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Mr Hans Hoogervorst
International Accounting Standards Board
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Our ref RD/288

14 December 2020

Dear Mr Hoogervorst,

Comment letter on Discussion Paper DP/2020/1 *Business Combinations – Disclosures, Goodwill and Impairment*

We appreciate the opportunity to comment on the International Accounting Standards Board's ('the Board') Discussion Paper DP/2020/1 *Business Combinations – Disclosures, Goodwill and Impairment* ('the DP') published in March 2020. We have consulted with, and this letter represents the views of, the KPMG network.

In considering the Board's preliminary views, we do not see a single unifying concept that necessitates tying together the introduction of goodwill amortisation, relief from the mandatory annual impairment test and the disclosures about an acquisition and its subsequent performance. We believe that each of the Board's preliminary views should be assessed separately rather than as a package.

We are supportive of the Board's initiative to enhance information disclosed on acquisitions. However, our view is that transparency and consistency in application will only be elicited through clear and specific disclosure requirements; principle-based requirements alone will not be sufficient.

We also note that sections of the information being proposed for disclosure is management commentary type information. Whilst they may be useful, there are concerns that financial statements may not be the most appropriate location for presenting such information.

We are supportive of the Board's initiative to simplify the calculation of value in use ("VIU"). We also believe that the current impairment test can be improved by adding application guidance to IAS 36 *Impairment of Assets* and by requiring the performance and disclosure of reasonableness tests and back-testing information.

We are not supportive of the relief from the mandatory annual impairment test. This would make impairment testing significantly less robust and exacerbate the recognition of goodwill impairments “too little, too late”. We are also not convinced that it would result in significant cost savings.

In considering the Board’s preliminary view on reintroducing goodwill amortisation, we acknowledge that the impairment-only model for subsequent accounting for goodwill may theoretically be better than a mixed impairment-amortisation model in providing more relevant information to users about the performance of a CGU. However, considering the application of this model in practice, we have mixed views with a slight preference towards reintroduction of amortisation. We encourage the Board to cooperate with the FASB on this issue, given its pervasiveness, for the sake of consistency from which users would benefit.

The Appendix to this letter contains our detailed responses to the questions on the Board’s preliminary views.

Please contact Reinhard Dotzlaw at Reinhard.Dotzlaw@kpmgifrg.com, Peter Carlson at pcarlson@kpmg.com.au or Eiichi Fujita at Eiichi.Fujita@jp.kpmg.com if you wish to discuss any of the issues raised in this letter.

Yours sincerely

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Appendix

This appendix contains our detailed responses to the questions of the Discussion Paper.

Question 1

<p>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.</p>
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<p>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.</p>
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| <p>(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?</p> <p>(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?</p> |
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- (a) We are not supportive of the Board's approach to view the proposals as a package rather than independent proposals that should be considered separately.

As explained in (b) below, we do not see a single unifying concept that necessitates tying together the introduction of goodwill amortisation, relief from the mandatory annual impairment test and the disclosures about an acquisition and its subsequent performance.

In the name of achieving a cost-effective package, the Board is proposing to provide a relief from the mandatory annual impairment test and to simplify the VIU test. We support the proposal to simplify the VIU test but not the relief. Furthermore, we are not convinced that the proposed relief would result in significant cost savings; such potential savings may be better achieved by the Board making the relief in paragraph 99 of IAS 36 more operable and usable (please see our answer to Question 9).

As for the package itself, we believe that the combination of the Board's proposal to provide companies with a relief from having to perform the mandatory annual impairment test (if there is no indicator of impairment) and the proposal not to reintroduce amortisation of goodwill is counter-productive in achieving the objective of recognising impairment losses on goodwill on a timely basis.

(b) None of our answers depend on answers to other questions.

Our view on keeping the mandatory annual impairment test is not dependent on our view whether amortisation of goodwill should be reintroduced. Although amortisation helps mitigate the risk of overstating the carrying amount of goodwill, an impairment may nevertheless occur, especially in the early years after an acquisition.

