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icac Instituto de Contabilidad y Auditoría de Cuentas

Comment Letter on the *DP 2020/1 Business Combinations- Disclosures, Goodwill and Impairment.*
European Financial Reporting Advisory Group
35 Square de Meeüs
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Dear Jean-Paul,

In the present letter ICAC gives its view on IASB's Discussion Paper the DP 2020/1 Business Combinations- Disclosures, Goodwill and Impairment, issued the 19 March 2020, and on EFRAG's position presented in your draft comment letter.

First of all, ICAC welcomes IASB's initiative aimed to explore whether companies can, at a reasonable cost, provide investors with more useful information about the acquisitions those companies make. It has being recognised by the IASB in the DP that there are shotcomings in how goodwill is currently accounted for. One of the main reasons is due to goodwill is a residual rather than a reflection of a real asset and the way that goodwill is tested for impairment, not directly but indirectly.

It seems that the proposals do not address all the concers that arise in PIR IFRS 3, in consequence there is room for improvement.

ICAC finds relevant to include disclosure objectives to provide information to help investors to understand the benefits that a company´s management expects from an aquisition and the extent to which an acquisition is meeting management´s objectives for the acquisition, but in some cases to provide those disclosures will have more costs than benefits and we have reservations in terms of reliability and feasibility.

Regarding the issue about reintroducing amortisation, we share the opinión that both methods of accounting for goodwill, impairment-only and amortisation with impairment, have limitations but despite the difficulty in finding evidence that can justify the reintroduction of amortization we understand the second one has merit because it is more practical and help to solve the concerns that the impairment- only method creates. The empirical information available to date shows that little impairment is recorded in adverse market situations, therefore the correlation of a negative market situation and the foreseeable accounting information of a decrease in CGUs should be questioned, assuming that the impairment test has been done correctly, taking into

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account that the goodwill acquired is depreciated, making it difficult to justify that goodwill is generated in this situation.

Our responses to the questions in the Discussion Paper and in the EFRAG´s draft comment letter are explained below.

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?

The ICAC agrees with the objective of the DP about exploring at a reasonable cost ways to provide investors with more useful information about the acquisitions that companies make. ICAC understands that after several options raised in an attempt to improve the standard, the package of measures established by the DP is only aimed at improving the information that users receive on acquisitions and reduce the cost of carrying out the impairment test, but more improvement should be done.

These proposals address partially the problems in the PIR of IFRS 3, in particular additional improvement should be done about the goodwilll accouting and the impairment test, due to that the general view that impairment losses on goodwill are sometimes recongnised too late, long after the events that caused those looses and maybe too little. If the final package choosen is the one regarding the options that lighten the demands in carrying out the impairment test, such as the impairment indicators approach, and the calculation of the current value of a CGU that

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includes restructuring and future improvements, without any modification aimed at addressing the direct deficiency of goodwill, an oportunity will be lost.

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 decisión 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 decisión 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?

ICAC agrees with EFRAG's preliminary opinion to question 2, that the proposed disclosures are of limited use. When the disclosure requirements are based on the information that the CODM monitors, it is difficult to be sure that the information provided is sufficiently reliable and relevant, since it depends on the will of companies to provide the information required. For this reason, we consider that should be explored if that information would be better allocated as part of the management report instead of the financial statements.

On the other hand, the information required could triggering comercial sensitivity if it is disclosured, this aspect should be taken in to acount and analysed to avoid negative and cost effects on the company, but companies probably have ways of providing this information in such a way that it does not harm them, we do not have a firm opinion in that respect.
We also agree with EFRAG that these disclosures, although provide useful information to users by giving them a greater ability to understand the business combinations that companies carry out, do not solve the current problems related to goodwill accounting.

Questions for EFRAG's constituents

54 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?

We understand that it could be a sensible information, then it seems be more appropriate to include it in the management commentary, but this issue should be analysed more deeply.

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

The information provided by the companies will be more useful or relevant and/or reliable if it is audited, those conditions can be achieved depending on the quality and extent of the information that the entities are going to provide. In any case, it will be difficult to audit these concepts data beyond consistency with other figures with the rest of the data provided in the financial statements, which is the same that is checked by the auditor in the management commentary.

