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22 December 2020

Dear Sir

**Exposure Draft DP/2020/1: Business Combinations – Disclosures, Goodwill and Impairment**

We are pleased to comment on the above Discussion Paper (the DP). Following consultation with the BDO network[1], this letter summarises views of member firms that provided comments on the DP. We support the efforts of the IASB to improve the measurement and disclosure requirements of IFRS as they apply to goodwill. We agree with most of the proposals presented by the Board in the discussion paper, as they generally increase the usefulness of information provided to users of financial statement.

We have mixed views as to whether an 'impairment only' or 'amortisation + impairment' model should be applied to goodwill, as neither of them is conceptually or practically perfect. However, we believe that regardless of the arguments in favour or against each of these models, global convergence (i.e. consistency of outcomes with US GAAP) is of significant importance. The FASB has tentatively decided to introduce an amortisation model for goodwill and, assuming this is taken forward, we encourage the IASB to seek to develop a similar approach. This is because of the potentially significant costs created by a significant difference between IFRS and US GAAP in accounting for goodwill and a related reduction in decision useful information for users of financial statements.

In addition to our comments supporting the proposals, we have a number of suggestions to improve and clarify the proposed requirements, particularly relating to disclosures.

Our responses to the questions in the DP are set out in the attached Appendix A.

We hope that you will find our comments and observations helpful. If you would like to discuss any of them, please contact me at +44 (0)20 7893 3300 or by email at abuchanan@bdoifra.com.

Yours faithfully

Andrew Buchanan

Andrew Buchanan

*Global Head of IFRS*

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# Appendix A

*<u>Question 1</u>*
*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?*

We agree with most, but not all, of the Board's conclusions; we have noted our views in questions 2-14. Additionally, the fact that the FASB tentatively decided to introduce an amortisation accounting model for goodwill at its 16 December 2020 meeting affects our view of the approach the IASB should take. Assuming the FASB's tentative decision is taken forward, we encourage the IASB to explore a converged approach, which would reduce differences between US GAAP and IFRS in accounting for goodwill.

(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?*

Where our answer would change depending on particular conclusions (e.g. impairment only or amortisation of goodwill), we have noted this in our responses to each question.

*<u>Question 2</u>*
*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?*

We agree that the proposed disclosures would provide better information about the subsequent performance of an acquisition. However, we suggest certain modifications to those requirements. See our response to question 2(b) below.

In addition to the additional disclosures as proposed in question 2(b), if the IASB ultimately decides to retain an impairment only model, other improvements should be made to the disclosure requirements.

Currently, IAS 36 requires an impairment test to be carried out at least annually, and certain disclosures to be made for goodwill and intangible assets with indefinite useful lives, regardless of whether impairment is recognised (IAS 36.134-135). We believe that these disclosures provide useful information to users of financial statements about the inputs and assumptions that have been used for the purposes of that test. In addition, those disclosures can provide useful information about the performance of cash-generating units that contain goodwill or intangible assets with indefinite useful lives. If a reasonably possible change in a key assumption would cause the carrying amount of a CGU to exceed its recoverable amount, then IAS 36 requires disclosure of information about how much 'headroom' exists before impairment might be recognised, as well as key assumptions used in determining that recoverable amount. However, we believe these disclosures might be further improved.

When financial statements require significant estimates be made in determining the carrying values of items recognised in the statement of financial position, users generally find information useful if it provides them a comparison of:

(i) Management's estimates; and
(ii) Management's current, cumulative to date estimate.

Examples of these types of disclosures already exist in IFRS, in particular, the requirement to disclose claims development for insurance contracts (IFRS 4.39(c)(iii) and IFRS 17.130). We believe a similar approach could be used for cash-generating units to which goodwill has been allocated, at least for a specified period of time.

