



Mr. Wolf Klinz
EFRAG Chairman
35 Square de Meeûs
1000 Brussels
Belgium

**Re: DCL- ED - Business Combinations –
Disclosures, Goodwill and Impairment**

Sophienstraße 44 DE – 60487
Frankfurt am Main, Germany
Direct number: +49 69 98959519
E-mail: office@effas.com
Internet: www.effas.com

Contact: Raquel Zaragoza

28 June 2024

Dear Mr Klinz,

The EFFAS Commission on Financial Reporting (“Commission”, “We”) would like to express its views on EFRAG’s Draft Comment Letter (“DCL”) **ED Business Combinations –Disclosures, Goodwill and Impairment**.

The Commission acknowledges EFRAG’s comments supporting the amendments outlined in the ED and the observations suggesting additional improvements in certain points. We also support EFRAG’s outreaches to include the feedback of different stakeholders to enhance EFRAG’s comments on the ED.

EFFAS supports EFRAG’s comprehensive and high-quality documents and would like to continue emphasizing the need for clarity and concreteness. Density, length and repetition on the documents should be avoided to facilitate a fluent reading.

Before commenting on the key points, the Commission would like to note that:

- whether or not successful, most business combinations are major events for most companies and very often have an important impact on future cash flows and on the creditworthiness and valuation of an entity.
- transparency is key in financial reporting. Therefore, financial markets – users of financial statements - need the factual information with regard to the performance of the acquired entity on time.
- to assess whether a business combination is successful or not, the initial targets of the acquisition and how achievable they are should be known from the outset.

As noted in the past, users need material information and not necessarily more information. We agree with the IASB's aim at achieving a balance by amending IFRS 3. Also, we think that not every business combination will have a major impact on an entity and there may be circumstances in which it becomes difficult for entities to communicate sensitive information.

This should not refrain companies from providing users with adequate – qualitative as well as quantitative - information about business combinations in terms of future performance and future cash flows, impact on creditworthiness, and value.

1. Disclosure-Performance of a business combination



We by and large agree with EFRAG's comments and the IASB's proposal. We understand that the amended Standard needs to balance the benefits of requiring an entity to disclose the information with the cost of doing so. We think the current proposals strike the right balance. However, we would like to note, as we also indicated in our letter to the IASB, that the aspect of potential additional costs for entities should not impinge on providing relevant information for users.

Companies should provide information about an entity's acquisition date, key objectives and related targets when signing an acquisition. This information is relevant to better understand the rationale of a company to enter into the transaction and the potential contribution of additional cash flow to the performance of the company and in return the expected improvement in valuation.

2.- Disclosures: Strategic business combinations

There are different business combinations which differ in significance. This implies that it is necessary to have an adequate definition of what a "strategic" acquisition is. We consider that an acquisition is a strategic investment if it can have a material impact on a company's cash flow and results, positive or negative, depending on the synergies of the business combination. This is why disclosures related to the price paid and whether the acquisition is meeting the expected expectations in terms of performance is key to value the impact of the acquisition.

Moreover, we think that providing information related to the progress of the integration of the acquisition and the achievement of the target-related objectives will be very helpful. For investors to know and understand the reasons for a company deciding to acquire another company is key for valuing the merit of the acquisition and the potential impact on the acquirer's valuation.

As to the approach we feel that an open list would be more appropriate as this would be a more principles-based approach. Based on the principles to be defined, a business combination could be strategic or not.

However, after having considered the possibility of an open list, we feel that the proposed closed list will most likely capture all business combinations that are of importance to the users of the financial statements. Hence, the proposed closed list is sufficient for us.

That said we do not think that the operating profit is an appropriate number to consider when deciding on something being strategic or not. Operating profit can be a very volatile number hence the same business combination could be strategic or not depending on when and how the deal has been signed. We would like the IASB to give this point some consideration.

3.- Disclosures: Exemption from disclosing information

Regarding the exemption the Commission considers that an entity should explain the reasons for applying the exemption. The potential sensitiveness of the information or risk of contingencies, for instance, risk of litigation, should be explained.

The Commission considers EFRAG's proposal of presenting "two options": the 'disclose or explain' approach, or to specify alternative information in the case an entity would not provide the required disclosures as unnecessary. The Commission considers that there should be no options as it can be a subjective decision for an entity to apply the exemption for some items considered commercially sensitive information without clearly stating why they are sensitive.



An entity should provide information explaining why the exemption is applicable due to the sensitive information or the risk of a potential contingency.

If due to the exemption, entities are reluctant to disclose information citing sensitive information or the risk of potential liabilities the Standard should provide guidelines to avoid providing information that is not relevant for users. Moreover, information available and provided by management should be reconciled with the Standard to facilitate comparison.

4.- Disclosures: Identifying information to be disclosed

The Commission agrees with the ED proposal to require an entity to disclose information about the evolution of the performance of an entity's acquisition that is reviewed by management. If the management does not review or stops reviewing the performance of the acquisition, we support disclosing the reasons for withholding the information as noted in BC121-BC130. The information provided should be relevant for valuing the performance of the acquisition.

We agree that the proposed disclosures about the performance of a strategic acquisition would be based on information that the management uses to review the strategic acquisition rather than a list of specified information because:

- management is assumed to review strategic acquisitions and be aware of how they are performing; and,
- objectives for an acquisition are typically company specific. No single set of information specified by the IASB could provide useful information for all acquisitions. The consequence of this approach is that the information could be of little use for an external observer.