Our views on whether to reintroduce goodwill amortisation and whether to keep the mandatory annual impairment test do not depend on our view with respect to requiring additional disclosures about an acquisition and its subsequent performance. Multiple studies have found that a large majority of mergers and acquisitions are unsuccessful (i.e. acquirers tend to overpay for the acquired business in relation to the expected benefits). Although an acquired business may underperform expectations, it may not be impaired in the context of the investment's recoverability.

We do not believe that the proposed disclosures about the performance of an acquisition should reduce the reliance on the impairment test. This is because this information is about the success of an acquisition rather than the related but different issue about the recoverability of the recognised goodwill. Therefore, additional disclosures about the performance of an acquisition would not necessarily appropriately compensate for the loss of disclosures about the impairment test. Furthermore, management may decide to stop separately monitoring an acquisition's performance and in such case the disclosures about the performance of the acquisition would no longer be provided by the company.

Question 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.

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| <p>(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?</p> <p>(b) Do you agree with the disclosure proposals set out in (i)–(vi) below? Why or why not?</p> <p>(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</p> |
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- 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).
- (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?
 - (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?
 - (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 are supportive of the direction the Board is taking to promote enhanced information around business acquisitions. We agree that the information provided should be based on the information and the acquisitions that the CODM reviews.

However, we believe that disclosure requirements need to be clear and specific. The proposed principle-based approach – allowing much flexibility for the reporting entity – would not be helpful in mitigating diversity in practice nor close gaps in disclosure expectations between preparers and users of financial statements. Further clarity in the required level of disclosures would also reduce the potential for commercial sensitivity arguments.

Consideration may also need to be given as to how long the information remains relevant and therefore disclosed. For example, the CODM may continue to use the same metrics to evaluate the performance of an investment which was previously an acquired business but is now a business-as-usual operating segment.

There is also the concern that some of the proposed disclosures may widen the scope of financial statements for management commentary type information.

Question 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?

As stated in our response to Question 2, we believe that principle-based disclosures alone will not be effective in encouraging the quality and consistency of information sought by investors. To best meet its stated objective the Board should consider accompanying these disclosure objectives with clear and specific disclosure requirements.

Question 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.
- Do you agree with the Board’s preliminary view? Why or why not?

We agree the information proposed for disclosure could help investors to better understand what the entity has paid for in an acquisition. However, we also note that IFRS 3.B64(e) already requires a qualitative description of the factors that make up goodwill, including expected synergies from combining operations. There are also other requirements in IAS 1 and IAS 36 which cover some of the same information proposed for disclosure.

The fact that there is continued demand for better information despite these existing requirements suggest that encouraging companies to provide quality disclosures may be challenging in practice. Consistent with our observation in Question 2, more detailed and specific disclosure requirements which complement the proposed disclosure objectives (and these existing requirements) would be the most effective. We also believe that locating all of the relevant proposed disclosures in one location (for example IFRS 3) will further aid clarity by helping to ease navigation. We believe that the current spread of requirements across various standards is not helpful.

In addition, similar to the disclosures proposed in Question 2, the narrative nature of the information proposed for disclosure around expected synergies is more suited for management commentary than financial statements.

Question 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?

(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?

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 support the Board’s proposal to retain the current requirements around pro-forma information. We also do not oppose expanding the requirement to cover cash flows from operating activities. However, we believe that the benefits will only be realised if there is related application guidance to ensure consistency and understandability.

We do not support the proposal to replace the term ‘profit or loss’ with ‘operating profit before acquisition-related transaction and integration costs’. We believe that introducing such new concepts does not help with already onerous and unfocused disclosure requirements. Furthermore, it may not be aligned with the definition of ‘Operating profit’ in the Exposure Draft *General Presentation and Disclosures* and may imply that ‘acquisition-related transaction and integration costs’ are not part of operating expenses.

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?
- (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?
- (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?

- (a) We agree with the Board’s preliminary view 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 for the reasons mentioned in the DP.

