and the acquirer (we refer to paragraph B64(ea) of IFRS 3). In this context, please see our answers to Questions 2, 3 and 5.

With regard to the proposals to improve the impairment testing of cash-generating units containing goodwill in accordance with IAS 36, we have considerable doubts that the Board's proposals will succeed in reducing, in particular, the shielding effect and management's overoptimism. However, for pragmatic reasons, we welcome the Board's proposals that an entity should no longer be prohibited from including cash flows from a future restructuring that the entity is not yet committed to undertaking or cash flows from an improvement or enhancement to an asset's performance in the value in use calculation and the removal of the requirement to use pre-tax cash flows and pre-tax discount rates in the value in use calculation. In this context, please see our answers to Questions 6 and 7.

The IDW comments on the individual questions posed by the IASB as follows:

**Question 1: Disclosures: Performance of a business combination (proposed paragraphs B67A-B67G of IFRS 3)**

*In the PIR of IFRS 3 and in responses to the Discussion Paper the IASB heard that:*

- *users need better information about business combinations to help them **assess whether the price an entity paid for a business combination is reasonable and how the business combination performed after acquisition**. In particular, users said they need information to help them assess the performance of a business combination against the targets the entity set at the time the business combination occurred (see paragraphs BC18-BC21).*
- *preparers of financial statements are concerned about the **cost of disclosing** that information. In particular, preparers said the information would be so **commercially sensitive** that its disclosure in financial statements should not be required and disclosing this information could expose an entity to **increased litigation risk** (see paragraph BC22).*

*Having considered this feedback, the IASB is proposing changes to the disclosure requirements in IFRS 3 that, in its view, appropriately balance the benefits and costs of requiring an entity to disclose this information. It therefore expects that the proposed disclosure requirements would provide users with*

*more useful information about the performance of a business combination at a reasonable cost.*

*In particular, the IASB is proposing to require an entity to disclose information about the **entity's acquisition-date key objectives and related targets** for a business combination and whether these key objectives and related targets are being met (information about the performance of a business combination). The IASB has responded to preparers' concerns about disclosing that information by proposing:*

- *to require this information **for only a subset** of an entity's business combinations - **strategic business combinations** (see question 2); and*
  - *to **exempt entities** from disclosing some items of this information **in specific circumstances** (see question 3).*
- (a) *Do you agree with the IASB's proposal to require an entity to disclose information about the performance of a strategic business combination, subject to an exemption? Why or why not? In responding, please consider whether the proposals appropriately balance the benefits of requiring an entity to disclose the information with the costs of doing so.*
- (b) *If you disagree with the proposal, what specific changes would you suggest to provide users with more useful information about the performance of a business combination at a reasonable cost?*

In general, the IDW supports the IASB's objective of improving information about business combinations in IFRS financial statements. We also believe that the Board's approach of balancing the need to provide information that helps users to better assess the performance of a business combination without overburdening preparers or jeopardising the success of the business combination is reasonable.

However, we have a few reservations about some of the details relating to the proposed requirements. These relate in particular to the determination of strategic business combinations, the exemption from disclosing specified information in accordance with paragraph B67D of IFRS 3 and the new disclosure requirements on the expected synergies from combining operations of the acquiree and the acquirer (we refer to paragraph B64(ea) of IFRS 3). In this context, please see our answers to Questions 2, 3 and 5.

Further, we welcome the fact that the IASB has addressed the question of whether the proposed disclosure of an entity's acquisition-date key objectives and related targets are auditable. In this context, the Board has stated that it expects that auditors and regulators will be able to verify:

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- whether the information disclosed is the information an entity's key management personnel receive to review a business combination,
- whether there is adequate explanation and appropriate evidence supporting the information and
- whether the information disclosed faithfully represents what it purports to represent (we refer to paragraphs BC145 et seq. of IFRS 3),

Nevertheless, we have serious concerns that the potential disclosure of an entity's acquisition-date key objectives and related targets (as well as the required quantitative information on expected synergies from a business combination<sup>2</sup>) could be misleading to users of financial statements. We believe that the mere fact that this internal, sensitive and largely non-financial information is required to be disclosed in the audited financial statements could suggest to users that the auditors have obtained reasonable assurance about the existence and achievability of an entity's acquisition-date key objectives and related targets. This could be detrimental, were it to lead to an increase in the so-called expectations gap.

