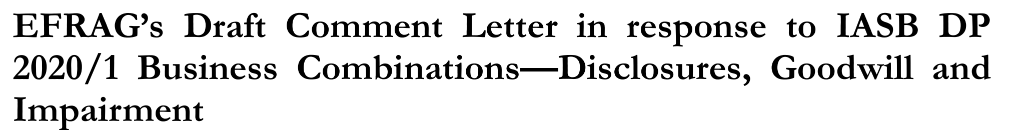
POSITION PAPER



EFRAG's Draft Comment Letter in response to IASB DP 2020/1 Business Combinations—Disclosures, Goodwill and Impairment

ESBG (European Savings and Retail Banking Group)

Rue Marie-Thérèse, 11 - B-1000 Brussels

ESBG Transparency Register ID 8765978796-80

November 2020

ESBG

ESBG welcomes the opportunity to comment on the EFRAG´s Draft Comment Letter in response to IASB DP 2020/1 Business Combinations—Disclosures, Goodwill and Impairment issued on 19 March 2020 (the 'DP').

Below you will find our answers as well as comments to some of the questions raised in both the Draft Comment Letter and in the DP itself, however we would like to draw EFRAG attention first to the following key messages:

- ESBG supports the objective of the DP to explore whether companies can, at a reasonable cost, provide investors with more useful information about the acquisitions those companies make. However, we are unable to agree with the IASB in what appears to be the intention to undertake a generalised implementation of standardised solutions without proper consideration of the current status quo. We question whether the IASB's preliminary views can bring any added value to highly regulated sectors, such as the banking sector, precisely from a cost/benefit perspective and, therefore, if a modification of the approach would be needed.
- As it is evidenced by the acquisitions made over the last years within the banking industry, companies involved are punctually disclosing to the market information about the strategic rationale, management's objectives, benefits, synergies (description, timing and amount), etc. This information is easily available to the public and is also submitted to local and non-local regulators and supervisors.
- We cannot agree, either, with the need for better information on the subsequent performance of an acquisition if referred to banks, considering the ongoing economic-financial information given nowadays (e.g. quarterly results, Pillar 3 reports, EBA transparency exercises, etc.) that, in our opinion, allow investors to assess if objectives are being met. In this context, there is hardly an industry where the companies' management are held more accountable than the banking industry.
- Based on the above, it could be argued that the vast majority of banks are already compliant with the disclosure requirements included in the DP and are fulfilling investors' expectations. Placing this information in the notes of the financial statements (or management commentary) would add complexity and unnecessary costs. We would expect greater flexibility in this matter.
- Regarding goodwill amortisation we note that the Board's objective is to decide whether there is compelling evidence that its reintroduction would significantly improve the information provided to investors. We are not in a position to present new practical or conceptual arguments, nor evidence for these arguments, to justify changes in IFRS Standards. If amortisation were to be reintroduced, we would expect a retrospective application aligned with the local regulation.
- Furthermore, we acknowledge that the impairment test is complex and costly (but not too complex and too costly). We share IASB's views that the often-mentioned management over-optimism about future cash-flows is being addressed by auditors and regulators but also by robust internal control systems and governance. We do not share that EFRAG's proposals included in the Draft Comment Letter (paragraph 139) could provide more transparency and more discipline. Instead companies would incur additional costs and the benefits would be limited. As a request focused on the banking sector, we believe that adding guidance on the target of the cost of capital could result in a more effective application of the impairment test.
- Finally, we do not agree with the IASB's proposals to present goodwill deducting from equity – for information purposes – neither with the approach to include some intangible assets within goodwill. It should be noted that, under the current prudential framework for the financial sector, goodwill treatment differs from the treatment of other intangible assets. Changing the range of identifiable intangible assets recognised separately from goodwill in an acquisition would create a significant prejudice for banks and other financial entities.

Section 1 – Introduction

Question 1

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

The IASB 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 IASB is of the view that the benefits of providing that information would exceed the costs of providing it.

Do you agree with the IASB'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?

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 IASB reintroduces amortisation of goodwill? Which of your answers depend on other answers and why?We would not expect a significant impact if the requirement for a company to perform an annual impairment test was to be removed but, on the other hand, it could be a reason for concern due to the expertise in performing the test would be likely to decline.