We believe that the current impairment test can be improved by adding application guidance to IAS 36 (please see our answer to Question 11). Furthermore, to address the issue of over-optimistic management assumptions, we believe that the impairment test can be made more effective by adding a requirement to consider reasonableness tests such as a reconciliation of recoverable amount estimates to the entity’s market capitalisation based enterprise value or benchmarking implied valuation multiples against relevant market multiples. This may encourage companies to take a closer look at the assumptions used in calculating VIU and may instil greater discipline in the impairment process with no significant additional cost. Disclosure of reasonableness tests and back-testing information would expose over-optimistic forecasts to scrutiny and increase rigour in the process. If the Board decides to add such a requirement, we believe that it would be useful to provide educational material on performing reasonableness tests.

- (b) n/a.

- (c) We agree that shielding and management’s over-optimistic estimates are the main two reasons why impairment losses are not recognised, or not recognised on a timely basis, though we believe the predominant reason for the late recognition is management’s over-optimistic estimates. Shielding is not really a timing issue because IAS 36 requires that recognised goodwill from acquisitions be tested for impairment with other operations that may have unrecognised goodwill, when this is appropriate under the entity’s cash generating unit structure. As such, shielding can lead to no recognition of impairment at all. We believe that it may be possible to reduce the shielding effect to some extent by adding guidance on the allocation and re-allocation of goodwill but this may affect the broader principle of testing acquired and other units as part of a single cash generating unit (please see our answer to Question 11(a)).

Management often assesses the recoverability of goodwill from investments that it itself had decided to acquire. In 2014, KPMG published a report [Who cares about goodwill impairment? A collection of stakeholder views](#). Page 5 in our report refers to studies that have considered the extent to which the timing and magnitude of

impairment charges may reflect management/agency issues – e.g. management may have an incentive to delay (or accelerate) or to minimise (or maximise) an impairment charge for reputational, compensation or financing covenant reasons. Such studies would appear to indicate that agency issues may play a role in the timing and magnitude of goodwill impairment recognition. Furthermore, the asymmetrical accounting for goodwill creates a disincentive to record an impairment because it can never be reversed.

According to paragraph 3.29 of the DP, the Board considers that if estimates of cash flows are too optimistic, this is best addressed by auditors and regulators, not by changing IFRS Standards. Using their professional scepticism and judgment, auditors regularly challenge management’s assumptions and estimates as required by auditing standards. This also is a significant focus area by audit regulators. However, auditors do not have the in-depth knowledge of the company, its operations, and its possible development compared to that of management of the company and those charged with governance. Although such challenge by auditors may temper any over optimism by management, we believe any management biases can be further tempered by introducing a requirement to perform and disclose reasonableness tests.

(d) Please see our answer to Question 11.

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

(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?

- (a) Whether goodwill should be amortised is a long-standing question that has been debated for years. There are conceptual merits to different views about what goodwill represents and how it should be accounted for. As a firm, we have mixed views on this. The impairment-only model for subsequent accounting for goodwill may theoretically be better than a mixed impairment-amortisation model in providing more relevant information to users about the performance of the CGU. However, we believe that the benefits of the impairment-only model are outweighed by the drawbacks arising from the application of this model in practice and therefore we have a slight preference towards reintroducing the amortisation of goodwill.

There are concerns over the application of the current impairment model, with impairments being perceived as “too little, too late”. In some cases impairment recognition may be motivated by a big bath strategy – e.g., after a change in top management has occurred. Therefore, we believe that a mixed model is a practical solution that would alleviate the “too little, too late” issue by reducing the carrying amount of goodwill.

As indicated in our answer to Question 13, our answers do not depend on whether the outcome is consistent with US GAAP as it exists today, or as it may exist after the current work of the Financial Accounting Standards Board (“FASB”). Nonetheless, we encourage the Board to cooperate with the FASB on this issue, given its pervasiveness, for the sake of consistency from which users would benefit.

- (b) We believe that significant issues have been raised since 2004, in particular in the aftermath of the global financial crisis, on the application of the goodwill impairment test in practice that support our view in our answer to (a) above.

