NZ ACCOUNTING STANDARDS BOARD

XRB EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho

Board Meeting Agenda

Thursday 7 May 2020 by videoconference

Est Time	Item	Topic	Objective		Page
B: PUBLIC SESSION					
Item in response to COVID-19 for consideration					
10.40 am	**4**	**Options for Relief from PBE FRS 48**	(JS)		
	4.1	Cover memo	Discuss	Paper	
	4.2	Draft ITC and ED (relief from comparatives)	Discuss	Paper	
	4.3	Draft ITC and ED (defer effective date)	Discuss	Paper	
PBE Items for Consideration					
11.00 am	**5**	**IPSASB Revenue and Transfer Expenses**	(JS)		
	5.1	Cover memo	Consider	Paper	
	5.2	IPSASB EDs (in separate file)	Note	Papers	
12.30 pm		*Lunch*			
1.00 pm	**6**	**Tier 3 and Tier 4 PIR**	(LK/JS)		
	6.1	Cover memo	Note	Paper	
	6.2	Draft Request for Information	Consider	Paper	
For-profit Items for Consideration					
1.30 pm	**7**	**Goodwill and Impairment**	(GS)		
	7.1	Cover memo	Consider	Paper	
	7.2	IASB DP/2020/1 *Business Combinations—Disclosures, Goodwill and Impairment*	Note	Paper	
	7.3	Snapshot – IASB DP/2020/1	Note	Paper	
2.30 pm	**8**	**For-profit RDR**	(VSF)		
	8.1	Cover memo	Consider	Paper	
Standards for Noting					
2.59 pm	**9**	**Standards Approved**	(VSF)		
	9.1	Approval 116 *Classification of Liabilities as Current or Non-current*	Note	Paper	

Next NZASB meetings:

Thursday 4 June 2020 (half day)

Wednesday 17 June 2020 (full day)

NZ ACCOUNTING STANDARDS BOARD

Memorandum

Date:	24 April 2020
To:	NZASB Members
From:	Joanne Scott
Subject:	**Proposed amendments to PBE FRS 48**

Purpose[1]

1. This item presents two options for short-term relief from the requirements of PBE FRS 48 *Service Performance Reporting*. These options have not been previously discussed by the Board and are presented for consideration as possible responses to COVID-19.

Background

2. PBE FRS 48 was issued in November 2017 with an effective date of 1 January 2021. The NZASB issued PBE FRS 48 to address a gap in the PBE Standards and to better meet the information needs of users of general purpose financial reports. The NZASB noted that financial statements provide some, but not all, of the information that users of general purpose financial reports of PBEs require for accountability and decision making. The provision of service performance information, together with financial statements, provides users with a more complete set of information.

3. In order to report the comparative information required by the standard, entities would need to collect information and fine tune their reporting systems throughout 2020. Given the recent disruption to activities from COVID-19, some PBEs may struggle to meet these requirements. Some entities may also face ongoing funding difficulties, which will limit the resources available for implementing new reporting requirements.

4. The difficulties are likely to be more acute for registered charities as they have not previously been required to report service performance information. However, public sector entities, including any moving from Tier 3 to Tier 2, could also be affected.

5. We have explored two possible forms of relief from the requirements of PBE FRS 48.
   (a) Relief from the comparative information requirements in the initial year of application.
   (b) Deferring the effective date from 1 January 2021 until 1 January 2022.

[1] This memo refers to the work of the International Accounting Standards Board (IASB) and uses registered trademarks of the IFRS Foundation (for example, IFRS® Standards, IFRIC® Interpretations and IASB® papers).

Structure of this memo

6. This memo outlines some pros and cons of each option. It then looks at some more detailed matters that are relevant if the Board decides to proceed with either of these options. The accompanying exposure drafts illustrate each option.

Pros and cons

7. Tables 1 and 2 set out some pros and cons of each option.

Table 1: Relief from comparative information requirements

Pros	Cons
A number of entities may experience difficulties in collecting and checking the information required to present comparative information. Entities may also face major disruption due to COVID-19. In granting this relief the NZASB could be seen to acknowledge this disruption without unduly compromising the quality of information reported.	Entities that have already devoted time and resources may feel unfairly treated as they may have done things differently if they did not have to collect information for comparatives.
Gives some relief while still indicating the NZASB's view of the importance of service performance information.	
The relief would be optional. Entities that are ready to report comparative information can still do so.	
The level of service provision in the initial comparative period may not reflect usual activity. It could be significantly lower or higher than usual.	The financial statements will reflect actual transactions and events. The service performance information should also reflect actual service performance.
Reduces risk of modified audit reports if information presented does not meet the requirements in the standard or cannot be audited.	COVID-19 might lead to more modified audit reports in general.

Table 2: Deferring effective date

Pro	Con
Entities may face major disruption due to COVID-19. In deferring the effective date the NZASB could be seen to acknowledge this disruption and give immediate short-term relief to entities.	Entities that have already devoted time and resources may feel unfairly treated as they may have done things differently if they had had more time to prepare.
	The benefits of the standard are delayed by a year. Users will need to wait another year for service performance information from many Tier 1 and 2 PBEs, despite Tier 3 and 4 PBEs having been required to report service performance information for a number of years.

Pro	Con
	The standard was deliberately issued with a long effective date (of three years) to make sure that entities had time to plan and prepare. Deferring the effective date could send the wrong signals and result in some entities continuing to defer the work needed to implement the standard.
Reduces risk of qualified audit reports if information presented does not meet the requirements in the standard or cannot be audited.	COVID-19 might lead to more modified audit reports in general.

Other matters

Explanations of variances

8. In December 2019 we advised the Board that the last sentence of PBE FRS 48 paragraph 37 (about explanations for variances) appears to be in the wrong place. If the NZASB decides to propose relief from the requirements of PBE FRS 48 we think this issue should be addressed at the same time (and have included amendments in both exposure drafts). Otherwise we suggest that the issue be addressed in the next PBE omnibus project.

Relief from comparative information requirements – how long?

9. If the Board decides to offer relief from comparative information requirements we propose that this be for one year.

Relief from comparative information requirements – first-time adopters

10. If the Board decides to offer relief from the comparative information requirements in PBE FRS 48 it will also need to make an equivalent short-term concession available in Appendix D of PBE FRS 47 *First-time Adoption of PBE Standards* (see paragraph D7 in agenda item 4.2).

11. In looking at PBE FRS 47 we have identified a further issue. PBE FRS 47 already has some Tier 2 RDR concessions in relation to comparative financial statements (see the extract shown below). However, it is not clear that the NFP concession in paragraph RDR 27.2 also covers service performance information. We think that it should and propose to amend paragraphs RDR 27.2 and RDR 27.3 to address this (see mark-ups in the following extract). We have included this amendment in both exposure drafts.

12. We note that public sector entities may make use of the concession in paragraph RDR 27.1 only, which is quite limited. We have not proposed any change to this. If we add a short-term concession to Appendix D of PBE FRS 47 (as shown in agenda item 4.3) this would be available to all entities, including Tier 1 and 2 public sector entities, for the period specified. By contrast, the concession in paragraph RDR 27.2 would continue to be available to NFP Tier 2 first-time adopters going forward.

Extract from PBE FRS 47

Comparative Information

25. **An entity's first set of financial statements under PBE Standards shall include at least three statements of financial position, two statements of comprehensive revenue and expense, two separate statements of financial performance (if presented), two cash flow statements and two statements of changes in net assets/equity, and related notes, including comparative information for all statements presented.**

26. An entity's opening statement of financial position may be presented in the notes.

27. An entity is required to present all comparative information in accordance with PBE Standards, including the presentation of a comparative cash flow statement in accordance with PBE IPSAS 2 *Cash Flow Statements*.

RDR 27.1 A Tier 2 entity is not required to provide a statement of financial position as at the beginning of the earliest comparative period in accordance with paragraphs 25 and 26.

RDR 27.2 A Tier 2 not-for-profit entity is not required to present comparative information in its first set of financial statements under PBE Standards, but is required to present the opening statement of financial position. A Tier 2 not-for-profit entity is not required to present comparative service performance information in its first financial report under PBE Standards.

RDR 27.3 A Tier 2 not-for-profit entity which applies RDR 27.2 ~~to its first set of financial statements under PBE Standards~~ shall attach a copy of the previous year's financial statements, and explain in the notes the significant differences in accounting policies applied between the two sets of financial statements.

Non-PBE Standards Comparative Information and Historical Summaries

28. Some entities present historical summaries of selected data for periods before the first period for which they present full comparative information in accordance with PBE Standards. This Standard does not require such summaries to comply with the recognition and measurement requirements of PBE Standards. Furthermore, some entities present comparative information in accordance with previous GAAP as well as the comparative information required by PBE IPSAS 1 *Presentation of Financial Reports*. In any financial statements containing historical summaries or comparative information in accordance with previous GAAP, an entity shall:

    (a) Label the previous GAAP information prominently as not being prepared in accordance with PBE Standards; and

    (b) Disclose the nature of the main adjustments that would make it comply with PBE Standards. An entity need not quantify those adjustments.

PBE FRS 48 amendments to other standards have been compiled

13. This section is for noting.

14. PBE FRS 48 amended a number of other standards. These amendments were set out in Appendix D of PBE FRS 48 when it was issued. In keeping with our usual practice of compiling standards a year before they become effective we have incorporated these amendments in the most recent versions of standards on the website. In developing the exposure drafts we checked the standards amended by PBE FRS 48 (including the standards dealing with interim, prospective and summary financial information) and considered the impact of each proposal on those standards.

15. The proposed amendments to other standards under each option are summarised in Table 3.

Table 3: Proposed amendments to other standards

Relief from comparative information requirements (see agenda item 4.2)	**Defer effective date (see agenda item 4.3)**
No change to: • PBE IPSAS 1 *Presentation of Financial Reports* • PBE FRS 42 *Prospective Financial Statements* • PBE FRS 43 *Summary Financial Statements*	No change to: • PBE IPSAS 1 *Presentation of Financial Reports* • PBE FRS 42 *Prospective Financial Statements* (not applicable – the scope does not include service performance information) • PBE FRS 43 *Summary Financial Statements* • PBE IAS 34 *Interim Financial Reporting* The effective date paragraphs for standards amended by PBE FRS 48 state that the amendments become effective when an entity adopts PBE FRS 48. There is no need to change this wording. If the effective date is changed we would update the History Tables at the back of each standard to reflect the new effective date and add an explanatory footnote.
PBE FRS 47 *First-time Adoption of PBE Standards* Paragraphs RDR 27.2 and 27.3: amend to clarify the NFP Tier 2 RDR concession for comparative information (as discussed above). Paragraph D7: Add a short-term exemption for all PBEs. Paragraph BC17: new BC paragraph.	PBE FRS 47 *First-time Adoption of PBE Standards* Paragraphs RDR 27.2 and 27.3: clarify the NFP Tier 2 RDR concession for comparative information (as discussed above). Paragraph BC17: new BC paragraph.
PBE IAS 34 *Interim Financial Reporting* Paragraph 49.11: new paragraph to give relief from comparative service performance information in the first year that PBE FRS 48 is effective.	No change. See first row in table.

Recommendations

16. This item outlines two options for offering short-term relief from the requirements of PBE FRS 48 as possible responses to COVID-19 and presents two exposure drafts that illustrate each option. We have not indicated a preference for one option over another as the Board will want to consider these options along with any other possible responses to COVID-19 before making a decision.

    (a) If the Board wishes to propose relief from the comparative information requirements of PBE FRS 48 we recommend that the Board APPROVES for issue the exposure draft and accompanying ITC set out in agenda item 4.2.

(b) If the Board wishes to defer the effective date of PBE FRS 48 we recommend that the Board APPROVES for issue the exposure draft and accompanying ITC set out in agenda item 4.3.

Question for the Board
Q1. Does the Board approve either of the exposure drafts for issue?

Attachments

Agenda item 4.2: Draft ITC and ED *Proposed 2020 Amendments to PBE FRS 48*
[Proposes relief from comparative information requirements]

Agenda item 4.3: Draft ITC and ED *Proposed 2020 Amendments to PBE FRS 48*
[Proposes to defer the effective date]

NZ ACCOUNTING STANDARDS BOARD

NZASB Exposure Draft 2020-X

Proposed 2020 Amendments to PBE FRS 48

(NZASB ED 2020-X)

Invitation to Comment

May 2020

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Information for respondents

Invitation to Comment

The New Zealand Accounting Standards Board (NZASB)[1] is seeking comments on the specific matters raised in this Invitation to Comment. We will consider all comments before finalising the proposals.

If you want to comment, please supplement your opinions with detailed comments, whether supportive or critical of the proposals, as both supportive and critical comments are essential to a balanced view.

Comments are most useful if they indicate the specific paragraph to which they relate, contain a clear rationale and, where applicable, provide a suggestion for an alternative. Feel free to comment on only those questions, or issues that are relevant to you.

Comments should be submitted electronically using our 'Open for comment' page at:
https://www.xrb.govt.nz/accounting-standards/standards-in-development/open-for-comment/.

Please include *Proposed 2020 Amendments to PBE FRS 48* in the subject line and indicate whether the comments are made on your own behalf, or on behalf of a group of people, or an entity.

The closing date for submissions is **10 August 2020**.

Publication of submissions, the Official Information Act and the Privacy Act

We intend publishing all submissions on the XRB website (xrb.govt.nz), unless the submission may be defamatory. If you have any objection to publication of your submission, we will not publish it on the internet. However, it will remain subject to the Official Information Act 1982 and, therefore, it may be released in part or in full. The Privacy Act 1993 also applies.

If you have an objection to the release of any information contained in your submission, we would appreciate you identifying the parts of your submission to be withheld, and the grounds under the Official Information Act 1982 for doing so (e.g. that it would be likely to unfairly prejudice the commercial position of the person providing the information).

Questions for respondents

		Page
1	Do you agree with the proposal to provide relief from the requirements to report comparative information in PBE FRS 48 *Service Performance Reporting*? If you disagree, please explain why.	5
2	Do you agree with the proposed clarification regarding explaining variances (see paragraphs 37 and 38A)? If you disagree, please explain why.	5
3	Do you agree with the proposed effective date of the amendments? If you disagree, please explain why.	5
4	Do you have any other comments on the ED?	5

[1] The NZASB is a sub-Board of the External Reporting Board (XRB Board), and is responsible for setting accounting standards.

1. Introduction

1.1 Proposed relief from comparative information in first year

1. The purpose of this Invitation to Comment (ITC) and associated Exposure Draft (ED) is to seek comments on proposals to provide relief from the comparative requirements in PBE FRS 48 *Service Performance Reporting* in the first year of adoption. The proposals are relevant for Tier 1 and 2 PBEs.

2. PBE FRS 48 was issued in November 2017 with an effective date of 1 January 2021. In order to report the comparative information required by the standard, entities would need to collect information and fine tune their reporting systems throughout 2020. Given the disruption to the operations of many entities during 2020 as a result of the COVID-19 pandemic, the New Zealand Accounting Standards Board (NZASB) has become aware that some PBEs would struggle to meet these requirements. The NZASB is therefore proposing to make the presentation of comparative service performance information optional in the first year of application of the standard.

3. The NZASB considers that this proposal will provide short-term relief for entities that have been unable to collect service performance information as planned.

Question for respondents

1. Do you agree with the proposal to provide relief from the requirements to report comparative information in PBE FRS 48 *Service Performance Reporting*? If you disagree, please explain why.

1.2 Proposed clarification re variances

4. The ED also seeks feedback on a proposed clarification to paragraph 37 of the standard in relation to explanations of variances. As written, paragraph 37 requires an explanation of all variances between the current and previous period. This was not the intention. The intention was to require that entities reporting comparisons of actual versus prospective information explain variances between the two.

Question for respondents

2. Do you agree with the proposed clarification regarding explaining variances (see paragraphs 37 and 38A)? If you disagree, please explain why.

1.3 Effective date and other comments

5. The proposed effective date of the amendments is 1 January 2021, with early adoption permitted.

Questions for respondents

3. Do you agree with the proposed effective date of the amendments? If you disagree, please explain why.

4. Do you have any other comments on the ED?

1.4 Timeline and next steps

6. Submissions on NZASB ED 2020-X are due by **10 August 2020**. After the consultation period ends, we will consider the submissions received, and subject to the comments in those submissions, we expect to finalise and issue the amendments.

NZ ACCOUNTING STANDARDS BOARD

EXPOSURE DRAFT NZASB 2020-X

PROPOSED 2020 AMENDMENTS TO PBE FRS 48

Issued [Date]

This [draft][1] New Zealand Tier 1 and Tier 2 Standard was issued on [Date] by the New Zealand Accounting Standards Board of the External Reporting Board pursuant to section 12(a) of the Financial Reporting Act 2013.

This [draft] Standard is a disallowable instrument for the purposes of the Legislation Act 2012, and pursuant to section 27(1) of the Financial Reporting Act 2013 takes effect on [Date].

Reporting entities that are subject to this [draft] Standard are required to apply the [draft] Standard in accordance with the effective date which is set out in Part E.

In finalising this [draft] Standard, the New Zealand Accounting Standards Board has carried out appropriate consultation in accordance with section 22(1) of the Financial Reporting Act 2013.

This [draft] Tier 1 and Tier 2 PBE Standard has been issued to grant short-term relief from the requirements in PBE FRS 48 *Service Performance Reporting* to present comparative information. The relief has been granted because some entities may experience difficulty in collecting the required information as a result of the disruption caused by the COVID-19 pandemic in 2020.

[1] References to "this Standard" throughout this Exposure Draft should be read as referring to "this draft Standard".

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ISBN:

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Part A – Introduction

This Standard sets out amendments to PBE FRS 48 *Service Performance Reporting*. It grants relief, in the first year of adoption, from the requirement to present comparative information. It also clarifies that explanations of variances are required only when an entity presents comparisons of actual versus prospective information.

Tier 2 public benefit entities are required to comply with all the requirements in this Standard.

Part B – Scope

This Standard applies to Tier 1 and Tier 2 public benefit entities.

Part C – Amendments to PBE FRS 48 *Service Performance Reporting*

Paragraphs 19 and 37 are amended. Paragraphs 38A and 49–50 are added. New text is underlined and deleted text is struck through. Paragraphs 36, 38–39 and 48 are shown for context.

19. The nature of the information that an entity provides to meet the requirements of paragraph 15(b) will depend on the circumstances of the entity. An entity shall consider all of the following factors in deciding what to report.

    (a) …

    (b) *What it intended to achieve during the reporting period.* … Public sector entities are often required to publish information about planned performance in planning documents. In such cases this Standard requires comparisons between actual and planned performance (see paragraph ~~37~~38A).

Comparative Information and Consistency of Reporting

36. Service performance information should provide users with a basis and context to compare an entity's service performance over time, and where appropriate, against planned performance or the performance of other entities. Consistency of reporting aids comparability and this Standard establishes requirements for consistent reporting. However, an entity's service performance activities and performance measures and/or descriptions may change over time. This Standard requires that an entity provide information about those changes.

37. **An entity shall report comparative information in respect of the preceding period. ~~An entity may also be required by legislation, or may elect, to report comparative information in respect of previously published prospective service performance information.~~ An entity shall report comparative information for all amounts reported in the current period and, where relevant, for the narrative and descriptive information reported in the current period. ~~Explanations for major variances shall be given.~~**

38. Comparative information shall be included for those performance measures and/or descriptions for which an amount is reported in the current period. Comparative information shall be included for narrative and descriptive information when it is relevant to an understanding of the current period's service performance information. Judgement is required in deciding when to provide comparative narrative and descriptive information.

38A. **An entity may also be required by legislation, or may elect, to report comparisons of previously published prospective service performance information and current period service performance information (also referred to as budget versus actual). In such cases an entity shall report comparisons of previously published prospective information and current period information for all amounts reported in the current period and, where relevant, for the narrative and descriptive information reported in the current period. Explanations for major variances shall be given.**

39. An entity reporting against previously published prospective service performance information shall consider whether original levels of planned activity or revised plans provide the most relevant and useful information. Information about revisions to plans during the period may help explain variances between original plans and actual results.

…

Effective Date

48. A public benefit entity shall apply this Standard for annual financial reports covering periods beginning on or after 1 January 2021. Earlier application is permitted.

49. A public benefit entity applying this Standard to annual financial reports covering periods beginning on or after 1 January 2021 but before 1 January 2022 is not required to present the comparative information required by this Standard.

50. *2020 Amendments to PBE FRS 48*, issued in [Date], amended paragraphs 19 and 37 and added paragraphs 38A and 49. An entity shall apply those amendments for annual periods beginning on or after [Date – proposed date is 1 January 2021].

In the Basis for Conclusions paragraphs BC46 and BC47 are added.

2020 Amendments

BC46. In [May 2020] the NZASB issued ED 2020-X *Proposed 2020 Amendments to PBE FRS 48*. The [proposed] amendments granted relief from the requirement in PBE FRS 48 to present comparative information, for the first year in which the Standard was effective. The NZASB granted this relief because some entities may have experienced difficulty in collecting the required information prior to PBE FRS 48 becoming effective. These potential difficulties were identified in 2020 when many entities experienced disruption due to the COVID-19 pandemic.

BC47. The [proposed] amendments also clarified that explanations of variances are required only when an entity presents comparisons of actual versus prospective information.

PART D – AMENDMENTS TO OTHER STANDARDS

AMENDMENTS TO PBE IAS 34 *Interim Financial Reporting*

Paragraphs 49.11 and 49.12 are added. New text is underlined. Paragraph 21.1 is shown for context.

21.1 Interim reports that include interim service performance information shall include service performance information (condensed or complete) for the current interim period and cumulatively for the current financial year to date, with comparative information for the comparable interim periods (current and year-to-date) of the immediately preceding financial year.

…

49.11 A public benefit entity applying this Standard to interim financial reports covering periods beginning on or after 1 January 2021 but before 1 January 2022 is not required to present the comparative service performance information required by paragraph 21.1 of this Standard.

49.12 *2020 Amendments to PBE FRS 48*, issued in [Date], added paragraph 21.2 An entity shall apply those amendments when it applies *2020 Amendments to PBE FRS 48*. [Proposed effective date of those amendments is 1 January 2021].

AMENDMENTS TO PBE FRS 47 *First-time Adoption of PBE Standards*

Paragraphs RDR 27.2 and RDR 27.3 are amended. Paragraph 42.13 is added. New text is underlined and deleted text is struck through. Paragraphs 25 to RDR 27.1 are shown for context.

Comparative Information

25. **An entity's first set of financial statements under PBE Standards shall include at least three statements of financial position, two statements of comprehensive revenue and expense, two separate statements of financial performance (if presented), two cash flow statements and two statements of**

changes in net assets/equity, and related notes, including comparative information for all statements presented.

26. An entity's opening statement of financial position may be presented in the notes.

27. An entity is required to present all comparative information in accordance with PBE Standards, including the presentation of a comparative cash flow statement in accordance with PBE IPSAS 2 *Cash Flow Statements*.

RDR 27.1 A Tier 2 entity is not required to provide a statement of financial position as at the beginning of the earliest comparative period in accordance with paragraphs 25 and 26.

RDR 27.2 A Tier 2 not-for-profit entity is not required to present comparative information in its first set of financial statements under PBE Standards, but is required to present the opening statement of financial position. A Tier 2 not-for-profit entity is not required to present comparative service performance information in its first financial report under PBE Standards.

