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21 December 2020

Re: DP Business Combinations—Disclosures, Goodwill and Impairment

Dear Jean-Paul,

We are pleased to have the opportunity to provide our comments on the EFRAG Draft Comment Letter on the IASB DP Business Combinations—Disclosures, Goodwill and Impairment (DP).

We welcome the IASB efforts to address the feedback received during the PIR of IFRS 3.
We agree that the DP responds to the overall objective that is to explore whether companies can, at a reasonable cost, provide investors with more useful information about the acquisitions those companies make. However, we are concerned that the DP is unbalanced, since is too much focused on the disclosures whilst it does not sufficiently address the issue related to the application of the impairment test and the debate around the re-introduction of the amortization of goodwill.
In relation to the proposals on the disclosures, we generally understand the need of users to have better information about the acquisitions but at the same time we cannot ignore the concerns of preparers to provide sensitive information. From the outreaches done with preparers the disclosures proposed by the IASB have been seen not only too burdensome but also almost impossible to being produced, with the difficulties to track the acquisition over the time.
We are not convinced by the arguments of the IASB that are listed in the DP to support the preliminary decision to retain the impairment only approach. We still consider that there are other arguments that should be further considered in order to revaluate the position on the reintroduction of the amortization. We suggest the IASB to further challenge its preliminary decision taking into account potential pro-cyclical effects, as presented to the IASB by some members of the ASAF, as well as the conceptual reasons for amortizing goodwill. We also believe that any proposals to simplify the impairment test without requiring the re-introduction of the amortisation of goodwill could increase the risk that impairment losses are not timely recognised. Consequently, we support the introduction of an indicator only approach only if this proposal is accompanied with the reintroduction of the amortization of goodwill.

Our detail comments are articulated in the appendix.

Should you need any further information, please do not hesitate to contact us.

Yours sincerely,
Angelo Casò
(Chairman)

Appendix

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 observe that following the PIR of IFRS 3 the IASB added, to its agenda, a research project on goodwill and impairment to address some of the feedback received. The research project has been updated during the years. In a first moment, the IASB explored whether it was possible to: make the impairment test more effective and less complex; improve the disclosures about impairment of goodwill and simplify separation of specified identifiable intangible assets acquired in a business combination. The IASB tried to design a different impairment test for CGU containing goodwill that was significantly more effective than the actual model at recognising impairment losses on goodwill on a timely basis and at a reasonable cost, however it concluded that was not feasible. In addition, the IASB considered to not have compelling evidence to permit or require some identifiable intangible assets to be included in goodwill.

Therefore, in 2018 the IASB revised the objective of the research project focussing on the following: a) Identifying disclosures to enable investors to assess management's rationale for the business combination and if the post-acquisition performance of the business combination meets expectations set at the acquisition date; b) simplifying the accounting for goodwill by permitting an indicator-only approach as to whether an impairment test is required and exploring whether to reintroduce amortisation of goodwill c) Improving the calculation of value in use by permitting cash flow projections that may include future enhancements to the asset and the use of post-tax inputs in the calculation of value in uses.

The result of the research project is a DP for which the overall objective is to explore whether companies can, at a reasonable cost, provide investors with more useful information about the acquisitions those companies make.

We appreciate the IASB's efforts to address the feedback received with proposals that allow users to have useful information about acquisitions and with proposals that try to simplify the application of the actual impairment test. However, we consider that the proposals present a number of limits, *that could give raise to other issues and do not respond to all the feedback raised during the PIR of IFRS 3 like the fact that the impairment test is not timely.*

We agree that the DP responds to the its overall objective. However, we are concerned about the fact that the DP is too focused on the disclosures and it does not sufficient address the issue related to the application of the impairment test. This is confirmed by the DP that states that the preliminary view on disclosures is central to its package of preliminary views, the overall aim of which is for companies to provide investors with better information about acquisitions and with a better understanding of the economics of these transactions.

