SVENSKT NÄRINGSLIV

International Accounting Standards Board
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Efrag

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Discussion Paper 2020/1

# Business Combinations – Disclosures, Goodwill and Impairment

Thank you for the opportunity to respond to the Discussion Paper. As accounting for business combinations and goodwill is an issue of great interest to the Swedish Enterprise Accounting Group, we appreciate that resources are put down in this area. In our response to IASBs Agenda Consultation 2015 we pointed out the project on goodwill and impairment as the single most important and most urgent among the Board's research projects. We also expressed a favour of reintroducing the amortisation of goodwill.

We are convinced that the best solution to the issues raised in the current DP is to require entities to amortise goodwill. The Board should therefore reconsider the decision not to propose a reintroduction of goodwill amortisation, in particular in light of the project on goodwill accounting launched by FASB in July.

Concerning the suggested changes to the impairment model in the DP, we basically agree with the proposal to abandon the requirement to perform the test on a yearly basis. We also welcome the proposed simplifications of the test. However, we cannot see that there are grounds for the extensive disclosure requirements suggested by the Board. The disclosures will be extremely costly to prepare. Some of the requirement may be in conflict with market abuse regulations or bilateral agreements of discretion between buyer and seller. We question that external users of financial information need to monitor individual acquisitions over time to such extent that the Board's proposal suggests.

Our comments to the individual questions posed in the DP are attached in the appendix below.

Kind regards,

CONFEDERATION OF SWEDISH ENTERPRISE

Sofia Bildstein-Hagberg

*The Swedish Enterprise Accounting Group (SEAG) represents more than 40 international industrial and commercial groups, most of them listed. The largest SEAG companies are active through sales or production in more than 100 countries.*

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1. Paragraph 1.7 summarises the objective of the Board's research project. Paragraph IN9 summarises the Board's preliminary views. Paragraphs IN50–IN53 explain that these preliminary views are a package and those paragraphs identify some of the links between the individual preliminary views.
The Board has concluded that this package of preliminary views would, if implemented, meet the objective of the project. Companies would be required to provide investors with more useful information about the businesses those companies acquire. The aim is to help investors to assess performance and more effectively hold management to account for its decisions to acquire those businesses. The Board is of the view that the benefits of providing that information would exceed the costs of providing it.
(a) Do you agree with the Board's conclusion? Why or why not? If not, what package of decisions would you propose and how would that package meet the project's objective?
(b) Do any of your answers depend on answers to other questions? For example, does your answer on relief from a mandatory quantitative impairment test for goodwill depend on whether the Board reintroduces amortisation of goodwill? Which of your answers depend on other answers and why?

*The proposed disclosures are extensive and will be burdensome for reporting entities to prepare and present. Some of the suggested disclosures may include sensitive business information that reporting entities will be reluctant to present or hindered from disclosing during to confidentiality agreements or market regulations. We do not see the need to monitor individual transactions to the extent the DP proposes. The benefits of providing the information are not likely to exceed the costs of doing so.*

*We believe that the best and least burdensome solution to the issues raised in this project is to reintroduce the amortisation of goodwill.*

2. Paragraphs 2.4–2.44 discuss the Board's preliminary view that it should add new disclosure requirements about the subsequent performance of an acquisition.

(a) Do you think those disclosure requirements would resolve the issue identified in paragraph 2.4—investors' need for better information on the subsequent performance of an acquisition? Why or why not?

*As pointed out above, we question the need for the proposed disclosures. We are not convinced that all the requested information will be disclosed in practice due to business discretion. Some of the disclosures are sensitive (i.e. margins, valuations, competitors etc.) and may be subject to silence agreements between the acquirer and seller.*

*We also question the need to appraise and review an acquisition on a single transactional basis, when many acquisitions are made with a wider aim of integration of businesses and thereby achieving synergies. In that perspective, it appears as it would be more relevant to evaluate the performance of the integrated business or segment going forward.*

(b) 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). 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), rather than on metrics prescribed by the Board.

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

(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).

(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).

(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).

*The information under (i) is usually disclosed under current practice. We believe that the other disclosures are too extensive. Most acquisitions are monitored in some way or another (if not monitored the acquisition is likely to be immaterial). We do not see why investors would need so much information about the monitoring of previous acquisitions. In our experience, investors are mainly interested in forward-looking information. It is not obvious what grounds investors have to monitor previous calculations as long as the overall aim of the acquisition is met. The information will soon be outdated due to new circumstances. If introduced, the disclosure requirements should be accompanied with a time limit during which the disclosures should be reported.*

(c) 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)? 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?