RDR 27.3 A Tier 2 not-for-profit entity which applies RDR 27.2 ~~to its first set of financial statements under PBE Standards~~ shall attach a copy of the previous year's financial statements, and explain in the notes the significant differences in accounting policies applied between the two sets of financial statements.

…

Effective Date

…

42.13 *2020 Amendments to PBE FRS 48*, issued in [Date], amended paragraphs RDR 27.2 and RDR 27.3 and added paragraph D7. An entity shall apply those amendments when it applies *2020 Amendments to PBE FRS 48*. [Proposed effective date of those amendments is 1 January 2021].

In Appendix D, paragraph D7 and the preceding heading are added. New text is underlined.

Appendix D

Service Performance Reporting

D7. A first-time adopter whose date of transition to PBE Standards is before 1 January 2021 may elect not to present comparative service performance information in accordance with PBE FRS 48 *Service Performance Reporting*.

Paragraph BC17 and the preceding heading are added. New text is underlined.

Basis for Conclusions

2020 Amendments to PBE FRS 48

BC17. In 2020 the NZASB acknowledged that the disruption caused by the COVID-19 pandemic could result in some entities experiencing difficulty in collecting the information required to report the comparative information required by PBE FRS 48 *Service Performance Reporting*. *2020 Amendments to PBE FRS 48* granted short-term relief from the requirements to present comparative information for the first year that PBE FRS 48 is effective. The amendment also clarified that the RDR not-for-profit concession (in paragraph RDR 27.2) also applies to comparative service performance information.

Part E – Effective Date

This Standard shall be applied for annual financial reports covering periods beginning on or after 1 January 2021. Earlier application is permitted.

NZ ACCOUNTING STANDARDS BOARD

NZASB Exposure Draft 2020-X

Proposed 2020 Amendments to PBE FRS 48

(NZASB ED 2020-X)

Invitation to Comment

May 2020

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Comments should be submitted electronically using our 'Open for comment' page at: https://www.xrb.govt.nz/accounting-standards/standards-in-development/open-for-comment/.

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If you have an objection to the release of any information contained in your submission, we would appreciate you identifying the parts of your submission to be withheld, and the grounds under the Official Information Act 1982 for doing so (e.g. that it would be likely to unfairly prejudice the commercial position of the person providing the information).

Questions for respondents

		Page
1	Do you agree with the proposal to defer the effective date of PBE FRS 48 *Service Performance Reporting* by one year (from 1 January 2021 to 1 January 2022)? If you disagree, please explain why.	5
2	Do you agree with the proposed clarification regarding explaining variances (see paragraphs 37 and 38A)? If you disagree, please explain why.	5
3	Do you agree with the proposed effective date of the amendments? If you disagree, please explain why.	5
4	Do you have any other comments on the ED?	5

[1] The NZASB is a sub-Board of the External Reporting Board (XRB Board), and is responsible for setting accounting standards.

1. Introduction

1.1 Proposed deferral of effective date

1. The purpose of this Invitation to Comment (ITC) and associated Exposure Draft (ED) is to seek comments on proposals to defer the effective date of PBE FRS 48 *Service Performance Reporting* by one year (from 1 January 2021 to 1 January 2022). The proposals are relevant for Tier 1 and 2 PBEs.

2. PBE FRS 48 was issued in November 2017 with an effective date of 1 January 2021. Comparative information is required.

3. Given the disruption to the operations of many entities during 2020 as a result of the COVID-19 pandemic, the New Zealand Accounting Standards Board (NZASB) has become aware that some PBEs may be unable to complete the steps required to implement PBE FRS 48 by its effective date. The NZASB is therefore proposing to defer the effective date of PBE FRS 48 by one year.

4. The NZASB considers that this proposal will provide short-term relief for entities that have experienced disruption to their operations during this period.

Question for respondents
1. Do you agree with the proposal to to defer the effective date of PBE FRS 48 *Service Performance Reporting* by one year (from 1 January 2021 to 1 January 2022)? If you disagree, please explain why.

1.2 Proposed clarification re variances

5. The ED also seeks feedback on a proposed clarification to paragraph 37 of the standard in relation to explanations of variances. As written, paragraph 37 requires an explanation of all variances between the current and previous period. This was not the intention. The intention was to require that entities reporting comparisons of actual versus prospective information explain variances between the two.

Question for respondents
2. Do you agree with the proposed clarification regarding explaining variances (see paragraphs 37 and 38A)? If you disagree, please explain why.

1.3 Effective date and other comments

6. The proposed effective date of the amendments is 1 January 2021, with early adoption permitted.

Questions for respondents
3. Do you agree with the proposed effective date of the amendments? If you disagree, please explain why.
4. Do you have any other comments on the ED?

1.4 Timeline and next steps

7. Submissions on NZASB ED 2020-X are due by **10 August 2020**. After the consultation period ends, we will consider the submissions received, and subject to the comments in those submissions, we expect to finalise and issue the amendments.

NZ ACCOUNTING STANDARDS BOARD

EXPOSURE DRAFT NZASB 2020-X

PROPOSED 2020 AMENDMENTS TO PBE FRS 48

Issued [Date]

This [draft][1] New Zealand Tier 1 and Tier 2 Standard was issued on [Date] by the New Zealand Accounting Standards Board of the External Reporting Board pursuant to section 12(a) of the Financial Reporting Act 2013.

This [draft] Standard is a disallowable instrument for the purposes of the Legislation Act 2012, and pursuant to section 27(1) of the Financial Reporting Act 2013 takes effect on [Date].

Reporting entities that are subject to this [draft] Standard are required to apply the [draft] Standard in accordance with the effective date which is set out in Part E.

In finalising this [draft] Standard, the New Zealand Accounting Standards Board has carried out appropriate consultation in accordance with section 22(1) of the Financial Reporting Act 2013.

This [draft] Tier 1 and Tier 2 PBE Standard has been issued to defer the effective date of PBE FRS 48 *Service Performance Reporting* by one year. The relief has been granted because, as a result of the disruption caused by the COVID-19 pandemic in 2020, some entities may experience difficulty in collecting the information required to report in accordance with PBE FRS 48.

[1] References to "this Standard" throughout this Exposure Draft should be read as referring to "this draft Standard".

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Part A – Introduction

This Standard sets out amendments to PBE FRS 48 *Service Performance Reporting*. It defer the effective date by one year, from 1 January 2021 to 1 January 2022. It also clarifies that explanations of variances are required only when an entity presents comparisons of actual versus prospective information.

Tier 2 public benefit entities are required to comply with all the requirements in this Standard.

Part B – Scope

This Standard applies to Tier 1 and Tier 2 public benefit entities.

Part C – Amendments to PBE FRS 48 *Service Performance Reporting*

> Paragraphs 19, 37 and 48 are amended. Paragraphs 38A and 49 are added. New text is underlined and deleted text is struck through. Paragraphs 36 and 38–39 are shown for context.

19. The nature of the information that an entity provides to meet the requirements of paragraph 15(b) will depend on the circumstances of the entity. An entity shall consider all of the following factors in deciding what to report.

    (a) …

    (b) *What it intended to achieve during the reporting period*. … Public sector entities are often required to publish information about planned performance in planning documents. In such cases this Standard requires comparisons between actual and planned performance (see paragraph ~~37~~38A).

Comparative Information and Consistency of Reporting

36. Service performance information should provide users with a basis and context to compare an entity's service performance over time, and where appropriate, against planned performance or the performance of other entities. Consistency of reporting aids comparability and this Standard establishes requirements for consistent reporting. However, an entity's service performance activities and performance measures and/or descriptions may change over time. This Standard requires that an entity provide information about those changes.

37. **An entity shall report comparative information in respect of the preceding period. ~~An entity may also be required by legislation, or may elect, to report comparative information in respect of previously published prospective service performance information.~~ An entity shall report comparative information for all amounts reported in the current period and, where relevant, for the narrative and descriptive information reported in the current period. ~~Explanations for major variances shall be given.~~**

38. Comparative information shall be included for those performance measures and/or descriptions for which an amount is reported in the current period. Comparative information shall be included for narrative and descriptive information when it is relevant to an understanding of the current period's service performance information. Judgement is required in deciding when to provide comparative narrative and descriptive information.

38A. **An entity may also be required by legislation, or may elect, to report comparisons of previously published prospective service performance information and current period service performance information (also referred to as budget versus actual). In such cases an entity shall report comparisons of previously published prospective information and current period information for all amounts reported in the current period and, where relevant, for the narrative and descriptive information reported in the current period. Explanations for major variances shall be given.**

39. An entity reporting against previously published prospective service performance information shall consider whether original levels of planned activity or revised plans provide the most relevant and useful information. Information about revisions to plans during the period may help explain variances between original plans and actual results.

…

Effective Date

48. A public benefit entity shall apply this Standard for annual financial reports covering periods beginning on or after 1 January 2022 ~~2021~~. Earlier application is permitted.

49. *2020 Amendments to PBE FRS 48*, issued in [Date], amended paragraphs 19, 37 and 48 and added paragraph 38A. If an entity applies PBE FRS 48 before the revised effective date of PBE FRS 48 (as set out in paragraph 48) it shall apply those amendments.

In the Basis for Conclusions, paragraph BC39 is amended and paragraphs BC46 and BC47 are added.

Effective Date

…

BC39. The NZASB agreed that the Standard should have a three-year implementation period, with early adoption permitted.*

* *2020 Amendments to PBE FRS 48*, issued in [Date], subsequently deferred the effective date by one year. See paragraphs BC46 and BC47.

2020 Amendments

BC46. In [May 2020] the NZASB issued ED 2020-X *Proposed 2020 Amendments to PBE FRS 48.* The [proposed] amendments defer the effective date of PBE FRS 48 by one year (from 1 January 2021 to 1 January 2022). The NZASB acknowledged that the disruption caused by the COVID-19 pandemic in 2020 would have resulted in some PBEs being unable to complete the steps required to implement PBE FRS 48 by its original effective date.

BC47. The [proposed] amendments also clarified that explanations of variances are required only when an entity presents comparisons of actual versus prospective information.

PART D – AMENDMENTS TO OTHER STANDARDS

AMENDMENTS TO PBE FRS 47 *FIRST-TIME ADOPTION OF PBE STANDARDS*

Paragraphs RDR 27.2 and RDR 27.3 are amended. Paragraph 42.13 is added. New text is underlined and deleted text is struck through. Paragraphs 25 to RDR 27.1 are shown for context.

Comparative Information

25. **An entity's first set of financial statements under PBE Standards shall include at least three statements of financial position, two statements of comprehensive revenue and expense, two separate statements of financial performance (if presented), two cash flow statements and two statements of changes in net assets/equity, and related notes, including comparative information for all statements presented.**

26. An entity's opening statement of financial position may be presented in the notes.

27. An entity is required to present all comparative information in accordance with PBE Standards, including the presentation of a comparative cash flow statement in accordance with PBE IPSAS 2 *Cash Flow Statements*.

RDR 27.1 A Tier 2 entity is not required to provide a statement of financial position as at the beginning of the earliest comparative period in accordance with paragraphs 25 and 26.

RDR 27.2 A Tier 2 not-for-profit entity is not required to present comparative information in its first set of financial statements under PBE Standards, but is required to present the opening statement of financial position. A Tier 2 not-for-profit entity is not required to present comparative service performance information in its first financial report under PBE Standards.

RDR 27.3 A Tier 2 not-for-profit entity which applies RDR 27.2 ~~to its first set of financial statements under PBE Standards~~ shall attach a copy of the previous year's financial statements, and explain in the notes the significant differences in accounting policies applied between the two sets of financial statements.

…

Effective Date

…

42.13 *2020 Amendments to PBE FRS 48*, issued in [Date], amended paragraphs RDR 27.2 and RDR 27.3. An entity shall apply those amendments when it applies *2020 Amendments to PBE FRS 48*. [Proposed effective date of those amendments is 1 January 2021].

Paragraph BC17 and the preceding heading are added. New text is underlined.

Basis for Conclusions

2020 Amendments to PBE FRS 48

BC17. In 2020 the NZASB acknowledged that the disruption caused by the COVID-19 pandemic could result in some entities experiencing difficulty in collecting the information required to report in accordance with PBE FRS 48 *Service Performance Reporting* from the original effective date of 1 January 2021. *2020 Amendments to PBE FRS 48* deferred the effective date of PBE FRS 48 by one year. The amendment also clarified that the RDR not-for-profit concession (in paragraph RDR 27.2) also applies to comparative service performance information.

Part E – Effective Date

This Standard shall be applied for annual financial reports covering periods beginning on or after 1 January 2021. Earlier application is permitted.

NZ ACCOUNTING STANDARDS BOARD

Memorandum

Date:	24 April 2020
To:	NZASB Members
From:	Joanne Scott
Subject:	**IPSASB ED 71**

Purpose and introduction[1]

1. The purpose of this agenda item is to progress the Board's discussion of the proposals in ED 71 *Revenue without Performance Obligations*.

Recommendations

2. We recommend that the Board:

   (a) CONSIDERS the points raised by staff in relation to ED 71 SMC 5 and PROVIDES FEEDBACK on those points; and

   (b) DISCUSSES the application of ED 71 to some examples.

Background

3. At its meeting on 1 April 2020 the Board focused on SMC 1 in ED 71. SMC 1 seeks views on the proposals that obligations to perform a specified activity or incur eligible expenditure can give rise to present obligations that meet the definition of a liability. Staff sought the Board's views on whether it agreed or disagreed with ED 71 on conceptual grounds, and, if it disagreed with ED 71 on conceptual grounds, whether it supported the proposals from a user information needs or decision-making perspective. Staff also invited discussion on the possible use of 'other obligations' to bring about the deferral of revenue in the circumstances proposed by ED 71.

4. The Board did not form a final view on SMC 1. A number of members disagreed with the IPSASB's proposals on conceptual grounds (or felt that the conceptual basis was debateable). The arguments raised were similar to the arguments made in the Board's comment letter on the IPSASB's 2017 Consultation Paper (the 2017 CP).[2] There were also a number of concerns about the workability of the proposals in terms of drawing a line between the transactions that qualified for deferral and those that did not and the interaction with IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*.

[1] This memo refers to the work of the International Accounting Standards Board (IASB) and uses registered trademarks of the IFRS Foundation (for example, IFRS® Standards, IFRIC® Interpretations and IASB® papers).

[2] Consultation Paper *Accounting for Revenue and Non-Exchange Expenses*

5. There were also mixed views about the proposals from a user information needs or decision-making perspective. There were differing views about circumstances in which Board members would support deferral of revenue. Some members indicated support for the Australian Accounting Standards Board's (AASB's) approach to capital grants (whereby revenue is recognised as the asset is constructed or when it is purchased). Others indicated they could contemplate deferral of revenue in other circumstances but noted that any such transactions would have to be clearly identified.

6. The Board suggested that, for the next meeting, staff do more work on transactions to inform Board discussions about deferral of revenue and the possible use of other comprehensive income and other obligations.

Structure of this memo

7. The main sections in this memo are as follows.
   (a) Measurement of receivables and binding arrangement assets
   (b) Examples
   (c) Next steps

8. In this memo we have chosen to deal with SMC 5 first, rather than SMC 1. That is because SMC 5 deals with a technical issue and it is easier to form a view on whether the proposals work. Also, our views on SMC 5 will not be affected by our views on SMCs 1 to 4. See Appendix 1 to this memo for a list of SMCs in ED 71.

Measurement of receivables and binding arrangement assets

9. The purpose of this section is to assist the Board in forming a view on SMC 5 in ED 71 (shown below). Although SMC 5 asks for views on the proposals in ED 71 we have also considered ED 70 *Revenue with Performance Obligations* as it contains similar proposals to ED 71. SMC 5 asks only about the treatment of receivables. We think that receivables and contract assets/binding arrangement assets should be considered together.

ED 71: Specific Matter for Comment 5: (Paragraphs 84–85)
Do you agree with the IPSASB's proposals that receivables within the scope of this [draft] Standard should be subsequently measured in accordance with the requirements of IPSAS 41, *Financial Instruments*? If not, how do you propose receivables be accounted for?

10. In this section we look at:

    (a) the requirements in IFRS Standards for receivables and contract assets from contracts with customers;

    (b) the current lack of guidance in IPSAS on non-contractual receivables;

    (c) the NZASB's views on the proposals in the 2017 CP;

    (d) the proposals in ED 70 *Revenue with Performance Obligations* and ED 71 (and our thoughts on those proposals); and

    (e) the AASB's requirements for statutory receivables.

11. Appendix 2 to this memo contains extracts of the relevant requirements in IFRS 15, ED 70 and ED 71, including the proposed amendments to IPSAS 41 *Financial Instruments*.

12. We conclude by seeking the Board's views on the issues that we have identified and which issues we should mention in our response to SMC 5.

IFRS Standards

13. Under IFRS 15 *Revenue from Contracts with Customers* an entity recognises revenue when (or as) performance obligations are satisfied. If the entity performs first, it recognises revenue and a receivable or a contract asset. A contract asset is defined as "An entity's right to consideration in exchange for goods or services that the entity has transferred to a customer when that right is conditioned on something other than the passage of time (for example, the entity's future performance)." If the entity has an unconditional right to consideration it recognises a receivable.

14. The application of IFRS 9 *Financial Instruments* to receivables and other contract assets differs. The scope of IFRS 9 excludes rights and obligations within the scope of IFRS 15 that are financial instruments, except for those that IFRS 15 specifies are accounted for in accordance with IFRS 9.

    (a) IFRS 15 (paragraph 108) states that "An entity shall account for a *receivable* in accordance with IFRS 9" – this statement brings receivables within the scope of IFRS 9 paragraph 2.1(j). Receivables generally meet the conditions to be accounted for at amortised cost. They would also be assessed for impairment in accordance with IFRS 9. As a practical expedient, IFRS 9 allows entities to apply a simplified impairment model to trade receivables that are due within 12 months and which do not contain a significant financing component. Instead of applying the usual 3-step impairment model, entities can recognise the 'lifetime expected credit losses' on these receivables.

    (b) IFRS 15 (paragraph 107) states that an entity "shall assess a *contract asset* for impairment in accordance with IFRS 9. An impairment of a contract asset shall be measured, presented and disclosed on the same basis as a financial asset that is within the scope of IFRS 9… ." IFRS 9 (paragraph 2.2) reiterates that the impairment requirements in IFRS 9 apply to certain rights as specified by IFRS 15. The practical expedient to assessing impairment of receivables in IFRS 9 is also available for contract assets.

15. Table 1 summarises these requirements, along with our views on which standard deals with initial recognition and subsequent measurement. We then use a similar approach to analyse the IPSASB's proposals.

Table 1

	IFRS Standards
Receivables that are financial instruments	Receivables that are financial instruments fall within the scope of IFRS 9. References: IFRS 15 paragraph 108 and IFRS 9 paragraph 2.1(j) • Initial recognition: IFRS 9 • Subsequent measurement: IFRS 9

	IFRS Standards
Receivables that are NOT financial instruments	Some receivables arising from transactions within the scope of IFRS 15 might not be financial instruments. For example, an entity could receive non-cash consideration from a customer. IFRS 15 does not explicitly discuss the accounting for such receivables. Although IFRS 15 says that an entity accounts for receivables in accordance with IFRS 9, IFRS 9 is clear that only those receivables that are financial assets fall within its scope. In such circumstances we think an entity would consider whether the asset falls within the scope of IAS 36 *Impairment of Assets.* If not, it would determine its accounting policy in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.
Contract assets	Contract assets are recognised and measured in accordance with IFRS 15. IFRS 15 states that contract assets are assessed for impairment in accordance with the impairment requirements in IFRS 9. IFRS 9 paragraph 2.2 acknowledges this. References: IFRS 9 paragraphs 2.1(j) and 2.2. IFRS 15 paragraphs 108 and BC63. • Initial recognition: IFRS 15 • Subsequent measurement: IFRS 15, and IFRS 9 for the purposes of recognising impairment gains or losses.

Gap in IPSAS

16. Up until now there has been a gap in IPSAS in relation to the measurement of non-contractual receivables (for example, non-contractual agreements for grants, taxes, fines, penalties, fees and licences). Such receivables are similar to financial instruments because they are usually settled by way of cash or another financial asset. However, they are not financial instruments because they are not contractual rights. They therefore fall outside the scope of the financial instruments standards.

17. This gap in the standards has led to some debate about whether non-contractual receivables should be accounted for in accordance with the requirements for financial instruments or assessed for impairment in accordance with IPSAS 26 *Impairment of Cash-Generating Assets*. The AASB's response to this issue is discussed later in this section.

18. The IPSASB is planning to address this gap in ED 70 and ED 71 because both of those EDs address transactions that could give rise to non-contractual receivables.

2017 CP proposals and NZASB views

19. The IPSASB's 2017 CP expressed two preliminary views about non-contractual receivables.

> PV8. The Board considers that at initial recognition, non-contractual receivables should be measured at face value (legislated amount) of the transaction(s) with any amount expected to be uncollectible identified as an impairment.
>
> PV9. The IPSASB considers that subsequent measurement of non-contractual receivables should use the fair value approach.

20. In responding to the 2017 CP the NZASB stressed that any proposals should encompass all non-contractual receivables, not just statutory receivables (such as receivables from fines).

The NZASB also disagreed that these PVs were appropriate for all types of revenue. The NZASB noted that different requirements for different types of revenue might be appropriate.

21. Extracts from the NZASB's response to the 2017 CP follow. These extracts include comments about disclosure which we will consider at a future Board meeting.

    With respect to PV 8 on measurement on initial recognition

    Examples of where initial measurement would be different under our proposed framework are as follows.

    - Transactions with performance obligations would be accounted for using the PSPOA. The initial measurement of receivables in relation to those transactions should be in accordance with an IPSAS based on IFRS 15. Subsequently, any impairment of such receivables would be recognised in accordance with an IPSAS based on IFRS 9 *Financial Instruments*.
    - Statutory receivables generally do not have performance obligations or stipulations. For these types of transactions (which would be in a residual revenue standard (or residual section of a revenue standard) based on an updated version of the applicable parts of IPSAS 23), it would be appropriate to initially measure the receivable at face value. Face value has information value and is easier for users to understand. The face value should be supported with disclosure of the impairment. Face value measurement and the disclosure of impairment promote accountability and transparency.

    With respect to PV 9 on subsequent measurement

    For statutory receivables, the fair value approach to subsequent measurement has appeal because it appears the most workable of the three approaches to apply in practice. However, we would recommend that the IPSASB determine the presentation and disclosure requirements for statutory receivables starting from scratch, rather than looking to adopt all the disclosures from IFRS 7 *Financial Instruments: Disclosures* by analogy. Many of the IFRS 7 disclosures have been designed with commercial contractual arrangements in mind, with a focus on counter-party credit risk and would therefore not be applicable to statutory receivables.

    In the New Zealand context, the Government's tax receivable portfolio is not overly sensitive to discount rates, but that may not be the case in other jurisdictions. The IPSASB would need to consider how the volatility in discounted cash flows is best presented in the statement of financial performance. Also, the IPSASB would need to consider where the fair value gain or loss is displayed in the statement of financial performance and what it is called. It may be better to display the movement in the same line each year, regardless of whether it moved from a loss or gain in different years.

ED 70 and ED 71 proposals

22. Table 2 summarises the proposals in ED 70 and ED 71 in relation to receivables and binding arrangement assets. We have considered three categories of receivables and binding arrangements assets: (i) those that arise from contracts and meet the definition of a financial instrument;(ii) those that arise from binding arrangements rather than contracts; and (iii) other, being those that do not arise from contracts or binding arrangements.

