la SOCIÉTÉ FRANÇAISE
des ANALYSTES FINANCIERS

13 July 2024

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Exposure Draft "Business Combinations - Disclosures, Goodwill and Impairment". Comments by the Financial Analysis and Accounting Committee of the French Society of Financial Analysts (SFAF)

Dear Sir,

The French Society of Financial Analysts, SFAF (Société Française des Analystes Financiers), is pleased to submit its contribution as part of the consultation undertaken by the IASB on the Exposure Draft *Business Combinations -Disclosures, Goodwill and Impairment*.

SFAF represents more than 1,400 members in France and is itself a member of the European Federation of Financial Analysts Societies (EFFAS), which comprises 16 member organizations representing more than 15,000 investments professionals. Its Accounting and Financial Analysis Commission was created to represent analysts, fund managers and professional investors in the debate on accounting standards more than 40 years ago. Financial analysts are among the principal users of corporate financial statements and therefore wish to express their opinion on the implementation of new or revised accounting standards.

For this reason, our Society, through its Accounting and Financial Analysis Commission, is keen to respond to your consultation on Business Combinations, a subject of utmost importance for our members.

As a preliminary step, SFAF Accounting Commission has repeatedly challenged the current standard IFRS 3 on Business Combination, pointing at conceptual and practical flaws in the current approach as soon as 2003[1]. As the key priority of the IASB at this time was to pursue a convergence with US GAAP, the Board decided to move to no-amortisation of goodwill, just after revising the IAS 22 standard in April 2001 without any significant change. Our concerns were repeated[2] when IFRS 3 was modified in 2005, supported with some early practice feed-back, already pointing at the "too little, too late" phenomenon. These conclusions were also repeated in the Post Implementation Review in 2014[3] when the Commission wrote: "S*FAF Accounting Commission in its comment letter on the ED 3 (CL 64) in 2003, i.e. 10 years ago, stressed that "the replacement of goodwill amortization by an impairment test […] would in practice, lead to no impairment being recognized". We unfortunately have to admit that this prediction has fully materialized, and that the information provided by the new standard on acquired goodwill to financial analysts has been mostly irrelevant"*. When the IASB published it Discussion Paper in March 2020, SFAF Accounting Commission[4], once again, identified the conceptual and practical flaws of IFRS 3, providing extensive examples of real-world failure to deliver any acceptable result, based on our 15 years' experience with the problems encountered with non-amortization of goodwill. The Commission added "*We believe that this general failure of impairment tests to deliver proper results has also caused some loss of credibility of financial information, accountants, auditors, boards and audit committees*".

These positions on Business Combinations and Goodwill have been also repeated by SFAF during the IFRS Foundation lasts Agenda Consultations, stressing that the problem was a top issue for users of financial information, together with performance reporting (IAS 1) and segment reporting (IFRS 8).

After a lasting failure to deliver any reasonable result for investor information, we are astonished to see the IASB is still keeping the flawed standard and pretending it can be saved with some limited disclosures (with possible exemptions), that, most probably, will be boilerplate. **As a summary, we are convinced that the proposed changes to IFRS 3 will not materially improve the practice of business combination and goodwill reporting, as the changes proposed fail to address the real issues.**

Question 1—Disclosures: Performance of a business combination (proposed paragraphs B67A–B67G of IFRS 3)

Analysts welcome the idea of increasing the transparency of reporting regarding business combinations as they often represent the most significant investments made by groups, often implying noticeable changes in group activities and/or coverage, with surprisingly little quantity of relevant information, in particular after the acquisition.

[1] See SFAF comment letter on Exposure Draft available at: https://www.sfaf.com/base-documentaire/telechargement/213

[2] See SFAF comment letter on Exposure Draft available at: https://www.sfaf.com/base-documentaire/telechargement/209

[3] See SFAF comment letter on the PIR available at: https://www.sfaf.com/base-documentaire/telechargement/229

[4] See SFAF comment letter on Discussion Paper available at: https://www.sfaf.com/base-documentaire/telechargement/246

The proposed change of disclosing the year of acquisition, and the following years, key objectives and related targets, are an attractive proposal, as it would allow, in principle, to better understand the full logic of the investment done with acquisitions.