We note that unlike most other assets and liabilities, management does not directly make an estimate of goodwill's value at the acquisition date because goodwill is a residual asset. Said another way, management is not explicitly required by IFRS 3 (or any other IFRS) to forecast cash flows in measuring the initial carrying value of goodwill. This may make it challenging to provide the analysis of initial estimate and current estimate as at the financial statement date. We believe this objective may still be achieved if the disclosure requirement were based on the cash flow estimates an entity is required to make. Under the current impairment only model, IAS 36 requires an impairment test be performed for goodwill at least annually, therefore, the cash flow estimates prepared for this purpose could be used to provide users of financial statements with information on the accuracy of management's estimates on a cumulative to date basis. The form of this disclosure is illustrated in the following example.

Assume Acquiror A purchases Acquiree B on 1 January 2020. Acquiror A has a 31 December year-end. Acquiror A pays Currency Units ('CU') 2,000 for Acquiree B and recognised CU 700 of goodwill in the purchase price allocation. IAS 36 requires Acquiror A to perform an impairment test of goodwill on an annual basis. Assume in this case, that Acquiror A performs the test on 31 December of each year. In preparing this impairment test each year, management makes an estimate of future cash flows.

As at 31 December 2024, the disclosure comparing management's estimates to actual cash flows to date can be illustrated as follows:

Example disclosure - 31 December 2024
financial statements

| | | *2021* | *2022* | *2023* | *2024* | *Cumulative estimate* | *Actual to date** | *Difference* |
|---|---|---|---|---|---|---|---|---|
| Forecast as at 31 December | 2020 | 100 | 100 | 120 | 120 | 440 | 335 | 105 |
| | 2021 | | 90 | 110 | 115 | 315 | 245 | 70 |
| | 2022 | | | 80 | 90 | 170 | 160 | 10 |
| | 2023 | | | | 85 | 85 | 80 | 5 |
| | Actual | 90 | 85 | 80 | 80 | | | |

*Actual to date is calculated by summing the total actual cash flows compared to the estimate made at each period end. For example, CU 335 in 2020 is the sum of 90, 85, 80 and 80 actual cash flows from 2021-2024 and CU 245 is the sum of 85, 80 and 80 from 2022-2024.

This disclosure provides users of financial statements with information on the accuracy of management's estimates of the future that had been made in the past, which provides an indication of the accuracy of future estimates without presenting future-oriented information (see our response to question 2(e)). For example, as at 31 December 2020, management had estimated that 2021-2024 would generate CU 440 of cash inflows, however, cumulative to date cash flows as at 31 December 2024 have only been CU 335. Even if sufficient headroom exists such that goodwill is not impaired in an impairment-only accounting model, this disclosure would assist a user in identifying a business experiencing deteriorations in cash flows compared to management's estimates over a period of time with subsequent cash flows potentially having been affected by unexpected changes in consumer preferences or government legislation.

In summary, if an impairment only model is to be retained, we believe that Acquiror A should be required to disclose a cumulative comparison of actual to initial expectation together with explanations of significant variances and, if impairment has not been recorded when there has been a significant negative variance between expected cash flows and actual, then disclosures supporting the rationale should be provided.

We believe this additional information would provide users with significant additional information to enable them to assess not only the performance of acquired businesses, but management's ability to make accurate estimates. We believe that if management is required to disclose information about how accurate they have been in estimating how an acquiree and other CGUs will perform, this will introduce additional discipline to the impairment test (question 10 in the discussion paper).

Although the table is based on the current impairment only model which requires at least an annual impairment test, a similar approach could be required for an amortisation and impairment model, for reporting periods after an impairment test has been required.

Finally, we believe that any additional disclosure requirements should be scoped similarly to the existing requirement in IFRS 3.B65, which requires entities to aggregate the more granular disclosure requirements that already exist in IFRS 3. The additional disclosures noted in the discussion paper and those that we propose introduce additional costs to preparers, therefore, appropriate allowances should be made to aggregate such disclosures if they are not individually material for separate acquisitions in the context of the financial statements as a whole.