23. Appendix 2 to this memo contains extracts of the relevant requirements in IFRS 15, ED 70 and ED 71, including the proposed amendments to IPSAS 41 *Financial Instruments*. You might find it helpful to print this 7-page Appendix. If you would like Appendix 2 as a separate file please contact staff (joanne.scott@xrb.govt.nz).

Table 2: ED 70 and ED 71 proposals

<table>
<tr><th></th><th>ED 70</th><th>ED 71</th></tr>
<tr><td>Receivables that are financial instruments</td>
<td> Example: Contract to deliver goods and services.
References: ED 70 paragraphs 3, 107, AG140 and AG141.
Account for receivable in accordance with IPSAS 41, both on initial recognition and subsequently.
<u>Initial recognition</u>
The IPSASB’s intention is clear but we do not think that the scope of ED 70 and IPSAS 41 work together.
If the IPSASB wants to align ED 70 and IPSAS 41 with IFRS Standards, it would amend the scope of IPSAS 41 to make it clear that ED 70 receivables that are financial instruments fall within the scope of IPSAS 41.
The proposed amendment to IPSAS 41 paragraph 3 should focus on those rights that ED 70 and ED 71 specify are accounted for in accordance with IPSAS 41 for the purpose of recognising impairment gains or losses.
ED 70 also (by amending paragraph 60 of IPSAS 41) seems to give entities a policy choice regarding the initial measurement of short-term receivables arising from ED 70 and ED 71. At initial recognition, these receivables may be measured at the transaction price as per ED 70 or ED 71, or they may be measured at fair value. By contrast, IFRS 9 requires trade receivables without a significant financing component to be measured at initial recognition at the transaction price per IFRS 15.
<u>Subsequent measurement</u>
The intention of paragraph AG140(a) is clear but if ED 70 made it clear that receivables that are financial assets fall within the scope of IPSAS 41, (a) wouldn’t be needed. </td>
<td> Example: Contract to carry out a specified activity.
References: ED 71 paragraphs 3, 124, 84 and 85 and IPSAS 41 paragraphs 2(j), 3 and A6.
The IPSASB’s intention is:

Initial recognition: as per ED 71 (see IPSAS 41 paragraph A6)
Initial measurement: as per ED 71 and IPSAS 41
Subsequent measurement: in accordance with IPSAS 41

However, we think the links between the scope of ED 71 and IPSAS 41 are unclear, especially when ED 71 paragraph 124 states that a transfer recipient shall account for a receivable in accordance with IPSAS 41.
If receivables that are financial instruments are outside the scope of ED 71 then neither paragraph 3(a) nor paragraph 84(a) would be needed. </td></tr>
</table>

	ED 70	**ED 71**
Receivables that arise from binding arrangements – and which are NOT financial instruments	*Example: Binding arrangement (that isn't a contract) to deliver goods and services.* The IPSASB's intention is set out in ED 70 paragraphs AG140 and AG141. ED 70 proposes that receivables outside the scope of IPSAS 41 be measured *on the same basis as a financial asset at amortised cost*[3]– as long as they also meet the requirements in IPSAS 41 paragraph 40.[4] If they do not meet these requirements ED 70 proposes that they be subsequently measured at fair value. The statement in ED 70 paragraph 107 that an entity shall account for a receivable in accordance with IPSAS 41 is too broad. As explained in paragraphs AG140(b) and AG141, some receivables arising from transactions in the scope of ED 70 may not be financial instruments. We think that such receivables should be treated in a similar way to contract assets under IFRS 15: outside the scope of the financial instrument standard, but subject to certain requirements in the financial instrument standards. We think that the scope of ED 70 and IPSAS 41 should be clearer about this. We also think that the IPSASB means that to be measured at amortised cost as per IPSAS 41, the non-contractual receivable must be solely payments of principal and interest and must be managed *similarly to* contractual receivables that are held to collect contractual cash flows.	*Example: Binding arrangement (that isn't a contract) to carry out a specified activity.* Our comments on ED 71 are similar to those on ED 70.

[3] Under amortised cost the asset is measured at the amount recognised at initial recognition minus principal repayments, plus or minus the cumulative amortisation of any difference between that initial amount and the maturity amount, and any loss allowance. Interest income is calculated using the effective interest method and is recognised in surplus or deficit. Changes in fair value are recognised in surplus or deficit when the asset is derecognised or reclassified.

[4] IPSAS 41 *Financial Instruments*, paragraph 40

40. A financial asset shall be measured at amortized cost if both of the following conditions are met:
   (a) The financial asset is held within a management model whose objective is to hold financial assets in order to collect contractual cash flows; and
   (b) The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

   Paragraphs AG48–AG88 provide guidance on how to apply these conditions.

	ED 70	**ED 71**
Other receivables	*Example: Levy that falls at least partly within scope of ED 70 because the entity that collects the levy has to deliver goods and services.* The IPSASB's intention is set out in ED 70 paragraphs AG140 and AG141. See comments in the row above. We think the proposals for these receivables could be clearer.	*Example: Receivables from fines, penalties and taxes.* Our comments on ED 70 also apply. These receivables might fail the management model and SPPI test more often than other receivables and therefore be subsequently measured at fair value.
Binding arrangement assets – that are financial instruments (and where the right to payment is subject to conditions other than the passage of time)	*Example: Contract to deliver goods and services.* IFRS 15 and IFRS 9 avoid the scope issue by clearly saying that such financial instruments are outside the scope of the financial instrument standards but the impairment requirements in IFRS 9 apply. We think ED 70 should amend the scope of IPSAS 41 to say that such "binding arrangement assets" are outside the scope of IPSAS 41 – at present it does not do this. ED 70 paragraph 106 sets out the IPSASB's intentions (which are equivalent to IFRS 15).	*Example: Contract to carry out a specified activity.* Our comments are similar to ED 70.
Binding arrangement assets – which are NOT financial instruments	*Example: Binding arrangement (that isn't a contract) to deliver goods and services.* See comments in the row above.	*Example: Binding arrangement (that isn't a contract) to carry out a specified activity.* Our comments are similar to ED 70.
Other binding arrangement assets	*Example: Levy that falls at least partly within scope of ED 70 because the entity that collects the levy has to deliver goods and services.* See comments in the row above.	*Example: Receivables from fines, penalties and taxes.* Our comments are similar to ED 70.

AASB requirements for non-contractual receivables

24. In 2016 the AASB introduced requirements in AASB 9 *Financial Instruments* to address the initial measurement and recognition, by not-for-profit entities in the private and public sectors, of non-contractual receivables (such as taxes, rates and fines) arising from statutory requirements. AASB 9 (paragraph Aus 2.1.1) states that the initial recognition and measurement requirements of AASB 9 apply to non-contractual receivables arising from statutory requirements as if those receivables are financial instruments. Appendix C to AASB 9 explains this in more detail (see Appendix 3 to this memo).

25. The additional guidance by the AASB addresses a subset of the non-contractual receivables being considered by the IPSASB; the IPSASB is also considering receivables arising from binding arrangements that might not be from statutory requirements.

Proposed response to SMC 5

26. We propose to draft a response to SMC 5 building on the points that we have identified in this memo, along with feedback from the Board. Issues we have identified include:

    (a) We find the links between the scope of ED 70 and ED 71 and IPSAS 41 unclear. The items that fall within the scope of IPSAS 41 should be clear. If only some of the requirements of IPSAS 41 apply to certain items that should also be clearly laid out in the scope section of IPSAS 41.

    (b) We think ED 70 should amend the scope of IPSAS 41 to say that binding arrangement assets (where the right to payment is subject to conditions other than the passage of time) are outside the scope of IPSAS 41.

    (c) The statement in ED 70 paragraph 107 that an entity shall account for a receivable in accordance with IPSAS 41 is too broad given that some receivables under ED 70 will be non-contractual.

    (d) In establishing requirements for receivables that are not financial instruments the IPSASB has referred to the requirements in IPSAS 41 paragraph 40 (which refer to collecting contractual cash flows). The application of the IPSAS 41 requirements to non-contractual receivables needs more explanation.

    (e) If both ED 70 and ED 71 amend a paragraph in a standard, the combined amendments to that paragraph should be shown in both EDs.

27. We will do further work to form a view on how well the EDs deal with initial recognition and measurement of revenue and receivables from donated assets. ED 71 deals with the initial recognition of assets acquired as part of a revenue transaction without performance obligations and requires that such assets be initially measured at fair value. IPSAS 41 prescribes that financial assets are initially measured at fair value and, depending on their classification, transaction costs may or may not be included. It looks as if the IPSASB is proposing to carry forward the current requirements whereby an entity looks first to the revenue standard and then considers initial recognition requirements in the financial instrument standards.

Questions for the Board

Q1 Does the Board agree that the response to ED 71 SMC 5 should build on the points identified in this memo?

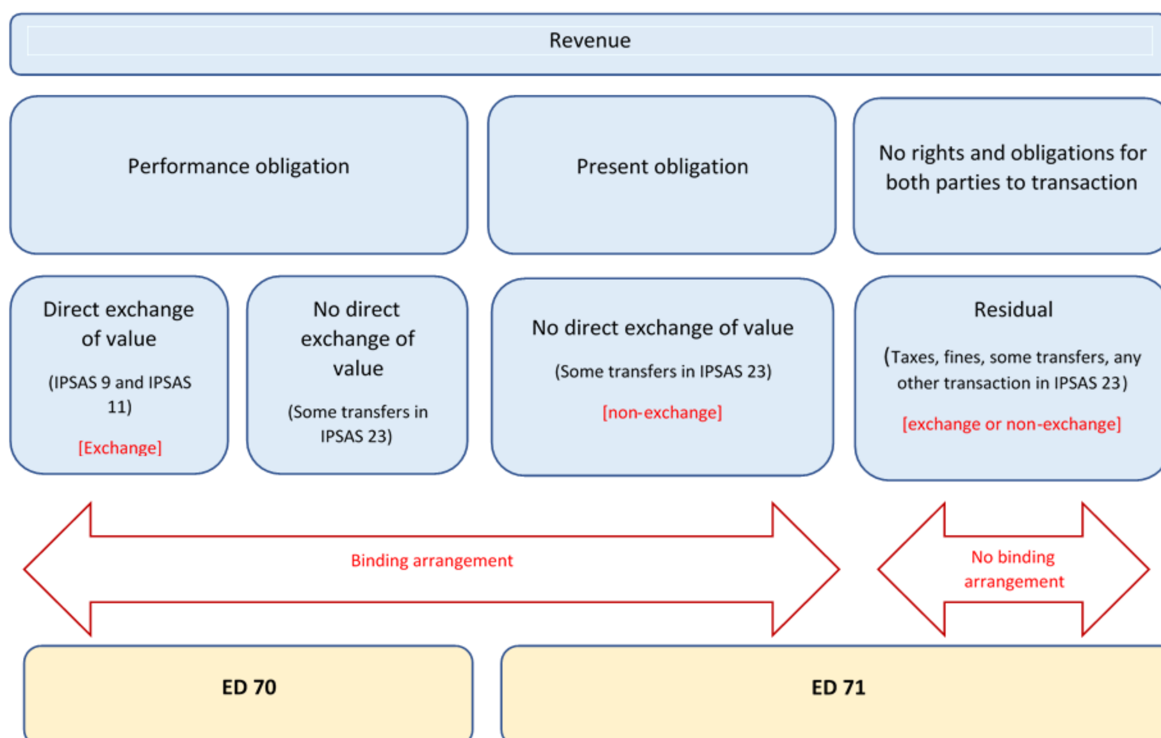
Q2 Does the Board have any other comments on the proposals considered in this section?

Examples

28. At the last Board meeting members indicated that, in order to form a view on the IPSASB's proposals, it would be helpful to focus on a few examples. We haven't gone as far as we had hoped with this work, but we have included some examples to prompt discussion.

29. Before getting into the examples we have included three diagrams that give an overview of the scope of ED 70 and ED 71, the decision-making process within ED 71 and the process within AASB 1058 *Income of Not-for-Profit Entities*.

Diagram 1: Current compared to proposed revenue recognition models[5]

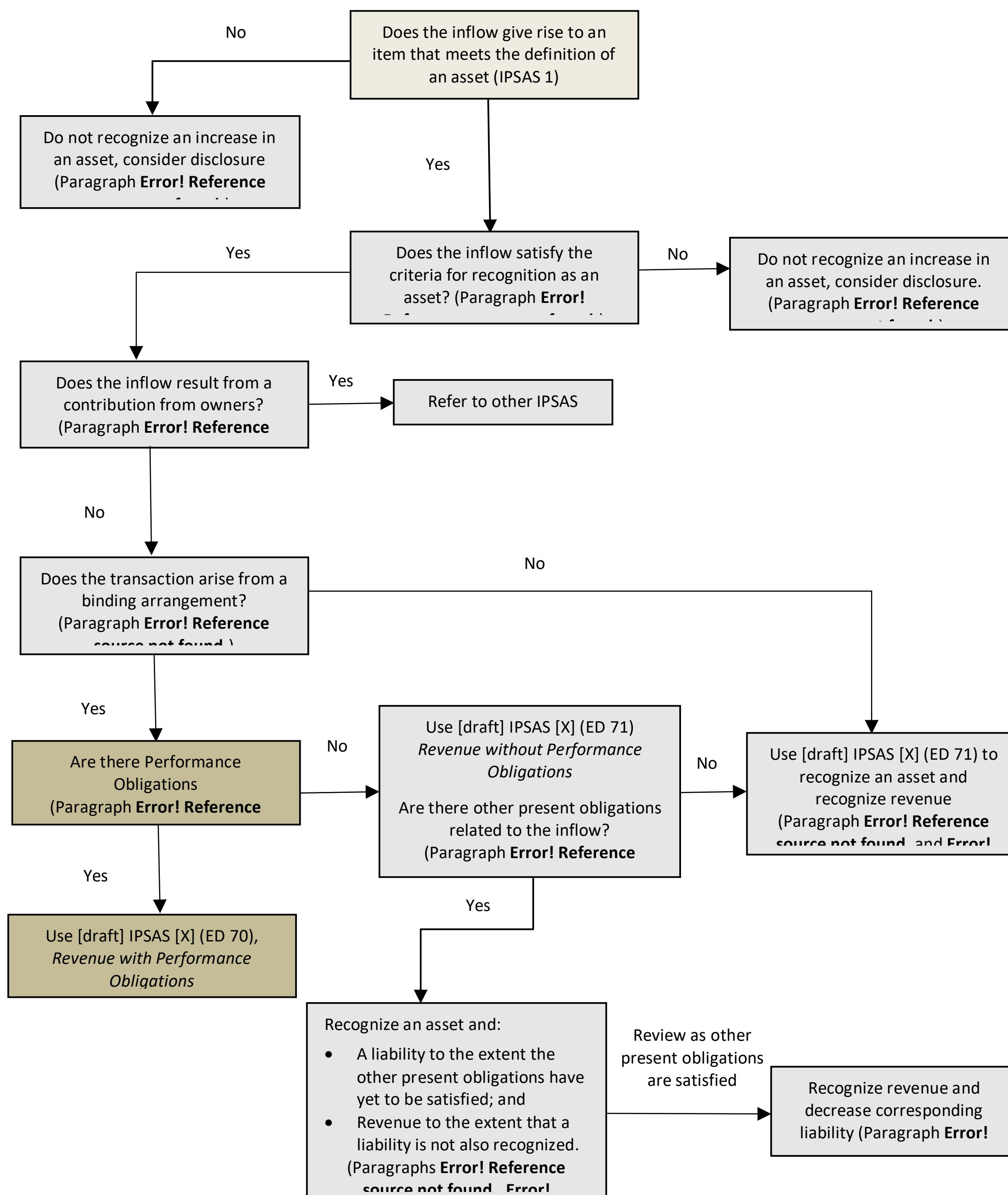


30. Diagram 2 is a flowchart from ED 71. SMC 2 asks whether this flowchart clearly sets out the process a transfer recipient uses to recognise revenue. We plan to deal with SMC 2 later in this project. For now, we are focused on a question in the second half of the diagram – Are there other present obligations related to the inflow?

31. Diagram 3 illustrates that in accounting for the credit side of a transaction within the scope AASB 1058, entities have to consider a range of possibilities including whether they need to recognise a provision. We will look more closely at the interaction between ED 70 and ED 71 and IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets* at a future meeting.

5 Diagram 1 was prepared by staff of the South African Accounting Standards Board.

Diagram 2: Flowchart from ED 71

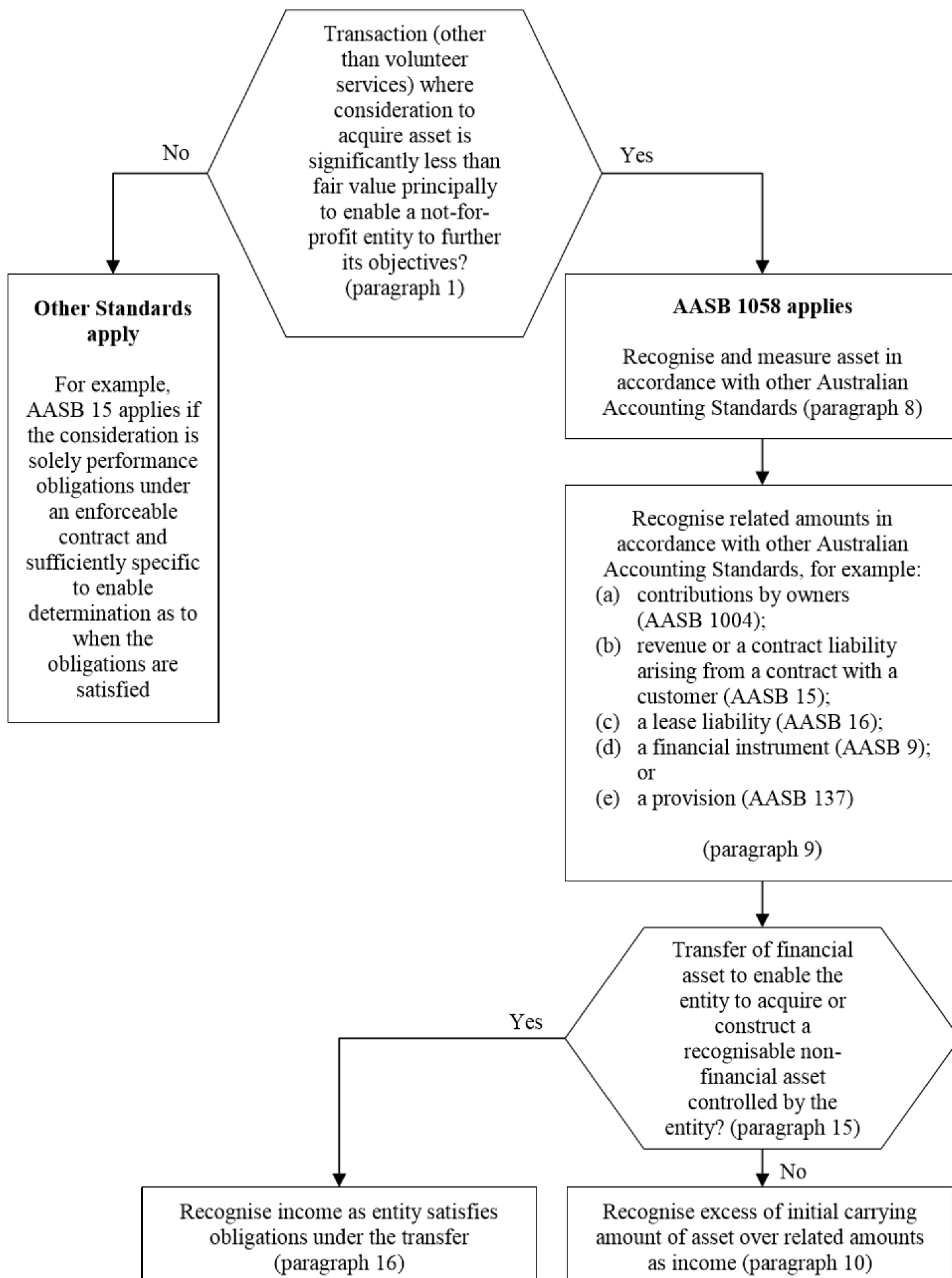


* The flowchart is illustrative only. It does not take place of this [draft] Standard and is provided as an aid to interpreting this [draft] Standard.

* In certain circumstances, such as when a creditor forgives a liability, a decrease in the carrying amount of a previously recognized liability may arise. In these cases, instead of recognizing an asset, the entity decreases the carrying amount of the liability.

* In determining whether the entity has satisfied all of the present obligations, the application of the definitions of specified activity or eligible expenditure, and the criteria for recognizing a liability, are considered.

Diagram 3: Flowchart from AASB 1058[6]



6 This flowchart summarises the main requirements of AASB 1058 to assist in its application.

32. ED 71 sets out the circumstances in which an entity applying ED 71 to a revenue transaction can recognise a present obligation (and defer revenue). There must be:
    - A binding arrangement under which both parties have enforceable rights and obligations.
    - A present obligation that meets the definition of a liability. A present obligation is a duty to act or perform in a particular way. A present obligation could arise from a specified activity or a requirement to incur eligible expenditure.

33. A <u>specified activity</u> is defined as an action in a binding arrangement that must be completed by a transfer recipient. The ED (paragraphs 18 and 19) gives examples of constructing an asset or conducting research.

34. <u>Eligible expenditure</u> is defined as an outflow of resources incurred in accordance with the requirements set out in a binding arrangement. The At-A-Glance that accompanies ED 71 explains that the expenditure may be to further the transfer recipient's objectives (for example, by paying salaries or office rent).

35. Extracts from ED 71 about specified activities and eligible expenditure follow. We have had difficulty deciding whether some examples illustrate specified activities or eligible expenditure. Paragraph 20 in particular is not clear (even if one adds the missing words). The IPSASB may intend that they be mutually exclusive concepts, but we think there is an overlap.

Table 3

ED 71 extracts
Specified Activity 18. A specified activity is a particular action, stated in a binding arrangement, that the transfer provider can compel the transfer recipient to perform, such as construct a hospital or conduct a form of research. Where a specified activity is imposed by the transfer provider as part of the terms of the transfer, a present obligation is created for the transfer recipient. 19. The transfer recipient is unable to avoid the outflow of resources as it is required to use the transfer in the delivery of the specified activity or return resources to the transfer provider or incur another form of redress.
Specified Activity AG27. This [draft] Standard defines a specified activity as an action specified in a binding arrangement that must be completed by a transfer recipient. A specified activity differs from a performance obligation because there is no requirement to transfer any good or service to the transfer provider or a third-party beneficiary. For example, a transfer provider provides funding to a government science agency (transfer recipient) to conduct research and development into a plant-based meat substitute. Any intellectual property developed by the government science agency remains the property of that agency. The funding is provided on the basis of a detailed project plan (with the individual stages of research and development identified) provided by the government science agency and the transfer provider requires the government science agency to report back at each stage. Each of these stages constitutes a specified activity and revenue would be recognized when (or as) they are completed and for the amount incurred in completing that specified action.