Section 2—Improving disclosures about acquisitions

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?

We can understand investor's need to have information about the subsequent performance of an acquisition, however, we do not share how this issue is addressed in the DP and we are concerned about some of the preliminary views being proposed.

In a regulated sector, such as the banking sector, subject to a high level of scrutiny, there are to this day several information tools and channels at investor's disposal that allow them to assess effectively the performance of banks after corporate operations of this kind. The ongoing information of key indicators and metrics on solvency, profitability, liquidity, but also on the business itself (market share, mix of products, digital capacities, etc.) are provided periodically in the form of regulatory reports, events (e.g. webcast with analyst) and through the bank's own publications.

Additionally, in view of the developments in the sector over the past decades (i.e. 2008 crisis, negative interest rates, frequent litigation, covid-19, etc.) it does not appear to be accurate to conclude that the new disclosure requirements included in the DP will be by themselves sufficient to confirm whether the price of an acquisition was reasonable and whether an acquisition has been successful.

On top of that, based on the experience of one of our members in recent acquisitions, it is certainly not straightforward for companies to isolate and measure the initial objectives (as it would appear the DP proposes) in order to inform about their degree of fulfillment, without taking into account operational issues - IT systems integration - and other variables and unexpected events as the ones commented previously. Companies might find themselves in a position to carry out estimates or judgements to assess if those objectives are met - in particular, when time passes from the acquisition date -, calling into question the comparability of this information between companies.

The own nature of the concepts addressed (cost savings, revenue attrition, etc.) may also prevent companies, from a commercial sensitivity standpoint, to disclose some of the information investors require.

For all the aforementioned reasons, we would oppose to the IASB's proposal to add new disclosure requirements to a banking sector which currently provides information overload in most cases and, particularly, we would disagree to place this and other information in the notes of the financial statements.

The primary objective of the project 'at a reasonable cost' would not be met in our industry, as some of these changes would add complexity and unnecessary costs, while benefits would be very limited. A certain degree of discretion or flexibility should be given, provided that the information would be easily available to the market, as it is now.

Finally, if companies were required to provide this information, we would agree that it should be based on the information and the acquisitions a company's CODM reviews, on the understanding that each and every acquisition that has a significant and material impact in the company are monitored at that level and, thus, are the acquisitions that investors should be informed about.

Questions for EFRAG's constituents

As stated above, EFRAG considers that the disclosures proposed in the DP could provide useful information. EFRAG has, however, not yet formed a view on whether the financial statements are the right place to disclose information about the performance of an acquired business compared with management expectations. Among other things, it might be difficult to audit the information if Standards do not provide guidance on how the non-GAAP metrics should be determined.

(a) Do you agree with the IASB's proposal to include the proposed information in the notes to the financial statements? Why/why not? If you disagree with the IASB, do you think it could be included in the management commentary?

(b) Do you think that the specific information would be more useful, relevant and/or reliable, if it is audited?

(c) Do you think it would be possible to audit the information/prepare the information in a manner that would make it possible to audit it?

Paragraph 42 above states that EFRAG expects that the requirement to disclose that an entity is not monitoring an acquisition could create a market discipline. If you are a user of financial statements, how would it affect your analysis if you receive information that an entity is not monitoring a significant acquisition?

The IASB considers that it is possible to disclose useful information on the level of achievement of the financial or non-financial targets initially defined at acquisition date and of expected synergies (see Question 4 below), without triggering commercial sensitivity. EFRAG is interested in understanding whether constituents agree with this approach and would like to receive practical examples in this regard.

Would there be any constraints within your jurisdiction that could affect an entity's ability to disclose the information proposed in the DP? If so, what are those constraints and what effect could they have?

As stated above, we cannot be in favour of including this information in the notes of the financial statements from a cost/benefit perspective as we do not share the view that it would be more useful, relevant or reliable if audited.