*(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).*

We agree with these proposed disclosures. In particular, we believe it is important to require management to note the reason it no longer monitors the acquisition to see whether it is meeting its objectives (point (iv) above). If management is not required to make such a disclosure, then they may be motivated to cease monitoring their original objectives in order to reduce the related disclosure requirements.

In addition to these requirements, we believe additional disclosure requirements should be considered, as noted in our response to question 2(a).

*(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?*

We agree that the information disclosed should be based on that which is provided to the company's CODM, however, in addition to this, we believe that such information should be linked to how management has estimated cash flows as required by IAS 36 over time. This information would provide users with useful information as described in our response to question 2(a).

If specific guidance is not provided relating to the types of disclosures and the minimum requirements, then 'boilerplate' disclosures may be common. For example, IFRS 7 requires entities to disclosure information based on information provided internally to key management personnel (IFRS 7.34(a)), which is a similar principle to what has been described in this discussion paper. However, we observe that in practice, entities may focus their disclosures on information which is specifically required by IFRS 7, for example, financial assets by credit risk rating trades (IFRS 7.35M), a maturity analysis for financial liabilities (IFRS 7.39), etc.

(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?*

We do not believe that commercial sensitivity is a valid reason for companies not to disclose information described in question 2(b) or in the additional disclosures we noted in response to question 2(a). If an acquisition is material, then a substantial amount of resources (both financial and non-financial) have been used to effect the business combination. Users of financial statements are commonly investors in debt or equity instruments, who fund such acquisitions, therefore, management should provide users with information on how the resources of the entity have been expended.

(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 have member firms in more than 160 jurisdictions worldwide. Based on our outreach, we believe that the requirements must be written in such a way to avoid conflict with certain securities regulations. This is because we believe that in some jurisdictions, some of the CODM's objectives for the acquisition and the metrics used to monitor progress could be seen as forward-looking information.

Preparers and auditors already need to consider this issue in satisfying the disclosure requirements of existing IFRS standards due to this issue. For example, in disclosing key assumptions made in estimating the recoverable amount of a cash-generating unit to which goodwill has been allocated, some entities need to ensure that these disclosures do not contain forecasts. For example, in some jurisdictions, disclosing that management has estimated discounted cash flows over the next 3 years to be an amount of X is not permitted in the entity's financial statements due to securities regulation.

The example of a potential disclosure that we included in our response to question 2(a) avoids this problem because it compares management's initial estimate on a cumulative to date basis. Said another way, management would only be disclosing cash flows to date that were expected as at the time of acquisition with historical information about actual cash flows, which does not contain forward-looking information. We believe this type of disclosure still provides users with useful information, as it allows them to compare the accuracy of management's estimates to date.

*<u>Question 3</u>*
*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 agree with the plan to develop these disclosure objectives. This type of qualitative information is important for users of financial statements to understand why a business combination has occurred.

*<u>Question 4</u>*
*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.*

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

We do not agree that further disclosures relating to synergies should be developed. IFRS 3.B64(e) currently requires a qualitative description of the factors that make up the goodwill recognised, such as expected synergies from combining operations of the acquiree and the acquirer. We believe this disclosure is useful in instances where a significant portion of the acquisition price paid relates to expected synergies (e.g. selling complementary goods and services, etc.).

The proposed disclosures include a requirement to disclose significantly more information, including 'the estimated amount or range of amounts of the synergies'. Disclosing quantitative information about synergies would require a robust definition of what 'synergies' mean in the context of IFRS. No such definition currently exists, and we believe it would be challenging to develop a definition. Additionally, in disclosing 'the estimated amount or range of amounts of synergies' entities would appear to be required to provide estimates of forward-looking information, which may not be in compliance with securities regulations in many jurisdictions (see our response to question 2(e)).

We believe the existing requirements of IFRS 3.B64(e), the other proposed disclosure requirements and those we proposed in our response to question 2(a) would provide users of financial statements sufficient decision useful information.

We agree with the proposal to specify that liabilities arising from financing activities and defined benefit pension liabilities are major classes of liabilities.