ED 71 extracts
Eligible Expenditure 20. A binding arrangement may require a transfer to be used by a transfer recipient for a particular purpose and incur eligible expenditure for that purpose, but does not have an identifiable specified activity. 21. Where a requirement to incur eligible expenditure exists in a binding arrangement, the transfer recipient accepts a present obligation to use the transfer as directed. The transfer recipient is unable to avoid the outflow of resources as it is required to use the transfer on eligible expenditure or return resources to the transfer provider or incur another form of penalty.
Eligible Expenditure AG25. This [draft] Standard defines eligible expenditure as an outflow of resources incurred in accordance with the requirements set out in a binding arrangement. A transfer, that arises from a binding arrangement may be provided with the requirement that the transfer recipient use the resources in furthering the transfer recipient's objectives, but the requirement does not meet the requirements to be classified as a performance obligation as defined in [draft] IPSAS [X] (ED 70) or as a specified activity. For example, funding may be provided to a university to employ a marketing manager to promote the university's courses to overseas students. The binding arrangement specifies that the funding is to be spent on promoting the university overseas and that the marketing manager's salary, travel expenses and any promotional materials used would all be classified as eligible expenditures. Revenue would be recognized as these eligible expenditures are incurred. AG26. The transfer provider needs to be able to confirm that all expenditure incurred was eligible and therefore the transfer recipient needs to keep appropriate documentation to show that the expenditure was incurred by the transfer recipient and for the purpose intended.

36. We have presented the following examples, or sets of examples, along with journal entries.

    (a) ED 71 Specified activity – based on ED 71 paragraph AG27. We contrast this example with a research grant example in AASB 1058.

    (b) ED 71 Eligible expenditure – based on ED 71 paragraph AG25.

    (c) ED 71 Example 12 – based on ED 71 paragraphs IE30–IE31. We have added a number of variations that are not in the ED.

    (d) AASB 1058, Example 8 Multi-year cash grant. We contrast the outcome in AASB 1058 Example 8A with what would be required by ED 71.

ED 71 Specified activity – based on paragraph AG27
A transfer provider is required, by the terms of a binding arrangement, to provide $10 million funding to a government science agency (transfer recipient) on 1 January 2021 to conduct research and development over a two-year period. Any intellectual property developed by the transfer recipient remains the transfer recipient's property. The transaction is therefore without performance obligations. The detailed project plan identifies two individual stages of research and development on which the transfer recipient is required to report back. Each of these stages constitutes a specified activity. Stage 1: Research with an associated cost of $3 million, estimated to take one year. Stage 2: Development with an associated cost of $7 million, estimated to take one year.

37. Revenue would be recognised in accordance with ED 71 when (or as) the specified activities are completed and for the amount incurred in completing the specified action. The journal entries are as follows.

1 Jan 2021	DR Bank/Receivable	$10 million	
	CR Liability		$10 million
	Receive transfer/raise receivable		
31 Dec 2021	DR Liability	$3 million	
	CR Revenue		$3 million
	Recognise revenue for completion of stage 1 specified activities		
31 Dec 2022	DR Liability	$7 million	
	CR Revenue		$7 million
	Recognise revenue for completion of stage 2 specified activities		

38. The outcome of this example differs from that of AASB 1058 Example 11. AASB 1058 Example 11 deals with an enforceable research grant that results in the development of intellectual property. AASB 1058 requires the immediate recognition of income in this example because the research activity generates an unrecognisable intangible asset. If the research had led to the creation of a recognisable asset AASB 1058 would have permitted income to be recognised over the period that the asset was created.

ED 71 Eligible expenditure – based on paragraph AG25

A university receives $4 million to employ a marketing manager to promote its courses to overseas students. The university will be entitled to $1 million a year for four years. The binding arrangement specifies that the funding is to be spent on the marketing manager's salary ($3 million), travel expenses ($800,000) and promotional materials (up to $200,000), all of which are to be classified as eligible expenditure.

The university accounts for the transfer based on the actual eligible expenditure incurred. Revenue is recognised as eligible expenditures are incurred. The journal entries are as follows for year 1.

Variation 1: Assumptions:

- The university can demonstrate what it has spent under the terms of the agreement.
- The funding is transferred at the beginning of each year.

DR Bank/Receivable	$1 million	
CR Liability		$1 million
Receive annual transfer/raise receivable		
DR Salaries	$750,000	
DR Travel expenses	$150,000	
DR Promotional materials	$45,000	
CR Bank/Accruals		$845,000
Incur eligible expenditures		
DR Liability	$845,000	
CR Revenue		$845,000
Recognise revenue to the extent that eligible expenditures were incurred		

Variation 2: Assumptions:	• The university <u>cannot</u> demonstrate what it has spent under the terms of the agreement. • The total amount of the funding is transferred at the beginning of the agreement.

DR Bank/Receivable	$4 million	
CR Revenue		$4 million
Receive annual transfer/raise receivable		
DR Salaries	$750 000	
DR Travel expenses	$150 000	
DR Promotional materials	$45 000	
CR Bank/Accruals		$845 000
Incur expenditures		

ED 71: Illustrative Examples IE30

Example 12–Transfer to a Public Sector University – unenforceable transaction (paragraph 53)

The national government (transfer provider) transfers 200 hectares of land in a major city to a university (transfer recipient) for the establishment of a university campus. The agreement specifies that the land is to be used for a campus, but does not specify that the land is to be returned if not used for a campus or incur another form of redress. The university recognizes the land as an asset in the statement of financial position of the reporting period in which it obtains control of that land. The land should be recognized at its fair value in accordance with IPSAS 17. The obligation is not enforceable therefore does not meet the definition of a liability or satisfy the criteria for recognition as a liability. Therefore, the university recognizes revenue in respect of the land in the statement of financial performance of the reporting period in which the land is recognized as an asset.

Journal entries ED 71 Example 12 – Variation 1 (as per ED 71)

Variation 1: Assumptions	• Transfer of land occurs on 1 January 2020 • Fair value of the land is $2million • The agreement is unenforceable

1 Jan 2020	DR Land	$2 million	
	CR Revenue		$2 million
	Recognise receipt of land and revenue		

Journal entries ED 71 Example 12 – Variation 2 (enforceable, build lecture theatres)

Variation 2: Assumptions	• Transfer of land with a fair value of $2 million occurs on 1 January 2020 • The agreement is enforceable. The university has to establish lecture theatres on the land by 30 June 2021 or return the land. • The university establishes the lecture theatres over time. They are half complete on 31 December 2020 and fully complete on 31 March 2021.

1 Jan 2020	DR Land	$2 million	
	CR Liability		$2 million
	Recognise receipt of land and a liability to carry out the specified activity		

31 Dec 2020	DR Liability	$1 million	
	CR Revenue		$1 million
	Recognise revenue as half the specified activity has been completed		
31 Mar 2021	DR Liability	$1 million	
	CR Revenue		$1 million
	Recognise revenue as all of the specified activity has been completed		

Journal entries ED 71 Example 12 – Variation 3 (enforceable, landscape area)

Variation 3: Assumptions

- Transfer of land with a fair value of $2 million occurs on 1 January 2020
- The agreement is enforceable. The university does not have to build lecture theatres, but it must landscape the area by 30 June 2021 or return the land. The agreement specifies the landscaping features required.
- The university spends $100,000 landscaping the land. It does this by 31 December 2020.

1 Jan 2020	DR Land	$2 million	
	CR Liability		$100,000
	CR Revenue		$1,900,000
	Recognise receipt of land and a liability to carry out the specified activity		
31 Dec 2020	DR Liability	$100,000	
	CR Revenue		$100,000
	Recognise revenue once the specified activity has been completed		

39. As noted earlier in the memo, we have found it difficult to distinguish between specified activities and eligible expenditure. In particular, paragraph 20 of the ED is difficult to understand. The landscaping obligation meets the definition of a specified activity because the national government is compelling the university to perform a particular action (the landscaping). But we also think that it could meet the definition of eligible expenditure because the national government is requiring the university to spend money on the landscaping (an outflow of resources), even though the government is not paying for the landscaping.

Journal entries ED 71 Example 12 – Variation 4 (enforceable, land plus cash for buildings)

Variation 4: Assumptions

- Transfer of land with a fair value of $2 million occurs on 1 January 2020
- Transfer of $5 million cash to build a lecture theatre occurs on 1 January 2020.
- The agreement is enforceable. The university has to establish the lecture theatre on the land by 30 June 2021 or return the land.
- The university establishes the lecture theatre over time. It is half complete on 31 December 2020 and fully complete on 31 March 2021.

1 Jan 2020	DR Land	$2 million	
	DR Cash	$5 million	
	CR Liability		$7 million
	Recognise receipt of land and cash, and recognise a liability to carry out the specified activity		
31 Dec 2020	DR Liability	$3,500,000	
	CR Revenue		$3,500,000
	Recognise revenue as half the specified activity has been completed		
31 Mar 2021	DR Liability	$3,500,000	
	CR Revenue		$3,500,000
	Recognise revenue as all of the specified activity has been completed		

40. We next consider what would happen if the Board supported the proposed accounting outcomes in the above variations of Example 12 but did not support the IPSASB's reasoning.

41. The IPSASB has not used the concept of other obligations in standards and has therefore not described the application of that concept. The IPSASB's previous discussions about other obligations focused on capital grants and multi-year grants. Variation 4, or at least the cash component of it, might be the type of transaction that the IPSASB discussed in relation to other obligations. The journal entries for other obligations would be similar to those shown above, but instead of initially recognising a liability, an entity would recognise an other obligation.

42. The IASB uses the concept of other comprehensive income (OCI) to deal with some value changes but the IASB's rationale for using this concept and principles for its application are hard to pin down. The IASB's Conceptual Framework (paragraph BC7.17) states that the Board may, in exceptional circumstances, require that changes in income or expenses arising from a change in current value of an asset or liability be included in OCI when doing so would result in the statement of profit or loss providing more relevant information, or providing a more faithful representation of the entity's financial performance for that period (see extracts shown below). The IASB continues to consider the role of OCI in its current projects.

Extract from IASB's Basis for Conclusions on the Conceptual Framework

BC7.21 As mentioned in paragraph BC7.17, the Board did not identify a single characteristic or a single set of characteristics shared by all items that are most appropriately included in the statement of profit or loss.

BC7.22 Further, the Board explored whether it might be possible to define a small number of categories of items that would or might be included in other comprehensive income. The Board described one approach to doing that in the 2013 Discussion Paper, but that approach did not attract significant support from respondents.

BC7.23 For the 2018 Conceptual Framework, the Board developed an approach to classifying income and expenses that is based on the description of the statement of profit or loss. As mentioned in paragraph BC7.15, that description states that the statement of profit or loss is the primary source of information about an entity's financial performance for the reporting period. If that statement is the primary source of that information, excluding income and expenses from that statement without compelling reasons could make that statement less useful.

BC7.24 Accordingly, the 2018 Conceptual Framework sets out a principle that all income and expenses are included in the statement of profit or loss. The Board's intention in establishing this principle was to emphasise that the statement of profit or loss is the default location for income and expenses. Thus, decisions to exclude any income and expenses from the statement of profit or loss and to include them in other comprehensive income can be made only in exceptional circumstances. Those exceptional circumstances would be when the Board concludes that requiring or permitting the exclusion of particular items of income or expenses from the statement of profit or loss would result in the statement of profit or loss providing more relevant information or providing a more faithful representation of an entity's financial performance for that period.

BC7.25 The 2018 Conceptual Framework does not include specific guidance on how the Board might reach that conclusion. The Board expects to take that decision when developing Standards and to explain its reasons in the bases for conclusions on those Standards. Entities cannot take that decision (see paragraph 88 of IAS 1).

43. Although it is possible to argue that using OCI to defer revenue until the university has built lecture theatres or completed the landscaping would result in the university presenting more relevant information on its revenue and expenses, the proposed revenue deferral would not relate to a change in current value and we do not think it would be appropriate to use the concept of OCI for these examples.

44. The next example comes from AASB 1058. There are three variations.

(a) Example 8A is outside the scope of AASB 15 and within the scope of the residual standard, AASB 1058. Application of AASB 1058 results in immediate recognition of the entire multi-year grant as income. ED 71 would lead to the same conclusion for Example 8A, but only because the MOU is not detailed enough. If the MOU specified the types of items or expenses the grant must be spent on, then there would be a present obligation under ED 71 to use the grant as directed on eligible expenditure (see Example 19 in ED 71).[7]

(b) Examples 8B and 8C are within the scope of AASB 15. They are therefore not relevant to the consideration of the proposals in ED 71. We have included them for completeness.

AASB 1058

Example 8—Multi-year cash grant

The Local Government enters into an agreement with the State Government in the form of a Memorandum of Understanding (MOU)[1] to receive a multi-year cash grant of $90,000 from the State Government, which is received in full on 24 June 20X0. The grant is to fund education programs over three years commencing 1 July 20X0, with the objective of increasing the literacy of students of a specific rural area.

The fact pattern and analysis applies to Examples 8A–8C, described below. Each example is considered in isolation.

1 Not all Memoranda of Understanding would necessarily be enforceable

7 Example 19 refers to "the types ~~or~~of items or expenses the transfer *can* be spent on". In order for there to be a present obligation we do not think the example should allow for any discretion as to what the money is spent on.

Example 8A – Enforceable, no sufficiently specific performance obligation

This example contains the following additional facts:

- the MOU does not specify the activities the grant must be used for, other than an education program to increase literacy in a particular area; and
- the State Government can enforce the repayment of the grant if the entity does not apply the funds to relevant education programs.

Scope and asset recognition

The Local Government determines:

- the $90,000 grant is an asset the Local Government acquired to further the objectives of the Local Government; and
- it controls a financial asset ($90,000) within the scope of AASB 9.

Based on the facts and circumstances, on gaining control of the grant, the Local Government determines that there are no related amounts under paragraph 9 of AASB 1058 as the grant does not give rise to:

- a contribution by owners, as the State Government does not control the Local Government;
- a contract with a customer within the scope of AASB 15. The agreement is enforceable as the grantor can enforce its rights in the contract to require the Local Government to return the funds if the Local Government does not undertake relevant programs. However, the Local Government's performance obligation to provide relevant education programs is not sufficiently specific to be able to determine when the obligation is satisfied.
- a lease liability as defined in AASB 16, as the grant agreement is not a lease and does not contain a lease;
- a financial liability within the scope of AASB 9, as there is no obligation to provide cash or another financial asset to other parties; or
- a provision within the scope of AASB 137, as the agreement does not set out specific constructive obligations.

The Local Government concludes that the grant is an asset acquired for consideration that is significantly less than the fair value of the grant principally to further its objectives, and so the grant is within the scope of AASB 1058.

Accounting treatment

The Local Government determines that there are no related amounts to recognise under the MOU and so recognises the grant as income in accordance with paragraph 10 of AASB 1058 on 24 June 20X0. The journal entry for the accounting is:

24 June 20X0	**Debit**	**Credit**
Cash	90,000	
Income		90,000

Example 8B – Enforceable and sufficiently specific performance obligation

This example contains the following additional facts:

- the MOU outlines the agreed activities of education programs that are tailored to the literacy needs of the students. The Local Government is required to provide to the State Government an annual report on the activities undertaken and the progress of the program. The Local Government is able to identify when its specific performance obligations are satisfied and expects to fulfil its promise to provide the agreed activities; and

- the State Government can enforce the repayment of the grant if the specified activities are not undertaken by requiring direct repayment or otherwise deducting unspent monies from future funding.

Scope and asset recognition

The Local Government determines:

- the $90,000 grant is an asset the Local Government acquired to further the objectives of the Local Government; and
- it controls a financial asset ($90,000) within the scope of AASB 9.

Based on the facts and circumstances, on gaining control of the grant, the Local Government determines that the grant agreement (the MOU) does not give rise to related amounts of the following types:

- a contribution by owners, as the State Government does not control the Local Government;
- a lease liability as defined in AASB 16, as the grant agreement is not a lease and does not contain a lease;
- a financial liability within the scope of AASB 9, as there is no obligation to provide cash or another financial asset to other parties; and
- a provision within the scope of AASB 137, as the agreement specifies legal obligations and there are no other sufficiently specific constructive obligations to consider.

The Local Government analyses the terms and conditions of the grant, and notes:

- the agreement is enforceable (refer to paragraphs F10–F18 of AASB 15), as the grantor can enforce its rights in the contract to require the Local Government to return the funds if the Local Government does not fulfil its specific performance obligations under the agreement (i.e. by providing literacy programs tailored to the needs of the students and annual reports to the State Government); and
- the Local Government’s obligation to transfer the specific services in return for the consideration from the State Government is sufficiently specific so as to be able to determine when the obligation is satisfied.

Consequently, the Local Government concludes that the grant is a contract with a customer as defined under AASB 15. The cost to be incurred by the Local Government in providing the literacy programs can vary from the amount of the grant received.

Accounting treatment

In accordance with AASB 15, the Local Government:

- identifies each performance obligation relating to the grant;
- recognises a contract liability for its obligations under the agreement; and
- recognises revenue as it satisfies its performance obligations.

The journal entries for the accounting treatment (to the end of the first year) are:

Initial recognition	**Debit**	**Credit**
24 June 20X0		
Cash	90,000	
Contract liability		90,000
Year 1		
30 June 20X1		
Contract liability	30,000	
Revenue		30,000
Expenses – literacy program	32,000	
Cash		32,000

Example 8C – Multi-year conditional grant

This example contains the following additional facts:

- the Local Government receives $30,000 in the first year; and
- in the following years, the grant is paid in two equal portions, with each payment conditional on the Local Government's adequate progress toward advancing literacy in the previous year.

In this case, the Local Government recognises a receivable for the first year's grant. However, the Local Government has no control over the cash flows that are conditional on its future performance. Accordingly, the Local Government will only recognise those future cash flows once the Local Government becomes unconditionally entitled to them.

The journal entries for the accounting treatment for the first year's grant are:

Initial recognition	**Debit**	**Credit**
24 June 20X0		
Cash	30,000	
Contract liability		30,000
Year 1		
30 June 20X1		
Contract liability	30,000	
Revenue		30,000
Expenses – literacy program	32,000	
Cash		32,000

45. ED 71 would lead to deferral of revenue in the following examples in this memo.

    - Example based on ED 71 paragraph AG27 – being a two-year research grant that is treated as a specified activity. Revenue is deferred over two years as the specified activities are completed.
    - Example based on ED 71 paragraph AG25 – being a four-year marketing grant. In Variation 1 the entity accounts for the grant as eligible expenditure and recognises revenue over four years as eligible expenditure is incurred. Variation 2 does not result in deferral of revenue as the entity cannot demonstrate what it has spent under the terms of the agreement.

- ED 71 Example 12 – Variation 2 (enforceable, build lecture theatres). The revenue from the donated land is recognised over two years as the university builds the theatres.
- ED 71 Example 12 – Variation 3 (enforceable, landscape area). Most of the revenue is recognised in the first year but the portion that relates to the landscaping is deferred until the second year, when the landscaping is completed.
- ED 71 Example 12 – Variation 4 (enforceable, land plus cash for buildings). The donated land and the cash grant are recognised over two years as the university builds the lecture theatre.

Question for the Board
Q3. What are your views on the examples that lead to deferral of revenue?

Next steps

46. The discussions at this meeting will guide further work on ED 71 SMCs 1 to 4, all of which deal with present obligations.

47. With respect to ED 70 and ED 71 we need to do further work on provisions. We will also begin work on ED 72.

Appendix 1 SMCs in ED 71

Specific Matter for Comment 1: (Paragraphs 14–21)

The ED proposes that a present obligation is a binding obligation (legally or by equivalent means), which an entity has little or no realistic alternative to avoid and which results in an outflow of resources. The IPSASB decided that to help ascertain whether a transfer recipient has a present obligation, consideration is given to whether the transfer recipient has an obligation to perform a specified activity or incur eligible expenditure.

Do you agree with the IPSASB's proposals that for the purposes of this [draft] Standard, *Revenue without Performance Obligations*, a specified activity and eligible expenditure give rise to present obligations? Are there other examples of present obligations that would be useful to include in the [draft] Standard?

Specific Matter for Comment 2: (Paragraph 31)

The flowchart that follows paragraph 31 of this [draft] Standard illustrates the process a transfer recipient undertakes to determine whether revenue arises and, if so, the relevant paragraphs to apply for such revenue recognition. Do you agree that the flowchart clearly illustrates the process? If not, what clarification is necessary?

Specific Matter for Comment 3: (Paragraphs 57–58)

The IPSASB decided that a transfer recipient recognizes revenue without performance obligations but with present obligations when (or as) the transfer recipient satisfies the present obligation.

Do you agree that sufficient guidance exists in this [draft] Standard to determine when a present obligation is satisfied and when revenue should be recognized? For example, point in time or over time. If not, what further guidance is necessary to enhance clarity of the principle?

Specific Matter for Comment 4: (Paragraphs 80–81)

The IPSASB decided that the objective when allocating the transaction price is for a transfer recipient to allocate the transaction price to each present obligation in the arrangement so that it depicts the amount to which the transfer recipient expects to be entitled in satisfying the present obligation. The amount of revenue recognized is a proportionate amount of the resource inflow recognized as an asset, based on the estimated percentage of the total enforceable obligations satisfied.

Do you agree sufficient guidance exists in this [draft] Standard to identify and determine how to allocate the transaction price between different present obligations? If not, what further guidance is necessary to enhance clarity of the principle?

Specific Matter for Comment 5: (Paragraphs 84–85)

Do you agree with the IPSASB's proposals that receivables within the scope of this [draft] Standard should be subsequently measured in accordance with the requirements of IPSAS 41, *Financial Instruments*? If not, how do you propose receivables be accounted for?

Specific Matter for Comment 6: (Paragraphs 126–154)

The disclosure requirements proposed by the IPSASB for revenue transactions without performance obligations are intended to provide users with information useful for decision making, and to demonstrate the accountability of the transfer recipient for the resources entrusted to it.

Do you agree the disclosure requirements in this [draft] Standard provide users with sufficient, reliable and relevant information about revenue transactions without performance obligations? In particular, (i) what disclosures are relevant; (ii) what disclosures are not relevant; and (iii) what other disclosures, if any, should be required?

Specific Matter for Comment 7: (Paragraphs N/A)

Although much of the material in this [draft] Standard has been taken from IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*, the IPSASB decided that the ED should establish broad principles for the recognition of revenue from transactions without performance obligations, and provide guidance on the application of those principles to the major sources of revenue for governments and other public sector entities. The way in which these broad principles and guidance have been set out in the ED are consistent with that of [draft] IPSAS [X] (ED 72), *Transfer Expenses*.

Do you agree with the approach taken in the ED and that the structure and broad principles and guidance are logically set out? If not, what improvements can be made?