We nevertheless understand that companies would, rather understandably, be reluctant to make public strategic projects or goals years ahead, for competitive reasons. For instance, if a company would plan to launch a new product with a technology mastered by the acquired entity in the next years, it would be clearly prejudicial. Additionally, based on our experience with stated long-term goals released by companies, they are often disclosed in a manner that would avoid to create liability to the management and/or the company. As a result, this kind of disclosures tend to be boilerplate information that is of little use for investors. **We thus fear that, in practice, these new disclosures will not be able to provide sufficient improvement to IFRS 3 to understand acquisitions and their subsequent performance. They can't therefore be a solution for the drawbacks of the current IFRS 3 standard.**

Question 2—Disclosures: Strategic business combinations (proposed paragraph B67C of IFRS 3)

We consider that the guidelines (B67C) defining strategic acquisitions are, by and large, reasonable and sufficient to provide sufficient information for significant acquisitions to users, and remove an unnecessary burden for reporting entities on smaller acquisitions while the information on non-strategic acquisitions would be of no-interest for users. The thresholds at 10% (revenues, assets, operating profit) and new major business line or geographic area, are seen as reasonable and workable definitions.

We are not comfortable in the case when a group would make a series of smaller acquisitions in the same year, with none of them being assessed as strategic under BC67C, but that together would be clearly above the BC67C thresholds. However, we have not easy solution in mind to provide a reasonable and workable solution. Perhaps a simple disclosure on the total aggregated revenues and a few words on the main activities of the acquired entities could provide basic information.

Question 3—Disclosures: Exemption from disclosing information (proposed paragraphs B67D–B67G of IFRS 3)

Regarding the exemption, we believe that in many cases, the information to be disclosed could be easily assessed as prejudicial (sensitive information, commercially sensitive, or bringing potential litigation risks…), as pointed in our answer to the first question. This exemption, most probably, will result in giving no real information about key matters when acquiring businesses, in an extensive manner.

Question 4—Disclosures: Identifying information to be disclosed (proposed paragraphs B67A–B67B of IFRS 3)

The Commission agrees to follow the information about the objectives and targets, plus the evolution related to these targets, as followed by the management. We believe that the information disclosed to investors should be based on what key management personnel follows as it is expected to offer

a better link with the economics of the reported business combination. We nevertheless believe that when the target is a financial performance indicator that is a non-GAAP (like EBITDA before marketing costs, or before PPA, or SG&A as a % of revenues…), it should be defined in a proper manner with some reconciliation with GAAP measure to allow a meaningful analysis and to avoid any misunderstanding.

And, as a minimum, the objectives and targets should be published for a minimum of two years, even if key management personnel stops reviewing them. We note that the targets are to be reported as long as the key management personnel follow them, which seems to be inconsistent with the indefinite useful life of the goodwill (and the related impairment test).

Question 5—Disclosures: Other proposals

The additional information required in B64(ea), required for each business combinations occurring in the reporting period, are also considered to be relevant (which synergies, which related costs, and estimated amounts, and timing) to assess the logic and the possible value creation of this investment.

We are quite surprised to see a requirement (B64(ea)(iii)) detailing disclosures on synergies timing, and whether or not there are expected to be finite or indefinite, as current standards state that goodwill has an indefinite useful life and expected synergies and goodwill are strongly interrelated. In practice, when companies making acquisition give details about expected synergies breakdown, and related costs, they often provide a new present value of the sum of costs and synergies, discounted at a disclosed rate, over an infinite (not *indefinite*) period. Such a calculation allows the announcing entity to easily report a very high NPV value, that may appear to be a highly unrealistic scenario.

As stated in our 2020 comment letter on the DP[5], there are however some simple ways to improve disclosures. Financial analysts are, in many cases, frustrated by the level / transparency / understandability / relevance of information provided on goodwill. We would very much welcome to introduce a table detailing the amount of goodwill (gross and net) per segment and to which material acquisition it is related (and its date). This kind of simple summary would be, in many cases, much more relevant for users than the extended information, often irrelevant and never summarized properly, that we have today.