*It is a reasonable approach to base disclosures on what the CODM actually reviews. We do not think that it will result in a lack of information about acquisitions. To follow the development of business, the segment information*

*is of more interest than information about single acquisitions. The disclosures already provided under IFRS 8 are therefore highly relevant for monitoring how acquisitions affect progress and the extent to which management objectives are reached over time.*

(d) Could concerns about commercial sensitivity (see paragraphs 2.27–2.28) 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?

*Yes, we believe reporting entities will find methods of avoiding the more sensitive disclosures by making the information more generic and boiler plate. We also fear that some of the requirements may be in conflict with market abuse regulations.*

(e) Paragraphs 2.29–2.32 explain the Board'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 Board 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 believe that the information is forward-looking, and we believe that there is a risk that the information will be in conflict with insider rules.*

3. Paragraphs 2.53–2.60 explain the Board's preliminary view that it should develop, in addition to proposed new disclosure requirements, proposals to add disclosure objectives to provide information to help investors to understand:
• the benefits that a company's management expected from an acquisition when agreeing the price to acquire a business; and
• the extent to which an acquisition is meeting management's (CODM's) objectives for the acquisition.
Do you agree with the Board's preliminary view? Why or why not?

*We believe that disclosure objectives would be helpful. We prefer disclosure objectives on a more principles-based level over detailed disclosure requirements that risk ending up in more boiler-plate information.*

4. Paragraphs 2.62–2.68 and paragraphs 2.69–2.71 explain the Board's preliminary view that it should develop proposals:
• to require a company to disclose:
○ a description of the synergies expected from combining the operations of the acquired business with the company's business;
○ when the synergies are expected to be realised;
○ the estimated amount or range of amounts of the synergies; and
○ the expected cost or range of costs to achieve those synergies; and
· to specify that liabilities arising from financing activities and defined benefit pension liabilities are major classes of liabilities.

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

*Information about synergies etc. may be difficult to disclose as it is challenging to describe in a manner that will be informative for users. Quantified estimations or ranges are particularly challenging to disclose as synergies seldom are measured and kept track of. Also, as synergies is an undefined concept any measurement will be dependent on a large number of estimations and assessments, we question if the information will be comparable.*

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 explain the Board's preliminary view that it should retain the requirement for companies to prepare this pro forma information.
(a) Do you agree with the Board's preliminary view? Why or why not?

*This information is disclosed today. We believe that the requirement should be retained.*

(b) Should the Board develop guidance for companies on how to prepare the pro forma information? Why or why not? If not, should the Board require companies to disclose how they prepared the pro forma information? Why or why not?

*We do not believe that guidance is necessary.*

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 explain the Board'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 Board's preliminary view? Why or why not?

*We believe that the information about cash flows would be difficult to provide and we doubt that there is a need for it.*

*If the Board decides to introduce the term "operating profit before acquisition-related transaction and integration cost", these costs need to be defined. Integration costs is an unclear concept that may be interpreted widely.*

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6. As discussed in paragraphs 3.2–3.52, the Board 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 Board'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?

*Yes, we agree that additional attempts to make the impairment test more effective is not the right way forward. We believe that the current problems with shielding and too optimistic assumptions are caused by other factors than design of the impairment test.*

(b) If you do not agree, how should the Board 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 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?

*We agree that both these reasons are relevant.*

(d) Should the Board 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?

*Many reporting entities question why goodwill impairments should be made when the overall business is profitable, as it may give the market incorrect signals. Amortisation of goodwill is a pragmatic solution to this.*

7. Paragraphs 3.86–3.94 summarise the reasons for the Board'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 Board should not reintroduce amortisation of goodwill? Why or why not? (If the Board were to reintroduce amortisation, companies would still need to test whether goodwill is impaired.)

*Referring to our previous comment letters regarding IASB Agenda Consultation 2015 as well as EFRAGs 2017 DP Goodwill Impairment Test, we believe that goodwill should be amortised. Our main argument for this is that it will essentially improve the comparability between entities with different growth strategies. Goodwill represent a measure of expected excess profitability and as such its consumed over time. We are aware of the difficulties in defining an appropriate amortisation period but believe that financial statements would gain in comparability from a pragmatic approach where a reasonable amortisation interval is defined.*

*The current principles for impairment measurement work poorly in practice. Impairment tests are based on too many assumptions and the options for reporting entities to reach a desired outcome of the tests are several.*

*We also think that the measurement of goodwill upon recognition is partly based on the preferences of the reporting entity, as the size of goodwill will depend on whether other intangible assets are individually identified and recognized upon the acquisition. Further, intangibles identified as part of an acquisition are difficult to comprehend for users of financial statements and are a source of impaired comparability.*

(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?

*Our view has not changed.*

(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?

*We believe it would resolve these concerns, provided that the amortisation period is reasonably defined.*

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

*Yes, there is an essential difference as acquired goodwill has a verifiable acquisition value. The concept of internally generated goodwill is difficult to grasp. As it is not verifiable it can be argued that it does not exist.*

(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?