Regarding EGRAG's observation related to the level of management –that should be disclosing information about the performance of a business combination -the CODM or key management personnel- the Commission considers that rather than the level of management releasing the information, relevant information should be disclosed by an authorised source representing the company.

5.- Disclosures: Other proposals

The Commission agrees with EFRAG's comments supporting an entity to provide additional information related to the strategic rationale for entering into a business combination and to provide quantitative information related to the expected synergies in the year of acquisition. The Commission, as noted in EFRAG's letter, prefers to have the information in the financial statements, as this provides the same level of assurance as the information included in the financial statements as a whole.

We agree with EFRAG, as we also noted in our letter to the IASB, that disclosing the expected timeline of synergies provides valuable information related, for instance, to the capability to generate cash flow, in contrast with the unspecified current situation.

6.- Changes to the impairment test

The revision of the impairment test is definitely required to improve the effectiveness of the test. As the IASB notes, and users have underlined several times, it has been a source of disappointment for users as there has been a lack of timely application of the impairment test in numerous occasions.



The Commission welcomes EFRAG's broad support to the ED proposal to address the concerns related to "shielding", and the management optimism. Reducing the effect of these concerns should improve the effectiveness of the impairment test and will provide a more accurate understating if the goodwill has lost the intended objectives following the acquisition.

As mentioned in paragraph 80 of the ED, we agree that the goodwill acquired in a business combination should be allocated to each of the acquirer's cash-generating units or groups that will benefit from synergies. This should be done at the level that the company's management monitors and is able to provide financial information about the cash-generating units.

Thus, the Commission welcomes EFRAG's indication to require entities reporting segment information for each reportable segment and group of cash-generating units that contain goodwill and the carrying amount of the goodwill in each unit. This is an important point for investors. Clearly identifiable cash-generating units provide information of how synergies are working facilitating the individual valuation of a business.

Moreover, including illustrative examples and scenarios for some industries, for instance when incorporating a fintech company based on the 10% approach, will be very helpful and will facilitate preparers to accurately apply the impairment test process. Also, when incorporating state-owned companies' additional guidance will be very useful.

7.- Changes to the impairment test: Value in use

Addressing management optimism which has resulted in a well identified "too little, too late" phenomenon, and considering that this as an auditors and regulators problem, see BC 189 (9), has not been a satisfactory response to the issue. The standard should be sufficiently solid and specific to allow for a fair and reasonable regulator audit and control. Actually, the current standard provides ample room for an entity's management to judge the performance of an acquisition which was previously decided by the same management.

The Commission would like to point out, as indicated in the letter to the IASB, the unsatisfactory enforceability of the current standard identified by ESMA in its 2020 comment letter on the DP, and the European financial market regulator stated clearly that the current impairment test needed to be significantly improved¹.

We indicated to the IASB that when reading the basis for conclusions it seems that the Board considers that management over-optimism is due to optimistic cash-flow forecasts. However, based on our experience a main source of optimism for the valuation relies on the application of the terminal value when discounting cash flows.

Sometimes expected growth rates, discount rates and "exit multiples" applied in discounting cash-flows are higher than market levels. It has been observed that in certain cases those multiples are higher than the multiples at which the entity is valued in the market. This issue has to be addressed to eliminate the over optimism negatively impacting the impairment test.

8.- Presentation of amounts attributable to ordinary shareholders

¹ See https://ifrs-springapps-comment-letter-api-1.azuremicroservices.io/v2/download-file?path=561_27311_AnnaSciortinoEuropeanSecuritiesandMarketsAuthorityESMA_0_ESMA3261413ESMAasCLtoIASBDPGoodwillandImpairment.pdf



We agree with EFRAG's support to the IASB requirements related to subsidiaries without public accountability in an acquisition. As also indicated in our letter to the IASB, understanding the project rationale of a business combination and to be informed about the objective of the acquisition will be very useful information. To disclose quantitative information will be relevant for users particularly focusing on the potential contribution of mid and long-term expected cash-flows to the acquirer in contrast to the paragraph BC255(a) suggestion to focus on short-term cash-flows.

Also, as noted in BC-89 users need at least some qualitative information about a business combination. The qualitative contribution of the acquired business should be clearly disclosed in contrast to the current information which is not specific enough. Moreover, we think that the reference to the operating margin ("better assessment") should be adjusted in the context of "the contribution of the acquired business. Additionally, providing the discount rate would be useful to understand how the value in use is calculated.

9.- Transition

We agree with the ED's proposal that a company should apply the amendments for reporting periods beginning on or after the effective date without restating comparative information.

If you would like to further discuss the views expressed in this letter, please contact us.

Javier de Frutos, Chair
EFFAS Commission on Financial Reporting

EFFAS was established in 1962 as an association for nationally based investment professionals in Europe. Headquartered in Frankfurt am Main, EFFAS comprises 14-member organizations representing more than 16,000 investment professionals. The Commission on Financial Reporting is a standing commission of EFFAS aiming at proposing and commenting on financial issues from an analyst standpoint. CFR members are Javier de Frutos (Chairman, IEAF-Spain), Jacques de Greling (Vice-Chairman- SFAF, France), Friedrich Spandl (ÖVFA, Austria), Henning Strom (NFF, Norway), Serge Pattyn (BVFA/ABAF, Belgium), Luca D'Onofrio (AIAF, Italy), Dr. Carsten Zielke (DVFA, Germany), and Andreas Schenone (SFAA, Switzerland) and Mihail Stan (Romania).