Generally, it should be possible to address internal, sensitive, non-financial and forward-looking information in the financial statement audit to obtain reasonable assurance in respect of the financial statements as a whole. However, we would like to point out that, due to its inherent nature, the veracity of such information is naturally associated with higher risks in terms of its completeness, relevance and audit procedures relating to such information are therefore, significantly more time-consuming and cost-intensive.

In our opinion, the following are the only ways to avoid the potential expectations gap described above:

- shifting the proposed disclosures to the Management Commentary or
- adding an explicit statement (analogous to IFRS 18.122) to clarify that these disclosures are based solely on information used internally by management and do not constitute forward-looking information. Furthermore, the information disclosed represents only a best estimate on the part of management, which cannot necessarily be expected to materialise in the future.

Moreover, we question whether the proposed disclosures also apply to the interim financial statements. In our view, the disclosure of an entity's acquisition-

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<sup>2</sup> In this context, we also refer to our answer to Question 5.

date key objectives should be largely unproblematic. However, for cost-benefit reasons, the disclosure of the related targets should be limited to the annual financial statements.

Finally, the IDW suggests that the proposed disclosure requirements be subjected to an exhaustive field test before they are finalised in order to identify and minimise all of the significant associated challenges for preparers, auditors and regulators as far as possible.

**Question 2: Disclosures: Strategic business combinations (proposed paragraph B67C of IFRS 3)**

*The IASB is proposing to require an entity to disclose information about the performance of a business combination (that is, information about the entity's acquisition-date key objectives and related targets for the business combination and whether these key objectives and related targets are being met) for only strategic business combinations – a subset of material business combinations. A strategic business combination would be one for which failure to meet any one of an entity's acquisition-date key objectives would put the entity at serious risk of failing to achieve its overall business strategy.*

*The IASB is proposing that entities identify a strategic business combination using a set of thresholds in IFRS 3 – a business combination that met any one of these thresholds would be considered a strategic business combination (threshold approach) (see paragraphs BC56-BC73).*

*The IASB based its proposed thresholds on other requirements in IFRS Accounting Standards and the thresholds regulators use to identify particularly important transactions for which an entity is required to take additional steps such as providing more information or holding a shareholder vote. The proposed **thresholds** are both **quantitative** (see paragraphs BC63-BC67) and **qualitative** (see paragraphs BC68-BC70).*

- (a) Do you agree with the proposal to use a threshold approach? Why or why not? If you disagree with the proposal, what approach would you suggest and why?*
- (b) If you agree with the proposal to use a threshold approach, do you agree with the proposed thresholds? Why or why not? If not, what thresholds would you suggest and why?*

The IASB is proposing to introduce a new concept into IFRS by differentiating between material and strategic business combinations, with the latter representing a subset of material business combinations.

Using a closed-list approach to determine what constitutes a strategic business combination, i.e. whereby the IASB specifies certain thresholds for strategic business combinations, has several considerable disadvantages compared to a principles-based approach. These include, among others:

- Thresholds harbour the risk of determining strategic business combinations too formally instead of taking appropriate account of the facts and circumstances of the individual case.
- In practice, there may be inconsistencies between the determination of strategic business combinations using the closed-list approach and the management's own categorisation of the same transaction.
- Thresholds, generally, provide an anchor for (abusive) structuring.

However, given the objective of the IASB's project, i.e. to provide users with better information on strategic business combinations while limiting the additional costs for preparers, we consider the Board's decision in favour of the closed-list approach as appropriate, since it is more pragmatic and easier to operationalise than alternatives.

In introducing a closed-list approach, the definition of suitable thresholds by the standard setter will be crucial. Therefore, we do not consider simply orientating the thresholds towards that specified in IFRS 8 for the identification of operating segments appropriate (we refer to paragraph BC67 in this ED). By prescribing the thresholds, the IASB determines the relative magnitude of the planned subset of "strategic business combinations" in comparison to material business combinations and how often entities will tend to be affected by the corresponding disclosure requirements. This raises the question of what the IASB's intention is.