Appendix 2 Receivables and contract assets – Comparison of IFRS 15, ED 70 and ED 71

IFRS 15	ED 70	ED 71
Scope … 5 An entity shall apply this Standard to all contracts with customers, except the following: (a) lease contracts within the scope of IFRS 16 *Leases*; (b) contracts within the scope of IFRS 17 *Insurance Contracts*. However, an entity may choose to apply…; (c) financial instruments and other contractual rights or obligations within the scope of IFRS 9 *Financial Instruments*, IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements*, IAS 27 *Separate Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures*; and (d) non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers. For example, this Standard would not apply to a contract between two oil companies that agree to an exchange of oil to fulfil demand from their customers in different specified locations on a timely basis.	**Scope** 3. An entity … shall apply this [draft] Standard in accounting for revenue arising from binding arrangements with a purchaser that include performance obligations …. This [draft] Standard does not apply to: (a) Revenue arising from other arrangements …; (b) Lease contracts within the scope of IPSAS 13, *Leases*; (c) Insurance contracts within the scope of the relevant international or national accounting standard dealing with insurance contracts; (d) Financial instruments and other contractual rights or obligations within the scope of, IPSAS 41, *Financial Instruments*; (e) Rights or obligations arising from binding arrangements within the scope of, IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, IPSAS 32, *Service Concession Arrangements: Grantor*, IPSAS 34, *Separate Financial Statements*, IPSAS 35, *Consolidated Financial Statements*, IPSAS 36, *Investments in Associates and Joint Ventures*, IPSAS 37, *Joint Arrangements*, IPSAS 39, *Employee Benefits* and IPSAS 40, *Public Sector Combinations*; (f) Non-monetary exchanges …; (g) Gains from the sale of non-financial assets	**Scope** 3. A transfer recipient that prepares and presents financial statements under the accrual basis of accounting shall apply this [draft] Standard in accounting for revenue from transactions without performance obligations. This [draft] Standard does not apply to: (a) Revenue from transactions with performance obligations (see [draft] IPSAS [X] (ED 70); (b) Contributions to social benefit schemes that are accounted for in accordance with paragraphs 26-31 of IPSAS 42, *Social Benefits* (the insurance approach); (c) A public sector combination that is a non-exchange transaction; (d) The accounting for contributions from owners; (e) Lease contracts within the scope of IPSAS 13, *Leases*; (f) Insurance contracts within the scope of the relevant international or national accounting standard dealing with insurance contracts1; (g) Financial instruments and other contractual rights or obligations within the scope of, IPSAS 41, *Financial Instruments*; (h) Rights or obligations arising from binding arrangements within the scope of, IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, IPSAS 32, *Service*

IFRS 15	ED 70	ED 71
	that are not an output of an entity's activities …; (h) Changes in the value of other current assets; (i) Initial recognition or changes in the fair value of biological assets related to agricultural activity (see IPSAS 27, *Agriculture*); and (j) The extraction of mineral resources.	*Concession Arrangements: Grantor*, IPSAS 34, *Separate Financial Statements*, IPSAS 35, *Consolidated Financial Statements*, IPSAS 36, *Investments in Associates and Joint Ventures*, IPSAS 37, *Joint Arrangements*, IPSAS 39, *Employee Benefits* and IPSAS 40, *Public Sector Combinations*; (i) Gains from the sale of non-financial assets that are not an output of a transfer recipient's activities and within the scope of IPSAS 16, *Investment Property*, IPSAS 17, *Property, Plant, and Equipment* or IPSAS 31, *Intangible Assets*; (j) Changes in the value of current and non-current assets arising from subsequent measurement; (k) Initial recognition or changes in the fair value of biological assets related to agricultural activity (see IPSAS 27, *Agriculture*); and (l) The extraction of mineral resources.

Presentation	**Presentation**	**Presentation**
…	…	…
107 If an entity performs by transferring goods or services to a customer before the customer pays consideration or before payment is due, the entity shall present the contract as a contract asset, excluding any amounts presented as a receivable. A contract asset is an entity's right to consideration in exchange for goods or services that the entity has transferred to a customer. An entity shall assess a contract asset for impairment in accordance with IFRS 9. An impairment of a contract asset shall be measured, presented and disclosed on the same basis as a financial asset that is within the scope of IFRS 9 (see also paragraph 113(b)).	106. If an entity performs by transferring goods or services to a purchaser or third-party beneficiary before the purchaser pays consideration or before payment is due, the entity shall present the binding arrangement as a binding arrangement asset, excluding any amounts presented as a receivable. A binding arrangement asset is an entity's right to consideration in exchange for goods or services that the entity has transferred to a purchaser or third-party beneficiary. An entity shall assess a binding arrangement asset for impairment in accordance with IPSAS 41, *Financial Instruments*. An impairment of a binding arrangement asset shall be measured, presented and disclosed on the same basis as a financial asset that is within the scope of IPSAS 41 (see also paragraph 113(b)).	123. If a transfer recipient performs by satisfying a present obligation before the transfer is received or before the transfer is due, the transfer recipient shall present the binding arrangement as a transfer recipient's binding arrangement asset, excluding any amounts presented as a receivable. A transfer recipient's binding arrangement asset is a transfer recipient's right to a transfer to satisfy a present obligation. A transfer recipient shall assess a transfer recipient's binding arrangement asset for impairment in accordance with IPSAS 41. An impairment of a transfer recipient's binding arrangement asset shall be measured, presented and disclosed on the same basis as a financial asset that is within the scope of IPSAS 41 (see also paragraph 140(b)).
108 A receivable is an entity's right to consideration that is unconditional. A right to consideration is unconditional if only the passage of time is required before payment of that consideration is due. For example, an entity would recognise a receivable if it has a present right to payment even though that amount may be subject to refund in the future. An entity shall account for a receivable in accordance with IFRS 9. Upon initial recognition of a receivable from a contract with a customer, any difference between the measurement of the receivable in accordance with IFRS 9 and the corresponding amount of revenue recognised shall be presented as an expense (for example, as an impairment loss).	107. A receivable is an entity's right to consideration that is unconditional. A right to consideration is unconditional if only the passage of time is required before payment of that consideration is due. For example, an entity would recognize a receivable if it has a present right to payment even though that amount may be subject to refund in the future. An entity shall account for a receivable in accordance with IPSAS 41. Upon initial recognition of a receivable from a binding arrangement with a purchaser, any difference between the measurement of the receivable in accordance with IPSAS 41 and the corresponding amount of revenue recognized shall be presented as an expense (for example, as an impairment loss).	124. A receivable is a transfer recipient's right to a transfer that is unconditional. A right to a transfer is unconditional if only the passage of time is required before a transfer is due. For example, a transfer recipient would recognize a receivable if it has a present right to a transfer even though that amount may be subject to refund in the future. A transfer recipient shall account for a receivable in accordance with IPSAS 41. Upon initial recognition of a receivable from a binding arrangement, any difference between the measurement of the receivable in accordance with IPSAS 41 and the corresponding amount of revenue recognized shall be presented as an expense (for example, as an impairment loss).

<table>
<tr><th>IFRS 15</th><th>ED 70</th><th>ED 71</th></tr>
<tr><td></td><td>Subsequent Measurement of Receivables
AG140. After initial recognition, an entity shall subsequently measure a receivable:
(a) Within the scope of IPSAS 41, Financial Instruments, as a financial asset in accordance with IPSAS 41; or
(b) Not in the scope of IPSAS 41 on the same basis as a financial asset at amortized cost in accordance with IPSAS 41.
AG141. Where a receivable as described in paragraph AG140(b) does not satisfy the requirements in paragraph 40 of IPSAS 41, it shall be subsequently measured at fair value. Changes in fair value are recognized in surplus or deficit.</td><td>Subsequent Measurement of Receivables
84. After initial recognition, a transfer recipient shall subsequently measure a receivable:
(a) Within the scope of IPSAS 41 as a financial asset in accordance with IPSAS 41; or
(b) Not in the scope of IPSAS 41 on the same basis as a financial asset at amortized cost in accordance with IPSAS 41.
85. Where a receivable not in the scope of IPSAS 41 as described in paragraph 84(b) does not satisfy the requirements in paragraph 40 of IPSAS 41, it shall be subsequently measured at fair value. Changes in fair value are recognized in surplus or deficit.</td></tr>
<tr><td></td><td>Subsequent Measurement of Receivables
BC62. IFRS 15 did not include specific guidance on the subsequent measurement of receivables, as IFRS 15 dealt with contractual agreements, and all receivables arising from such agreements would be within the scope of the financial instrument standards. Because [draft] IPSAS [X] (ED 70) applies more broadly to binding arrangements with performance obligations, it is possible for receivables to fall outside the scope of IPSAS 41, Financial Instruments. Applying the measurement requirements of [draft] IPSAS [X] (ED 70) to such receivables would result in their initial measurement at the transaction price, as required by paragraphs 57–60 and AG115–AG117 of IPSAS 41. To address the lack of guidance for subsequent measurement of these receivables, the IPSASB added paragraphs AG140–AG141, which are based on the subsequent measurement guidance in IPSAS 41.</td><td>Subsequent Measurement of Receivables
BC42. [Draft] IPSAS [X] (ED 71) applies to binding arrangements without performance obligations, which are broader than contractual agreements. It is therefore possible for receivables to fall outside the scope of IPSAS 41, Financial Instruments. Applying the measurement requirements of [draft] IPSAS [X] (ED 71) to such receivables would result in their initial measurement at the transaction price, as required by paragraphs 57-60 and AG115-AG117 of IPSAS 41. To address the lack of guidance for subsequent measurement of these receivables, the IPSASB added paragraphs 84-85, which are based on the subsequent measurement guidance in IPSAS 41.</td></tr>
</table>

IFRS 15	ED 70	ED 71
IFRS 9 ***Financial Instruments***	**IPSAS 41** ***Financial Instruments*** (as amended by ED 70)	**IPSAS 41** ***Financial Instruments*** (as amended by ED 71)
2.1 This Standard shall be applied by all entities to all types of financial instruments except: **…** **(j) rights and obligations within the scope of IFRS 15** ***Revenue from Contracts with Customers*** **that are financial instruments, except for those that IFRS 15 specifies are accounted for in accordance with this Standard.**	[ED 70 does not propose to amend paragraph 2 of IPSAS 41. We think an amendment is required here.]	2. **This Standard shall be applied by all entities to all types of financial instruments except:** … (j) **The initial recognition and initial measurement of rights and obligations arising from non-exchange revenue transactions to which ~~IPSAS 23,~~ *~~Revenue from Non-Exchange Transactions (Taxes and Transfers)~~* [draft] IPSAS [X] (ED 71)** ***Revenue without Performance Obligations*** **applies; except as described in AG6.** …
2.2 The impairment requirements of this Standard shall be applied to those rights that IFRS 15 specifies are accounted for in accordance with this Standard for the purpose of recognising impairment gains or losses.	[read para 3 in conjunction with ED 71] 3. The impairment requirements of this Standard shall be applied to those rights arising from ~~IPSAS 9,~~ *~~Revenue from Exchange Transactions~~*[draft] IPSAS [X] (ED 70), *Revenue with Performance Obligations* and IPSAS 23 transactions which give rise to financial instruments for the purposes of recognizing impairment gains or losses.	[read para 3 in conjunction with ED 70] 3. **The impairment requirements of this Standard shall be applied to those rights arising from IPSAS 9,** ***Revenue from Exchange Transactions*** **and ~~IPSAS 23~~ [draft] IPSAS [X] (ED 71) transactions which give rise to financial instruments for the purposes of recognizing impairment gains or losses.** …
5.1 Initial measurement … 5.1.3 Despite the requirement in paragraph 5.1.1, at initial recognition, an entity shall measure trade receivables at their transaction price (as defined in IFRS 15) if the trade receivables do not contain a significant financing component in accordance with IFRS 15 (or when the entity applies the practical expedient in accordance with paragraph 63 of IFRS 15).	**Initial Measurement** … 60. Despite the requirement in paragraph 57, at initial recognition, an entity may measure short-term receivables that do not have a significant financing component (determined in accordance with [draft] IPSAS [X] (ED 70) at their transaction price (as defined in [draft] IPSAS [X] (ED 70) for transactions with performance obligations or [draft] IPSAS [X]	

IFRS 15	ED 70	ED 71
	(ED 71) for transactions without performance obligations) ~~and payables at the original invoice amount if the effect of discounting is immaterial~~. An entity may measure short-term payables at the original invoice amount if the effect of discounting is immaterial.	AG6. Rights and obligations (assets and liabilities) may arise from ~~non-exchange~~ revenue transactions without performance obligations.~~,~~ F~~f~~or example, an entity may receive cash from a multi-lateral agency to perform certain specified activities. Where the performance of those specified activities is subject to conditions, an asset and a liability is recognized simultaneously. Where the asset is a financial asset, it is recognized in accordance with ~~IPSAS 23~~ [draft] IPSAS [X] (ED 71), and initially measured in accordance with ~~IPSAS 23~~ [draft] IPSAS [X] (ED 71) and this Standard. A liability that is initially recognized as a result of conditions imposed on the use of an asset is outside the scope of this Standard and is dealt with in ~~IPSAS 23~~ [draft] IPSAS [X] (ED 71). After initial recognition, if circumstances indicate that recognition of a liability in accordance with ~~IPSAS 23~~ [draft] IPSAS [X] (ED 71) is no longer appropriate, an entity considers whether a financial liability should be recognized in accordance with this Standard. Other liabilities that may arise from ~~non-exchange~~ revenue transactions without performance obligations are recognized and measured in accordance with this Standard if they meet the definition of a financial liability in IPSAS 28.

IFRS 15	**ED 70**	**ED 71**
IFRS 7 ***Financial Instruments: Disclosures*** 5A The credit risk disclosures in paragraphs 35A–35N apply to those rights that IFRS 15 *Revenue from Contracts with Customers* specifies are accounted for in accordance with IFRS 9 for the purposes of recognising impairment gains or losses. Any reference to financial assets or financial instruments in these paragraphs shall include those rights unless otherwise specified.	**IPSAS 30** ***Financial Instruments: Disclosures*** See ED 71 column	**IPSAS 30** ***Financial Instruments: Disclosures*** **Scope extracts** (based on ED 71 Appendix D) 5A The credit risk disclosure requirements in paragraphs 42A–42N apply to those rights for receivables that result from ~~exchange~~ revenue transactions with performance obligations that are within the scope of ~~IPSAS 9~~[draft] IPSAS [X] (ED 70), *Revenue with Performance Obligations* and ~~non-exchange~~ revenue transactions without performance obligations within the scope of ~~IPSAS 23~~[draft] IPSAS [X] (ED 71), *Revenue without Performance Obligations* which give rise to financial instruments for the purpose of recognizing impairment gains or losses in accordance with paragraph 3 of IPSAS 41. Any reference to financial assets or financial instruments in these paragraphs shall include those rights unless otherwise specified.

Appendix 3 Extracts from AASB 9 *Financial Instruments*

Appendix C Australian implementation guidance for not-for-profit entities

This appendix is an integral part of AASB 9 and has the same authority as other parts of the Standard. The appendix applies only to not-for-profit entities.

Introduction

C1 AASB 9 *Financial Instruments* incorporates International Financial Reporting Standard IFRS 9 *Financial Instruments*, issued by the International Accounting Standards Board. Consequently, the text of AASB 9 is generally expressed from the perspective of for-profit entities in the private sector. The AASB has prepared this appendix to explain the principles in the Standard in relation to non-contractual receivables arising from statutory requirements ('statutory receivables') from the perspective of not-for-profit entities in the private and public sectors. The appendix does not apply to for-profit entities or affect their application of AASB 9.

C2 This appendix provides guidance to assist not-for-profit entities to determine whether particular transactions or other events, or components thereof, are within the scope of this Standard. If a transaction is outside the scope of AASB 9, the recognition and measurement of the asset and income arising from the transaction may instead be specified by another Standard, such as AASB 1058 *Income of Not-for-Profit Entities.*

Non-contractual receivables arising from statutory requirements

C3 The scope of AASB 9 depends on the definition of a financial instrument, which is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. Therefore, AASB 9 specifically addresses financial assets (and financial liabilities) that arise from contracts.

C4 Financial assets include contractual rights to receive cash or another financial asset from another entity. However, in a not-for-profit context, a receivable may arise from statutory requirements rather than through a contract (for example, rates, taxes and fines). The nature of such a receivable arising from statutory requirements is, in substance, similar to a contractual receivable, as the statutory requirements also provide an entity with a right to receive cash or another financial asset from another entity.

C5 Accordingly, an entity recognises and measures a statutory receivable as if it were a financial asset when statutory requirements establish a right for the entity to receive cash or another financial asset. Such a right arises on the occurrence of a past event.

C6 A past event relating to taxes occurs as specified for each tax levied in the relevant taxation law. Examples of taxable events include:

(a) income tax – the end of the taxation period in respect of which taxable income of a taxpayer is determined;

(b) goods and services tax – the purchase or sale of taxable goods and services during the taxation period;

(c) customs duty – the movement of dutiable goods or services across the customs boundary; and

(d) property tax – the passing of the date on which the tax is levied, or, if the tax is levied on a periodic basis, the period for which the tax is levied.

C7 In some instances, assets arising from taxable events cannot be measured reliably until after the taxing entity's financial statements are authorised for issue. This may occur, for example, if a tax base is volatile and reliable estimation is not possible. Consequently, in those cases, the assets would be recognised in a period subsequent to the occurrence of the taxable event, which may be several reporting periods after the taxable event.

C8 It is unlikely that taxes or fines will qualify as assets of the government agency or department responsible for their collection. This is because the government agency or department responsible for collecting taxes or fines does not normally control the future economic benefits embodied in tax collections, and the taxes and fines are controlled at a whole of government level.

NZ ACCOUNTING
STANDARDS
BOARD

Memorandum

Date:	24 April 2020
To:	NZASB Members
From:	Lisa Kelsey and Joanne Scott
Subject:	**PIR of Tier 3 and Tier 4 Standards**

Recommendations[1]

1. The Board is asked to:

   (a) CONSIDER and provide FEEDBACK on the draft request for information (RFI) for the post-implementation review (PIR) of the Tier 3 and Tier 4 standards; and

   (b) AGREE that the draft RFI can be used as the basis for discussions with key stakeholders.

Background

2. At its meeting in December 2019 the Board noted that it has committed to undertake a PIR of the Tier 3 and Tier 4 standards (as per Action 1.9 of the NZASB's Strategic Action Plan for 2019–2024). The objective of the PIR is to assess whether the standards, guidance and templates are working as intended and achieving their objectives.

3. The Board agreed that we should commence work on the PIR of the Tier 3 and Tier 4 standards, as resources permit.

4. The Board noted that the PIR will consist of the following steps.

   (a) Step 1: Initial assessment of issues

   (b) Step 2: Outreach with consultative network

   (c) Step 3: Request for Information and outreach plan

   (d) Step 4: Analysis of comments

   (e) Step 5: Determine next steps

   (f) Step 6: Feedback statement

5. We anticipate that standard-setting activity (including amending guidance and templates) will be required in relation to some issues. At the completion of the PIR the Board will need to decide which issues should be addressed in a standard-setting project.

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[1] This memo refers to the work of the International Accounting Standards Board (IASB) and uses registered trademarks of the IFRS Foundation (for example, IFRS® Standards, IFRIC® Interpretations and IASB® papers).

6. The Board had a preliminary discussion about matters to be included in the Request for Information (RFI).

7. At its meeting in February 2020 the Board provided feedback on the proposed timeline (see Appendix A) and proposed outreach. The Board agreed we should develop a draft RFI in conjunction with two NZASB members and bring it to the May 2020 meeting.

Draft RFI

8. As agreed by the Board, the RFI will seek feedback from constituents on the significance and prevalence of issues arising from the application of Tier 3 and Tier 4 standards, guidance and use of our template performance reports. The Board has indicated that the RFI should give examples of issues but should not indicate possible courses of action. Agenda item 6.2 contains a draft RFI.

9. We are seeking feedback from the Board on the draft RFI and requesting agreement to use it as the basis for discussions with key stakeholders.

10. We plan to seek approval to issue the RFI in September.

Examples of issues

11. We are seeking the Board's views on how much to say about specific issues in the RFI and how to present those issues.

12. To assist the Board in coming to a view on this matter, we have set out two options in the RFI. Option A gives a narrative and very brief description of a couple of issues. Option B uses a tabular layout to highlight more issues and gives more details about the issues. A third option would be not to identify any specific issues in the RFI.

13. The issues identified in tables 4 and 5 of the draft RFI come from an analysis of queries received and issues raised since the standards were issued.

14. We have also outlined some pros and cons of identifying specific issues in the RFI.

Pros	**Cons**
We will hopefully receive more information on the prevalence and impact of known issues	Risk that we may bias the responses we receive
Shows we have been listening	The focus could shift to these issues to the detriment of identifying other issues
Starts the conversation	Issues that we consider to be largely resolved could gain momentum again
	If issue is listed, respondents may feel no need to provide feedback

Question for the Board
1. Does the Board prefer Option A or Option B in the draft RFI?

Next steps

15. During the months of June to August we will consult with the consultative network which consists of our key stakeholders. We will organise one-on-one meetings with Charities Services, Audit NZ, CA ANZ on issues encountered, the draft RFI and proposed outreach. We will seek feedback from TRG on issues encountered, the draft RFI and proposed outreach. If needed, we will contact additional stakeholders (taking account of feedback from consultative network).

Attachments

Agenda item 6.2: Draft request for information

Appendix A: Proposed timeline

Table 1 sets out the proposed timeline for the PIR of the Tier 3 and Tier 4 standards. We are currently part way through Step 2.

Table 1 Proposed timeline

Activity	Timing
Step 1: Initial assessment of issues	
Preparation • Analyse queries received and issues raised, but not yet addressed (information gathering) • Identify key issues (to inform discussions with consultative network and to draft RFI)	December 2019 – February 2020
Step 2: Consult with consultative network	
The consultative network will be made up of representatives from key stakeholder groups. We propose that it consist of Charities Services, Audit New Zealand, the TRG and CA ANZ.[2] We are planning to use a draft RFI as the basis for discussion with the consultative network. *Preparation* • Draft RFI, including drafting descriptions of key issues identified in step 1 above • Seek feedback from NZASB subcommittee on draft RFI • Monitor Incorporated Societies Bill[3] • Monitor the Department of Internal Affairs project on Modernising the Charities Act[4]	February 2020 – April 2020
Board engagement • Feedback from Board on draft RFI • Seek approval to use the draft RFI in discussions with the NZASB's consultative network	7 May 2020 NZASB meeting
Consult with consultative network • Organise one-on-one meetings with Charities Services, Audit NZ, CA ANZ on issues encountered, the draft RFI and proposed outreach • Seek feedback from TRG on issues encountered, the draft RFI and proposed outreach • If needed, contact additional stakeholders (taking account of feedback from consultative network)	June 2020 – August 2020
Step 3: Issue the RFI	
Board engagement • Update on feedback from consultative network • Update on modernising the Charities Act and Incorporated Societies Bill • Update on proposed outreach	10 September 2020 NZASB meeting

[2] We plan to consult with the TRG as part of both steps 2 and 3. We think this is appropriate as TRG members have previously raised issues about the standards. We will also consult with XRAP and the NZAuASB as part of step 3.

[3] The Incorporated Societies Bill is expected to be introduced to Parliament this year.

[4] At this stage there is no target date for Cabinet approval or the drafting of legislation to amend the Charities Act. Source: Department of Internal Affairs website, accessed 6 December 2019. https://www.dia.govt.nz/charitiesact#Background-to-review

Activity	Timing
• Seek approval to issue the RFI	
• Issue the RFI • Appropriate communications	September 2020
Public consultation • 6-month comment period • Proposed outreach is discussed later in this memo	September 2020 – March 2021
Step 4: Analysis of public comments and feedback from outreach activities	
Preparation • Analyse comments and feedback *Board engagement* • Consider comments and feedback	H1 2021
Step 5: Determine next steps	
Preparation • Identify possible next steps ○ No action ○ Standard setting/guidance ○ Education *Board engagement* • Seek Board feedback on next steps • Update Board on Incorporated Societies Bill and modernising the Charities Act	H1 2021
Step 6: Issue feedback statement	
Preparation • Draft feedback statement	H2 2021
Board engagement • Seek approval to issue feedback statement	H2 2021
Conclusion of PIR • Issue feedback statement • Report back to consultative network	H2 2021

NZ ACCOUNTING STANDARDS BOARD

Request for Information

Simple Format Reporting Standards – Post-implementation Review

Issued: [Month] 2020[1]

Comments due: [Month 2021][2]

[1] September 2020 is the target issue date

[2] Six-month comment period

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Information for respondents

Request for Information

The New Zealand Accounting Standards Board (NZASB)[1] is conducting a post-implementation review of the Simple Format Reporting Standards. As part of this review the NZASB is seeking feedback on the questions in this Request for Information.