It must be acknowledged that before the information on an acquisition within the banking sector is published, it goes through a robust internal governance approval process and it is usually shared and discussed with banking regulators and supervisors. The information is submitted to the national stock market regulators as well. Audit would create unnecessary costs (economical and in terms of time-consuming discussions), would add complexity and the benefits would be limited. Including this information in the management commentary would not be make such a great difference.

Leaving aside the topic of commercial sensitivity, which could be an issue of concern and should be appropriately addressed, we concur with the idea that providing this information outside the financial statements would reduce the risk of litigation.

Question 3

Paragraphs 2.53–2.60 of the DP explain the IASB'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:

(a) the benefits that a company's management expected from an acquisition when agreeing the price to acquire a business; and

(b) the extent to which an acquisition is meeting management's (CODM's) objectives for the acquisition.

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

We agree with the IASB's preliminary view about the usefulness of providing this information to investors, but we understand that an alternative approach to this issue should be considered in relation to highly regulated sectors, such as the banking sector.

At present, banks inform about the management's specific objectives for an acquisition to the market as at the acquisition date. The requirement to include that information in the notes of the financial statements would provide limited benefits and would increase costs, so we would expect more flexibility in this regard.

Moreover, as explained above, companies usually find technical and operational challenges to monitor whether an acquisition is meeting managements objectives, therefore we are not convinced about the suitability of this proposal.

Lastly, we would like to provide some comments on arguments used in the DP that have caught our attention:

- The first of these is that, by means of the new disclosure requirements, management will be held (more) accountable when making a corporate operation of this kind and greater care and diligence will be taken as a consequence of the pressure that implies having to report on the subsequent performance of that acquisition. We cannot under any circumstances share this vision, basically for two reasons: (i) exaggerated influence given to disclosures in the financial statements when, at present, there are other mechanisms to verify the performance of a company and its top management (ii) shareholders, internal governing bodies, supervisors and regulators continually evaluate the level of competence of the management of an entity in aspects a lot wider than corporate acquisitions. Not taking this into account would diminish the importance of the current regulation and policies on corporate governance.

- In relation to the 'reasonable price' concept and its impact in the banking sector, the DP should not give the impression that 'reasonable' is the price that generates less goodwill, with the risk of linking the payment of a non-reasonable price with benefits for the entity. As per the current prudential treatment, goodwill is deducted from CET1 capital, so it can no longer be understood that banks obtain a clear advantage derived from its recognition.

Question 4

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

(a) to require a company to disclose:

> (i) *a description of the synergies expected from combining the operations of the acquired business with the company's business;*
>
> (ii) *when the synergies are expected to be realised;*
>
> (iii) *the estimated amount or range of amounts of the synergies; and*
>
> (iv) *the expected cost or range of costs to achieve those synergies; and*
>
> *(b) to specify that liabilities arising from financing activities and defined benefit pension liabilities are major classes of liabilities.*
>
> *Do you agree with the IASB's preliminary view? Why or why not?*

We agree with the IASB's preliminary views that it should develop proposals to require companies to disclose information on synergies expected from acquisitions (description, timing, amounts, etc.). In this sense, it must be stressed that this is already the common practice within the banking sector.

It should be borne in mind that before this information is communicated to the market, it goes through an exhaustive approval process (internal and external) which guarantees the reliability of the figures presented and, nowadays, is easily available to the general public.

We would like to note, however, that its nature, the process to identify and calculate them, may include forward-looking statements, projections, objectives, estimates and forecasts which involve known and unknown risks, uncertainties and other factors, which may cause actual results, performance or achievements of a company to be materially different from those expressed or implied by these forward-looking statements.

These forward-looking statements are based on numerous assumptions regarding company's present and future business strategies and the environment in which the company expects to operate in the future, which may not be fulfilled. Due to such uncertainties and risks, investors are always cautioned not to place undue reliance on such forward-looking statements as a prediction of actual results.]

In addition, as per our knowledge on previous and current business combinations, there is not a single definition on how a synergy should be estimated. Increasing the comparability between companies will therefore be more complex to achieve.

Based on the above, in the banking sector case, we question about the usefulness and appropriateness of including this information within the notes of the financial statements from a cost/benefit perspective. We would welcome certain room of manoeuvre to maintain the current situation.

> ***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?