According to a survey conducted by EFRAG in 2023, only very few business combinations would be affected by the proposed disclosure requirements for strategic business combinations in the case of a 10 % threshold. Notwithstanding this finding, we recommend that the Board conducts its own outreach activities and field testing to determine an appropriate threshold for the proposed IFRS 3 disclosures. It would then be helpful for the IASB to explain why the threshold will ultimately be set at x % - and not, for example, at 5 %, 20 % or 30 %.

In addition, we believe that it would be reasonable to give entities the opportunity to rebut the presumption of a strategic business combination even if the defined quantitative thresholds are reached. This would allow the specific facts and circumstances of the individual case to be better taken into account. It is also clear that the higher the thresholds set by the IASB, the more difficult it will be for entities to rebut the presumption.

Furthermore, we have the following comments on the thresholds proposed in this ED:

- - It is unclear whether the acquiree's financial information to be used for the quantitative threshold test according to paragraph B67C of IFRS 3 must be determined in line with IFRS Accounting Standards. This can sometimes become difficult and costly, in particular, if
    - the acquired entity is a part of a legal entity (so-called carve-out),
    - the financial statements of the acquired entity were not audited, or
    - the financial statements of the acquired entity were prepared in accordance with other Generally Accepted Accounting Principles.
  - Further, we question how differences in the annual reporting periods of the financial statements of the acquirer and the acquiree should be dealt with for the purpose of assessing whether the thresholds are exceeded.
  - We consider a fixed percentage of operating profit or loss to generally be an inappropriate threshold for determining whether a strategic business combination has taken place. The operating profit or loss is usually subject to annual fluctuations and so will hardly allow for an objective and undistorted assessment of several business combinations by a single acquirer over time. For this reason, we recommend at least normalising the operating profit or loss (in the sense of averaging it over a certain number of years) in order to use it as a quantitative threshold. Specific guidance on how to operationalise this threshold in the case of loss-making acquirers and/or acquired entities would also be helpful.
  - With regard to the proposed qualitative threshold in paragraph B67C(c) of IFRS 3, we consider the use of the terms "major line of business" and "geographical area" from paragraph 32 of IFRS 5 to be unfortunate, as these terms have not only been used in a different context in IFRS to date, but they also regularly lead to considerable application problems in

practice when determining discontinued operations. Therefore, we propose the IASB refrain from referring to IFRS 5 and instead align the wording of paragraph B67C(c) of IFRS 3 in this ED with that of paragraph BC55 as follows: “*entering a new ~~major~~ line of business or geographies ~~eat~~ area of operations that is essential to the entity’s overall business strategy.*”

- As stated, the IASB has not succeeded in clarifying how to deal with a series of business combinations that an entity undertakes in order to achieve an overall strategic objective when applying the proposed closed-list approach (we refer to paragraphs BC71 et seq.). This is unsatisfactory, since such cases occur regularly in practice. We would urge the IASB to examine this issue further.

**Question 3: Disclosures: Exemption from disclosing information (proposed paragraphs B67D-B67G of IFRS 3)**

*The IASB is proposing to exempt an entity from disclosing some of the information that would be required applying the proposals in this Exposure Draft in specific circumstances. The exemption is designed to respond to preparers’ concerns about commercial sensitivity and litigation risk but is also designed to be enforceable and auditable so that it is applied only in the appropriate circumstances (see paragraphs BC74-BC107).*

*The IASB proposes that, as a principle, an **entity be exempt from disclosing some information if doing so can be expected to prejudice seriously the achievement of any of the entity’s acquisition-date key objectives for the business combination** (see paragraphs BC79-BC89). The IASB has also proposed application guidance (see paragraphs BC90-BC107) to help entities, auditors and regulators identify the circumstances in which an entity can apply the exemption.*

- Do you think the proposed exemption can be applied in the appropriate circumstances? If not, please explain why not and suggest how the IASB could amend the proposed principle or application guidance to better address these concerns.*
- Do you think the proposed application guidance would help restrict the application of the exemption to only the appropriate circumstances? If not, please explain what application guidance you would suggest to achieve that aim.*



In general, we agree with the IASB's intention to address preparers' concerns about the proposed disclosure of information related to a business combination that is sometimes commercially sensitive or involves litigation risk by providing an exemption in this ED.

