



Centre of
Expertise
for Finance
Professionals

30 November 2020

EFRAG

Attn. Rasmus Sommer

35 Square de Meeûs

1000 Brussels

Belgium...

Via email: rasmus.sommer@efrag.org

Dear Rasmus,

Re: The IASB's Discussion Paper on *Business Combinations—Disclosure, Goodwill and Impairment* (March 2020)

As explained already, the Belgian Association of Financial Analysts is preparing its comment letter on the IASB's DP on *Business Combinations-Disclosures, Goodwill and Impairment*. We will forward EFRAG in due course our letter that can also be read of course as a response to EFRAG's own draft comment letter.

A part from that we would also like to react directly to a couple of specific points in EFRAG's draft comment letter with which we fundamentally disagree. More specifically we disagree with a few distinct assertions in the cover letter. We would like to explain our disagreement in this separate letter.

The cover letter states that:

- "there are shortcomings in how goodwill is currently accounted for"
 - The cover letter cannot state that without explaining what the exact problem is;
 - Moreover, whether or not there are shortcomings in how goodwill is accounted for, is part of the current discussion (paper);
 - We are e.g. convinced that there is nothing wrong with how goodwill is accounted for. The "impairment-test-only" model is the only conceptually correct model for goodwill accounting. The "too little, too late" discussion is about the impairment test and how it is applied in practice, about how goodwill is allocated, about the shielding-effect and management optimism, the definition of value in use.... but that does not mean that there is something wrong with the concept as such.

- "goodwill is a mixture of many different elements":
 - We disagree. This statement in the cover letter is incorrect and certainly EFRAG should explain itself when advancing this thesis. EFRAG could e.g. refer to research or other studies that defend that idea;
 - This is how we see goodwill (and this is also why goodwill is not a mixture of things):
 - In a business combinations an acquirer is not buying assets, he is buying future free cash flows;
 - Unfortunately, those free cash flows are generated by a combination of assets (often production installations) and the purchase price is allocated to these assets (and liabilities) on the basis of their respective fair values;
 - Of course there is usually a difference between the price paid and the sum of the fair values. The price paid is often higher than the fair values and that "premium" is the extra amount paid ("invested in" future free cash flows) that cannot be allocated to specific assets and is therefore recognised as goodwill;
 - Therefore we also disagree with the thesis that goodwill is an *accounting construct* (which has a very negative connotation). *Accounting construct* suggests that goodwill is an amount that nobody understands and has no meaning at all (which is not the case). But because debits have to equal credits, the amount is despite everything put on the balance sheet. Nobody's is happy therewith but there is no suitable solution. That line of thinking is in our view not the right approach because goodwill has a clear conceptual meaning (as explained above);
 - In that context, we cannot see how goodwill could be a mixture of things. It is the premium paid, it is an asset but not a piece of machinery or a production facility that is generating free cash flows on its own. It is an "intangible" investment on which the acquirer hopes to earn a return ... forever (at least until the subsidiary is sold again). Hence also why goodwill has no finite life and is not a wasting asset;

- "reported goodwill has limited relevance"

- Goodwill is part of the acquisition price paid and is therefore an indicator for the value of the future free operating cash flows (at least seen through the eyes of the acquirer). ABAF/BVFA is not aware of the fact that analysts would consider goodwill as having limited relevance. Goodwill is an asset, is part of "invested capital" and determines thus whether or not a reporting entity is profitable or not. We have no idea why EFRAG comes to the overall conclusion that goodwill on the balance sheet has no relevance.

Perhaps there is some confusion with the fact that a number of analysts neglect the amortisation cost related to goodwill (if goodwill is amortised of course). The reason is of course that amortising goodwill has absolute no relevance (see our conceptual thinking explained above). Goodwill is not automatically losing its value, is not to be replaced after some kind of useful period hence does not have to be recovered from clients through the sale of products or the delivery of services. The only challenge for the acquirer is to earn a return on the amount invested (in fixed and current assets and goodwill).

Adding to that, an impairment charge should be an indicator, to the extent that the financial markets have not yet discovered the problem, that the acquisition was overpaid, c.q. that the free operating cash flows do not live up to the expectations.

