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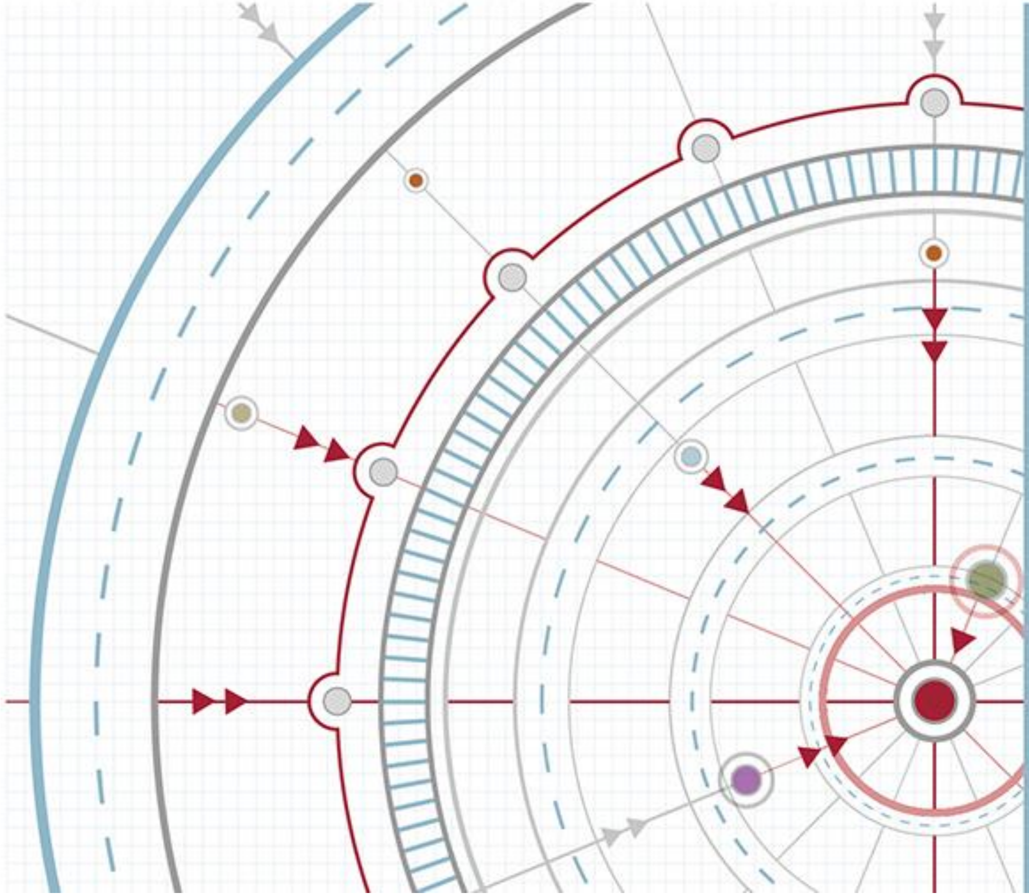

# Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment*

Accounting Standards Advisory Forum meeting
April 2020

ASAF Agenda Paper 1

The views expressed in this presentation are those of the presenter, not necessarily those of the International Accounting Standards Board or IFRS Foundation.



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# Contents

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# Purpose of meeting

# Purpose of meeting



## Discussion Paper

- Present Board's preliminary views and provide clarification where needed.
- Comment period until Mid September.

## Outreach & Fieldwork

The staff is seeking advice on:

- How to encourage responses from stakeholders on DP; and
- How fieldwork on disclosures could be conducted.

# Questions for discussion



## Questions for ASAF members

Do members have:

- Any clarifications or questions on the contents of the Discussion Paper?
- Any suggestions on outreach activities for the project?
- Any suggestions on the fieldwork approach?
- Any other comments?

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# Project background & overview

# The Discussion Paper



**Timeline**

| 2004 | 2013–2015 | 2015–2020 | March 2020 |
|---|---|---|---|
| IFRS 3 issued* | PIR of IFRS 3 | Goodwill and Impairment Project | Discussion Paper |

**Objective**

To improve the information companies provide to investors, at a reasonable cost, about the businesses those companies buy.