However, such provisions always harbour the risk of misuse, i.e., in particular the risk of excessive use of the exemption. For this reason, we believe it is appropriate and necessary for an entity that applies the proposed exemption to an information item always disclose in its financial statements both the fact that it applies the exemption and the reason why it has not disclosed the information item (we refer to paragraph B67E of IFRS 3 in this ED).

Despite the application guidance provided in paragraphs B67D-B67G of IFRS 3 in this ED, we believe the implementation of the proposed exemption from disclosing information will prove difficult in practice. In particular, we question the purpose of the provision in paragraph B67E, according to which, before applying the exemption, the acquirer must re-examine whether the information cannot be made available to users in another way (e.g. at an aggregated level).

To facilitate implementation in practice, we recommend the IASB include further examples in paragraph B67D as well as add a note that the exemption from disclosing information is expected to only be used in “extremely rare cases”.

**Question 4: Disclosures: Identifying information to be disclosed (proposed paragraphs B67A-B67B of IFRS 3)**

*The IASB is proposing to require an entity to disclose information about the performance of the entity's strategic business combinations (that is, information about its acquisition-date key objectives and related targets for a strategic business combination and whether these key objectives and related targets are being met) that is reviewed by its key management personnel (see paragraphs BC110-BC114).*

*The IASB's proposals would require an entity to **disclose this information for as long as the entity's key management personnel review the performance of the business combination** (see paragraphs BC115-BC120).*

*The IASB is also proposing (see paragraphs BC121-BC130) that if an entity's key management personnel:*

- *do not start reviewing, and do not plan to review, whether an acquisition-date key objective and the related targets for a business combination are*

*met, the entity would be required to disclose that fact and the reasons for not doing so;*

- *stop reviewing whether an acquisition-date key objective and the related targets for a business combination are met before the end of the second annual reporting period after the year of acquisition, the entity would be required to disclose that fact and the reasons it stopped doing so; and*
  - *have stopped reviewing whether an acquisition-date key objective and the related targets for a business combination are met but still receive information about the metric that was originally used to measure the achievement of that key objective and the related targets, the entity would be required to disclose information about the metric during the period up to the end of the second annual reporting period after the year of acquisition.*
- (a) *Do you agree that the information an entity should be required to disclose should be the information reviewed by the entity's key management personnel? Why or why not? If not, how do you suggest an entity be required to identify the information to be disclosed about the performance of a strategic business combination?*
- (b) *Do you agree that:*
- (i) *an entity should be required to disclose information about the performance of a business combination for as long as the entity's key management personnel review that information? Why or why not?*
  - (ii) *an entity should be required to disclose the information specified by the proposals when the entity's key management personnel do not start or stop reviewing the achievement of a key objective and the related targets for a strategic business combination within a particular time period? Why or why not?*

The IDW agrees with the proposal that an entity should be required to disclose the information about the performance of the entity's strategic business combinations reviewed by its key management personnel. We consider the reference to key management personnel to be appropriate and also practicable, as the concept is familiar in IFRS and well established in practice.

Key management personnel usually monitor if the structure of an entity changes (e.g. in cases of a material acquisition and integration of another entity). In our view, this should always be presented transparently. In general, the reference to an individual business combination and the resulting new disclosure requirements, as proposed in this ED, only make sense as long as the integration of the acquired entity has not yet been completed.

We consider the proposed maximum period for the new disclosure requirements of two annual reporting periods after the year of acquisition appropriate.

### **Question 5: Disclosures: Other proposals**

The IASB is proposing other amendments to the disclosure requirements in IFRS 3. These proposals relate to:

#### New disclosure objectives (proposed paragraph 62A of IFRS 3)

The IASB proposes to add **new disclosure objectives** in proposed paragraph 62A of IFRS 3 (see paragraphs BC23-BC28).

#### Requirements to disclose quantitative information about expected synergies in the year of acquisition (proposed paragraph B64(ea) of IFRS 3)

The IASB proposes:

- to require an entity to describe **expected synergies by category** (for example, revenue synergies, cost synergies and each other type of synergy);
- to require an entity to disclose for each category of synergies:
  - the estimated amounts or range of amounts of the expected synergies;
  - the estimated costs or range of costs to achieve these synergies; and
  - the time from which the benefits expected from the synergies are expected to start and how long they will last; and
- to exempt an entity from disclosing that information in specific circumstances.

See paragraphs BC148-BC163.