Our report [Who cares about goodwill impairment? A collection of stakeholder views](#) indicated considerable support for a return to an amortisation-based model of accounting for goodwill. Page 5 in our report refers to studies that have shown that goodwill impairments generally lag behind true economic impairment. This seems to imply that the market, at least partially, anticipates impairments before their announcement. Two separate studies have shown that the announcement of goodwill impairments lag deteriorating operating performance and share returns by at least two years. Other studies have considered the extent to which the timing and magnitude of impairment charges may reflect management/agency issues (please see our answer to Question 6(c)). As we indicated in our report, some use the

argument of impairment charges being recognised “too little, too late” to support their preference for reintroducing goodwill amortisation.

- (c) We do not view the introduction of goodwill amortisation as a tool to resolve the main reasons mentioned in Question 6(c), it is only a practical approach that may alleviate the “too little, too late” issue by reducing the carrying amount of the acquired goodwill and with it the risk of its potential overstatement.
- (d) We do not believe that it is practically possible to distinguish between acquired goodwill and the internally generated goodwill in the same CGU. The two become indistinguishable after the acquisition. Goodwill is allocated to all of an acquirer’s CGUs that are expected to benefit from the synergies of the business combination. Therefore, the integration of the acquired business effectively co-mingles the acquired goodwill with the unrecognised internally-generated goodwill from the existing business.
- (e) If amortisation was to be reintroduced, we strongly believe that companies would add-back the goodwill amortisation expense in their alternative performance measures, in the same way that companies add back amortisation of intangible assets. Prior to the abolishment of goodwill amortisation under IFRS and US GAAP, many companies reported earnings before goodwill amortisation on the grounds that it is a “non-cash” item. Similarly, companies add back impairment losses in their alternative performance measures under the impairment-only model. However, management teams are often much less sensitive to recording amortisation rather than impairments, suggesting they are more concerned with users’ reactions to impairment notwithstanding the presentation adjustments adopted.
- (f) Determining the period and pattern of goodwill amortisation may be a complex exercise for preparers, in which they may face significant challenges. Such a determination could be very subjective. We believe that the approach/es for determining the goodwill amortisation period should limit the subjectivity involved and be cost-effective for preparers. In its Invitation to Comment, *Identifiable Intangible Assets and Subsequent Accounting for Goodwill*, the FASB listed several possible approaches for determining the goodwill amortisation period, including a default period and a period that is based on weighted-average useful lives of identifiable asset(s) acquired. Each approach has its benefits and its limits. The default period approach is both easy to apply and objective, though it may not provide meaningful information on the economic consumption of goodwill. In some cases, determining the amortisation period based on the weighted-average useful lives of identifiable asset(s) acquired may provide more meaningful information. However, goodwill may relate at least in part to an expectation that the business will develop new unrecognised intangible assets into the distant future, replacing the

acquired intangibles, e.g., as is the case when a terminal value is calculated using a perpetuity formula. If so, a goodwill useful life equal to the weighted-average useful lives of the acquired tangible and intangible assets would have little to nothing to do with the expected economic life of the goodwill.

We would support amortisation on a straight-line basis due to the difficulty in reliably determining the pattern of consumption of the economic benefits embodied in the goodwill.

We encourage the Board to cooperate with the FASB on this issue, given its pervasiveness, for the sake of consistency from which users would benefit.

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

- (a) We believe that the Board should not develop such a proposal.

Given that the Exposure Draft *General Presentation and Disclosures* contains a proposed requirement for goodwill to be presented as a separate line item on the face of the statement of financial position, it is not clear what the benefits are in presenting equity excluding goodwill; it is a straight-forward calculation.

Presenting an amount of equity excluding goodwill may imply that goodwill is not an asset worth including in equity or that it is an asset that should be disregarded.

- (b) Consistent with our answer to 8(a), we do not have any comments.

Question 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?