We agree with IASB's preliminary view that it should retain the requirement for companies to prepare pro forma information in the year of acquisition. However, the IASB may provide alternatives, which could work for preparers from a cost/benefit perspective when preparing current disclosures, by allowing to disclose the revenue and profit or loss of the acquiree for the period before the acquisition date, instead of this pro forma information.

Questions for EFRAG's constituents

In paragraph 85 above, the preliminary view of EFRAG is reflected that pro forma information should be presented in the notes to the financial statements on revenue and a profit measure (see paragraphs 88 - 93) of the combined business for the current reporting period, as though the acquisition date had been as of the beginning of the annual reporting period. Do you agree with EFRAG's preliminary view to retain such a requirement? If not, please explain.

In paragraph 95 above, EFRAG questions the usefulness of disclosing 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. Would you find the suggested information useful? Please explain.

As a next step in this project, the IASB intends to investigate whether it could remove any of the disclosure requirements from IFRS 3 without depriving investors of material information (IASB DP Paragraph 2.88).

Do you have specific input on this topic?

We agree with EFRAG's preliminary view that it should retain the requirement for companies to prepare pro forma information as though the acquisition date had been as of the beginning of the annual reporting period. However, please see our comments in the previous question. In addition to this, we support EFRAG's questions on the usefulness of disclosing 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. We do not see any benefit in that proposal if applicable to the banking sector.

Question to preparers: costs of the disclosure (ref. Questions 2 to 5)

As mentioned in paragraph 89 above, EFRAG is unsure about how costly it will be to prepare disclosures on how performance figures would have been without the effects of the purchase price allocation (including revaluation to fair value of most of the acquired business' assets and liabilities). Do you assess that this information would be costly to preparer? Please explain.

As mentioned in paragraph 89 above EFRAG seeks input on the costs to prepare the information about 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, in particular when the acquired business is fully integrated and does not prepare separate accounts.

In general (ref. to Questions 2 to 5): EFRAG is also interested in receiving preparers' inputs on the operational implications (e.g. quality of data, internal control and auditability) of these disclosures and their costs.

We consider the current requirements on business combinations to be sufficient and for this reason we might not agree with the proposal to prepare disclosures on how performance figures would have been without the effects of the purchase price allocation. We are uncertain about the additional benefits this information would provide to investors and, on the contrary, from a preparer's perspective, ad-hoc disclosures not used by the management in its daily activities implies unnecessary costs. Such information may not be in the operational IT systems of the acquirer, therefore it could be very complex and costly to obtain.

We understand that the information about cash flows in the banking sector is of limited relevance. We would not support further requirements from a cost/benefit perspective.

Section 3— Goodwill impairment and amortisation

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?

Overall, we are of the opinion that the impairment test is complex and costly (but not too complex and too costly). It requires a high degree of expertise, several departments within an entity are involved in the exercise and some elements of the calculation are a source of discussion (e.g. estimating the projections not included in approved budget).

Having said that, we 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 or, at least, we do not have the arguments to backup changes that would make this test significantly more effective.

Even though we understand concerns on management over-optimism, we do believe, sharing IASB's views, that this issue is addressed by auditors and regulators. Furthermore, the banking sector follows best market practice in terms of reviewing and approving procedures: among other questions, 3-year

projections are aligned with the information sent to regulators (e.g. ICAAP) and first year back-testing is shared with internal governing bodies and supervisors.

Questions for EFRAG's constituents

Do you agree that the IASB should consider improving guidance on allocation and reallocation of goodwill to cash generating units as this would improve the discipline in the application of impairment testing in practice? Do you see such improved guidance in connection with better information about business combinations as a basis for a better assessment on whether there is any indication for impairment?

Do you think that the benefit from changing such guidance would outweigh costs? Would there be significant additional costs?

Do you agree with the IASB's view that management over-optimism is best addressed by auditors and regulators, not by changing IFRS Standards? Please explain why.