#### The strategic rationale for a business combination (paragraph B64(d) of IFRS 3)

The IASB proposes to replace the requirement in paragraph B64(d) of IFRS 3 to disclose the primary reasons for a business combination with a requirement to disclose the **strategic rationale** for the business combination (see paragraphs BC164-BC165).

Contribution of the acquired business (paragraph B64(q) of IFRS 3)

The IASB proposes to amend paragraph B64(q) of IFRS 3 to improve the information users receive about the contribution of the acquired business (see paragraphs BC166-BC177). In particular, the IASB proposes:

- to specify that the amount of profit or loss referred to in that paragraph is the amount of operating profit or loss (operating profit or loss will be defined as part of the IASB's Primary Financial Statements project);
- to explain the purpose of the requirement but add no specific application guidance; and
- to specify that the Basis for preparing this information is an accounting policy.

Classes of assets acquired and liabilities assumed (paragraph B64(i) of IFRS 3)

The IASB proposes to improve the information entities disclose about the pension and financing liabilities assumed in a business combination by **deleting the word 'major'** from paragraph B64(i) of IFRS 3 and adding pension and financing liabilities to the illustrative example in paragraph IE72 of the Illustrative Examples accompanying IFRS 3 (see paragraphs BC178-BC181).

Deleting disclosure requirements (paragraphs B64(h), B67(d)(iii) and B67(e) of IFRS 3)

The IASB proposes to delete some disclosure requirements from IFRS 3 (see paragraphs BC182-BC183).

Do you agree with the proposals? Why or why not?

Quantitative information about expected synergies in the year of acquisition (proposed paragraph B64(ea) of IFRS 3)

We acknowledge that information about the nature, timing and amount of expected synergies from a business combination is important information for users of financial statements, because it provides them with a better understanding of the reasons for the business combination and the price the entity paid.

In this context, however, we would like to point out that synergies are often, but not always (and not always in full), reflected in the transaction price and that other factors can also influence the price paid for a business combination.

Moreover, in our experience, not all the information required to fulfil the proposed disclosure requirements will be gathered automatically as part of the transaction process. We therefore take a critical view of the proposed disclosure requirements from a cost-benefit perspective. In this context, we are concerned

that many entities may seek to use the exemption proposed in paragraphs B67D et seq. to avoid making these disclosures.

In general, we believe that the Board should focus on qualitative rather than quantitative disclosure requirements on synergies from business combinations for the following reasons:

- There is still no clear definition of “synergies”. This inevitably leads to difficulties in identifying synergies and distinguishing between the different categories of synergies. In the case of quantitative disclosure requirements, the problem becomes even more acute.
- The proposed new disclosures require preparers to artificially quantify management information that is regularly of a non-financial and forward-looking nature. Determining such quantitative disclosure requirements will often only be possible by means of a best estimate. In our opinion, the reliability and informative value of such information is limited. We therefore doubt their benefit to users.
- As already addressed in our answer to Question 1, we are concerned that – despite the IASB's comments in paragraphs BC145 et seq. of this ED – the requirement to disclose information on expected synergies in the notes of the financial statements will most likely lead to an expectation gap for users. This is because they will regularly assume that the information provided has also been comprehensively audited (i.e. with a supposedly “uniform” level of reasonable assurance having been obtained, whereas this will generally not be the case, given the inherent limitations attaching to such information).

It should be possible to address such internal, sensitive, often non-financial and forward-looking information in the financial statement audit to obtain reasonable assurance in respect of the financial statements as a whole. However, auditing procedures relating to such information are much more complex and time-consuming and would, therefore, lead to significant additional costs for preparers.

Consequently, we recommend deleting the proposed *quantitative* disclosure requirements on expected synergies from business combinations in accordance with paragraph B64(ea) of IFRS 3. Furthermore, additional application guidance would be helpful with regard to the proposed *qualitative* disclosure requirements.

Contribution of the acquired business (paragraph B64(q) of IFRS 3)

We agree with replacing the term “profit and loss” with “operating profit and loss” as defined in IFRS 18 *Presentation and Disclosure in Financial Statements*.