**Feedback**

The Board is mainly seeking comments on:

- usefulness and feasibility of its new disclosure ideas; and
- any new evidence or new arguments on how goodwill should be accounted for.

* IFRS 3 introduced the impairment-only approach and replaced IAS 22 (which required amortisation).

# Stakeholders' feedback



**What we have heard**

Investors do not get enough information about acquisitions and their subsequent performance.

The impairment test is complex and costly for companies.

Impairment losses on goodwill are recognised too late.

Goodwill should be amortised. It has been paid for and so, sooner or later, it should have an impact on profit or loss.

It is difficult to recognise intangible assets, such as customer relationships and brands, separately from goodwill.

# The Board's preliminary views



| | | |
|---|---|---|
| ❶ Improving disclosures about acquisitions | Require companies to disclose:<br>• managements' objectives for acquisitions, in the year of acquisition; and<br>• how acquisitions have performed against those objectives in subsequent periods. | |
| ❷ Improving accounting for goodwill | A Can impairment test be made more effective? | No, not at a reasonable cost. |
| | B Should goodwill be amortised? | No, retain the impairment-only model. |
| | C Can impairment test be simplified? | Yes, provide relief from the annual impairment test and simplify how value in use is estimated. |
| ❸ Other topics | • Require companies to present on their balance sheets the amount of total equity excluding goodwill.<br>• Do not change the range of intangible assets recognised in a business combination. | |

# ➊ Improving disclosures about acquisitions

# ❶ Improving disclosures about acquisitions



**What we have heard**

Investors do not get enough information about acquisitions and their subsequent performance.

**The Board is seeking feedback**

- Do you think investors would find the information useful?
- Is the Board’s approach feasible?

**Preliminary views on disclosures**

At the acquisition date

Strategic rationale for acquisition

↓

Objectives for the acquisition

↓

Metrics for monitoring achievement of objectives

↓

After the acquisition date

Performance against objectives

# ❶ Improving disclosures about acquisitions



## Principle

Companies would disclose information management uses internally to monitor acquisitions. Companies would not need to create information solely for external reporting purposes.

**Why is information needed?**

- To assess performance of companies making acquisitions
- To hold management to account (stewardship)

**What metrics should be disclosed?**

- No single metric suitable
  - Diversity of business combinations
- Management approach
  - Less costly to produce
  - Insights into how management manage
- Operational or financial metrics

# ❶ Improving disclosures about acquisitions

**Should all material acquisitions be disclosed?**

- Disclosure depends on what ‘management’ monitors.
- Could be onerous disclosure for serial acquirers
- ‘Management’ defined as ‘chief operating decision maker’ (CODM) (IFRS 8 *Operating Segments*).
- Are these the acquisitions that investors would like to know more about?

**How long should information be provided for?**

- Disclosure required for as long as it is monitored by management.
- Expect management to know how acquisition is performing in first few years.

**Reporting performance of an acquisition**

| At acquisition date | |
|---|---|
| if monitored by chief operating decision maker<br>disclose objective | if not monitored<br>disclose reason for not monitoring |

| Within 2 years* | |
|---|---|
| if monitoring continues<br>disclose performance against objectives | if monitoring ceases<br>disclose reason for ceasing to monitor |

| After 2 years* | |
|---|---|
| if monitoring continues<br>disclose performance against objectives | if monitoring ceases<br>no further disclosure needed |

*Two full years after the year of acquisition

# ❶ Improving disclosures about acquisitions

## Principle

**Companies would disclose information management, the CODM, uses internally to monitor acquisitions. Companies would not need to create information solely for external reporting purposes.**

| What happens if | Companies should disclose |
| --- | --- |
| acquired business is integrated with existing business? | the metrics that the CODM uses for monitoring; this may be about the combined business. |
| the metric used for monitoring changed? | reason for change, and performance based on the revised metric. |
| the information is commercially sensitive? | not sufficient reason if investors need this information. |
| CODM does not monitor the acquisition? | that fact and reason why. No further action needed. |