To address management over-optimism, EFRAG suggests that the IASB considers developing possible disclosure solutions for a better transparency of the estimates made or their achievement. EFRAG considers that the possible approaches below, or a combination of them, could provide more transparency and more discipline in relation to being over-optimistic by the management. Such a requirement will allow users to make a better assessment of the estimations made by management to calculate the recoverable amount. EFRAG notes that such possible requirements could help in identifying events that trigger impairment. Furthermore, as a consequence of being generally overoptimistic over a certain period (e.g. five years) impairment test or additional disclosure requirements (like disclosing recoverable amount calculated on actual basis) could be discussed. Therefore, EFRAG is asking constituents' view on the usefulness and practicability of the following suggestions:

(a) Historical estimations to allow assessment of over-optimism

Similar to the disclosure requirements suggested in the DP addressing whether objectives of acquisitions have been met, a disclosure requirement could be introduced on how the management's cash flow predictions differ from the obtained cash flows. This could make it transparent whether the management is over-optimistic. Most useful in this regard would be assessment of target achievement on a mid-term basis for more than the respective preceding year (e.g. assessment of the last prior three years of the mid-term assumptions by comparing projections to the actuals achieved). Such information about achievement of prior projections could be given on a qualitative or quantitative basis.

(b) Improve information on assumptions over the period for which management has projected cash flows based on financial budgets

Another possible approach could be to improve the usefulness of the mid- term period information as required by IAS 36 paragraphs 134(d)(ii) or 134(e)(ii) as the recoverable amount is driven by assumptions taken to reach a terminal value. According to IAS 36 paragraph 134, an entity has to provide information about the method of estimation of cash flows but not the specific growth rate within the period over which management has projected cash flows based on financial budgets/forecasts. Such growth rate has to be specified only for the terminal value. Requiring disclosure of how the growth rate in the terminal value compares to the current growth rate (e.g. increased by 30%) or to disclose the level of profit margin applied when going into the terminal value could make management estimations transparent and allow users to make their own judgement, especially as such a level of cash flows reached forms the basis of the terminal value and thus the major part of the recoverable amount of the CGU.

(c) Current level of cash flows/margins or earnings

Lastly, a requirement could be introduced to provide quantitative information of the present performance, present relevant margins or current cash flows and therefore give information to the users to do

estimations and projections themselves. That information could be used to assess whether a recoverable amount is in question and to give transparency to estimation uncertainty. Furthermore, this approach would avoid any discussion about disclosing forward looking information.

Do you consider additional disclosures in relation to estimates used to measure recoverable amounts of cash-generating units containing goodwill is necessary as suggested above? Could those suggested disclosures provide more transparency and more discipline in relation to being over-optimistic by the management? If so, which option in paragraph 139 do you consider best addressing the management over-optimism issue and provide more transparency and more discipline:

(a) achievement of previous estimations (make over-optimism transparent);

(b) information on assumptions related to the period for which management has projected cash flows based on financial budgets;

(c) to disclose the current level of cash flows/earnings to allow users to model themselves.

Do you consider that the options listed are feasible and practicable for prepares and provide useful information for users? Please explain your response and explain whether you prefer a combination of them, or whether you consider that other qualitative information could be required.

Do you consider it necessary to introduce consequences like discussed in paragraph 120 for those that are generally overoptimistic?

We cannot share EFRAG's view and approach to address management over-optimism, as it is assumed that management fails on discipline when performing the impairment test. The specific suggestions would imply that to disclose information will be difficult to prepare and highly sensitive, so we would expect companies to be reluctant to provide the suggested disclosures.

In any case, it seems somehow contradictory that some of the arguments used by certain stakeholders to place new disclosure requirements in the notes of the financial statements, in the sense that they could be more useful, relevant and/or reliable if audited, have been disregarded in relation to over-optimistic projections within the impairment test.

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?*

Regarding goodwill amortisation, we note that the Board's objective is to decide whether there is compelling evidence that its reintroduction would significantly improve the information provided to investors. We are not in a position to present new practical or conceptual arguments, nor evidence for these arguments, to justify changes in IFRS Standards.

As per the current prudential treatment, goodwill is deducted from CET1 capital, so no difference in the solvency of the banking sector could be expected if the current impairment only model was replaced.

If amortisation were to be reintroduced, we would expect a retrospective application aligned with some local GAAP already applied to separate financial statements to achieve consistency and lead to comparable figures under different accounting frameworks.