However, we are concerned about using the term "accounting policies" in the context of the proposal on pro forma information in paragraph B64(q)(ii) of IFRS 3 in this ED. Pro forma information merely serves as an illustration in the sense of "what if". It does not fairly present the financial position, financial performance and cash flows of an entity. Therefore, we believe that the use of the term "accounting policies", which is clearly defined in IAS 8 and refers to the application of IFRS Accounting Standards, is inappropriate and even misleading in the context of pro forma information. Irrespective of this, we believe it is important that the preparers disclose and explain within the relevant note how they have determined the proposed pro forma information.

**Question 6: Changes to the impairment test (paragraphs 80-81, 83, 85 and 134(a) of IAS 36)**

*During the PIR of IFRS 3, the IASB heard concerns that the impairment test of cash-generating units containing goodwill results in impairment losses sometimes being recognised too late.*

*Two of the reasons the IASB identified (see paragraphs BC188-BC189) for these concerns were:*

- *shielding; and*
- *management over-optimism.*

*The IASB is proposing amendments to IAS 36 that could mitigate these reasons (see paragraphs BC192-BC193).*

*Proposals to reduce shielding*

*The IASB considered developing a different impairment test that would be significantly more effective at a reasonable cost but concluded that doing so would not be feasible (see paragraphs BC190-BC191).*

*Instead, the IASB is proposing changes to the impairment test (see paragraphs 80-81, 83 and 85 of IAS 36) to reduce shielding by **clarifying how to allocate goodwill to cash-generating units** (see paragraphs BC194-BC201).*

Proposal to reduce management over-optimism

*The IASB's view is that management over-optimism is, in part, better dealt with by enforcers and auditors than by amending IAS 36. Nonetheless, the IASB is proposing to amend IAS 36 to require an entity to **disclose in which reportable segment a cash-generating unit or group of cash-generating units containing goodwill is included** (see paragraph 134(a) of IAS 36). The IASB expects this information to provide users with better information about the assumptions used in the impairment test and therefore allow users to better assess whether an entity's assumptions are over-optimistic (see paragraph BC202).*

- (a) Do you agree with the proposals to reduce shielding? Why or why not?*
- (b) Do you agree with the proposal to reduce management over-optimism? Why or why not?*

a) Proposals to reduce shielding

The IDW agrees that the shielding effect is one of the main reasons why impairment losses on goodwill are rarely recognised, and if they are, then often too late. The allocation of goodwill to cash-generating units is crucial in this context. However, with regard to the proposals in the ED, we are unclear as to the Board's intentions and how some of the proposals are to be understood in detail.

First of all, we strongly recommend the IASB clarify whether the proposed amendments to IAS 36 in relation to the allocation of goodwill for the purpose of impairment testing constitute substantive changes (i.e. an amendment) or just clarifications. If the IASB's proposals merely serve to explain or to clarify the existing requirements of IAS 36, then we do not expect them to have any significant impact in practice. This is because any change (i.e. a reallocation of goodwill to another lower level) that would be made as a result of the IASB's proposed clarification would mean that an entity has incorrectly allocated goodwill in prior periods. In our opinion, this will not happen in practice, so the IASB would not achieve its current objective of reducing the shielding effect. However, if these proposals are an amendment aimed at fundamentally changing current practice and thus reducing shielding, specific transition requirements will be needed (we refer to our answer to Question 9).

In our understanding, the proposed new paragraphs 80A and 80B of IAS 36 are intended to further explain the existing requirements for allocating goodwill to cash-generating units, in particular those addressed in paragraph 80 of IAS 36.

Paragraph 80(a) of IAS 36 is adjusted as follows: “goodwill is monitored” is replaced with “the business associated with goodwill is monitored”. In this context, we have the following comments:

- The meaning of “the business associated with goodwill is monitored” is unclear from our point of view. For example, we question whether “the business associated with the goodwill” relates only to the newly-acquired business, or the acquirer's existing business, or a combination of both. In particular, an illustrative example where the level of testing includes both the acquired and existing businesses would be helpful.
- We question the meaning of “internal management” compared to “key management personnel”. Although paragraph 83(b) of IAS 36 addresses potential differences between the level of management for the purposes of disclosures under IFRS 3 and for the purposes of allocating goodwill under IAS 36, in our view, it is not yet sufficiently clear which level of management is intended in paragraph 80(a) of IAS 36. As entities regularly have multiple levels of management, we believe that the correct identification of the level of “internal management” in the context of paragraph 80(a) will be fundamental to an effective application of the proposals. An example or additional application guidance could be helpful.
- We do not agree with the last sentence of the proposed paragraph 80A(b) of IAS 36. Accordingly, financial information that management uses regularly to monitor the business associated with the goodwill, but which does not reflect how the benefits expected from the synergies of the combination are managed, would not be sufficient to identify a cash-generating unit or a group of cash-generating units to which the goodwill should be allocated. In our view, this additional new demand on the financial information could lead to goodwill having to be allocated at a higher level, which runs counter to the IASB's current objective.