# ❶ Improving disclosures about acquisitions



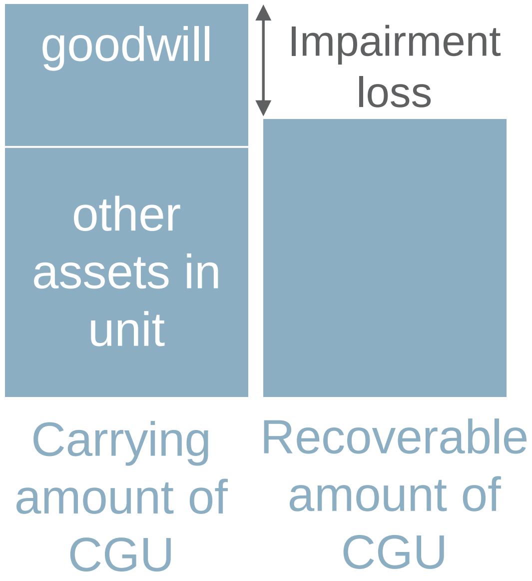
| | Message from stakeholders | Preliminary view of the Board |
|---|---|---|
| Disclosure of expected synergies | • Synergies are often an important part of an acquisition.<br>• Help investors better understand the factors that contributed to the acquisition price. | • To require companies to disclose the amount, or range, of synergies expected from the acquisition. |
| Defined benefit pension liabilities & debt | • Some investors consider these liabilities to form part of the capital employed for acquisitions.<br>• Needed to assess return on capital employed. | • Require companies to disclose the amount of defined benefit pension liabilities and debt of the acquiree. |
| Pro-forma information | • Existing disclosure requirements lack guidance, resulting in diversity in practice.<br>• Preparers question the usefulness of the information, while investors think that the information is important. | • Require companies to disclose both actual and pro-forma revenue, operating profit and cash flows from operating activities. |

# ❷ Improving accounting for goodwill

# ❷ Improving accounting for goodwill

## How is goodwill tested for impairment?

- Goodwill does not generate its own cash flows
- Goodwill is tested for impairment as part of a cash-generating unit (CGU)/group of CGUs
- Any reduction in recoverable amount of CGU(s) is first charged against goodwill




## What are the issues?

Stakeholders have said that:

- impairment losses on goodwill are often recognised too late; and
- the impairment test can be costly and complex to perform.

In view of these issues, the Board considered whether:

A. the impairment test could be made more effective (slides 18–19);

B. goodwill should be amortised (slides 20–21); and

C. the impairment test could be simplified (slides 22–24).

# ❷Ⓐ Can the impairment test be made more effective?



## What is the issue?

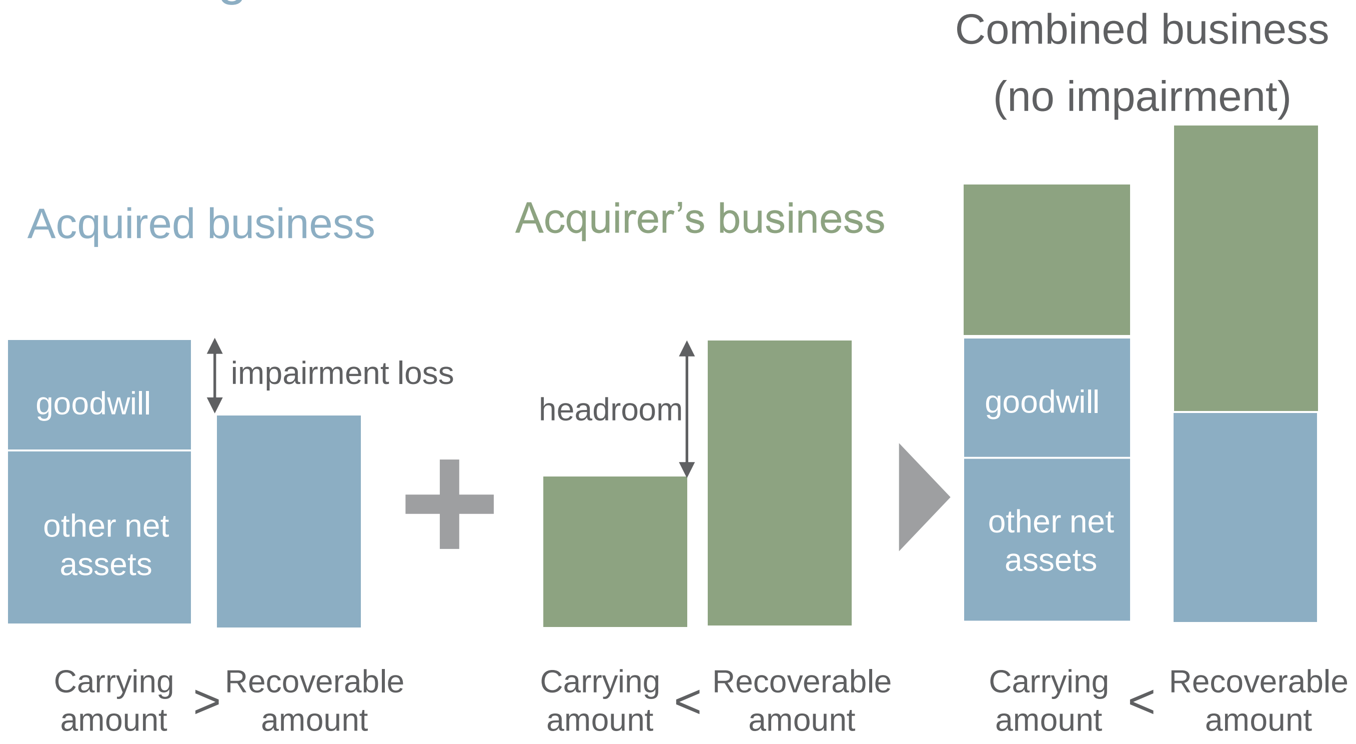
Delay in recognising impairment losses on goodwill could be due to:

- cash flow estimates that are too optimistic; and
- ‘shielding’ of impairment by ‘headroom’.

Headroom = excess of recoverable amount over carrying amount arising from:

- Pre-existing business with which the acquired business is combined; or
- Goodwill internally generated after acquisition.

## Shielding—illustration




*Headroom could shield goodwill from impairment loss that would have otherwise occurred.*

# ❷Ⓐ Can the impairment test be made more effective?



## ✓ An impairment test seeks to assess:

- whether a company's assets are worth less than their carrying amounts.
- for assets that are part of a CGU, whether the unit (or group of units) as a whole is worth less than the carrying amount of its assets.

## ✗ An impairment test:

- cannot test goodwill directly.
- is not designed to signal whether an acquisition is succeeding or failing.
- cannot be performed without relying on management's estimates of future cash flows. These estimates will always be subjective.

## Board's preliminary view:

Board's preliminary view

- Significantly improving the effectiveness of the test at a reasonable cost is not feasible.
- Shielding cannot be eliminated because goodwill has to be tested for impairment with other assets.
- The test cannot always signal how an acquisition is performing, but that does not mean that the test has failed.
- When performed well, the test can be expected to achieve its objective of ensuring that the carrying amount of the CGU as a whole is not higher than its combined recoverable amount.
- The disclosure ideas (discussed in slides 11–14) could help provide investors with the information about the performance of acquisition they need.
- If estimates of cash flows are too optimistic, this is best addressed by auditors and regulators, not by changing IFRS Standards.

# ❷🅑 Impairment-only vs amortisation



## A lookback in time

| IASC | | IASB | | |
|---|---|---|---|---|
| 1983 | 1993 | 2004 | 2013–2015 | 2015–Present |
| IAS 22 issued | IAS 22 amended | IFRS 3 issued | Post-implementation Review of IFRS 3 | Goodwill and Impairment research project |
| Amortisation or direct write-off | Required amortisation | Introduced the impairment-only approach | | |

# ❷Ⓑ Impairment-only vs amortisation



Having concluded that the impairment test cannot be significantly improved at a reasonable cost, the Board considered whether to reintroduce amortisation of goodwill (an impairment test would still be required).