(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?**

ICAC understands that if the purpose is that the entities can provide real information that they are using in their decision-making process, to prepare the information in such a way that it is verifiable by an auditor will be difficult, since each manager will prepare the information depending on the management procedures that the company follows.

55 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?

No answer from ICAC

56 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.

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This issue should be carefully analyzed with the aim of achieving the goals pursued with the disclosure of information.

57 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?

That issue should be more deeply analysed, but for example, our capital companies law in its article 197 Right of information in the public limited company, in section 3 states that company administrators will be obliged to provide the information requested (under the two previous sections), unless this information is unnecessary for the protection of the rights of the partner, or there are objective reasons to consider that it could be used for extra-social purposes or its publicity damages the company or related companies.

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?

ICAC considers that such information will be useful if it is included in the notes to the financial statements in order to learn about the strategic rationale and management´s objectives for an acquisition as at the acqisition date and also information on whether the entitiy is meeting the goals.

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;

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Y AUDITORÍA DE CUENTAS

(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?

ICAC agrees with the EFRAG that the disclosure of the expected synergies would provide useful information, however information about concrete figures of both the expected benefits and the costs could represent a significant cost for companies, and could be complicated to audit, because they are estimates.

On the one hand, it is still hypothetical information, it was one of the concerns that arose during the review of PIR 3. Perhaps, it could be more useful to provide qualitative information on the expected synergies.

In any case, it will be useful to report the projected data and justify the differences with the results achieved, at least for the first year or the current year in relation to what was estimated in the previous year and see if there have been relevant changes in the hypotheses considered in the initial moment.

Regarding synergies, an informative guide on the concept of synergies should be developed to standardize the responses provided by the entities, as well as to reveal the factors that influence in the calculation of synergies.

On the other hand, EFRAG is also considering whether it would be appropriate to provide similar information for other components of goodwill, ICAC believes that should be analized the cost expected in comparation with the benefits of providing the disclosures. Among the different components of goodwill, the synergies for the acquiring business in terms of costs, synergies in income and the residual formed mainly by intellectual capital or other assets generated that do not meet the requirements for recognition as an asset could be highlighted.

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?

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Y AUDITORÍA DE CUENTAS

(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?

Questions for EFRAG's constituents

97 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.

98 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.

99 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?

Regarding paragraph 85 ICAC agrees that this requirement be maintained, which is the one that has already been applied in IFRS 3.

Regarding paragraph 95 ICAC is of the view that further guidance about the way to calculate those figures is needed to have comparable information in practice, and the analisis of cost-benefit should be done, because in case that the company does not have this data for its internal management it could imply a high cost to disclosure it.

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?

Questions for EFRAG's constituents

136 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?

ICAC agrees with EFRAG that if the guidance on the allocation and reallocation of goodwill in CGUs could be improved, the tendency to reallocate goodwill to those CGUs that have more room for possible impairment would be avoided. We understand that setting better criteria on the allocation of goodwill in CGUs, the impairment will probably arise earlier, since the pre-existing shielding effect in the UGES would be limited in some way.

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

ICAC considers that the benefit of improving the guidance would outweigh the costs, since it would reduce discretion in the current application. Regarding the application of this additional guidance in the entities that carry out acquisitions, it should not involve an additional cost, beyond applying the restrictions established by the standard.

138 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.

The ICAC understand that both auditors and regulators have their own role, but if the standard is too ambiguous, open or permissive, and allows management, complying with the regulations, to reflect an over-optimism it is difficult to tackle this problem. This exceeds the approach to accounting regulation, logically the better the practices and the more professional supervision of them is guaranteed, the better, but this approach exceeds what is now being considered with the improvement of the standard.

139 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 midterm 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.

140 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.

141 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.

Revealing additional information about the estimates used to measure the recoverable amounts of CGUs that have goodwill would be relevant and very useful information to reduce over-optimism, since if all entities have to provide this information, it makes the comparison between similar and makes optimistic deviations more evident.

Practice shows that the information disclosed by companies in the impairment section of the notes is very scarce, so as a general approach to take into account, trusting all the improvement to the information to be disclosed seems very optimistic.