Questions for EFRAG's constituents

EFRAG would welcome constituents' views and arguments to the IASB questions listed in Question 7 of the DP. EFRAG is particularly interested in learning whether any new evidence, new arguments or new assessments of the existing evidences have emerged since 2004.

When looking for new evidence and impact analyses, EFRAG invites you to also refer to other areas of regulation that may provide indirect incentives to prefer one or the other approach, such as tax deductibility of goodwill or prudential treatment of goodwill in case of regulated entities.

Two of the different arguments in favour of amortisation included in paragraphs 156 and 159 above are that:

(a) Goodwill is a wasting asset; and

(b) Goodwill is an accounting construct, which is not useful to have on the statement of financial position.

Do you think that goodwill (or some of the parts goodwill consists of) is (are) a wasting asset(s)? Do you consider goodwill to be an accounting construct that it is not useful to have recognised in the statement of financial position? Please explain.

Paragraph 163 states that goodwill impairment losses are often added back when entities are presenting "underlying profit" (or similar non-GAAP measures). If amortisation were to be reintroduced, do you think that companies would adjust or create new management performance measures to add back the amortisation expense? Why or why not?

If amortisation is not reintroduced, do you consider that it would be useful to require companies to disclose information about the "age" of goodwill to reflect which part of their goodwill is older (and thus, by some is considered to be less relevant)?

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?

We do not share IASB's proposal to disclose on the balance sheet a subtotal of equity excluding goodwill as we believe that it would be more harmful and misleading than beneficial.

Section 4—Simplifying the impairment test

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?

From a cost perspective, we would not expect significant savings if the requirement to perform a quantitative impairment test every year were to be removed. Even when there was no indicator of impairment we believe we would keep performing this exercise either due to internal control or managerial reasons, external audit request, etc.

The arguments we find against this proposal is that we do not only envisage a decline in the expertise of the company when performing the test, but also the whole process would suffer in terms of data collection and internal organisation, so this exercise could become more complex.

Question to constituents

EFRAG has illustrated in the paragraphs above the implications of and concerns about the adoption of an indicator-only approach. The IASB has received the feedback that the impairment test is considered to be complex by many preparers. Accordingly, some stakeholders considered that if companies do not perform an impairment test regularly, their expertise in performing the test is likely to decline. Thereafter, it could be difficult for preparers to execute the complex test in a situation where impairment is triggered. This could further reduce the effectiveness of the impairment test and the confidence in the reliability of the test. Do you agree with this feedback and with the concerns expressed above? If so, what measures could be taken to mitigate this issue? If not, why not and how audit evidence is reached without a yearly impairment test?

See response above.

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.

We support IASB's preliminary views to develop proposals to remove the restriction 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 - and to allow companies to use post-tax cash flows and post-tax discount rates in estimating value in use.

In our opinion both changes do reduce the cost and complexity of the impairment test.

Questions for EFRAG's constituents

The DP suggests removing the restriction that prohibits companies from including cash flows arising from a future uncommitted restructuring, or from improving or enhancing the asset's performance. Do you think that there are other cash flows (inflows and outflows) that should also be allowed to be included in the value in use calculation (e.g. cash flows from investments that could increase the production capacity for a group of assets that are part of the same cash generating unit)?

Post-tax input for the calculation of value in use of a cash generating unit might, unless otherwise specified, take into account items such as unused tax loss carry- forwards which would not meet the criteria for recognition under IAS 12 Income Taxes (and would accordingly not be included in the carrying amount of a cash generating unit). Potentially this could result in a goodwill impairment loss not being recognised when post-tax inputs are used, that would have been recognised had pre-tax inputs been used. Do you consider this risk to be significant? Do you think that it should be explicitly required that when post-tax inputs are used, this input should be aligned with the principles of IAS 12? Do you think there are other ways to deal with the issue?

In addition to the issue described above in paragraph 218, do you think that there are other issues or risks that could arise from the use of post-tax inputs in the value in use calculation?

In order to reduce complexity and risks derived from these changes, we would not oppose to further guidance to avoid double counting of tax cash flows in estimates of value in use.

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?