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

- (a) We believe that the Board should not develop such proposals because removing the requirement to perform annually a quantitative impairment test would not reduce costs significantly (please see our answer to (b) below) and it would make the impairment test significantly less robust (please see our answer to (c) below). Removing this requirement would exacerbate the recognition of goodwill impairments “too little, too late”.

For the purposes of the annual impairment test, preparers can use the relief already included in paragraph 99 of IAS 36. We understand this paragraph is currently applied very conservatively in practice, perhaps to avoid challenges from auditors and securities regulators over management’s interpretation of “significant”, “substantial margin” and “remote” in paragraphs 99(a), (b), and (c), respectively. Rather than removing the requirement to perform annually a quantitative impairment test, we believe that the Board should build on the relief in paragraph 99 to make it more operable in practice so that companies will not hesitate using it when justified.

- (b) We do not believe that a significant reduction of costs would be achieved by the relief.

The costs of conducting the impairment test each year may not be significantly higher than the costs that would be incurred if the impairment test is run every few years because there would already be a process in place. Additionally, in cases where it is clear that no impairment exists, companies would not incur significant costs if paragraph 99 of IAS 36 is applied while in cases where an impairment is likely there is no difference. The experience with the qualitative evaluation under US GAAP (‘Step zero’) is that significant effort just short of a full impairment analysis is still required so the envisaged savings are unlikely to materialise.

- (c) In line with our answer to Question 9(a), we believe that the proposals would make the impairment test significantly less robust. If the impairment test is not performed on an annual basis, this may impede preparers’ competencies and processes (e.g. data collection) that are used in performing the impairment test. Additionally, if the impairment test is not performed on an annual basis, trend information on certain estimates (such as the WACC) that are used in the discounted cash flows (“DCF”) may not be available, as well as a history of the company’s previous estimates. This may undermine the auditor’s ability to perform back-testing and benchmark the

previous period estimates versus actual outcomes in order to assess management’s history of forecasting accurately or over-optimistically. This is a useful tool in assessing management’s estimates of future cash flows and, when necessary, determining whether, and to what extent, the discount rate should reflect forecasting risk.

We note also that removing the requirement to perform annually a quantitative impairment test would result in a loss of disclosures of the assumptions and estimates used by management in performing the impairment test (e.g. discount rate, growth rates, profitability) which users of the financial statements find very valuable.

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?
- (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.

(a) We believe that the Board should develop such proposals.

We support the removal of the restriction that prohibits the inclusion of cash flows arising from a future expected uncommitted restructuring or from enhancing an asset’s performance. We believe there is no conceptual reason for prohibiting or for having a higher burden to include such cash flows under VIU compared to FVLCD.

We support the second proposal to allow the use of post-tax cash flows and discount rates in estimating VIU on the grounds that, in general, only a post-tax discount rate is observable in the market. The proposal would align IAS 36 with the approach that has long been applied in practice of using post-tax inputs in performing the impairment test. See also our answer to Question 11(b).

We also suggest that the Board considers other simplifications to the VIU test – please see our answer to Question 11(a).

- (b) We are not in favor of requiring discipline (i.e., having a higher burden to be met in estimating the cash flows) in addition to that already required by IAS 36. The discipline required under VIU should be the same as under FVLCD; there is no conceptual basis for making a distinction. Under FVLCD these cash flows are included in the DCF if a market participant would include them in pricing the CGU. IAS 36 already has a threshold for including cash flows in VIU – paragraphs 33(a) and 38 of IAS 36 require that in using information from financial budgets or forecasts, this information should reflect reasonable and supportable assumptions and represent management’s best estimate.

Rather than requiring further discipline, it may be helpful to highlight in IAS 36 itself that management’s assumptions about future cash flows from future uncommitted restructurings or asset enhancements should be reasonable and supportable and subject to the disclosure requirements of IAS 36.134(d)&(f).

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?
- (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?

- (a) We believe that the Board should develop application guidance in the areas indicated in paragraph 4.55(a) and (d) of the DP. Application guidance could help reduce the complexity of the impairment test and improve consistency in its application in practice. We recommend that the Board develops guidance on the following items.