*<u>Question 5</u>*
*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?*

We agree with the Board's preliminary view. We agree that disclosing such information provides users of financial statements with useful information that they may not be able to ascertain otherwise. For example, if the acquiree does not produce publicly available financial information for users of financial statement to base their own pro forma estimates on (or does not produce that information at the same time as the acquiror), or if the acquiree's business is highly seasonal.

*(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 required to explain how such pro forma information should be prepared. In our experience, preparers are able to produce the information accordance with the current requirements that are included in IFRS Standards.

*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 do not agree that entities should be required to disclose 'operating profit before acquisition-related transaction and integration costs', however, we agree that disclosing 'operating profit before acquisition-related transaction costs' would provide users with useful information.

We disagree with the proposed requirement that 'integration costs' be adjusted in this measure because, if management believes that such disclosure is useful, they could choose to disclose a management performance measure ('MPM'), which is contemplated in the General Presentation and Disclosure Exposure Draft, which was issued earlier in 2020. 'Integration costs' is also a subjective term, which is not currently defined by IFRS and we believe it would be challenging to develop a sufficiently robust definition.

In contrast, 'acquisition-related transaction costs' are already well understood by preparers and users because IFRS 3.B64(m) requires such expenses to be disclosed. Taken together with operating profit, which will have a robust definition (assuming the exposure draft 'Primary Financial Statements' is finalised largely as proposed as an IFRS standard), disclosing 'operating profit before acquisition-related transaction costs' would not be costly for preparers, and would provide useful information. This figure would provide users with an estimate of the 'incremental' profit earned by an acquiree in the period, after considering the costs required to affect the business combination.

We do not agree with the proposal to require the disclosure of 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. We believe that the other disclosure requirements proposed by the discussion paper are useful, but must be weighed holistically together to determine the additional cost borne by preparers in providing them. In considering this, we believe this is the least important of the disclosures proposed in the discussion paper. This is partially because much of the information relating to operating cash flows of the acquiree since acquisition could be estimated based on other information provided in the financial statements, assuming the acquiree is significant (e.g. segmented profit or loss +/- changes in working capital derived from the segmented disclosures and the acquisition date values of major assets and liabilities acquired).

*Question 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?*

We agree that the impairment test cannot be feasibly changed to achieve a higher quality result than the current requirements without a fundamental change to the model, which is beyond the scope of this discussion paper. As noted in the discussion paper, such concerns were raised during the post-implementation review of IAS 36, and we do not believe that significant additional considerations are relevant.

As noted in the discussion paper, although there may be ways to reduce the amount of shielding that occurs as goodwill acquired in a business combination is consumed and replaced with internally generated goodwill, there is no practicable way to address this concern without significant additional costs being incurred.

(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?*

Not applicable, as we agree in question 6(a).

(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 believe that another contributing factor for the concerns that impairment losses on goodwill are not recognised on a timely basis is the requirement in IAS 36 that value-in-use be based on cash flow projections on the most recent financial budgets/forecasts approved by management (IAS 36.33(b)). We observe that in many cases, budgets and forecasts prepared by management are aspirational, which is designed to incentivise certain behaviour (e.g. sales targets, bonuses, commissions, etc.), rather than be a neutral estimate of uncertain future events. In some cases, management budgets may represent an 'upper zone' in terms of an acceptable range of cash flow estimates, and in order to obtain a neutral estimate, adjustments would need to be made.

While IAS 36.34 requires management to assess the reasonableness of the assumptions on which its current cash flows projects are based, the fact that these estimates are based on management approved budgets may inherently bias the starting point of the value-in-use test in a way that cannot be satisfactorily dealt with based on the existing requirements of IAS 36.

We believe that the impairment test would be improved if IAS 36 required management's cash flow projections to be used as a starting point, with a requirement to incorporate probability weighted scenarios such that the overall projection is a neutral forecast of future results. This would be similar to the projections of forecast cash flows which are used for the purposes of an expected credit loss provision in accordance with the requirements of IFRS 9.