Your comments are important to help the NZASB assess how well the standards are working and decide whether any changes are needed.

The closing date for comments is **XX Month 20XX**.

How to comment

You may comment on any or all of the questions. Please indicate who the comments are from (for example, you as an individual, a group of people, an entity or a number of entities).

We prefer to receive comments electronically. However, you may comment using any of the following methods.

Electronically	Visit our 'Open for comment' page at: https://www.xrb.govt.nz/accounting-standards/standards-in-development/open-for-comment/
By email	Send comments to submissions@xrb.govt.nz with Simple Format Reporting Standards in the subject line
By post	External Reporting Board PO Box 11250 Manners St Central Wellington 6142 NEW ZEALAND

Publishing comments

We will publish all comments on the XRB website, unless they may be defamatory. If you have any objection to publication, we will not publish your comments on the internet. However, your comments will remain subject to the Official Information Act 1982 and, therefore, may be released in part or in full. The Privacy Act 1993 also applies.

If you object to the release of any information in your comments, we would appreciate you identifying the parts to be withheld, and the grounds under the Official Information Act 1982 for doing so (for example, that it would be likely to unfairly prejudice the commercial position of the person providing the information).

What happens next?

After the consultation period ends the NZASB will consider all comments and the appropriate courses of action. This could include proposing amendments to the Simple Format Reporting Standards, changing guidance and templates or education. The NZASB would seek feedback on any proposals to amend the standards.

[1] The NZASB is a sub-Board of the External Reporting Board (XRB Board), and is responsible for setting accounting standards.

1. Introduction

1.1 Purpose of this Request for Information

1. The New Zealand Accounting Standards Board (NZASB) has issued this Request for Information to seek feedback from constituents on how well the Simple Format Reporting Standards are working.

2. The NZASB is carrying out a post-implementation review of the Simple Format Reporting Standards. The objective of a post-implementation review is to assess whether standards are working as intended and achieving their objectives. They are a regular part of standard setting and are usually carried out once a new standard has been applied for a few years. They help ensure that standards remain current and operational. The NZASB relies on extensive outreach to make the best decisions when developing new standards. However, it is not until the standards are actually applied in practice that any unforeseen issues become apparent.

3. Whilst not reopening the standard, a PIR looks at:

   (a) whether the requirements are performing as intended;

   (b) whether any new issues have emerged since the standards were issued; and

   (c) whether compliance costs are consistent with expectations.

4. Understandably, the requirement to comply with the Simple Format Reporting Standards has imposed costs on individual entities. These costs need to be weighed up against the benefits to a wide range of users (including funders, donors, members, managers and the general public), of having access to reliable and comparable information.

5. On the positive side, feedback indicates that the standards have led to improved accountability and more consistent information which has been beneficial to users. Greater disclosure of service delivery outcomes and outputs has also enabled entities to tell a more complete story of the year's performance.

6. However, the NZASB is aware that some entities are experiencing challenges in applying the standards. The NZASB is interested in whether refinements to the standard are required or more guidance is needed to assist smaller entities in applying these standards.

7. The standards were issued at the end of 2013 and have been applied for five years.[1] It is therefore an appropriate time to review whether they are working as intended and achieving their objectives.

8. The Request for Information is seeking feedback on the standards, guidance and templates issued by the NZASB. It is not seeking feedback on guidance issued by any other bodies or filing requirements such as the annual return required by registered charities.

1.2 Simple Format Reporting Standards

9. Legislation establishes **who** is required to report in accordance with standards issued by the XRB. The XRB is responsible for the XRB accounting standards themselves, which state **what** and **how** entities are required to report.

[1] The standards were effective for public sector PBEs from 1 July 2014 and NFP PBEs from 1 April 2015.

10. Registered charities and many public sector entities are required by legislation to prepare financial statements in accordance with accounting standards issued by the XRB. In the case of registered charities this requirement was introduced to the Charities Act in 2013.[2] Prior to this registered charities were required to file annual returns with the Registrar of Charities, but there were no specific requirements for the content and format of financial statements. Not surprisingly, the content and format varied, and comparisons between the financial statements of registered charities were difficult.

11. The Simple Format Reporting Standards were developed to set out the reporting requirements for Tier 3 and Tier 4 public benefit entities (PBEs) when preparing reports to meet the accountability and decision-making needs of a wide range of users. The standards were intended to improve the quality and consistency of the information reported, and to facilitate comparability between entities, and between years for the reporting entity. Non-financial information was seen as an important component of these reports.

12. The NZASB aimed to develop a single short and relatively simple standard for each group of entities, written in less technical language than is normally found in accounting standards. The standards focussed on transactions expected to be common in that tier.[3] This reflected a desire to meet the needs of the majority of entities in a tier without unnecessarily complicating the standards. The standards were based on extensive consultation and research (see Appendix 1 for more details).

13. There are four Simple Format Reporting Standards (see Table 1). The public sector and not-for-profit versions of each standard are almost identical. Each standard is accompanied by optional performance report templates and associated guidance material.

Table 1 The Simple Format Reporting Standards

Tier 3	PBE Simple Format Reporting – Accrual • PBE SFR-A (PS) Public Benefit Entity Simple Format Reporting – Accrual (Public Sector) • PBE SFR-A (NFP) Public Benefit Entity Simple Format Reporting – Accrual (Not-for-Profit)
Tier 4	PBE Simple Format Reporting – Cash • PBE SFR-C (PS) Public Benefit Entity Simple Format Reporting – Cash (Public Sector) • PBE SFR-C (NFP) Public Benefit Entity Simple Format Reporting – Cash (Not-for-Profit)

14. The Tier 3 standards establish accrual-based reporting requirements. Although some of the recognition and measurement requirements are similar to the Tier 1 and 2 requirements in PBE Standards, the Tier 3 standards are much simpler and do not have the options available in the Tier 1 and 2 PBE Standards (such as the option to measure property, plant and equipment using the revaluation model). Entities applying the Tier 3 standards have the option of applying the requirements in PBE Standards for a specific type of transaction (including any disclosure concessions for Tier 2 entities), as long as the entity applies those requirements to all transactions of that type. This is referred to as ‘opting up’.

15. The Tier 4 standards establish cash-based reporting requirements for entities permitted by legislation to use a cash accounting standard (referred to in legislation as a non-GAAP standard). These standards are fundamentally different to the accrual standards. For example, entities applying the cash standards are required to provide some information about assets

[2] Introduced by the Financial Reporting (Amendments to Other Enactments) Act 2013

[3] For example, the accrual standards did not contain guidance on financial instruments (other than payables, receivables and term deposits), nor did they contain guidance on complex transactions such as insurance contracts.

and obligations but they do not prepare a balance sheet. However, the categories of receipts and payments have been aligned with the categories of revenue and expenses in the Tier 3 accrual standards to the extent possible.

1.3 Other reviews and developments

16. This Request for Information is seeking feedback on the Simple Format Reporting Standards at this point in time. However, the financial reporting landscape continues to evolve and there are other developments or reviews that could change the number or type of entities required to apply the standards. Appendix 2 outlines the following reviews and reforms that have recently occurred or are still in progress.

    (a) Targeted Review of the Accounting Standards Framework

    (b) Review of the Charities Act 2005

    (c) Incorporated Societies Act Reform

1.4 Limited changes since issue

17. When the standards were first issued the NZASB had a clear view that they should be amended as infrequently as possible. The NZASB wanted to allow time for entities, particularly charities, to become familiar with the requirements and was aware that changes to the standards could impose undue costs on smaller entities. In addition, the large number of entities applying the standards and the reliance on volunteers makes it more difficult to communicate changes.

18. Despite this objective, a few changes have been required.

    (a) September 2014: *Interests in Other Entities*
    When the Tier 3 standards were first issued they were silent as to the treatment of interests in other entities. Subsequently Tier 3 entities were required to account for interests in other entities by applying the requirements in the Tier 1 and 2 PBE Standards. In January 2017 the relevant paragraphs were updated to refer to new PBE Standards dealing with interests in other entities (being PBE IPSASs 34–38).

    (b) December 2015: *Amendments to Simple Format Reporting Accounting Requirements as a Consequence of XRB A1*
    These amendments aligned the wording in the standards with the revised wording in XRB A1.

    (c) July 2018: *2018 Omnibus Amendments to Tier 3 and Tier 4 PBE Accounting Requirements*
    These amendments were relatively minor. They aligned wording with other new pronouncements such as the PBE Conceptual Framework, clarified existing requirements and made editorial amendments. In response to feedback received from a range of stakeholders, a requirement to date and sign the performance report was added.

2. Request for Information

2.1 Objectives and scope of the review

19. The objective of the review is to seek feedback on whether the Simple Format Reporting Standards are working as intended and achieving their objectives.

20. The scope of the review includes the standards and the guidance and templates issued by the NZASB (see Tables 2 and 3) and available on the XRB website. We are not seeking feedback on the resources developed by Charities Services to assist registered charities to complete their performance reports and submit their annual returns. However, if you consider that there is a need for more guidance on a topic, please let us know.

Table 2 NFP Standards, Guidance and Templates

Standards
• PBE SFR-A (NFP) Public Benefit Entity Simple Format Reporting – Accrual (Not-for-Profit) • PBE SFR-C (NFP) Public Benefit Entity Simple Format Reporting – Cash (Not-for-Profit)
Guidance and templates
• EG A5 *Optional Template and Associated Guidance Notes for Applying Public Benefit Entity Simple Format Reporting – Accrual (Not-For-Profit)* • EG A6 *Optional Template and Associated Guidance Notes for Applying Public Benefit Entity Simple Format Reporting – Cash (Not-For-Profit)* • EG A8 *Financial Reporting by Not-for-profit Entities: The Reporting Entity* • EG A9 *Financial Reporting by Not-for-profit Entities: Identifying Relationships for Financial Reporting Purposes* • Templates: XLSX and PDF versions Links

Table 3 Public Sector Standards, Guidance and Templates

Standards
• PBE SFR-A (PS) Public Benefit Entity Simple Format Reporting – Accrual (Public Sector) • PBE SFR-C (PS) Public Benefit Entity Simple Format Reporting – Cash (Public Sector)
Guidance and templates
• EG A3 *Optional Template and Associated Guidance Notes for Applying Public Benefit Entity Simple Format Reporting – Accrual (Public Sector)* • EG A4 *Optional Template and Associated Guidance Notes for Applying Public Benefit Entity Simple Format Reporting – Cash (Public Sector)* • Templates: XLSX and PDF versions Links

2.2 What we've heard

Note for the Board

The Board has previously indicated that the RFI should give a few examples of issues we've heard about but should not present a detailed list nor identify possible solutions. We have presented two options and are seeking feedback on which option the Board prefers. Option A gives a narrative description of some issues. Option B uses a tabular layout and has more issues and more detail.

Option A

21. Over the past five years we have received feedback from our constituents regarding the implementation of the standards. Some constituents have raised specific issues while others, particularly Tier 4 entities, have voiced more general concerns about the ability of volunteers to apply the requirements in the standards.

22. Some of the initial implementation issues (for example, applying the minimum categories) have been largely resolved as people become more familiar with the requirements in the standards and the information they need to collect. Guidance issued by Charities Services and others has been helpful in dealing with these initial implementation issues.

23. Some Tier 3 entities have indicated a desire for the standards to cover a broader range of transactions and allow more options, such as allowing revaluation of investments as an accounting policy choice. There have also been some issues raised in relation to accounting for multi-year grants and donations, both from the perspective of the donor/grantor and recipient.

24. We are interested in hearing your views on any issues or other matters that should be considered as part of this review.

Option B

25. Over the past five years we have received feedback from our constituents regarding the implementation of the standards. Some constituents have raised specific issues while others, particularly Tier 4 entities, have voiced more general concerns about the ability of volunteers to apply the requirements in the standards.

26. Some of the initial implementation issues, such as deciding what to report under the minimum categories, have been largely resolved as people become more familiar with the requirements in the standards and the information they need to collect. Guidance issued by Charities Services and others has been helpful in dealing with these initial implementation issues.

27. We are aware of some specific issues raised by constituents, most of which relate to the Tier 3 accrual standards (see Tables 4 and 5). We are interested in your views on these issues and on any other issues that you think should be considered as part of this review.

Table 4 Examples of Tier 3 Issues Raised

Investments The Tier 3 accrual standards require that investments be accounted for at cost, less any impairment. An entity wishing to revalue investments must opt up and apply the requirements in the Tier 1 and 2 PBE Standards. Some constituents would like the Tier 3 accrual standards to explicitly address revaluation of investments as an accounting policy choice.
Investment property The holding of investment properties was not identified as a common Tier 3 entity transaction, so the Tier 3 accrual standards do not specifically deal with investment properties. Some constituents have requested that separate guidance on investment properties be added to the Tier 3 accrual standards.

Multi-year grants/donation revenue The Tier 3 accrual standards require that multi-year grants and donations be accounted for as revenue when received or receivable unless there is a 'use or return' condition. This can result in large upfront recognition of revenue. Some charities have requested more flexibility to record revenue over time when grants and donations relate to multiple accounting periods.
Multi-year grants/donation expense The Tier 3 accrual standards require that entities making multi-year grants and donations expense the full amount of the transaction in the year the grant or donation is approved and the recipient advised. Some funders do not consider that this is appropriate, especially when the payment of all or part of the grant or donation is conditional on a future event (such as demonstrating satisfactory progress on a project) at the reporting date.
Minimum revenue categories Some constituents have experienced difficulty in deciding how to classify revenue, particularly the classification of grant revenue and distinguishing between members and non-members. Some entities would prefer to choose their own categories of revenue for reporting purposes.
Opting up If an entity decides to opt up and apply the requirements in the Tier 1 and 2 PBE Standards for certain transactions and events, it may find it difficult to decide how to apply those requirements within the primary statements of a Tier 3 performance report. For example, PBE Standards may require some items to be recognised in other comprehensive revenue and expense but there is no equivalent concept in the Tier 3 accrual standards. Some constituents have requested more specific guidance about how to comply with the requirements of Tier 1 and 2 PBE Standards in performance reports.
Information about commitments The Tier 3 standards require information about operating commitments. Some constituents consider that these requirements are excessive.

Table 5 Examples of Tier 4 Issues Raised

Minimum categories Some constituents have experienced difficulty in classifying their receipts and payments into the minimum categories required.
Statement of Resources and Commitments The Tier 4 standards require information about resources including amounts for each category of resources. There is some relief for non-cash resources if the cost is not available or it is not practicable to obtain current values. They also require information about commitments including money payable by the entity, other commitments and guarantees. Some constituents consider that these requirements are excessive.

Note to Board – Option B ends here.

2.3 Feedback sought

28. Your feedback is essential to enable the NZASB to carry out this review. We are interested in feedback from:

    (a) preparers, auditors, funders and other users;

(b) public sector entities as well as registered charities; and

(c) entities required to apply the standards, as well as those voluntarily applying the standards.

29. In order to obtain feedback from a wide range of constituents we will be making contact with a number of umbrella organisations. You may therefore receive requests from any collective bodies that you belong to. We will also be making contact with professionals that prepare and audit performance reports. You are therefore welcome to comment individually or as part of a group. [Discuss with Charities Services and NZ Audit. There may be other opportunities for people to give feedback].

Questions for respondents

1. What is your overall view on whether the standards are working as intended and meeting their objectives? In responding to this question you might want to consider whether:

   (a) the requirements are performing as intended;

   (b) any new issues have emerged since the standards were issued;

   (c) there is anything we did not think about or anything we did not get right; and

   (d) compliance costs are consistent with expectations.

2. What specific issues have you encountered in applying the standards, guidance or templates? Please outline:

   (a) the specific paragraph or paragraphs that you are commenting on (where relevant);

   (b) the types of entities affected, the prevalence of the issue and the impact of the issue on the entities concerned;

   (c) why the issue should be addressed, having regard to the objectives of the standards; and

   (d) how the issue should be addressed.

3. In addition to any specific issues identified in response to question 2, do you have any suggestions for clarifying requirements in the standards or for clarifying the guidance or templates?

4. Have you developed any in-house guidance to assist people in applying the standards consistently? If yes, what does the guidance cover and do you think it would be of use to other entities? We welcome copies of any such guidance (by separate email to name@xrb.govt,nz). Any guidance you send us will remain confidential and will not form part of your formal comments.

5. Do you have any other comments, including comments on any unexpected or unintended consequences of the standards?

Information about respondents

Please tell us:

- Your name
- Whether the comments are from you in a personal capacity, or on behalf of an entity or a number of entities
- How we can contact you if we need further information

3. Next steps

30. After the consultation period ends the NZASB will consider all the comments it receives, along with other information it gathers through outreach. On the basis of that information, the NZASB will form its views about what actions it should take. This could include proposing amendments to the standards (and guidance and templates), education or developing more guidance.

31. Before proposing any changes to the standards the NZASB would need to weigh up the costs and benefits of changes on all entities and users, bearing in mind the original objectives of the standards and the desire to maintain a relatively stable platform. Any proposals to change the standards would require careful consideration. For example, requests to include requirements for a wider range of transactions and events could make the standards longer, more detailed and less comprehensible for some preparers.

32. The NZASB would also liaise with Charities Services, the Office of the Auditor-General and Audit New Zealand in considering appropriate courses of action.

33. If the NZASB subsequently proposes any changes to the standards it would issue an exposure draft and seek your feedback on the proposals.

Appendix 1 How the standards were developed

In 2011 a not-for-profit working group, including experienced preparers and users of financial reports from across the not-for-profit sector, was established to consider options for simple format reporting for NFPs. The working group's report, *Simple Format Reporting for NFP Entities* (November 2011),[4] was carefully considered when developing the standards. The working group focused on two main issues: what statements should be included in the simple format financial reports of NFP entities; and what specific items should be disclosed in those statements.

Both the working group and the NZASB were of the view that non-financial information is crucial to an understanding of an NFP's performance. This led to the requirements to prepare performance reports that include both financial and non-financial information. The working group was also of the view that the Tier 4 cash standards should be aligned as much as possible with the Tier 3 accrual standards.

The NZASB also used research to assist it in identifying transactions which did not need to be addressed in the standards because they were infrequently undertaken by small and medium charities. The research report, *Typical transactions in charities* (2012),[5] pulled together information from a sample of charities, together with feedback from telephone interviews and one-on-one meetings.

The public sector standards were developed in consultation with the Office of the Auditor-General. Research was also undertaken into the types of transactions entered into by public sector entities eligible to apply the standards.

The NZASB sought public feedback on the proposals before finalising the standards. The NZASB joined with Charities Services to promote awareness of the new Accounting Standards Framework and outlined the proposals in a series of seminars held throughout the country.

The NZASB and Charities Services also ran seminars explaining the new standards.

4 https://www.xrb.govt.nz/reporting-requirements/history/

5 https://www.xrb.govt.nz/reporting-requirements/history/

Appendix 2 Other reviews and developments

[This section will need to be checked and updated before issue]

Targeted Review of the ASF

The XRB recently carried out a targeted review of the Accounting Standards Framework (ASF).[6] The ASF sets out New Zealand's financial reporting strategy and establishes which standards apply to which entities.

The purpose of the Targeted Review was to 'check in' with constituents on whether the ASF is functioning as anticipated and achieving its original objectives. As part of this review the XRB sought feedback on whether the PBE tier size criteria need to be revisited. The majority of respondents did not identify specific unintended consequences or new developments that would require refinements to the PBE tier size thresholds.

Review of the Charities Act 2005

In February 2019 the Department of Internal Affairs issued the Discussion Document *Modernising the Charities Act 2005*. One of the proposals in that document was the establishment of a new 'micro entity' tier for charities with less than $10,000 operating expenditure and the suggestion that such entities should not be required to comply with XRB accounting standards. Following widespread public consultation the Department released a summary of submissions.[7]

Of the submitters that commented on obligations of charities, 211 specifically commented on reporting requirements. More than two thirds of these submitters favoured reducing reporting requirements for small charities. Suggestions for achieving this included: increasing the maximum expenditure of a Tier 4 charity, introducing a 'micro entity' or 'Tier 5' reporting tier and simplifying the current reporting forms. The Department has indicated that it will provide advice on the issues to the Minister for the Community and Voluntary Sector and that there will be further consultation before any legislative changes.

If the Government decides to act on the proposals to change the requirements for small charities it would reduce the number of small charities required to apply the Tier 4 cash standard. However, there would still be a large number of charities required to report in accordance with the Tier 3 and Tier 4 standards. In addition, any legislative changes would take time. The NZASB therefore considers that it is appropriate to carry out this review of the Simple Format Reporting Standards as planned.

Incorporated Societies Act Reform

The Government has indicated its intention to replace the Incorporated Societies Act 1908. The Exposure Draft of the Incorporated Societies Bill was released in November 2015. In May 2019, the Government considered feedback on that Exposure Draft and agreed to make a number of changes to the reform Bill before introducing it to Parliament.

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6 Discussion Paper *Targeted Review of the Accounting Standards Framework* (July 2019)

7 https://www.dia.govt.nz/charitiesact

In respect of incorporated societies that are not registered as charities the Government has agreed (as per the Cabinet decisions, May 2019)[8] that the requirement to use XRB standards in annual financial statements will be limited to those societies that have one or more of the following:

(a) annual payments of $10,000 or more; and/or

(b) assets of $30,000 of more; and/or

(c) donee status under the Income Tax Act 2007.

It will be some time until requirements for incorporated societies that are not registered charities have been finalised. At that point the NZASB will consider the appropriateness of the standards for such entities. However, any incorporated societies currently applying the Simple Format Reporting Standards are welcome to respond to this request for information.

8 https://www.mbie.govt.nz/assets/6f974df044/reform-of-the-incorporated-societies-act-1908-minute-of-decision.pdf

List of abbreviations and terms

The following abbreviations and terms are used in this Request for Information.

NZASB	New Zealand Accounting Standards Board, a sub-Board of the External Reporting Board
PBE	Public benefit entity
PBE Accounting Requirements	The accounting requirements for each tier of PBEs required to apply standards issued by the XRB (or the NZASB). XRB A1 *Application of the Accounting Standards Framework* specifies the tier criteria and the standards that comprise each tier of PBE Accounting Requirements.
PBE Standards	PBE Standards are standards issued by the XRB or the NZASB. They comprise: • PBE IPSASs; • PBE IFRSs, including PBE IASs; and • PBE FRSs.
PBE Standards RDR	PBE Standards with disclosure concessions for Tier 2 public benefit entities.
Simple Format Reporting Standards	There are four Simple Format Reporting Standards. PBE Simple Format Reporting – Accrual • PBE SFR-A (NFP) Public Benefit Entity Simple Format Reporting – Accrual (Not-For-Profit) • PBE SFR-A (PS) Public Benefit Entity Simple Format Reporting – Accrual (Public Sector) PBE Simple Format Reporting – Cash • PBE SFR-C (NFP) Public Benefit Entity Simple Format Reporting – Cash (Not-For-Profit) • PBE SFR-C (PS) Public Benefit Entity Simple Format Reporting – Cash (Public Sector)
Tier criteria	The criteria for PBEs to be eligible to report in accordance with a particular tier of PBE Accounting Requirements.
XRB	External Reporting Board
XRB A1	XRB A1 *Application of the Accounting Standards Framework*

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NZ ACCOUNTING
STANDARDS
BOARD

Memorandum

Date:	24 April 2020
To:	NZASB Members
From:	Gali Slyuzberg
Subject:	***Business Combinations – Disclosures, Goodwill and Impairment***

Recommendations[1]

1. Regarding the IASB Discussion Paper DP/2020/1 *Business Combinations – Disclosures, Goodwill and Impairment* (the DP), we recommend that the Board:

    (a) AGREES on the general approach to developing a comment letter to the IASB;

    (b) PROVIDES FEEDBACK on the updated project plan; and

    (c) PROVIDES FEEDBACK on the sections of the DP discussed in this memo.