Question 6—Changes to the impairment test (paragraphs 80–81, 83, 85 and 134(a) of IAS 36)

Users have repeatedly stated that impairments on goodwill in most cases are done “too little, too late”, often years after the market has become aware of the failure of the acquisition. This is due to the conceptual and practical flaws in the impairment test that have been well identified for years. Tentative to solve these well-known flaws by the IASB (Headroom goodwill) and EFRAG (Goodwill accretion) have resulted in no change to the test. As the impairment test is supposed to be the cornerstone of the non-amortisation of goodwill, we struggle to understand why the IASB has concluded that it is not possible to improve the test, and still maintains the non-amortisation of goodwill, in contrast with all other operating assets.

[5] Available at: https://www.sfaf.com/base-documentaire/telechargement/246

To reduce (not to supress) the shielding of acquired goodwill, the IASB is proposing to allocate the goodwill in a clearer manner to cash generating units, and not, by default, to operating segments. Even though we consider that this clarification is an improvement, we consider that no goodwill should be allocated at operating segment level (except in the case when the segment is a CGU), but all acquired goodwill should be, at minimum, followed at CGU level. In most cases, this "targeted change" is not expected to result in any material improvement of the shielding effect.

Question 7—Changes to the impairment test: Value in use (paragraphs 33, 44–51, 55, 130(g), 134(d)(v) and A20 of IAS 36)

The Board has well identified the management over-optimism as one the main reasons of the failure of the impairment test to deliver proper result, a point well known by users. The Board, according to BC189(c), considers that over-optimism is to be addressed by auditors and regulators. This conclusion is not acceptable, as the impairment test has been plagued, for years, with well-identified conceptual and practical flaws that the Board has not been able to address. The standard should be sufficiently solid, specific, and demanding to allow a fair and reasonable auditor and regulator control. In reality, the current standard provides too ample room for an entity's management to judge the performance of an acquisition which was previously decided by the same management. ESMA[6] stated clearly in its comment letter on the DP in 2020 that the main reason for its letter was "*to improve the enforceability*" and added that "*In light of the enforcement experience of European accounting enforcers, ESMA highlights that the current model relies too heavily on estimates and variables which depend to a large extent on management judgement on the basis of company-specific projections and inside knowledge, which enforcers struggle to challenge*".

When reading the basis for conclusions, we understand the Board considers that management over-optimism is due to optimistic cash-flow forecasts. However, based on our experience, a main source of over-optimism for the valuation relies on the calculation of the terminal value when discounting cash flows. Low discount rates and high terminal growth rate very often result in exit multiples that are unrealistic, as they are far above the market multiples at which the reporting entity is itself traded, and sometimes several times higher than the reporting entity market multiples. This problem was well identified in an ESMA 2013 report[7] on impairment of goodwill. If the Board really wants to address management over-optimism, this exit multiple issue has to be solved in a reasonable and enforceable manner.

As a general rule, even though users are willing to reduce costs and undue complexity for issuers, we are uncomfortable with the stated target of reducing the cost and complexity of impairment test. This could be a stated goal, only if the impairment test was working properly. The simple fact that we discuss it, and that the Board considered extensive improvements without being able to deliver an acceptable solution, is a proof of the contrary.

We are favourable to remove the obligation to disclose pre-tax discount rates for the impairment tests. Accepting to take into account future restructuring and improving assets performance costs and the related benefits could make the impairment test closer to the real-world economics of the

[6] Available at: https://www.esma.europa.eu/sites/default/files/library/esma32-61-413_esmas_cl_to_iasb_dp_goodwill_and_impairment.pdf

[7] Available at: https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-02.pdf

acquisition, but would however open the door to even more management judgement in impairment tests, that has resulted in very low auditability and enforceability as already stressed by ESMA.

Question 8—Proposed amendments to IFRS X Subsidiaries without Public Accountability: Disclosures

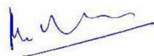
We have no views on this point. No comment.

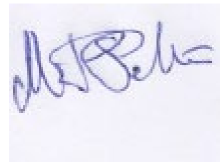
Question 9—Transition (proposed paragraph 64R of IFRS 3, proposed paragraph 140O of IAS 36 and proposed paragraph B2 of the Subsidiaries Standard)

We agree with the proposed transition method.

We thank you for the opportunity given to us to provide our view on such important aspects of financial reporting for users. If you would like to further discuss the views expressed in this letter, please do not hesitate to contact us.

Yours faithfully,





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