(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?*

As noted in our response to question 2(a), we believe that the disclosure requirements of IAS 36 should be expanded to provide users information on the accuracy of management's historic forecasts and estimates used to determine recoverable amounts on a cumulative to date basis.

*Question 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.)*

During our outreach process, we received mixed and strongly held views as to whether the current 'impairment only' model should be replaced with an 'impairment + amortisation' model. As has been noted in the discussion paper, neither of the models is conceptually and practically perfect, and neither of them is clearly superior to the other.

We observe that amortising goodwill is a simpler methodology and results in fewer instances where a sudden and potentially large impairment of goodwill is recognised. Additionally, we believe that in many cases, the value that is subsumed into goodwill (e.g. assembled workforce, synergies, etc.) may be wasting in nature, meaning their value is consumed and reduced over time, which is consistent with an amortisation model.

However, amortisation expense would almost certainly be adjusted by users of financial statement, which reduces the information value of profit or loss and every sub-total affected by this amount. Additionally, recognising impairment of goodwill provides confirmatory value to users, meaning that despite the loss potentially being recognised relatively late due to shielding, the disclosure of the inputs in the impairment test (IAS 36.134-135) are extremely useful. A model that required amortisation and impairment would result in fewer impairment losses due to the decreasing value of goodwill over time.

Therefore, based on the technical merits of the two approaches, we have mixed views, however, our overall view is affected by the fact that on 16 December 2020, the FASB reached a tentative view that goodwill should be amortised. Assuming this approach is taken forward, significant costs would be created if the IASB did not seek a converged approach in the subsequent accounting for goodwill. Therefore, we believe that the IASB should seek to achieve a converged approach.

Please refer to our response to question 13 for our views on the costs that would be incurred if convergence between FASB and IASB is not reached in this area, which we believe would be significant.

(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 on the amortisation of goodwill has not changed since 2004. Our views on the pros and cons of this approach are discussed in our response to question 7(a).

Amortisation over a specified period will rarely reflect the consumption of the goodwill because it will depend on the industry and the nature of the entity acquired. Consequently, an amortisation model will necessarily be somewhat arbitrary rather than accurately depicting the consumption of goodwill.

(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?*

In many cases, amortisation of goodwill may result fewer charges for impairment being recognised in financial statements because reducing the carrying value of goodwill over time will result in impairment losses being less common. As a practical point, the amortisation of goodwill could contribute to the elimination of some of the ‘surprise factor’ that currently often arises under the impairment only model when goodwill is impaired.

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

Acquired goodwill is distinct from internally generated goodwill in that a price is attributable to that goodwill. The value of any type of goodwill is challenging to estimate or observe in any way other an indirect manner, which is why IFRS 3 does not permit or require goodwill to be measured at fair value; instead, it is often estimated as a residual amount. The initial carrying value goodwill may be indirectly affected if non-controlling interest is measured at fair value in accordance with IFRS 3.19(a), however, only the portion of goodwill attributable to non-controlling interest will have an observable value based on the fair value of non-controlling interest at the acquisition date.

Estimating a value to attribute to internally generated goodwill is more challenging because it cannot be estimated as a residual value without a price for the combined group of assets and processes to which that goodwill relates being established.

Additionally, goodwill acquired in a business combination carries a duty of responsibility for management to report on results of the acquired business subsequent to the acquisition. This is because business combinations often require significant financial and non-financial resources be expended, meaning that goodwill relating to a business combination has a cost attributable to it, in which users of financial statements have an interest. For example, in determining whether the price paid for a business was reasonable, a user of financial statements might consider an impairment of goodwill two years after the business was acquired a sign that management may have paid too high a price. Such concerns of users of financial statements do not exist for internally generated goodwill. While internally generated goodwill does come at a cost (e.g. development of the business, advertising, training employees, etc.), it is not recorded as an asset in the statement of financial position, and is much more challenging to estimate and cannot be done in a manner that is not arbitrary.