*It is probable that some reporting entities will present new management performance measures, just like it is probable that some users will add back the goodwill amortisations. But only during the period when goodwill is amortised. We doubt that adjustments will be made when goodwill is written off in its entirety.*

*We do not see that the fact that financial analysts use different methods and assumptions is a reason for not applying a certain accounting principle.*

(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?

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*We suggest that an amortisation period is set somewhere in the interval 10-20 years, but it will have to be subject to further analysis. It would improve information usefulness as it would add comparability.*

8. Paragraphs 3.107–3.114 explain the Board'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 Board 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 Board develop such a proposal? Why or why not?

*No, we do not believe that should be a requirement as it would not add any value. The amount is easily accessible to the reader as the amounts of equity and goodwill are disclosed in the financial statements.*

(b) Do you have any comments on how a company should present such an amount?

*If it would become a requirement, we would argue that it should be a note disclosure and not in the statement of financial position.*

9. Paragraphs 4.32–4.34 summarise the Board'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 Board develop such proposals? Why or why not?

*Yes, we believe such proposals should be developed. Impairment testing is to a large extent a mere routine exercise as the goodwill value is difficult to question. The Board may also have to consider developing more robust criteria for indication of goodwill impairment, otherwise there is a risk that the indication test makes room for flexibility for preparers in a similar manner as the current impairment test.*

(b) Would such proposals reduce costs significantly (see paragraphs 4.14–4.21)? 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.

*For some companies it would definitely lead to a reduction of cost. In some cases there may be a need of keeping the impairment test due to e.g. audit requirements. Or it may be replaced by other activities with the aim of assessing the carrying value of goodwill.*

(c) In your view, would the proposals make the impairment test significantly less robust (see paragraphs 4.22–4.23)? Why or why not?

*No, we do not believe it would as long as there is a robust indication test with sufficient links to the impairment test. The underlying assumptions of the impairment test need to be updated regularly in order to detect any indications*

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*of impairment, even if the test is not actually performed. Otherwise there is a risk that the routine for preparing the test and sustaining the model will diminish over time.*

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

*Yes, such proposals would be a good development. In practice, it is often difficult to separate cash flows in order to perform the test as if certain investments or organisational changes to improve the business have not taken place. Over time, it becomes a hypothetical exercise.*

*Regarding post-tax cash flows and discount rates we fully agree with the proposal. Pre-tax rates are normally only computed in order to fulfil the requirements in IAS 36.*

(b) Should the Board 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.

*No. It would be difficult to require more than what is already required.*

11. Paragraph 4.56 summarises the Board's preliminary view that it should not further simplify the impairment test.
(a) Should the Board develop any of the simplifications summarised in paragraph 4.55? If so, which simplifications and why? If not, why not?

*We believe that the Board further should explore the possibility to allow entities to allocate and test goodwill at the level of reportable segments (4.55 c). This would be in line with the management approach logic in IFRS 8. It would be a significant simplification for reporting entities that presently use this approach to monitor goodwill. It would also be easier for users to understand the basis on which the tests are performed.*

(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?

*No.*

12. Paragraphs 5.4–5.27 explain the Board's preliminary view that it should not develop a proposal to allow some intangible assets to be included in goodwill.

(a) Do you agree that the Board should not develop such a proposal? Why or why not?

*No, we do not agree. It would be good – and would probably increase comparability – if intangible assets were included in goodwill to a greater extent. There is a risk today that the separation of intangibles from goodwill is done arbitrarily. Since the intangibles with a definite useful life is subject to amortisation, management preferences frequently decide to what extent separate intangibles should be recognised. We believe that this is detrimental to the comparability of financial statements.*

*The purchase price allocation would be significantly simplified if intangibles were allowed to be included in goodwill. The PPA work is also a significant cost for entities and in many cases external consultants are involved in the identification and measurement of intangibles separate from goodwill.*

(b) If you do not agree, which of the approaches discussed in paragraph 5.18 should the Board 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?

*We do not believe that the information value for investors increases from separating certain intangibles from goodwill. Today, creating the PPA is many times an artificial exercise and the underlying logic of the separately recognised intangibles are often difficult to understand for users.*

(c) Would your view change if amortisation of goodwill were to be reintroduced? Why or why not?

*No, if goodwill amortisation is re-introduced, we believe that there is even less need to separate intangibles from goodwill.*

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

*The essence and main features of the two should be the same, such as re-introducing goodwill amortization. Our approach and attitude towards the amortization issue will not be affected by how US GAAP develops.*

14. Do you have any other comments on the Board's preliminary views presented in this Discussion Paper? Should the Board consider any other topics in response to the PIR of IFRS 3?

*Our comments concerning the reintroduction of goodwill also applies to other intangible assets with an indefinite useful life.*