On the other hand, providing the historical estimates refering in paragraph (a) would be an interesting piece of information because it improves transparency, but it could also serve to annually modify the assumptions made to transform them into more realistic. Information on the assumptions used to calculate the cash-flow projections in suggestion b) could also be useful, but less complete than option a).

However, suggestion c) provides information that could be excessive, and that is not assimilable and directly comparable with other entities. As the objective of the information is that the user can process the information to perform his calculations on the entity that is reporting, it could complicate the information provided so much that it loses usefulness. In addition, it could add a cost and be sensitive information for the entity that issues the accounts.

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

Paragraph 120 refers to the IASB's consideration that it is auditors and regulators who should solve the problem of over-optimism. As we have already commented previously, as far as the over-optimism of the entities is not contravening any regulation, it would not be appropriate to introduce consequences, they use the room available from the standard to be able to adopt an optimistic position.

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

(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.)

The empirical information available to date shows that little impairment is recorded in adverse market situations, therefore the correlation of a negative market situation and the foreseeable accounting information of a decrease in CGUs should be questioned, assuming that the impairment test This has been done correctly, taking into account that the goodwill acquired is depreciated, making it difficult to justify that goodwill is generated in this situation.

About the information to be reported in the accounting year in which the negative effects of COVID are reported, if low impairment losses are recognized, the correlation with accounting goodwill will be complicated.

If the goodwill is residual, there would be no problem with amortizing it even if the amortization period was arbitrary. However, it is clear that the theoretical construction of goodwill is complicated.

In our opinión, improvement should be done about the goodwilll accouting and the impairment test, due to that the general view that impairment losses on goodwill are sometimes recongnised too late and in sometimes too little. Then we believe that reintroduce amortisation is a practical option, even if the impairment continues.

Regarding the current experience and researches of how the impairment-only model has been working, failures have been checked in the model, then perhaps an appropriate solution is the reintroduction of amortization keeping in force the impairment test.

(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?

The impairment-only model has not worked as theoretically might be expected. The review of IFRS 3 has revealed deficiencies in the application of the standard that would justify the reintroduction of amortization, since after seeking other solutions to the deficiencies, none have been obtained that can resolve the shortcomings that have arisen in the application of the impairment-only model.

(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?

Reintroducing amortisation conceptually is not the perfect option but a solution has to be found. If in the impairment-only model when impairment has to be recognized it is conceived as an acquisition failure, since due to the way the impairment test is built, it is not possible to assess directly the goodwill, and it implies that the entire CGU has a loss in value. With the amortization, the perception could be less pesimistic in terms of acquisition failure.

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Y AUDITORÍA DE CUENTAS

(d) Do you view acquired goodwill as distinct from goodwill subsequently generated internally in the same cash-generating units? Why or why not?

In our view, the information on goodwill becomes less useful with the time, because the user cannot differentiate the goodwill consumed (which should be amortized) from the added value generated internally (which should not be recognized). In addition, the internally generated will come to a point that cannot be shown in the book value either because its indirect recognition is limited to the goodwill acquired in the combination.

Internally generated goodwill can only be reflected in accounting to the extent that an acquisition of goodwill has previously occurred. Therefore, it makes the accounts of entities that have organic growth less comparable with those that grow through acquisitions. On the other hand, managements may have incentives to grow through mergers or acquisitions.

(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?

New performance measures would probably not be created since amortization is less discretionary, a more linear expense over time and it is known from the moment of acquisition. On the other hand, managements could be using impairment expense as a tool to smooth out trend changes in the profit and loss account, it means that impairment could rise easily when the companies have "underlying earnings".

(f) If you are in favor of 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?

If the company had to estimate the useful life as well as the amortization structure for goodwill, the parameters used for this estimate would provide relevant information. ICAC believes that each company should be the one to establish both the useful life and the amortization structure, based on the best information available at the time it decides to make the acquisition.

However, we are aware that estimating the useful life and consumption pattern is very complicated. Given the lack of reliability, the accounting standard could prescribe a presumption that admits evidence to the contrary, in principle linear, in a maximum number of years.

Questions for EFRAG'S constituents:

165 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.