Background

2. The IASB issued the DP in March 2020. This DP was issued as part of the IASB's *Goodwill and Impairment* project – a research project initiated with a view to considering issues identified in the Post-implementation Review (PIR) of IFRS 3 *Business Combinations*.

3. In issuing the DP, the IASB's objective is to explore whether companies can, at a reasonable cost, provide investors with more useful information about the acquisitions those companies make. Better information should help investors assess the performance of companies that have made acquisitions and hold a company's management to account for acquisition decisions.

4. The DP sets out the IASB's preliminary views that the IASB:

    (a) should improve the information provided to investors about an acquisition and its subsequent performance, by developing proposals to enhance the disclosure objectives and requirements in IFRS 3;

    (b) cannot design a different impairment test that is significantly more effective than the current impairment test in IAS 36 *Impairment of Assets* at recognising impairment losses on goodwill on a timely basis and at a reasonable cost;

    (c) should not reintroduce amortisation of goodwill;

[1] This memo refers to the work of the International Accounting Standards Board (IASB) and uses registered trademarks of the IFRS Foundation (for example, IFRS® Standards, IFRIC® Interpretations and IASB® papers).

(d) should propose a requirement to present the amount of total equity excluding goodwill on the balance sheet, to help investors better understand a company's financial position;

(e) should reduce the cost and complexity of the impairment test by providing relief from the requirement to perform an annual impairment test for goodwill if there is no indication that impairment has occurred (the same relief would apply to intangible assets with indefinite useful lives and those that are not yet available for use);

(f) should simplify the estimation of value in use (VIU) to reduce cost and complexity and to provide more useful and understandable information, by:

(i) removing the restriction on including cash flows from a future uncommitted restructuring or from improving or enhancing an asset's performance; and

(ii) permitting the use of post-tax cash flows and post-tax discount rates; and

(g) should not change the range of identifiable intangible assets recognised separately from goodwill in an acquisition.

5. The IASB is seeking comments on the above preliminary views. Specifically, the IASB wants to hear from stakeholders:

(a) whether its suggested disclosure requirements for acquisitions would provide useful information and are feasible; and

(b) whether stakeholders have new evidence or new arguments on how companies should account for goodwill.

6. Initially, comments on the DP were due to the IASB by 15 September 2020. However, due to the COVID-19 pandemic, the IASB extended the comment period to 31 December 2020.

7. At the Board's meeting in February 2020, the Board:

(a) received an education session on the (then forthcoming) DP;

(b) agreed to comment on the DP;

(c) agreed on the project plan proposed by staff; and

(d) provided feedback on one of the topics in the IASB's (then forthcoming) DP – namely, the IASB's preliminary view that it should simplify the estimation of VIU, by removing the restriction on including cash flows from future restructures or improvements to assets and permitting the use of post-tax cash flows and post-tax discount rates.

8. Furthermore, at the joint NZASB and NZAuASB meeting in February 2020 (the joint Board meeting), the Board discussed the merits of a holistic review of IAS 36, which is different to the approach taken by the IASB when developing the DP.

9. To progress the development of the Board's comment letter on the DP, at this meeting staff propose to:

(a) confirm with the Board the general approach for developing the comment letter, considering the discussion at the joint Board meeting;

(b) seek the Board's feedback on the updated project plan, which has been amended in light of the extension of the DP comment period; and

(c) seek the Board's feedback on the selected topics in the DP, which have not yet been discussed by the Board.

Structure of this memo

10. The remaining sections in this memo are:

    (a) General approach to developing the comment letter;

    (b) Updated project plan;

    (c) Discussion of selected topics in the DP (see paragraphs 11–15 below); and

    (d) Next steps.

Discussion of selected topics in the DP

11. As the DP covers multiple topics, we propose to split the Board's discussion of these topics between this meeting and the June meeting.

12. The sections of the DP that we propose to discuss at this meeting are listed in the table below. We recommend that Board members read these sections of the DP. The DP is attached as agenda item 7.2.

Table 1 DP topics for discussion at this meeting

DP topic	DP reference
• Goodwill impairment and amortisation (also covering the proposed presentation of equity excluding goodwill)	Section 3 (paragraphs 3.1–3.115 and questions 6–8)
• Simplifying the impairment test, focusing only on relief from the annual impairment test *(The Board has already discussed the remaining sub-topics in this section, i.e. the proposed simplifications to estimating VIU)*	Section 4 (paragraphs 4.5–4.34 only, question 9 only)
• Intangible assets	Section 5 (paragraphs 5.1–5.28 and question 12)

13. The Board is not expected to read sections 1, 2 or 6 of the DP ahead of this meeting. These sections will be discussed with the Board at the June meeting.

14. In staff's view, the DP is set out in a very clear and logical manner, which makes it easy to read. Therefore, this memo is set up as a "navigation tool" for the relevant sections of the DP.

15. This means that rather than repeating the information contained in the DP, the memo:

    (a) refers Board members to the relevant sections of the DP;

(b) reproduces questions in the DP

(c) sets out the preliminary staff views on these questions; and

(d) asks for the Board's feedback on the DP questions.

General approach to drafting the comment letter

16. At the joint Board meeting, the Board received a presentation on AASB Research Report 9 *Perspectives on IAS 36: A Case for Standard Setting Activity* (AASB Research Report).[2]

17. The AASB Research Report notes that the ongoing application issues relating to IAS 36 demonstrate a consistent divergence in preparers', users', auditors' and regulators' understanding of the impairment requirements.

18. Consequently, the AASB Research Report recommends a holistic review of IAS 36 – that is, that IAS 36 be reviewed in its entirety with a view to issuing a new standard, rather than making piecemeal changes.

19. By contrast, the DP focuses on specific aspects of the impairment test in IAS 36, as well as disclosures about business combinations. This is because the DP was developed to address issues identified through the IASB's PIR of IFRS 3, a standard that focuses on business combinations rather than impairment.

20. During the discussion at the joint Board meeting, there was some support among Board members for a holistic review of IAS 36, as proposed in the AASB Research Report.

21. Section 6 of the DP mentions the AASB Research Report. The DP notes the following.

    (a) A holistic review of IAS 36 as proposed in the AASB Research Report is beyond the scope of this project.

    (b) However, stakeholders who consider that such a holistic review is required are encouraged to provide this feedback by responding to the IASB's forthcoming 2020 agenda consultation.

22. On this basis, staff propose the following approach to developing the Board's comment letter on the DP.

    (a) Include in the cover letter a general comment expressing support for a holistic review of IAS 36 and the intention to recommend such a review in response to the IASB's forthcoming 2020 agenda consultation; and

    (b) Focus the responses in the comment letter on those specific issues and questions raised in the DP – with the understanding that other issues and views, that would fit better under a holistic review of IAS 36, will be raised when we comment on the IASB's 2020 agenda consultation.

[2] This report was published in March 2019. It was authored on behalf of the AASB by Moana Overton (Principal, National Accounting Technical – Deloitte Australia) and Emily Fox (Manager, National Accounting Technical – Deloitte Australia).

Question for the Board

Q1. Does the Board agree with the proposed general approach to developing the comment letter on the DP?

Updated project plan

23. The project plan that the Board agreed to at the February 2020 meeting was based on the IASB's original due date for comments, which was 15 September 2020. Staff have updated the project plan to reflect the IASB's recent extension of the comment period to 31 December 2020.

24. Consistently with the IASB's extension of the comment period, staff have deferred the date by which comments from New Zealand constituents are due to the NZASB. As a result, comments are now due to the NZASB by 7 October 2020 (rather than the original date of 1 August 2020).

25. As part of the updated project plan, staff propose to invite investors and analysts to the Board's September meeting to discuss the DP. The September meetings usually include a session with external guests, and this meeting now falls within the DP comment period. Therefore, staff propose to invite to the September meeting the same group of investors and analysts that attended the Board's discussion on the *General Presentation and Disclosures* Exposure Draft and discuss the DP with this group. We think this will be a good opportunity for the Board to hear directly from investors and analysts – a key stakeholder group affected by the DP.

26. The following table sets out the updated project plan.

Table 2 Updated project plan

Date	Meeting	Proposed activity
7 May 2020	**NZASB meeting** (this meeting)	Discuss the following topics: • Goodwill impairment and amortisation (DP Section 3) • Simplifying the impairment test (DP Section 4) – focusing only on relief from the annual impairment test • Intangible assets (DP Section 5) *(Note: The Board has already provided feedback on the remainder of Section 4, which relates to the simplification of estimating VIU)*
21 May	XRAP meeting	• Cover all topics at high level • Focus on selected specific issues (improving disclosures about acquisitions, presentation of equity excluding goodwill, the preliminary view not to reintroduce amortisation)
26 May 2020	TRG meeting	Discuss the topic of improving disclosure about acquisitions (DP Section 2)
3 June 2020	NZAuASB meeting	• Cover all topics at high level • Focus on audit-related matters (e.g. audit matters relating to the proposed disclosures about acquisitions, simplification of the estimation of VIU and the relief from annual impairment testing).

Date	Meeting	Proposed activity
17 June 2020	**NZASB meeting**	Discuss the remaining topics not yet discussed by the Board: • Improving disclosure about acquisitions (DP Section 2) • Other recent publications (DP Section 6) • Whether the IASB's package of preliminary views meet the objectives of the project (DP Section 1) *(Note: This discussion – particularly on Section 2 – will be informed by comments to be received by staff from the TRG, XRAP and NZAuASB.)*
10 Sep 2020	**NZASB meeting**	Discussion of the DP (all topics) with investors and analysts
22 Sep 2020	TRG meeting	Discuss the remaining topics not yet discussed with the TRG (i.e. all topics except Section 2 – improving disclosures about acquisitions).
7 Oct 2020	Comments due to the NZASB	
4 Nov 2020	**NZASB meeting**	Discussion of first draft of the comment letter
17 Dec 2020	**NZASB meeting**	Seek Board approval of the comment letter
31 Dec 2020	Comments due to the IASB	

27. A discussion with the FMA will also be scheduled during the comment period.

Question for the Board

Q2. Does the Board have any feedback on the updated project plan?

Discussion of selected topics in the DP

Goodwill impairment and amortisation (DP Section 3)

Sub-topic: Can the impairment test be made more effective?

28. In response to stakeholder concerns that goodwill impairment losses are recognised too late, the IASB investigated whether it is feasible to make the impairment test significantly more effective at recognising impairment losses on goodwill on a timely basis at a reasonable cost. The IASB's preliminary view is that this is not feasible.

29. The Board is asked to refer to paragraphs 3.2–3.54 of the DP for further information on this sub-topic.

30. Questions 6(a)–(d) of the DP are the relevant questions for this sub-topic. The preliminary staff views on this question are included in the following paragraphs. Question 6 is then reproduced again to seek the Board's feedback.

Preliminary staff views

Question 6(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?

31. We agree with the IASB that it is not feasible to design an impairment test that is significantly more effective at recognising impairment losses on goodwill on a timely basis and at a reasonable cost.

32. As the DP notes, goodwill does not generate cash flows independently and cannot be measured directly. Therefore, goodwill must be tested for impairment together with other assets as part of a cash generating unit (CGU) or group of CGUs.

33. As such, we agree that goodwill will inevitably be shielded by unrecognised headroom within the CGU, be it headroom generated before or after the acquisition.

34. We note the following regarding the "headroom approach" discussed in the DP (which indicates impairment has occurred when the recoverable amount of the CGU is lower than the combined total of the recognised net assets of the CGU plus the previous balance of unrecognised headroom of the CGU, and attempts to allocate some or all of this impairment to acquired goodwill).
    (a) In theory, this approach should reduce the impact of shielding on goodwill, particularly with regards to "legacy" unrecognised headroom within a CGU.
    (b) However, we agree with the IASB that it would be difficult to determine reliably how much of the impairment amount identified under this approach should reduce the value of the unrecognised headroom, and how much should be recognised in the financial statements as a reduction to acquired goodwill. We agree with the IASB that each of the possible allocation methods discussed in the DP have flaws, and therefore would not necessarily be more effective at recognising impairment losses than current requirements. We also note the IASB's comments that preparers indicated that the headroom approach would lead to increased costs.
    (c) Therefore, we agree with the IASB's decision not to propose replacing the current impairment requirements with the headroom approach.

Question 6(b): If you do not agree, how should the IASB change the impairment test? How would those changes make the test significantly more effective? What cost would be required to implement those changes?

35. We have not provided a staff view on this question, as we agree with the IASB's preliminary view. If the Board disagrees, we will consider this question further.

Question 6(c) Paragraph 3.20 of the DP 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?

36. We agree with the IASB that overly optimistic estimates and shielding are the main reasons for the concern that goodwill impairment is not recognised on a timely basis. We also think there could be other reasons for this concern, as explained below.

Additional possible reason: expectation gap regarding the purpose of the impairment test

37. Another reason for this concern could be an "expectation gap" in terms of the purpose and capability of the impairment test. That is, perhaps certain users of financial statements expect the goodwill impairment test to inform them that a business acquisition is performing worse than expected as soon as a deterioration in performance occurs, or to explicitly confirm that the acquisition is performing well. However, as explained in the DP, the purpose of the impairment test is to ensure that the combined carrying amount of assets, including goodwill, within a CGU does not exceed their combined recoverable amount.

38. In some cases, the goodwill impairment test can provide some information about the performance of an acquisition. For example, if goodwill is impaired, this means that the acquired business or combined businesses are not able to recover the carrying value of their assets, which indicates that the business combination is performing poorly.

39. However, if an acquired business performs worse than was expected at acquisition date, but the combined recoverable amount of the assets of this business exceed their carrying amount, no impairment would be recognised. This is consistent with the purpose of the impairment test – it does not mean that the impairment test is not working as intended.

40. We think that the IASB's proposed disclosures on acquisitions (to be discussed with the Board at the June NZASB meeting) could potentially help with this "expectation gap", by providing users with the information they require about the subsequent performance of acquisitions (which the goodwill impairment test cannot always provide).

Additional possible reason: Inappropriate allocation of goodwill to CGU

41. Another possible reason, which is somewhat related to overly optimistic estimates, is that in some cases management might allocate goodwill to an excessively large CGU or group of CGUs. That is, management may overestimate the size of the "the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or group of assets".

42. To the extent that this issue arises from incorrect application of IAS 36, we think this issue is perhaps better addressed by auditors and regulators than through standard setting. However, respondents that provided input into the AASB Research Report noted that due to lack of clarity around the requirements in IAS 36 to allocate goodwill to CGUs, these requirements are difficult to interpret and implement, require a high degree of subjectivity and result in diversity in application.

43. Therefore, we think there is merit in considering whether the guidance on allocating goodwill to CGUs or groups of CGUs could be clarified.

44. The difficulties and subjectivity involved in allocating goodwill to CGUs for impairment testing purposes was one of the concerns raised by stakeholders during the IASB's PIR of IFRS 3. Therefore, in theory, this matter could be considered as part of this project. Alternatively, it could be considered as part of a holistic review of IAS 36 at a later stage.

Question 6(d): Should the IASB 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?

45. Please see the comment above on the allocation of goodwill to CGUs. We are interested in Board members' feedback as to whether this matter should be addressed as part of this project or as part of a holistic review of IAS 36.

46. We are interested to hear from Board members whether they identified any other matters that should be considered by the IASB as part of this project.

Questions for the Board	
Q3. Question 6 of the DP	
(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 IASB 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 of the DP 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 IASB 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?

Sub-topic: Should amortisation of goodwill be reintroduced?

47. Having concluded that the goodwill impairment test under IAS 36 cannot be made significantly more effective at a reasonable cost, the IASB considered whether amortisation of goodwill should be reintroduced.

48. Both the current impairment-only model and the amortisation model (which would still require impairment) have advantages and disadvantages, which the IASB had already considered in the past. The IASB found no compelling evidence that a change from the impairment-only model to the amortisation model is needed.

49. Therefore, the IASB's preliminary view is that it should not develop a proposal to reintroduce amortisation of goodwill. Nevertheless, the IASB would welcome feedback from stakeholders that provides new practical or conceptual arguments, together with evidence for these

arguments, and suggestions for identifying arguments which should be given more weight and why.

50. The Board is asked to refer to paragraphs 3.55–3.106 of the DP for further information on this sub-topic.

51. Questions 7(a)–(f) of the DP are the relevant questions for this sub-topic. The preliminary staff views on this question are included in the following paragraphs. Question 7 is then reproduced again to seek the Board's feedback.

<u>Preliminary staff views</u>

Question 7(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.)

52. We tend to agree with the IASB that amortisation of goodwill should not be reintroduced, based on the conceptual and practical considerations listed below.

Conceptual considerations: Whether goodwill has a finite or indefinite life

53. Conceptually, if goodwill is primarily not a "wasting asset" and has an indefinite useful life, then the impairment-only method seems more appropriate (and consistent with the treatment of other intangible assets with indefinite useful life). Conversely, the amortisation method would be appropriate if goodwill is a wasting asset with a finite, determinable useful life. In that case, the amortisation method would appropriately allocate the cost of goodwill over the discrete period in which its economic benefits are consumed.

54. There is an argument that goodwill (or at least most of the goodwill amount) is not a wasting asset and has an indefinite useful life. Support for this argument was recently expressed by the International Valuation Standards Council (IVSC). According to a recent IVSC article[3], business valuation models used to price businesses generally assume that the core elements of goodwill (being the going concern element and a synergies element) are non-wasting. Therefore, the amortisation method (which assumes that goodwill is a wasting asset and has a finite useful life) would not be consistent with the principles used to determine the purchase price of the acquired business, which in turn is used for determining the goodwill amount on acquisition.

55. However, we are interested to hear the Board's views as to whether goodwill is generally a wasting asset with a finite life or a non-wasting asset with an indefinite life.

56. As noted in the DP, the IASB considered separating goodwill into components and amortising some of these components as appropriate. Under this approach, those elements of goodwill that could be considered "wasting", such as the economic benefit embodied in the assembled workforce of the acquired business, could be amortised over their expected useful life (e.g. the time over which the workforce is expected to be replaced by new employees).

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[3] *IVSC Perspective Paper: Business Valuation – Is Goodwill a Wasting Asset?* (September 2019)

However, it may not be possible to separate goodwill into its components in a practicable or reliable manner.

Conceptual considerations: Whether the impairment-only model results in the recognition of internally-generated goodwill

57. Another conceptual consideration relates to whether the impairment-only model effectively results in the recognition of internally-generated goodwill, which must not be recognised according to IAS 38 *Intangible Assets*. There is an argument that as time passes, acquired goodwill is used up and replaced by internally-generated goodwill. Furthermore, when reduction in the value of acquired goodwill is not recognised as an impairment loss because of shielding from unrecognised internally-generated goodwill, this could be interpreted as effectively recognising internally-generated goodwill in place of the impaired acquired goodwill.

58. However, as noted by a participant in the AASB Research Report, it could be very difficult to distinguish between internally-generated goodwill replacing the acquired goodwill and benefits arising from the synergies and going concern benefits embodied in the acquired goodwill. That is, it may not be possible to distinguish between economic benefits generated by the acquired goodwill (which are built into the value of the acquired goodwill) and "true" internally-generated goodwill that is over and above the economic benefits that were expected at acquisition date.

59. Therefore, the extent to which the impairment-only model causes the recognition of internally-generated goodwill is unclear, and might not be significant.

Conceptual considerations: Whether goodwill balances are overstated under the impairment-only model

60. A related argument stated in the DP in favour of amortisation is that due to the shielding effect and the impairment test's reliance on management's assumptions, there is a high risk that goodwill balances are overstated and do not faithfully represent the economic benefits embodied in the goodwill. We agree that amortisation would help reduce the value of the goodwill, thus helping ensure that its economic benefits are not overstated.

61. However, decreasing the balance of goodwill should not be an end in itself. If it was, then goodwill may as well be written off immediately on acquisition, and as the DP notes, this would be inconsistent with the view that goodwill is an asset.

62. Furthermore, while amortisation could help ensure that goodwill is not overstated, the difficulty of estimating reliably the useful life of goodwill and the pattern of its consumption may result in goodwill balances that are perhaps not overstated but also not necessarily representationally faithful. In fact, one of the reasons why the impairment-only approach was introduced is that goodwill amortisation resulted in arbitrary estimates of the consumption of goodwill in a given period, due to the inability to predict the useful life of goodwill and the pattern in which it diminishes.

Conceptual considerations: Whether the impairment-only model allows goodwill to include amounts related to overpayment

63. In practice, it is possible for an entity to overpay for an acquired business (i.e. to pay an amount over and above the fair value of the acquiree's net assets plus the value of the going concern element of the business and the expected synergies from the business combination).

64. Conceptually, by its nature an overpayment is unlikely to generate future economic benefits and therefore should not be recognised as an asset. However, if goodwill is allocated to a CGU that includes pre-existing internally-generated goodwill or other headroom items, the overpayment amount might be shielded from impairment. This would mean that under the impairment-only model, the overpayment amount would be included in the balance sheet as part of the goodwill balance until the unrecognised headroom in the CGU is fully impaired.

65. However, we would not expect overpayments to occur often in business combinations.

Practical considerations: Ability to provide useful information to users

66. Due the difficulty of reliably estimating the useful life of goodwill and the pattern of its consumption (assuming it is consumed over a finite period), there is a risk the amortisation approach will result in arbitrary amounts being deducted from goodwill over an arbitrary time period. This is unlikely to provide useful information to investors, and unlikely to help them hold management to account for acquisition decisions. For the same reason, the amortisation amount may not faithfully represent the consumption of goodwill.

67. We consider that impairment, including the fact that it has occurred, provides useful information to investors. As the DP notes, some investors said that the information provided by the impairment test is useful, particularly in the first few years after the acquisition. Under the amortisation method, some of this useful information could be lost. This is because, under the amortisation method, true impairment events (i.e. a decrease in value outside of the expected regular consumption of economic benefits) could be disguised by "business as usual" amortisation charges.

68. Furthermore, according to the AASB Research Report, some investors view the effect of shielding (which is one of the key concerns relating to the impairment-only model) as an acceptable by-product of investing in an integrated business and may not necessarily influence investment decisions. The AASB Research Report noted the following.

> "Whilst respondents across all categories have acknowledged the mathematical concept of 'shielding' on impairment calculations, those who took this view also recognised that 'shielding' is a by-product of the integration process especially where businesses are acquired for strategic purposes and subsidised by another group of assets. As an outcome of this it is expected that one business in isolation may be considered a poor performer. However, in the absence of other factors it is generally considered an acceptable by-product of owning a portfolio of businesses, and would not individually influence an investor's decision to buy or sell."

