Comissão de Normalização Contabilística

Comments on EFRAG's draft comment letter in response to the IASB's Discussion Paper DP/2020/1 Business Combinations—Disclosures, Goodwill and Impairment

CNC provides this submission in response to the EFRAG's draft comment letter in response to the IASB's Discussion Paper DP/2020/1 Business Combinations—Disclosures, Goodwill and Impairment.
We are pleased to provide below our responses to the each question of the DP.

Question 1.
CNC supports the DP's objective to provide investors with better information about acquisitions companies make. Better information will improve investors' understanding on such transactions, and ultimately make management more accountable for these decisions.
However, we partially don't support the IASB's preliminary views shared in paragraph IN9 as we point out in the next questions.

Question 2.
CNC agrees that the disclosure requirements would help investors understand the subsequent performance of the acquisition and assess whether management's objectives for the acquisition are being met.
We understand that disclosing the strategic rationale and management's objectives for the acquisition provides a logical starting point for comparison in assessing subsequent performance of the acquisition. However, we note that disclosures about management's strategic rationale for undertaking the acquisition, the objectives of the acquisition and metrics used to monitor the acquisition may be commercially sensitive. We suggest the IASB to consider the right balance between the benefits to investors and the commercially sensitivity of these disclosures.
We suggest the IASB to consider a lower management level as the threshold for monitoring the acquisitions (e.g. the level at which goodwill is being monitored internally) and disclose metrics used by this lower management.

Question 3.
CNC understands that disclosures about the benefits expected from the acquisition would help investors understand the rationale behind the price. However, such information may be commercially sensitive.

Question 4.
CNC agrees that disclosure of synergies is an appropriate means to enable users to better understand the potential impact of a business combination on the combined financial statements, but. We point out that some information could be commercially sensitive.

CNC supports the Board's proposal to specifically disclose certain major classes of assumed liabilities. This information is an integral part of the deal reporting anyway, therefore, there may be no additional costs on preparer side, while providing useful information for investors.

Question 5.

CNC supports retaining the requirement to prepare proforma information as this would help investors understand the annual impact of the business and facilitate annual analysis. Therefore, we also agree that providing more guidance on how to prepare this proforma information as it would help preparers and improve consistency.

We also suggest the Board do define or provide guidance on what entails 'acquisition-related costs' and 'integration costs' in order to ensure comparability.

Finally, we support the proposal to disclose cash flows from operating activities as such information helps investors in their cash flows analysis.

Question 6.

CNC agrees that it is not feasible to design a significantly more effective impairment test.

CNC agrees that too optimistic estimates and 'shielding' are the main reason for not recognizing impairment losses on goodwill on a timely basis. Notwithstanding, we do believe that not only management estimates are optimistic, but they have to be optimistic. In fact, the boards require the executive teams to be optimistic, and challenge them in that sense. The management team believe in their actions, in their plans, in their executive decisions to be profitable. Management budgets are optimistic, and the accounting rules should not make pressures in a different way.

Furthermore, CNC do not support the Board's view, that over-optimism should best be dealt with by auditors and regulators because there is information asymmetry between the parties which usually does not allow enforceable corrections to a business plan beyond technical or obvious mistakes.

Question 7.

CNC is favorable to the reintroduction of the amortization of goodwill. Goodwill acquired comprises a set of future earnings that the acquirer expects acquired business to generate. As the business acquired is generating the acquired expected earnings, goodwill should be amortized to reduce earnings portion that was acquired. We suggest that the use of a multiple such as price / current earnings (or price / expected earnings) should be discussed as an estimate of the useful life of goodwill.

Question 8.
CNC does not support the Board's preliminary view to require companies to present on their balance sheets the amount of 'total equity excluding goodwill' because the figure can be computed easily if interesting for some users and as goodwill is an asset under IFRS, we wonder why it should be subtracted from equity and are concerned on how the resulting (artificial) figure will interpreted.

Question 9.
CNC does not support the Board's preliminary view to develop proposals to remove the requirement to perform a quantitative impairment test every year because:

(i) information that is valuable for users of financial statements would be lost (e.g., regular disclosure of discount rates, growth rates and key assumptions as required by paragraph 134 of IAS 36).

(ii) the removal of annual testing might postpone even more the "too late" risk of impairments on goodwill

(iii) the proposal may further undermine the confidence that is placed on the results of the impairment testing process as a whole, including triggering events testing

(iv) It may result in a high risk of losing expertise in doing impairment tests; in fact, a loss of valuation expertise can be expected, especially on preparers' side.

(v) in case due to a trigger an impairment test is required for the first time after several years of successful operations, it will be more difficult for both the preparer and the auditor to assess the reasonableness of the assumptions and input factors, since there will be no history of quantitative information against which the test could be benchmarked.

(vi) such a proposal would be reasonable only if amortization is reintroduced.

Question 10.
CNC agrees with these proposals as both would reduce costs and susceptibility of the impairment test to errors, without compromising the decision usefulness of the information provided.

Question 11.
CNC agrees with Board's preliminary view that it should not further simplify the impairment test.

Question 12.
CNC agrees with Board's preliminary view that it should not develop a proposal to allow some intangible assets to be included in goodwill.

Question 13.
CNC supports globally converged reporting standards as necessary to improve comparability and transparency in the market. Therefore, we suggest the IASB and FASB to collaborate during these projects and aim for converged proposals.

Question 14.

CNC would add the discussion the interdiction of a reversion on an impairment lost in goodwill. We believe that this interdiction contributes to the delay of the impairment recognition. Because preparers and auditors know that it is forbidden to revert an impairment loss on goodwill, when an impairment is near to be recognized, they will search for certainty before recognizing the loss.

CNC points out that it is easier to recognize a reversion (because it only needs the test result to be above the cost) than to recognize an impairment lost (when we have to be sure about the amount).

CNC also points out that there is an important inconsistency concerning the interdiction of a reversion of an impairment lost in goodwill and the non-interdiction to revert an impairment loss on intangibles in indefinite useful life such as acquired brands. Internally generated goodwill and brands (which are not as different within) should not be recognized as assets but inconsistently the interdiction to revert an impairment lost in goodwill is not applicable to brands.

Lisbon, 30th November 2020