166 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.

167 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.

Goodwill can be considered as a residual of a set of elements that cannot be defined individually, concepts that lose value over time (for example, synergies, know-how, an advantage competitive…) In some cases, companies over time can replacing the goodwill that was paid for that generated internally.
We understand that goodwill has to be in the financial statements because it is an asset that is paid for in an acquisition, even if it is a residual asset and with certain peculiarities.

168 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?

New performance measures would probably not be created since amortization is less discretionary, more homogeneous over time and is known from the moment of acquisition. On the other hand, impairment losses can be registered in some companies depending on the general performance at times that have "underlying earnings".

169 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)?

Yes, it could be relevant information so that users can assess better the goodwill.

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?

The ICAC agrees with the EFRAG that goodwill should not be presented on their balance sheets separately from the total equity amount.

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?

Question to constituents

197 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?

ICAC agrees that by not doing the impairment test annually, the company loses not only the knowledge of doing it but also the elements of comparison with previous years. In addition, the information between entities from the same sector also decrease. To carry out the impairment test, the data available used by the companies inside a sector would also decrease in quantity and quality if the companies will not carry out the test annually either.
We also agree that this approach complicates the task of enforcing the standard by auditors, or where appropriate regulators, because it reduces comparable data and experience.

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 IASB DP 2020/1 Business Combinations—Disclosures, Goodwill and Impairment done and state whether this should apply to all cash flows included in estimates of value in use, and why.

Questions for EFRAG's constituents

217. 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)?

We are of the view that the proposed cash flows can be sufficient if additional evidence does not arise. This proposal should be complemented with the issuance of a guidance which establishes the specific time they can be included, to make it more homogeneous and to avoid over-optimism of the management.

218 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 carryforwards 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?

It seems it does not result in a significant risk since it is a small part in the assessment of the CGU. The proposed change derives from the fact that after-tax discount rates are those that are generally used in the valuation of companies and in this way it can simplify the impairment test. Consistency between the rates and the inputs used for the calculation should be required without explicitly demanding more requirements to the test.

219 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?

We are not aware of other risks.

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?

The ICAC agrees with the EFRAG that the proposal to add more guidance on the allocation of goodwill to cash-generating units should be developed.

Section 5-Intangible assets

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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 see no merit in increasing goodwill with the amounts of intangible assets that are identifiable, information will be lost both for users and for the valuation of goodwill and its impairment test. The complexity could be reduced at the time of acquisition, but not as much in subsequent years. In addition, it can increase the problem of recognizing impairments too late. It will be appreciated if prepares have available more guides to properly separate these intangibles.

Question to constituents that are users of financial statements

239 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?

No comments from ICAC

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?

In our opinión, the final decision of the IASB should be coordinated with the FASB and carefully analyze the arguments used to take it. Divergent accounting practices hurt comparability between companies.

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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

258 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."

259 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.

260 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.

261 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)?

262 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.

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

Reversal of goodwill impairment losses

264 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.

The deferred liability arising in a business combinations is an element that is subsumed in the valuation of goodwill as a residual element.

The goodwill includes in the acquisition of a business, all those unidentifiable assets that are likely to generate future economic benefits, which is what is considered the "core" goodwill, the only thing which should reflect goodwill.

But taking into account the definition of goodwill as a residual built with assets that are not identifiable, goodwill can be made up of different elements that, if observed individually, would also lead to the conclusion that in fact they do not generate future benefits, as happens with deferred liabilities, but it would be impossible to filter them all and leave the concept of goodwill pure, in the same way that goodwill cannot be valued separately and it is done in conjunction with a cash-generated unit.

A practical solution to manage the peculiarity and characteristic of this asset would also be amortization.

The possibility of reversal of goodwill impairments in general and specifically in the case of impairment losses recognised in an interim period should not be introduced, the amount of goodwill in the balance sheets of the company should be reduced. The goal should be that the amount of goodwill should be decreased, no arguments should be incorporated to justify that it remains indefinitely when it has already deteriorated.

Please don't hesitate to contact us if you would like to clarify any point of this letter.

Yours sincerely,

Santiago Durán Domínguez

Chairman of the ICAC

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