Lastly, we consider that the DP does not address the guidance about the allocation/reallocation of the goodwill to the CGU(s) and does not sufficient discuss the separation of goodwill into components.

Our concerns on the single proposals are expressed below.

Question 2

Paragraphs 2.4–2.44 of the DP discuss the IASB's preliminary view that it should add new disclosure requirements about the subsequent performance of an acquisition Do you think those disclosure requirements would resolve the issue identified in paragraph 2.4 of the DP—investors' need for better information on the subsequent performance of an acquisition? Why or why not?

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 of the DP). 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 of the DP), rather than on metrics prescribed by the IASB.

(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 IASB should not require a company to disclose any metrics in such cases (see paragraphs 2.19–2.20 of the DP).

(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 of the DP).

(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 of the DP).

(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 of the DP).

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 of the DP)? 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?

Could concerns about commercial sensitivity (see paragraphs 2.27–2.28 of the DP) 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?

Paragraphs 2.29–2.32 explain the IASB'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 IASB 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?

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?

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?

Answer

As we noted above, proving better information to the users is central to the IASB DP. The IASB affirms that the proposed information would allow users to have more useful information on the business acquisition and their subsequent performance. This information would help users to assess management's ability to realise the expected benefits from an acquisition and to assess whether an acquisition's subsequent performance indicates that management paid a reasonable price for the acquired business. The proposed information allows users to assess management's stewardship of the company's economic resources.

We observe that the proposed information is based on management expectations and refers to non-GAAP indicators: according to the IASB proposal, a company disclosure about an acquisition's subsequent performance should reflect the information and metrics the company's management uses to monitor and measure the acquisition's progress against the objectives of the acquisition.

We consider that including this type of information in the notes to the financial statement could give rise to risks for both prepares and auditors because the information could be commercially sensitive, forward looking and difficult to verify. Therefore, we think that probably the better place to collocate this kind of information is in the management commentary.

We note that the FASB in its ITC issued in 2019 excludes the possibility to require information on the key performance targets supporting an acquisition and information about performance against those targets for several years after the acquisition because of concerns about: cost, complexity of integration and the forward-looking information nature of this information.

We appreciate the effort of the IASB to improve the information about the acquisitions described in the DP to answer to the needs of the users. We consider that the new information could be useful for them. However, we believe that the IASB should not ignore the concerns of preparers to provide *sensitive information. Moreover, from the outreaches done with preparers the disclosures proposed by the IASB has been seen not only too burdensome but also almost impossible to being produced, with the difficulties to track the acquisition over the time. For the reasons mentioned above we believe that the better place to include the new information proposed is the management commentary. However, a second-best solution could be to include in the financial statements only the information based on financial metrics and to include in the management commentary the other information based on Non-Gaap measures and on management assumptions.*

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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 of the DP explain the IASB's preliminary view that it should retain the requirement for companies to prepare this pro forma information.

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

(b) Should the IASB develop guidance for companies on how to prepare the pro forma information? Why or why not? If not, should the IASB 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 of the DP explain the IASB'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 IASB's preliminary view? Why or why not?

Answer

Overall, we see merits in the preliminary view of the IASB.

Question 6

As discussed in paragraphs 3.2–3.52 of the DP, the IASB 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 IASB'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 IASB 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 of the DP 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 IASB 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 goodwill cannot be measured directly and is measured as a residual. Goodwill can only be tested for impairment as part of a cash-generating unit to which goodwill is allocated.

We agree that the shielding effect and the over-optimism of the management are the principal reasons for the so-called too little too late issue. We concur with the consideration of the IASB that obviously this issue is considered by auditors and regulators, however we note that both auditors and regulators may not be in the conditions to challenge the business assumptions of the management and therefore that it could result, in facts, to a late impairment being recognised.