— **4.55(a): Guidance on how to adjust an entity’s cash flows to reflect market participant assumptions and to elaborate on the differences between VIU and FVLCD:**

When determining the recoverable amount using FVLCD, preparers often use a DCF calculation so as to include the impact of a future restructuring or asset enhancement to which management are not yet formally committed (which is prohibited under VIU). However, other than this, preparers generally do not adjust the cash flow estimates under FVLCD to reflect market participant

estimates because the latter are not observable. It would be useful to have application guidance in this area to clarify how to adjust cash flows to reflect a market participant's perspective.

If the Board decides to remove the restrictions mentioned in Question 10, fewer differences will remain between FVLCD and VIU. Consequently, it would be helpful if the Board elaborates on the differences that remain, by, for example, adding more items to the differences already listed in paragraph 53A of IAS 36, and explaining conceptually why such differences should persist.

One of the arguments supporting the Board's proposals is to better align VIU with FVLCD (paragraph 4.48(d)). We note that the Board has kept the restriction under VIU in paragraph 36 of IAS 36 to use a steady or declining growth rate, unless supportable by objective information; such a restriction does not exist under FVLCD. It is not clear why the Board has not sought to remove this restriction, or whether the Board does not see this as a difference between FVLCD and VIU.

Where the recoverable amount of a quoted CGU is measured at FVLCD, it would be helpful if the Board clarifies whether the unit of account of an investment in a subsidiary, associate or joint venture is the investment as a whole or the individual share making up the investment. The unit of account for such investments is not clear because the investment held by the entity comprises a number of individual shares. If the unit of account is the investment as a whole, it may be appropriate to add a premium in measuring the fair value of the investment – even if Level 1 prices exist for individual shares. However, if the unit of account is each individual share making up the investment, a premium related to the whole investment cannot be added in measuring the fair value of the investment.

- **4.55(d): Guidance on allocation and reallocation of goodwill to CGUs:** As mentioned in the DP, one of the key reasons for the delay in (or no) recognition of impairment is due to the shielding effect. We believe that providing guidance on the allocation of goodwill following a business combination (e.g., guidance on allocation methods) and on reallocation of goodwill following a restructuring or a disposal may somewhat alleviate the shielding issue and improve the application of the impairment test. There is limited guidance in this area in IAS 36.

Furthermore, the requirement in paragraph 80(a) of IAS 36 to allocate goodwill to the lowest level within the entity at which it is monitored for internal management purposes is not clear or well understood in practice. This is because companies do not monitor goodwill directly but rather businesses or business activities. The Board's preliminary view, as stated in paragraph 2.15 of the DP, is that the information a company discloses about an acquisition's

subsequent performance should reflect the information and metrics the company's management uses to monitor and measure the acquisition's progress. It is not clear from the DP whether the level at which management monitors an acquisition's performance (per paragraphs 2.15 and 2.25) should be the same as the level at which management monitors goodwill (per paragraph 80(a) of IAS 36) and whether this is the level at which goodwill should be allocated to CGUs. Moreover, it would be helpful to clarify how management's decision to stop monitoring the acquisition's performance would impact the monitoring of goodwill.

Regarding 4.55(b), If only few differences remain between VIU and FVLCD, the Board may wish to explore a move to a single method approach.

- (b) With respect to the proposal in paragraph 4.53(b) to allow companies to use post-tax discount rates in estimating VIU, we suggest that the Board develops guidance to address application issues that arise in performing such calculations on a post-tax basis – e.g., on how to take into account deferred taxes in performing the impairment test.

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

We agree that all identifiable intangible assets should continue to be recognised separately from goodwill. Whilst we are aware that some valuers in practice do not distinguish customer-related intangibles, we believe the disaggregated information is important for investors to understand what assets were acquired in a business combination.

Our view would not change even if amortisation of goodwill were to be reintroduced.

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?

We ultimately do not see a need for overall convergence between US GAAP and IFRS. We acknowledge that disparities may continue to exist, especially given the two GAAPs are based on fundamentally different conceptual frameworks.