Section 5—Intangible assets

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?

We agree with the IASB's preliminary view to not develop a proposal to allow some intangible assets to be included in goodwill. Considering recent changes on the prudential treatment of some intangible assets (software), proposals in another direction would create a relevant prejudice for the banking sector.

Question to constituents that are users of financial statements

Would you be in favour of including some of the intangible assets acquired in a business combination that are currently recognised separately in goodwill?

(a) If yes, under which circumstances would you include in goodwill, intangible assets acquired in a business combination that are currently recognised separately?

(b) If no, how do you currently use the information about intangible assets acquired in a business combination that are currently recognised separately?

We would not be in favour of including in goodwill some of the intangible assets acquired in a business combination which are currently recognised separately. From a banking sector perspective, recognition criteria does affect the prudential treatment of those intangible assets, so therefore any changes should be carefully assessed in order to avoid unintended consequences.

Section 6—Other recent publications

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?

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?

Questions for EFRAG's constituents

Effects of deferred tax liabilities and other tax implications

Paragraph 19 of IAS 12 states that "[w]ith limited exceptions, the identifiable assets acquired, and liabilities assumed in a business combination are recognised at their fair values at the acquisition date. Temporary differences arise when the tax bases of the identifiable assets acquired, and liabilities assumed are not affected by the business combination or are affected differently. For example, when the carrying amount of an asset is increased to fair value but the tax base of the asset remains at cost to the previous owner, a taxable temporary difference arises which results in a deferred tax liability. The resulting deferred tax liability affects goodwill."

This means that a portion of goodwill may result from the effects of deferred tax liabilities. This portion of goodwill does not represent the "core goodwill", i.e. the fair value of the going concern element of the acquiree's existing business and the fair value of the expected synergies and other benefits from combining the acquirer's and acquiree's net assets and businesses (see BC313-BC318 of IFRS 3). This portion of goodwill is only due to an accounting mismatch arising from the fact that deferred taxes are not recognised at fair value in business combinations.

It may be argued that, after the business combination, the portion of goodwill resulting from the effects of deferred tax liabilities should be reduced over time (i.e. reversed to P&L) to reflect the reduction of the deferred tax liabilities that originated that portion of goodwill.

Is the portion of goodwill resulting from the effects of deferred tax liabilities significant compared with the goodwill recognised in your financial statements/in your jurisdiction (e.g. >10% of recognised goodwill)?

Would you support a change in the goodwill accounting (along the lines of paragraph 260 above), such that the portion of goodwill resulting from the effects of deferred tax liabilities, is subsequently measured at an amount that reflects the deferred tax liabilities that originated that portion of goodwill? Please explain. The IASB is proposing in this DP to allow for the adoption of post-tax inputs for the calculation of the value in use. How would such a proposal interact with the issue described in the above paragraphs (i.e. goodwill originated by an accounting mismatch due to effect of deferred tax liabilities? Please explain.

Would you anticipate other tax implications from the proposals in the DP?

Reversal of goodwill impairment losses

Should the IASB consider introducing reversal of goodwill impairments in general and specifically in the case of impairment losses recognised in an interim period (see paragraphs 255-257? If yes, please specify why and under which circumstances.

About ESBG (European Savings and Retail Banking Group)

ESBG represents the locally focused European banking sector, helping savings and retail banks in 21 European countries strengthen their unique approach that focuses on providing service to local communities and boosting SMEs. An advocate for a proportionate approach to banking rules, ESBG unites at EU level some 900 banks, which together employ more than 650,000 people driven to innovate at roughly 50,000 outlets. ESBG members have total assets of €5.3 trillion, provide €1 trillion in corporate loans (including to SMEs), and serve 150 million Europeans seeking retail banking services. ESBG members are committed to further unleash the promise of sustainable, responsible 21st century banking. Our transparency ID is 8765978796-80.

European Savings and Retail Banking Group – aisbl
Rue Marie-Thérèse, 11 ▪ B-1000 Brussels ▪ Tel: +32 2 211 11 11 ▪ Fax : +32 2 211 11 99
Info@wsbi-esbg.org ▪ www.wsbi-esbg.org

Published by ESBG. November 2020