#### b) Proposal to reduce management over-optimism

In general, we are not convinced that the proposed additional disclosure requirement in paragraph 134(a) of IAS 36 in this ED will lead to a noticeable reduction in management over-optimism in the context of impairment testing in accordance with IAS 36.

It is also unlikely that the proposed disclosure will provide users with additional information, as, in any case, goodwill is often tested at segment level in practice. Instead, consideration could be given to whether users would have significantly



better information if the separate disclosure of the amount of change required in each key assumption used in impairment testing of a cash-generating unit containing goodwill that results in the recoverable amount just covering the carrying amount of that cash-generating unit were required.

Finally, we do not agree with the statement in paragraph BC189(c) of IAS 36, i.e., that “overly optimistic estimates of cash flows are best addressed by auditors and regulators, instead of by changing IFRS Accounting Standards”. In our view, the leeway for (management) judgement inherent in the current impairment model is best addressed by a combination of the following: clear accounting principles, transparent disclosures, good governance rules within the reporting entities, quality audits, and strong enforcement.

**Question 7: Changes to the impairment test: Value in use (paragraphs 33, 44-51, 55, 130(g), 134(d)(v) and A20 of IAS 36)**

*The IASB is proposing to amend how an entity calculates an asset's value in use. In particular, the IASB proposes:*

- *to remove a constraint on cash flows used to calculate value in use. An entity would **no longer** be **prohibited** from including cash flows arising from a **future restructuring to which the entity is not yet committed** or **cash flows arising from improving or enhancing an asset's performance** (see paragraphs BC204-BC214).*
  - *to **remove the requirement to use pre-tax cash flows and pre-tax discount rates** in calculating value in use. Instead, an entity would be required to use internally consistent assumptions for cash flows and discount rates (see paragraphs BC215-BC222).*
- (a) *Do you agree with the proposal to remove the constraint on **including cash flows arising from a future restructuring** to which the entity is not yet committed or from improving or enhancing an asset's performance? Why or why not?*
- (b) *Do you agree with the proposal to **remove the requirement to use pre-tax cash flows and pre-tax discount rates** in calculating value in use? Why or why not?*

a) Proposal to remove the constraint on including cash flows arising from a future restructuring

From a conceptual point of view, we note that this proposal is not in line with the IASB's objective of counteracting management over-optimism. However, for reasons of practicability, we welcome the proposal that cash flows arising from a future restructuring to which the entity is not yet committed or cash flows arising from improving or enhancing an asset's performance should no longer be excluded from the calculation of value in use.

As a result, the differences between the value in use and the fair value less costs of disposal are reduced further. In our opinion, this is a good opportunity for the Board to review whether:

- it continues to make sense to adhere to the concept of the recoverable amount in IAS 36. If this continues to be the case, the IASB should point out again the significance and the remaining (conceptual) differences between the two types of values in order to promote a better understanding of the IAS 36 value concept amongst stakeholders.
- to switch to a single-value concept for reasons of further simplification and cost, i.e. to introduce either value in use or fair value less costs of disposal as the only comparative figure against the carrying amount in order to determine whether an asset or a cash-generating unit is impaired.

According to paragraph 44A of IAS 36, "cash flows associated with the *current potential* of an asset" are now included in the "*current condition*" of the asset (we refer to the first sentence of paragraph 44A(b) of IAS 36). In our view, it would be helpful to mention this in the first sentence of paragraphs 44 and 44A of IAS 36 also, in order to avoid possible misunderstandings of this requirement, because the "current potential" of an asset may not intuitively be considered in regard to its "current condition".