## Arguments for reintroducing amortising

Some say:

- feedback from PIR of IFRS 3 suggests that impairment test is not be working as the Board intended.
- carrying amounts of goodwill are overstated and, as a result, a company's management is not held to account.
- amortisation provides a simple mechanism that targets acquired goodwill directly, which the impairment-only model cannot.
- goodwill is a wasting asset, reducing as the benefits are consumed—amortisation shows consumption of goodwill.
- amortisation would eventually make impairment testing easier and less costly because amortisation would reduce the carrying amount of goodwill, making impairment less likely.

## Arguments for retaining impairment-only

Some say:

- the impairment-only model provides more useful information than amortisation which is arbitrary—many investors would ignore it and many companies would adjust it from their results.
- if applied well, the impairment test achieves its purpose of ensuring the combined carrying amount of the CGU (or group of CGUs) to which goodwill has been allocated is not higher than the combined recoverable amount.
- benefits of goodwill are maintained for an indefinite period of time, so goodwill is not a wasting asset with a finite life.
- amortising goodwill would not significantly reduce the cost of impairment testing, especially in the first few years.

The Board's preliminary view is that it should retain the impairment-only approach because there is no compelling evidence that amortisation would significantly improve financial reporting.

Stakeholders are invited to provide new arguments to help the Board decide how to move forward.

# ❷ⓒ Simplifying the impairment test



Having to perform goodwill impairment test when there is no indicator of impairment adds unnecessary cost.

## Relief from an annual impairment test

| Existing requirements | Board's preliminary view |
|---|---|
| Companies must perform annual impairment test, even when there is no indicator. | • Remove requirement to test CGU containing goodwill for impairment at least annually.<br>• Companies must still assess if there is any indicator of impairment, and perform the test if there is.<br>• Helps companies to reduce cost.<br>• Reduction in robustness of the test marginal because it is unlikely that material impairment losses occur with no indicator.<br>• Benefit of performing the test when there is no indicator is marginal. |

# ❷ⓒ Simplifying the impairment test



It's costly to decide which cash flows to exclude from value in use estimates.

## Simplifying value in use estimates
## - Remove restriction of uncommitted restructuring and asset enhancement cash flows in value in use estimates

| Existing requirements | Board's preliminary view |
|---|---|
| Companies must exclude cash flows from future uncommitted restructuring or asset enhancements from their forecasts. | • Would reduce the cost and complexity of performing impairment tests<br>• Less prone to error.<br>• These cash flow forecasts would still need to be reasonable and supportable. |

# ❷Ⓒ Simplifying the impairment test



Pre-tax discount rates are not observable. In practice, valuation is usually performed on a post-tax basis.

## Simplifying value in use estimates
## - Allowing post-tax discount rate and post-tax cash flows

| Existing requirements | Board's preliminary view |
|---|---|
| Companies must estimate value in use based on pre-tax cash flows and pre-tax discount rate. | • Discount rate and cash flows need to be internally consistent.<br>• Would reduce the cost and complexity of performing impairment tests.<br>• More understandable and better aligned with industry practice. |

# ❸ Other topics

# ❸ Other topics

## Presenting total equity excluding goodwill

Goodwill is different from other assets because it:

- can only be measured indirectly; and
- cannot be sold separately.

Presenting total equity excluding goodwill on the balance sheet helps to:

- draw attention to companies whose goodwill constitute a significant portion of their equity; and
- make this amount more prominent.