As we noted in question 1, the IASB during the last years tried to make the impairment test more effective to avoid the so called "too little too late". The IASB developed the headroom approach with the objective to mitigate the buffering effect of the internal generated goodwill and of other items included in the CGU. However, the headroom approach presented a number of limits and the IASB concluded that it is not feasible to significantly improve the effectiveness of the impairment test of goodwill at a reasonable cost. Other attempts were made in the years by EFRAG (2017) and EFRAG/OIC/ASBJ (2014) to make the impairment test more effective but all these attempts were abandoned.

Taking into account this consideration, we agree that it is not feasible to make the impairment test more effective in recognising the impairment losses in a timely basis at reasonable costs.

However, such a conclusion does not imply that the IASB should not intervene on other areas to make the impairment test more effective. For example, we observe that IASB decided not to add guidance on identifying cash-generating units and on allocating goodwill to cash-generating units because it would be difficult to provide guidance on identifying cash-generating units. It seems that the actual guidance on the application of goodwill in some case is difficult to apply with the consequence that often entities allocate goodwill to an operating segment. The IASB did not even consider the possibility to develop more guidance on goodwill allocation to divested businesses and reorganisations. This is a critical area of the impairment test.

However, we consider that these proposals will be more relevant if the IASB decides to not reintroduce the amortization of goodwill.

Question 7

Paragraphs 3.86–3.94 of the DP summarise the reasons for 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.
(a) Do you agree that the IASB should not reintroduce amortisation of goodwill? Why or why not? (If the IASB 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?

We disagree 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 for the following reasons.

From a conceptual perspective we observe that the current IFRS Standards only allow the recognition of the acquired goodwill and prohibit the recognition of the internally generated goodwill. However, the impairment test only approach allows internally generated goodwill being recognised implicitly replacing acquired goodwill that has been consumed. This means that an entity that grows through acquisitions could implicitly recognise internally generated goodwill in contrast with IFRS.

In terms of impact, we note that under the impairment only approach goodwill entities could recognize significant losses in economic downturns. We acknowledge that generally users ignore this type of impairment losses in their valuation but the recognition of relevant losses could have negative impact on other aspects for an entity, for example on the capital requirements. In such cases the recognition of impairment losses could give rise to pro-cyclical effects.

Another aspect to consider is that under the current approach, in period of economic upturn, the management could be incentivized to acquire businesses for higher prices (moral hazard). This is because the cost of the acquisition does not affect the PL after the acquisition. The higher prices paid will impact the PL later maybe in economic downturn.

We consider that the amortization could mitigate these concerns. The amortization allows to recognise the consumption of the goodwill to PL and to distribute the consumption PL over time, this reduces the impact to PL and the pro-cyclical effects. In addition, we observe that the European entities that apply the accounting directives amortize goodwill and also the entities that apply the IFRS for SMEs amortise goodwill. Therefore, a relevant number of entities, maybe of smaller dimension compared to IFRS adopters, amortise goodwill and estimate in a reasonable way the useful life of the goodwill. For example, a better understanding of what composes goodwill is some circumstances could help in determining the useful life of goodwill. We have an experience on applying National GAAP that we would be happy to share with the IASB.

Question 8

Paragraphs 3.107–3.114 of the DP explain the IASB'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 IASB 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 IASB develop such a proposal? Why or why not?
(b) Do you have any comments on how a company should present such an amount?

Answer

We understand that when the amount of goodwill represents a significant proportion of the total equity, having the information about the amount of total equity excluding goodwill could be useful however, we do not support this proposal.
According to IAS 1 when the amount of goodwill is material it is already presented in a separate line on the balance sheet as part of intangibles. In addition, the ED General Presentation and Disclosures issued by the IASB requires goodwill to be presented as a separate line item on the balance sheet. Therefore, users that need this information can find it when the goodwill is presented separately.

Question 9
Paragraphs 4.32–4.34 of the DP summarise the IASB'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 IASB develop such proposals? Why or why not? (b) Would such proposals reduce costs significantly (see paragraphs 4.14– 4.21 of the DP)? 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 of the DP)? Why or why not?