We also have some comments on the discussion with regard to the newly created intangible assets that are (often) recognised when accounting for a business combination.

Entities indeed often create strange intangibles when accounting for business combinations (brand name, client relationships, know how, technology...). The problem is well-known. These intangibles have an advantage, namely they can be amortised. As a consequence, invested capital goes lower in the future which has a positive impact on certain return ratios. Furthermore, if the purchase price is allocated to a number of intangibles and all other things remaining the same, goodwill is lower. That is seen as an "advantage", because goodwill is often seen - totally incorrect by the way - as an indicator for overpaying an acquisition.

The DP correctly starts the discussion whether or not something should be done about this. Users can give numerous examples of intangibles that have been recognised deliberately but in fact have no rights to exist on their own. Therefore we see these intangibles as part of goodwill. We agree with the IASB to be more strict on that. Intangible assets can be accounted for to the extent that they are real intangibles, e.g. for which there is an active market where these intangibles can be sold again. To give a counterexample: "client relationships" cannot normally be sold on an active market so should not be capitalised when accounting for a business combinations.

EFRAG now states in the draft comment letter that this discussion on intangibles is not really urgent. EFRAG suggests to tackle this when IAS 38 is revised. We disagree with that. The problem is urgent and should be dealt with in the short-term.

A few additional comments:

The DP is in essence about better information about acquisitions. Both at the time of signing (project rationale, expectations...) as afterwards (is the business combinations living up to the expectations).

ABAF/BVFA is of the opinion that the DP is about more than just better information. The DP touches upon the impairment test, goodwill amortisation and even suggests to introduce a new number. For simplicity one could argue that all proposals have to do somehow with better information but we disagree with that idea. Certain assessments are in fact "new" and fundamentally change IFRS 3. Hence the proposals in the DP cannot be seen as a package.

Furthermore, if IFRS 3 was to be reopened we would see enough arguments to take a more close look at e.g. contingent consideration, contingent liabilities, the fair value of inventories, the measurement option for non-controlling shareholders...).

EFRAG's draft comment letter also lacks some structure in our view. There are "Notes to constituents - Summary of the proposals in the DP" all over the place. Very often unclear why they are put here or there. Furthermore, it does not add to the credibility of the draft comment letter that the meaning of the constituents is asked for so often. This often gives the impression "we do not know but please help us".

In terms of structure, we would structure the draft comment letter as follows:

Section 1

Notes to constituents - Summary of the proposals in the DP...

Question ...

EFRAG answer summary

Additional comments

Question ...

EFRAG answer summary

Additional comments

Question ...

EFRAG answer summary

Additional comments

Section 2

Notes to constituents - Summary of the proposals in the DP...

Question ...

EFRAG answer summary

Additional comments

With regard to the specific questions:

- **On Question 1**

The question is quite focussed while the answer already elaborates on the different topics that are covered in the other questions. That causes confusion and hampers the readability of the document.

- **On Question 2**

Question 2 is in fact a series of questions. The answer(s) should in our view be structured in chronological order. It is terribly confusing that the comments start with an unclear (and totally irrelevant) introductory remark.

The letter investigates in paragraph 23-26 where the disclosures should be put while this is not part of the question.

What is the meaning of paragraph 53?

- **On Question 3**

With regard to EFRAG's response I would suggest you check the wording because it now seems that EFRAG would not agree with the proposals if the information would be put in the management section of the annual report.

- **On Question 4**

Again a lot of answers and comments that the question is not looking for.

- **On Question 6**

Questions to constituents (paragraphs 136-142) is simply too much.


- **On Question 7**

Too much text because the answer to the question so far is "we do not know". I assume that the comments will change drastically once EFRAG has formed its view.

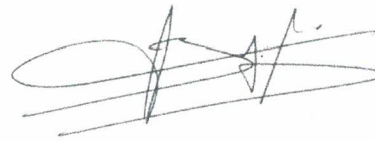
Questions to constituents (paragraphs 165-169) : keep this shorter i.e. do not repeat yourself.

We hope these comments are of some use but please do not hesitate to get in touch with us if we can be of further help.

Yours faithfully



Serge Pattyn
Board Member



Hans Buysse
Chairman