We also note that the recognition of goodwill acquired in a business combination may indirectly result in the recognition of internally generated goodwill. This is because goodwill recognised in a business combination may be ‘shielded’ from impairment by cash flows generated by organic growth within an organisation. As the separately acquired goodwill would otherwise be impaired if not for the effects of this shielding, the internally generated goodwill is indirectly recognised due to this shielding effect. Therefore, the current accounting model may result in the indirect recognition of internally generated goodwill by virtue of separately acquired goodwill being recognised, whereas an identical entity would not be able to recognise internally generated goodwill if it does not have sufficient separately acquired goodwill to achieve the effect described above.

(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?*

We believe that many companies would adjust amortisation of goodwill from reported profit or loss in order to produce management performance measures (e.g. EBITDA and other similar measures which would exclude amortisation of goodwill).

The reasons for this are similar to the reasons why other 'non-cash' types of expenditure are adjusted (e.g. amortisation of property, plant and equipment, share-based payments, fluctuations in fair value of investment property). Part of these reasons is that these are amounts recognised in income, which management may consider should be adjusted to provide users of financial statements with a closer approximation of net operating cash flows. However, property, plant and equipment (as well as goodwill) once cost an amount of financial resources to acquire, and this is typically cash. Adjustments to exclude amortisation from management performance measures arguably results in adjusted amounts not faithfully representing the cost of operating the business. However, these measures are commonly used, and we believe similar adjustments would be made for goodwill.

Under the impairment-only model, impairment losses are often adjusted as well, for the same reasons noted above (e.g. they are non-cash expenses/losses). However, because impairment losses are trigger-based rather than an ongoing recurring expense, we believe that users of financial statements do still obtain some information value when they are recognised.

*(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?*

If amortisation of goodwill were reintroduced, it would be challenging to determine its useful life in a non-arbitrary manner. One possible way to do this would be to require the component parts of goodwill to be estimated in some way. For example, which portion relates to assembled workforce, synergies between business line A and B, etc; however, determining useful lives for each of those components would be difficult and could result in arbitrary periods being determined.

In contrast, permitting a consistent, but arbitrary maximum period to be used (e.g. 10 years) would not necessarily provide useful information to users of financial statements either. However, our view of the appropriate approach to be taken in accounting for goodwill would be affected by the model adopted by the FASB, which should be considered by the IASB due to the costs that would be incurred globally by companies in applying two substantially different models for goodwill.

*<u>Question 8</u>*
*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?*
*(b) Do you have any comments on how a company should present such an amount?*

We do not agree that the Board should develop such a proposal. We do not believe it is appropriate to 'carve out' a portion of total equity relating to that goodwill for two reasons:

1. Any user of financial statements could easily obtain this information by subtracting one figure from the other, meaning that the introduction of a new requirement is not necessary; and
2. Financial statement users already have complex methodologies to adjust total equity and/or assets. For example, many banks already deduct goodwill from total assets when they are determining a borrowing base, along with other complex adjustments.

*<u>Question 9</u>*
*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?*

If an impairment only model is to be followed, we strongly disagree with the Board's preliminary view that the requirement to prepare an annual impairment test should be removed.

As the Board has observed, the current requirements already produce impairment losses that arguably are (or appear to be) recorded too late. Removing the requirement to perform the test annually will only exaggerate this problem.

We agree that the test might be simplified in a number of ways to reduce the complexity of performing it (see our response to question 10), however, the loss of information for users of financial statements arising from elimination of the annual testing requirement would be significant. Significant disclosures would no longer be provided (IAS 36.134-135) and the recognition of impairment losses could be delayed. Additionally, additional disclosures proposed in question 2 would become more challenging to prepare if management is not required to perform an impairment test at least annually. This is because obtaining the information relating to cash-generating units to which goodwill has been allocated may not be straightforward based on entities' systems and processes unless an impairment test is otherwise required to be performed, which necessitates that information be generated.