Answer

We welcome the efforts of the IASB to reduce the cost of making the impairment test.
We acknowledge that in some circumstances to the impairment test is costly, time consuming and it does not give raise to any real practical benefit.
We believe that any proposals to simplify the impairment test without requiring the re-introduction of the amortisation of goodwill could increase the risk that impairment losses are not timely recognised. Consequently, we support the introduction of an indicator only approach only if this proposal is accompanied with the reintroduction of the amortization.

Question 10

The IASB's preliminary view is that it should develop proposals:
(a) 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 of the DP); and
(b) 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 of the DP).
The IASB expects that these changes would reduce the cost and complexity of impairment tests and provide more useful and understandable information.
(c) Should the IASB develop such proposals? Why or why not?
(d) Should the IASB 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.

Answer

We do not support the proposals of including the cash flows arising from a future uncommitted restructuring, or from improving or enhancing the asset's performance in the value in use. We are concerned that this proposal would result in a change of the structure of IAS 36 and would result in a greater alignment between FV and VIU. However, a guidance may be needed to better understand which improvements have to be considered and which don't.
Instead, we support the proposal to allow companies to use post-tax cash flows and post-tax discount rates in estimating value in use. We think that this proposal is in line with the current practice.

Question 11
Paragraph 4.56 of the DP summarises the IASB's preliminary view that it should not further simplify the impairment test.
(a) Should the IASB develop any of the simplifications summarised in paragraph 4.55? If so, which simplifications and why? If not, why not?
(b) Can you suggest other ways of reducing the cost and complexity of performing the impairment test for goodwill, without making the information provided less useful to investors?

We agree with the IASB's preliminary view to not develop the proposal including in paragraph 4.55 a)-c). However, we consider that the IASB should explore the possibility to add further guidance on allocating goodwill to cash-generating units in order to make more effective the application of the impairment test.

Question 12
Paragraphs 5.4–5.27 of the DP explain the IASB's preliminary view that it should not develop a proposal to allow some intangible assets to be included in goodwill.
Do you agree that the IASB should not develop such a proposal? Why or why not?
(a) If you do not agree, which of the approaches discussed in paragraph 5.18 should the IASB 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?
(b) Would your view change if amortisation of goodwill were to be reintroduced?
Why or why not?

Answer

We agree with the IASB's preliminary view that it should not permit or require some identifiable intangible assets to be included in goodwill.
We understand the issue that in some circumstances the separate recognition of the intangible assets is perceived complex and judgemental and that it could be appropriate to separate only the intangible assets that meet the contractual legal criteria.
However, we consider that including some intangible assets into goodwill could be inconsistent with the always greater request of evidence of intangible assets. Moreover, the inclusion of intangible assets into goodwill, without reintroducing the amortization of goodwill would lead to a loss of information about the consumption of those intangible assets and could increase the shielding effect.

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 of the DP summarise an Invitation to Comment issued by the US Financial Accounting Standards Board (FASB).
Do your answers to any of the questions in the DP 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?

Aswer

We suggest that the two Boards work together to ensure that the system of accounting rules is as aligned as possible.

Question 14
Do you have any other comments on the IASB's preliminary views presented in the DP?
Should the IASB consider any other topics in response to the PIR of IFRS 3?

We observe that the IASB does not consider the possibility of separating goodwill into components. Whilst we concur that such a separation may imply complexities, we note that a part of the excess of the fair value over the book value of the acquiree's net assets at the date of acquisition refers to the recognition of deferred taxes according to IAS 12. Therefore, it may be considered to evaluate the amortization of this component of goodwill during the same period in which the related deferred tax liabilities reverse in PL. Indeed, this portion of goodwill is only due to an accounting mismatch arising from the fact that deferred taxes are required to be measured in accordance with IAS 12, instead other asset and liability acquired in a business combination are measured at fair value.