**XYZ Group – Statement of financial position as at 31 December 20X0**

| | |
|---|---|
| Property, plant and equipment | 1,000 |
| Goodwill | 2,000 |
| **Total non-current assets** | 3,000 |
| Inventories | 1,000 |
| Trade receivables | 2,000 |
| Cash and cash equivalents | 3,000 |
| **Total current assets** | 6,000 |
| **Total assets** | 9,000 |

| | |
|---|---|
| Long-term borrowings | 1,000 |
| Deferred tax | 2,000 |
| **Total non-current liabilities** | 3,000 |
| Trade and other payables | 3,000 |
| **Total current liabilities** | 3,000 |
| **Total liabilities** | 6,000 |
| Share capital | 1,000 |
| Retained earnings | 2,000 |
| **Total equity** | 3,000 |
| **Total equity and liabilities** | 9,000 |
| **Total equity excluding goodwill** | 1,000 |

# ❸ Other topics

## Recognise acquired intangible assets separately from goodwill

Separate recognition helps to explain what companies have acquired. It also ensures that intangible assets with a finite useful life are recognised separately and amortised.

Separate recognition does not provide useful information, because:

- similar intangible assets are not recognised if they are generated internally; and
- some intangible assets are difficult to identify and value.

### Existing requirements

All identifiable intangible assets acquired in an business combination need to be separately recognised.

### Board's preliminary view

- No compelling evidence that requirements in IAS 38 should be amended.
- Considering whether to align the accounting treatments for acquired and internally generated intangible assets is beyond the scope of this project.

# Overall package of preliminary views

# Overall package of preliminary views



In the Board's view, its package of preliminary views achieves a balance between the following objectives:

- providing more useful information, allowing investors to hold management to account; and
- reducing costs for companies.

The table summarises whether each of the changes suggested:

- is in line with the objective ( ✓ );
- is in conflict with the objective ( ✗ ); or
- is expected to have no significant impact on meeting the objective (**…**).

| Preliminary view – changes to existing requirements | More useful information | Reduce cost |
|---|---|---|
| Improve disclosures about acquisitions | ✓ | ✗ |
| Provide relief from mandatory annual impairment test | … | ✓ |
| Amend how value in use is estimated | ✓ | ✓ |
| Present total equity excluding goodwill | ✓ | … |

The Board has also considered, and decided against, the suggestion to reintroduce amortisation of goodwill. Furthermore, the Board decided that all identifiable intangible assets acquired in an business combination should continue to be separately recognised from goodwill. This is because:

- there is no compelling evidence that the Board should make these changes; and
- both changes would likely reduce the usefulness of information provided to investors.

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# Outreach and fieldwork

# Outreach and fieldwork



March 2020 — DP issued

April 2020 — ASAF meeting

September 2020 — End of comment period

October 2020 ~ — Comment letter analysis and redeliberation

Stakeholders outreach

- roundtables in various jurisdictions for all stakeholders
- focused investor outreach

Project fieldwork – preparers

Planning → Feedback

# Fieldwork



| Tentative plan | |
|---|---|
| **Scope** | Board's preliminary view on disclosures about subsequent performance of acquisitions. |
| **Purpose** | Help the Board to understand:<br>• feasibility of preliminary view<br>• usefulness of information<br>• how management monitors acquisitions (or not)<br>• specific issues encountered during preparation |
| **Participants** | Looking at around 15 to 20 companies to participate, with diverse geographic and industry backgrounds. |

# Fieldwork



| Tentative plan | |
|---|---|
| **Format** | • Kick-off meeting to explain and clarify Board's preliminary view.<br>• Volunteers prepare mock disclosures based on actual acquisition.<br>• Follow-up via VC or face-to-face meeting to discuss mock disclosure—follow-up questions could include:<br>  • How readily available was the information?<br>  • Why was the CODM monitoring this acquisition?<br>  • How did the CODM receive the information?<br>  • Has there been any changes in the information used?<br>  • Are any of the metrics used based on combined business?<br>  • Was any supplementary information needed?<br>  • Is any of the information commercially sensitive? |

# Fieldwork



## Addressing concerns on commercial sensitivity

- Need not be a recent acquisition—preferably a well-reported past acquisition.
- Focus on how management monitor acquisitions and what the disclosures might look like, not factual accuracy of information.
- Response will only be shared within the team; reporting back to the Board will be on no-name basis.

# Get involved



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