We note that if the Board were to conclude that goodwill should be amortised, then we believe an indicators-only impairment test would be appropriate. This is because the mechanical reduction in the carrying amount of goodwill would result in a reduction in amount of losses recognised if and when an impairment test is carried out as a result of a trigger event.

*(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.*

As noted in our response to question 9(a), removing the requirement to perform the impairment test annually would result in reduced costs (e.g. management time, hiring valuation experts, etc.). However, we do not believe the benefits of this proposal outweigh the costs if an impairment only model is retained.

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

We believe strongly that this proposal would make the impairment test significantly less robust if an impairment only model is retained. This is for the reasons we have noted in our response to question 9(a).

*Question 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?*

We agree that the Board should develop these proposals. These would significantly reduce the costs of performing the impairment test because they would reduce the number of adjustments management is required to make to information they might otherwise have available because they produce it for their own purposes.

For example, entities will commonly produce long-term cash flow forecasts for business units, however, under existing requirements, management is regularly required to make significant adjustments to these forecasts to eliminate cash flows that may arise from capital improvements which are not permitted to be included in the current value-in-use test.

It is challenging for entities to do so because this is not how they project cash flows for internal purposes and it is often difficult to distinguish between the cost of maintaining assets, which must be included in a value-in-use estimate, and improvements and enhancements to assets, which must be excluded.

(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.*

We do not believe additional discipline should be specified because we do not believe there is a cost-effective manner to do so that will achieve the desired result. However, as we noted in our response to question 2(a), modifying certain disclosure requirements may have the indirect effect of increasing discipline.

*Question 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 do not believe the Board should develop any of the simplifications summarised in paragraph 4.55. As noted earlier in our response, performing the impairment test is already complex, and most of the proposals noted in paragraph 4.55 would produce further guidance, which may, rather than simplifying it, increase the complexity of the test by reducing management's ability to make judgements that they consider to be appropriate in the circumstance.

(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?*

We have no further suggestions for improving the goodwill impairment test that would not provide less useful information to investors.

*Question 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?*

We agree that the Board should not develop such a proposal. As noted earlier in our response, there are legitimate concerns about the information value produced by any model applied to account for goodwill subsequent to initial recognition. Subsuming further portions of the purchase price paid into this value would not produce more useful information, despite the fact that some purchased intangibles have their values determined using subjective techniques. We believe that the current separation of intangible assets provides additional useful information to users of financial statements.

(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?*

Not applicable as we agree.

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

Our view would not change if amortisation of goodwill were to be reintroduced. This is because we believe that identifiable assets, including identifiable intangible assets, acquired in a business combination should be accounted for separately.

*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 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?*

In weighing the costs and benefits of any approach, careful consideration needs to be given to decisions made by the FASB. As noted earlier in our response, on 16 December 2020, the FASB tentatively decided that goodwill should be amortised on a straight-line basis. We believe that the IASB should seek to develop a converged approach for the subsequent accounting for goodwill or else significant costs will be incurred globally. Significant differences between US GAAP and IFRS would create numerous significant and potentially costly issues, including:

- A significant reduction in the ability to compare companies on a global basis;
- Significant additional cost for entities required to prepare accounts under both sets of standards (e.g. a subsidiary in the United States with a parent in Europe); and
- The opportunity for 'accounting arbitrage' where entities which have a choice of framework (e.g. foreign private issuers in some jurisdictions might choose either US GAAP or IFRS based on which framework serves their own interest rather than those of users of their financial statement).

Our answers to numerous questions in the DP are affected by the decisions of the FASB due to our view that neither of the accounting models (impairment only and amortisation plus impairment) are conceptually or practically perfect, meaning that a converged accounting approach is more important than the particular approach taken.

The pros and cons of either of the accounting models that could be applied to goodwill are outweighed by the costs described above if a significant GAAP difference were created between IFRS and US GAAP.

*<u>Question 14</u>*

*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?*

We have no further comments.