In general, we agree with the proposed new paragraph 44B(b) of IAS 36 which states that "estimates of future cash outflows for restructuring are excluded from the value in use calculation if those cash outflows are included in the restructuring provision in accordance with IAS 37". However, the proposed requirement is only appropriate if the provision for restructuring is not included in the carrying amount of the cash-generating unit. This is because, in our opinion, it is also acceptable if the entity decides to include both items. Normally, the result would hardly differ. Accordingly, we suggest the guidance in paragraphs 44B(b) and

76(b) of IAS 36 be amended to focus on the “like-for-like”-principle, which is also applicable to other cash flows.

b) Proposal to remove the requirement to use pre-tax cash flows and pre-tax discount rates

As already explained in our comments on the IASB Discussion Paper DP/2020/1 “*Business Combinations – Disclosures, Goodwill and Impairment*” (27 November 2020), we welcome the proposal to remove the requirement to use pre-tax cash flows and pre-tax discount rates in calculating value in use. In our view, the pre-tax requirement has proven ineffective. It is widely accepted, that, in the typical case of impairment testing on the level of a cash-generating unit, a pre-tax calculation is impossible because a market-based discount rate for a cash-generating unit cannot be determined on a pre-tax basis.

In this context, however, we would appreciate additional application guidance, particularly with regard to the treatment of deferred tax assets on tax loss carry forwards, to minimise the likelihood of different interpretations and support uniform application.

**Question 8: Proposed amendments to IFRS X Subsidiaries without Public Accountability: Disclosures**

The IASB proposes to amend the forthcoming **IFRS X Subsidiaries without Public Accountability: Disclosures** (Subsidiaries Standard) to require eligible subsidiaries applying the Subsidiaries Standard to disclose:

- information about the strategic rationale for a business combination (proposed paragraph 36(ca) of the Subsidiaries Standard);
- quantitative information about expected synergies, subject to an exemption in specific circumstances (proposed paragraphs 36(da) and 36A of the Subsidiaries Standard);
- information about the contribution of the acquired business (proposed paragraph 36(j) of the Subsidiaries Standard); and
- information about whether the discount rate used in calculating value in use is pre-tax or post-tax (paragraph 193 of the Subsidiaries Standard).

See paragraphs BC252-BC256.

Do you agree with the proposals? Why or why not?

We agree with the proposed consequential amendments to IFRS 19 *Subsidiaries without Public Accountability: Disclosures*. However, we would ask that the comments the IDW made in regard to the previous questions be taken into account accordingly.

**Question 9: Transition (proposed paragraph 64R of IFRS 3, proposed paragraph 140O of IAS 36 and proposed paragraph B2 of the Subsidiaries Standard)**

*The IASB is proposing to require an entity to apply the amendments to IFRS 3, IAS 36 and the Subsidiaries Standard prospectively from the effective date without restating comparative information. The IASB is proposing no specific relief for first-time adopters. See paragraphs BC257-BC263.*

*Do you agree with the proposals? Why or why not? If you disagree with the proposals, please explain what you would suggest instead and why.*

In general, the IDW agrees that the amendments to IFRS 3, IAS 36 and IFRS 19 should be applied prospectively from the effective date without restating comparative information.

As already mentioned in our answer to Question 6(a), the IASB should clarify whether the proposed amendments to IAS 36 in relation to the allocation of goodwill constitute substantive changes (i.e. an amendment) or merely clarifications. If the IASB intends to change practice substantially and the expected changes are really amendments, appropriate transition guidance should be provided. Furthermore, the Board could consider transition relief that would, for example, allow any change in the allocation of goodwill and any resulting impairment loss in prior periods to be recognised as an adjustment to opening retained earnings in the period in which the amendments are first applied without affecting the prior period.

Finally, we do not agree with the fact that the IASB has not proposed any specific relief for first-time adopters. As long as an entity's date of transition to IFRSs is before the effective date of the amendments proposed in this ED, first-time adopters of IFRSs would be subject to more stringent requirements than entities that already apply IFRSs. This is incomprehensible from a conceptual point of view. In addition, the Board's proposal not to provide specific relief for first-time adopters should also be rejected for cost reasons (we refer to the statements in paragraph BC259 of this ED).

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We would be pleased to answer any questions that you may have or discuss any aspect of this letter.

Yours sincerely,

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Financial & Sustainability Reporting

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