However, we also appreciate that retaining existing convergence – where possible – would be helpful towards mitigating the use of non-GAAP measures.

We understand that the FASB is exploring the idea of whether amortisation should be added to the goodwill impairment model after the feedback received on its July 2019 Invitation to Comment. Working closely with the FASB on this initiative would be beneficial, given the relevant accounting principles are similar and the underlying issue is pervasive irrespective of the GAAP applied (see our answer to Question 7(f)).

Question 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?

We believe the following areas call for imminent attention from the Board.

Accounting for non-controlling interests (NCI)

Prior to 2008, the definition of minority interests was based on the minority's share of the net assets of the group; this was an easy concept to understand and apply, because the statement of financial position number could always be proven. However, the current requirement based on equity not attributable to the parent is more difficult.

The lack of a clear, comprehensive framework creates challenges in accounting for certain subsequent transactions, which has led to diversity in practice.

Examples of application challenges include:

- In a subsequent sale of interests to NCI while retaining control, IFRS 10.23 and B96 require the NCI to be adjusted. However, it is not clear how this adjustment should be made, especially when an entity elected to measure NCI using the proportionate interest approach. Further complications arise where goodwill – which would not have been attributed to NCI on initial recognition – is involved.
- Under IFRS 3.19, the proportionate basis of NCI measurement is limited to those that represent present ownership interests and entitle the holder to a share of net assets in the event of liquidation ('ordinary' NCI). It is not clear whether this should be interpreted as only a test for limiting the application of the proportionate approach, or whether it is also an instruction as to how to apply the proportionate approach – i.e. that it is the liquidation proportion.

This issue is particularly relevant when there is also other NCI measured at fair value.

- Where the proportionate interest approach is applied, it is unclear what effect the settlement of pre-existing relationships has on the measurement of NCI. For example, if the acquirer had a loan outstanding from the acquiree, should the net assets from which NCI's proportionate share is calculated be based solely on the identifiable net assets recognised in the business combination accounting as IFRS 3.19 suggests or the net assets of the acquiree as legally construed (i.e. including the loan that remains outstanding to the acquirer).

We await to see further progress being made on put options over non-controlling interests, with questions continuing to arise in practice. We also note that accounting for call options held by non-controlling interest also lacks clear guidance. For example, should/could a receivable be recognised if the option gives the holder access to returns?

IAS 38 Intangible assets

We support the idea of pursuing a broader project on intangible assets. There is growing evidence that IAS 38 has become outdated. Technological advancements are replacing historical, tangible asset-based business models by the day. As part of the broader project on intangible assets, the Board should therefore also consider how to improve the requirements to address the increasing number of complex technology-based arrangements (e.g. agile software development, cloud computing arrangements).

We also see a need for explicit guidance around variable payments and milestone payments.

The disparity in accounting between internally developed and externally acquired intangibles warrants attention as we believe this both fuels and exacerbates the debate around reintroducing goodwill amortisation and separate identification of intangible assets.

Interaction between IFRS 3 and IFRS 15

IFRS 3 does not include any exceptions to the recognition or measurement principles for contracts with customers. This leads to apparent tension between the business combination accounting under IFRS 3 (which is based on fair value and a market participant perspective) and subsequent accounting under IFRS 15 (which is based on the contract with the customer and an entity-specific perspective).

We recommend the Board investigate this matter – considering the various application issues the FASB¹ is already researching – to fill the void and resolve the confusion amongst preparers.

Accounting for asset acquisitions

The amended IFRS 3 allows more transactions to be accounted for as asset acquisitions applying the asset concentration test. Despite the fact that these transactions are often substantial and may involve features similar to a business combination (e.g. non-controlling interests, replacement share based payments), no further guidance has been provided for such transactions. Compounded with the lack of specific disclosure requirements, it can be difficult for users to understand the magnitude of the acquisition and accounting applied.

¹ FASB (February 2019), [*Invitation to Comment: Measurement and Other Topics Related to Revenue Contracts with Customers under Topic 805*](#)