Practical considerations: Costs to preparers

69. As the DP notes, one of the arguments for reintroducing goodwill amortisation is that it would reduce the cost and complexity of accounting for goodwill. However, we note that under the amortisation approach impairment testing would still be required. Plus, the requirement to estimate the useful life and pattern of consumption of goodwill would introduce additional costs. Therefore, we are not sure that the costs associated with the amortisation approach would necessarily be significantly lower than the costs associated with the impairment-only approach.

Practical considerations: The hybrid approach

70. The DP notes that according to feedback received by the IASB, information about impairment losses is particularly useful to investors in the first few years following the acquisition – whereas in later years, information about impairment becomes less useful as the acquired business becomes fully integrated and "indistinguishable from the rest of the business". For this reason, the IASB considered a hybrid approach to accounting for goodwill, whereby goodwill is subject to the impairment-only approach in the first few years after the acquisition and then amortised in later years.

71. While not a conceptually pure approach, this approach could have some practical merits. It could provide investors with impairment-related information when it is most useful to them, and potentially reduce costs for preparers in the later years of the acquisition, while also ensuring that the goodwill balance is not overstated.

72. However, as noted above, we are not sure that amortising goodwill would significantly reduce costs for preparers. Furthermore, the potential arbitrariness of the amortisation charges due to the inability to estimate the useful life of goodwill in a reliable and representationally faithful manner would still be an issue under the hybrid approach once the amortisation model starts applying.

73. Therefore, staff's preliminary view is not to support the hybrid approach. However, staff is interested in the Board's views as to the merits of this approach.

74. Staff have also considered another possible version of the hybrid approach, whereby goodwill is subject to the impairment-only approach for the first few years after the acquisition and then is completely written off, potentially through other comprehensive income (OCI). Effectively, this would be a combination of the hybrid approach as per the DP, and the "immediate write-off" approach that was also considered in the DP (albeit the DP envisaged write-off through equity, rather than OCI). As noted above, we do not think that eliminating goodwill from the balance sheet should be a goal in and of itself as it is inconsistent with the IASB's conclusion that goodwill is an asset. Therefore, our preliminary view is not to propose this approach to the IASB. However, we are interested in the Board's views on this approach.

Question 7(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?

75. We are not aware of significant new evidence or arguments in relation to the relative benefits of the impairment-only approach and amortisation approach.

76. We note a recent study by the Hong Kong Institute of Certified Public Accountants and the Accounting Standards Board of Japan, which shows that goodwill balances around the world have been increasing since 2004.[4] As noted in the DP, some IASB members considered that the increasing goodwill balances around the world indicate that amortisation is needed to hold management to account for acquisition decisions and to maintain the integrity of financial reporting.

77. However, we also note the counter-argument presented by other IASB members, who noted that the global increase in goodwill balances could be due to a number of reasons, including economic trends whereby unrecognised intangible assets are generating more value (and become recognised as goodwill when the business is acquired). That is, the global increase in goodwill balances does not necessarily mean that the impairment-only model is not working properly. We also agree with the IASB members who noted that goodwill amortisation should not be reintroduced purely for the purpose of reducing goodwill balances.

78. On balance, we do not think that the increase in goodwill balances around the world is a reason to reintroduce amortisation.

Question 7(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?

79. The DP identifies two main reasons for the concern that impairment losses are not recognised in a timely manner: over-optimistic estimates and shielding.

80. In terms of shielding, we acknowledge that unlike the impairment-only model, amortisation targets goodwill directly, and therefore decreases the shielding effect and the risk of overstated goodwill. However, while amortisation could potentially reduce the carrying value of goodwill in a timelier manner, it would not necessarily make the recognition of impairment losses more timely. This is because the amortisation method could lead to impairment losses (as distinct from regular reduction in value through consumption) being mislabelled as regular amortisation.

81. In terms of over-optimistic estimates, the amortisation method would require management to estimate the useful life of goodwill and the expected pattern of consumption. These estimates could equally be subject to management over-optimism. On the other hand, it is possible that, under the amortisation method, the IASB would require a specific amortisation period or would introduce a cap on the permitted amortisation period. This would significantly decrease

[4] *Goodwill: Improvements to Subsequent Accounting and an Update of the Quantitative Study* (March 2020)

the impact of management over-optimism under the amortisation method. However, this would also increase the arbitrariness of the goodwill's useful life and amortisation amount, which would decrease the usefulness of this information.

Question 7(d): Do you view acquired goodwill as distinct from goodwill subsequently generated internally in the same cash-generating units? Why or why not?

82. As noted above, while it is possible for internally-generated goodwill representing benefits over and above those embodied in the acquired goodwill to be generated subsequent to the acquisition, we think it may not be practical to distinguish between such post-acquisition internally-generated goodwill and the future economic benefits embodied within the acquired goodwill. Please refer to the staff views on question 7(a) above.

Question 7(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?

83. As noted in paragraph 3.74 of the DP, an investor group responding to a 2014 discussion paper on goodwill noted that "if goodwill were amortised, investors would add the amortisation expense back, whether the useful life was considered to be arbitrary or not, because the amortisation expense would not help their assessment of performance". [5]

84. We think the arbitrary nature of the amortisation period is likely to make investors add the amortisation expense back to profit or loss when assessing a company's performance. On this basis, companies may do the same in their management performance measures.

Question 7(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?

85. While we agree with the IASB's preliminary view not to reintroduce amortisation, we note the following in relation to this question.

    (a) Arguably, the appropriate useful life of goodwill and pattern of consumption would depend on what the goodwill mainly relates to – for example, if it mainly relates to synergies, then estimate over what period of time you expect to realise these synergies (assuming these are realised over a definite time period in the first place). However, as noted above, estimating this period reliably and in a manner that is representationally faithful may not be possible.

    (b) The IASB could specify a rebuttable amortisation period, or a maximum amortisation period, which would reduce the cost to preparers in terms of having to determine an appropriate period. However, a specified period is likely to be arbitrary, and therefore of limited usefulness to users.

[5] The 2014 discussion paper that this paragraph refers to is *Should goodwill still not be amortised? Accounting and disclosure for goodwill*. That paper was published by the European Financial Reporting Advisory Group, Accounting Standards Board of Japan and Organismo Italiano di Contabilità.

Questions for the Board
Q4. Question 7 in the DP
Paragraphs 3.86–3.94 summarise the reasons for the IASB'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 IASB should not reintroduce amortisation of goodwill? Why or why not? (If the IASB 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?

Sub-topic: Presentation of total equity excluding goodwill

86. The IASB noted that goodwill is different to other assets in several ways: it cannot be measured directly, it does not generate independent cash flows and therefore cannot be tested for impairment directly, and in times of liquidation goodwill is harder to convert into cash compared to other assets.

87. Therefore, the IASB's preliminary view is that it should propose to require companies to present on their balance sheets the amount of total equity excluding goodwill (as a free-standing item, rather than a subtotal within the structure of the balance sheet).

88. The Board is asked to refer to paragraphs 3.107–3.115 of the DP for further information on this sub-topic. The Board is also asked to review the Appendix of the DP, which illustrates two possible ways in which the amount of equity excluding goodwill could be presented on the balance sheet.

89. Questions 8(a)–(b) of the DP are the relevant questions for this sub-topic. The preliminary staff views on this question are included in the following paragraphs. Question 8 is then reproduced again to seek the Board's feedback.

Preliminary staff views

Question 8(a): Should the IASB develop such a proposal? Why or why not?

90. We agree with the IASB that the proposed requirement to present equity excluding goodwill on the balance sheet will provide more transparency around goodwill, and help investors identify companies in which goodwill forms a large part of the equity balance.

91. As noted in para 3.107 of the DP, "goodwill cannot be sold separately and, because its value often disappears quickly when a business is in difficulty, it is harder to convert into cash than many other assets on liquidation of the company". In light of the global economic impact of the COVID-19 pandemic, we think that this distinguishing feature of goodwill makes information about total equity excluding goodwill particularly relevant to investors at the present time. Such presentation could indicate to investors which companies would have negative equity (or close to it) if it was not for goodwill.

92. Furthermore, we have heard from some investors that they typically ignore the goodwill balance or adjust for it when assessing the financial position of an entity. Presenting equity excluding goodwill would be consistent with how these investors analyse the financial position of certain entities in practice.

Question 8(b): Do you have any comments on how a company should present such an amount?

93. Staff prefer the option whereby the equity excluding goodwill amount is presented at the very bottom of the balance sheet.

94. We think that the other presentation option – where the amount of equity excluding goodwill is presented in the same line as total equity as a description – may potentially be confusing for users and may potentially be less visible than the option we prefer.

Questions for the Board
Q5. Question 8 in the DP
Paragraphs 3.107–3.114 of the DP explain the IASB'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 IASB 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 the DP). (a) Should the IASB develop such a proposal? Why or why not? (b) Do you have any comments on how a company should present such an amount?

Simplifying the impairment test: relief from the annual impairment test (DP Section 4, paragraphs 4.5–4.34 only)

95. Some stakeholders told the IASB that the impairment test is costly and complex, and that, due to the limitations of the impairment test, the benefits of the impairment test may not always justify the cost.

96. In response to these concerns, the IASB's preliminary view is that it should propose to remove the requirement to perform an annual impairment test for CGUs containing goodwill, if there is no indication that the CGUs may be impaired. The same proposal would also apply to intangible assets with an indefinite useful life and intangible assets that are not yet available for use (both of which are currently subject to the impairment-only model).

97. The Board is asked to refer to paragraphs 4.5–4.34 of the DP for further information on this sub-topic.

98. Questions 9(a)–(c) of the DP are the relevant questions for this sub-topic. The preliminary staff views on this question are included in the following paragraphs. Question 9 is then reproduced again to seek the Board's feedback.

<u>Preliminary staff views</u>

Question 9(a): Should the IASB develop such proposals? Why or why not?

99. We disagree with the proposal to remove the requirement for a quantitative annual impairment test for goodwill. Removing this requirement would mean that management will need to determine whether there is an indication that goodwill is impaired, and if there is, then an impairment test will be performed. The DP notes that management over-optimism when making estimates as part of the goodwill impairment test is one of the key reasons for the concern that goodwill impairment is recognised too late. Removing the requirement for an annual impairment test for goodwill would introduce an additional layer of management judgement, which could be subject to management over-optimism and subjectivity. Thus, removing this requirement could make the impairment test less robust and exacerbate the concern that goodwill impairment is recognised too late.

100. We also note and agree with the following arguments noted in the DP.

(a) Some stakeholders, including preparers, consider the annual impairment test to be a good governance mechanism that promotes good stewardship.

(b) Some investors consider that the disclosures relating to the impairment test are useful, particularly disclosures around assumptions used to calculate recoverable amount and sensitivities. Such disclosures are currently provided every year for CGUs containing goodwill or indefinite-lived intangibles, even when the impairment test does not result in an impairment loss. If the annual impairment test requirement is removed, this information will no longer be available every year.

101. We also think that the requirements on the timing of the impairment test for intangible assets with an indefinite useful life should be consistent with the requirements for goodwill impairment. That is, we think that the annual quantitative impairment test should remain a requirement for both goodwill and other intangible assets with an indefinite useful life.

Question 9(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.

102. Reverting to an indicator-only approach for goodwill impairment testing could potentially reduce costs. However, we are not sure how significant such a reduction would be, given that management would still need to assess whether there are indicators of impairment. Furthermore, entities may need to spend more time and effort in setting up their impairment models, if after a few years of no indicators, such indicators would again arise.

Question 9(c): In your view, would the proposals make the impairment test significantly less robust (see paragraphs 4.22–4.23 of the DP)? Why or why not?

103. We think the proposals could make the impairment test significantly less robust – see the answer to Question 9(a) above.

104. The decrease in robustness could be remedied to some extent by considering amendments to the impairment indicators in IAS 36, to improve the ability of this set of indicators to "detect" possible impairment.

<table>
<tr><th>Questions for the Board</th></tr>
<tr><td>Q6. Question 9 of the DP</td></tr>
<tr><td>Paragraphs 4.32–4.34 of the DP summarise the IASB'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 IASB 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?</td></tr>
</table>

Intangible Assets (DP Section 5)

105. The IASB received mixed feedback on the current requirement in IFRS 3 to recognise all identifiable intangible assets separately from goodwill in a business combination. Some stakeholders said that the separate recognition of such intangible assets is costly and complex. Others expressed concerns about the level of measurement uncertainty in estimating the fair value of these assets. On the other hand, some stakeholders found that this requirement results in useful information about intangible assets acquired in a business combination.

106. The IASB found no compelling evidence that a change in the recognition of intangible assets acquired in a business combination is required. Therefore, the IASB's preliminary view is that

it should not develop proposals to allow some intangible assets to be included in the goodwill balance.

107. The Board is asked to refer to paragraphs 5.1–5.28 of the DP for further information on this topic.

108. Questions 12(a)–(c) of the DP are the relevant questions for this topic. The preliminary staff views on this question are included in the following paragraphs. Question 12 is then reproduced again to seek the Board's feedback.

<u>Preliminary staff views</u>

Question 12(a): Do you agree that the IASB should not develop such a proposal? Why or why not?

109. We agree that the IASB should not develop proposals to allow some identifiable intangible assets to be subsumed within goodwill.

110. As the DP notes in paragraph 5.25(b), the importance of intangible assets in the model economy has been growing, and there have been many calls in recent years for financial statements to provide better information about intangible assets. Allowing some identifiable intangible assets to be subsumed within goodwill, rather than being recognised separately, would mean that investors will have less information about companies' intangible assets, and would not be consistent with the growing demand for information about such assets.

111. Furthermore, as the DP mentions, co-mingling goodwill with intangible assets that are separately identifiable and have different characteristics to goodwill would result in a loss of information about both types of assets.

Question 12(b): If you do not agree, which of the approaches discussed in paragraph 5.18 should the IASB 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?

112. We have not provided a staff view on this question, as we agree with the IASB's preliminary view. If the Board disagrees, we will consider this question further.

Question 12(c): Would your view change if amortisation of goodwill were to be reintroduced? Why or why not?

113. Staff's view would not change if amortisation of goodwill were to be reintroduced. The introduction of amortisation would not change the points under Question 12(a) above.

Q7. Question 12 of the DP
Paragraphs 5.4–5.27 of the DP explain the IASB'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 IASB 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 IASB 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?

Next steps

114. We plan to seek feedback from the Board on other proposals in the DP at the June meeting.

Attachments

Agenda item 7.2: IASB DP/2020/1 *Business Combinations – Disclosures, Goodwill and Impairment*

Agenda item 7.3 Snapshot – IASB DP/2020/1

March 2020

IFRS® Standards
Discussion Paper DP/2020/1

Business Combinations—Disclosures, Goodwill and Impairment

Comments to be received by 15 September 2020

IASB®

Business Combinations—Disclosures, Goodwill and Impairment

Comments to be received by 15 September 2020

Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment* is published by the International Accounting Standards Board (Board) for comment only. Comments need to be received by **15 September 2020** and should be submitted in writing to the address below, by email to commentletters@ifrs.org or electronically using our 'Open for comment documents' page at: https://www.ifrs.org/projects/open-for-comment/.

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Summary and invitation to comment

Why is the Board publishing this Discussion Paper?

IN1 Mergers and acquisitions—referred to as business combinations in IFRS Standards—are often large transactions for the companies involved.[1] These transactions play a central role in the global economy, with deals announced in 2019 totalling in excess of $4 trillion.[2] According to data extracted from Capital IQ in February 2020, goodwill amounted to $8 trillion for all listed companies worldwide, accounting for around 18% of their total equity and 3% of their total assets.

IN2 IFRS 3 *Business Combinations* specifies how companies must account for these transactions. The International Accounting Standards Board (Board) is carrying out a research project on Goodwill and Impairment, considering issues identified in a Post-implementation Review (PIR) of IFRS 3. (The purpose of a PIR is to identify whether a Standard is working as the Board intended.)

IN3 The project's objective is to explore whether companies can, at a reasonable cost, provide investors with more useful information about the acquisitions those companies make. Throughout this Discussion Paper, the term 'investors' refers to the primary users of financial statements, defined in the *Conceptual Framework for Financial Reporting* as existing and potential investors, lenders and other creditors.

IN4 Better information would help investors assess the performance of companies that have made acquisitions. Better information would also be expected to help investors more effectively hold a company's management to account for management's decisions to acquire those businesses.

IN5 The project considers the following topics identified in the PIR of IFRS 3:

(a) disclosing information about acquisitions;

(b) testing goodwill for impairment—effectiveness and cost;

(c) whether to reintroduce amortisation of goodwill; and

(d) recognising intangible assets separately from goodwill.

IN6 This Discussion Paper examines these topics and expresses the Board's preliminary views on them. The Board's objective is to decide whether it has compelling evidence that changes to IFRS Standards are necessary and would justify the cost of change.

IN7 The Board would welcome feedback from all parties on all these topics. After considering feedback, the Board will decide whether and how to move forward with the project. The Board will also decide whether to change any of its preliminary views set out in this paper as it develops proposals. If the Board

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1 Throughout this Discussion Paper, the term 'acquisition' refers to a business combination within the scope of IFRS 3 *Business Combinations* and defined as a transaction or other event in which an acquirer obtains control of one or more businesses.

2 JPMorgan, '2020 Global M&A Outlook', 2020, https://www.jpmorgan.com/jpmpdf/1320748081210.pdf, (accessed 7 February 2020).

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decides to amend IFRS Standards, it will publish proposals in an exposure draft.

IN8 Reviewing either IAS 36 *Impairment of Assets* or IAS 38 *Intangible Assets* in their entirety is beyond the scope of this project. If stakeholders would like the Board to consider adding such projects to its work plan, the Board encourages them to respond to the Board's 2020 Agenda Consultation.[3]

What are the Board's preliminary views?

IN9 The Board's preliminary views are that it:

(a) should develop proposals to enhance the disclosure objectives and requirements in IFRS 3 to improve the information provided to investors about an acquisition and its subsequent performance (Section 2);

(b) cannot design a different impairment test for cash-generating units containing goodwill that is significantly more effective than the impairment test in IAS 36 at recognising impairment losses on goodwill on a timely basis and at a reasonable cost (Section 3);

(c) should not reintroduce amortisation of goodwill (Section 3);

(d) should develop a proposal to help investors better understand companies' financial positions by requiring companies to present on their balance sheets the amount of total equity excluding goodwill (Section 3);

(e) should develop proposals intended to reduce the cost and complexity of performing the impairment test by:

   (i) providing companies with relief from having to perform an annual quantitative impairment test for cash-generating units containing goodwill if there is no indication that an impairment may have occurred; and

   (ii) extending the same relief to companies for intangible assets with indefinite useful lives and intangible assets not yet available for use (Section 4);

(f) should develop proposals intended to reduce cost and complexity, and to provide more useful and understandable information by simplifying the requirements for estimating value in use by:

   (i) removing the restriction on including cash flows from a future uncommitted restructuring or from improving or enhancing an asset's performance (Section 4); and

   (ii) permitting the use of post-tax cash flows and post-tax discount rates (Section 4); and

3 See www.ifrs.org/projects/work-plan/2020-agenda-consultation/.

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(g) should not change the range of identifiable intangible assets recognised separately from goodwill in an acquisition (Section 5).

Who will be affected if the preliminary views are implemented?

IN10 If implemented, the Board's preliminary views would enhance the information provided to investors about the subsequent performance of acquisitions.[4] IFRS Standards do not specifically require companies to provide information about whether an acquisition is meeting management's expectations for that acquisition. This information would be expected to help investors assess performance and more effectively hold management to account for its acquisition decisions.

IN11 Implementing the Board's preliminary views would affect companies that acquire businesses. Such companies would have to provide investors with information on the subsequent performance of their acquisitions based on how management monitors those acquisitions.

IN12 The Board would particularly welcome investors' views on how useful the information about the subsequent performance of an acquisition would be and on whether implementing the Board's preliminary views would provide the type of information that investors need. The Board would also like to understand the operational and cost implications of a requirement to disclose the information about the subsequent performance of an acquisition. If companies, auditors and regulators have concerns about these implications, the Board would welcome their suggestions for making the requirements more operable or less costly while still providing the information investors need. This would help the Board when it performs a cost-benefit analysis of any possible future requirements to disclose such information.

IN13 The Discussion Paper also examines whether to reintroduce amortisation of goodwill. Reintroducing amortisation could reduce the costs of performing the impairment test for companies that recognise goodwill, but it could also reduce the usefulness of the information these companies provide to investors. The Board's preliminary view is that it should not reintroduce amortisation, but the Board would welcome any new arguments or new evidence that stakeholders have on this topic.

IN14 The Board accepts that both accounting models for goodwill—the impairment-only model in IAS 36 and an amortisation model—have limitations. The Board's preliminary view is that there is no compelling evidence to justify once again changing the accounting for goodwill and the costs that such a change would entail. This Discussion Paper provides stakeholders with an opportunity to explain whether they agree with that preliminary view.

4 Throughout this document, terms such as 'subsequent performance of an acquisition' refer to the performance after the acquisition of the acquired business together with the performance of any other part of the acquirer's business where synergies arise because of the acquisition.

IN15 Simplifying the impairment test would reduce the cost of performing the test for those companies that recognise goodwill, and could affect other companies because some of the preliminary views would amend impairment testing for all assets in the scope of IAS 36.

IN16 The Discussion Paper covers several important topics that will affect many investors, companies, auditors and regulators. Your responses will help the Board decide whether to develop proposals based on its preliminary views. Your responses will be most useful if you provide evidence to support your comments.

What does this Discussion Paper include?

IN17 A summary of the Board's preliminary views with the main reasons for them is provided in paragraphs IN18–IN49. The issues summarised in this section are discussed in further detail in Sections 2–5. Section 6 of the Discussion Paper outlines recent publications from two national standard-setters on similar topics:

(a) an Invitation to Comment published by the US Financial Accounting Standards Board; and

(b) a Research Report published by the Australian Accounting Standards Board.

Disclosures

IN18 Investors have said they want to understand whether the price of an acquisition was reasonable and whether that acquisition has been successful. They say some companies do not provide enough useful information for those investors to fully understand an acquisition, despite the volume of disclosure requirements in IFRS 3.

IN19 They also say that companies typically do not provide enough information about the subsequent performance of the acquisition, because they are not specifically required to do so. Although the impairment test for cash-generating units that contain goodwill could provide some information about the subsequent performance of an acquisition, stakeholders have told the Board that this information is not timely. The impairment test cannot inform investors whether an acquisition has been a success (see paragraphs IN29–IN30).

IN20 The Board's preliminary view is that it should require companies to disclose:

(a) management's objectives for an acquisition;

(b) the metrics that management will use to monitor whether the objectives of the acquisition are being met;

(c) the extent to which management's objectives for the acquisition are being met in subsequent reporting periods, using those metrics; and

(d) other information, reflecting possible targeted improvements to the disclosure objectives and disclosure requirements of IFRS 3.

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IN21 Because the cost of an acquisition is often large relative to the value of the acquiring company, and the implications of failure are therefore often significant, the Board presumes that the management of the acquiring company monitors an acquisition internally and is aware of how well an acquisition is performing against management's expectations for it. The Board takes the view that a company should be required to provide investors with information that its management uses to monitor an acquisition, even if that information is about the combined business because the acquired business has been integrated. If management does not monitor an acquisition, the Board suggests that companies should be required to make investors aware of that fact.

IN22 The Board's preliminary view is that the information disclosed, and the acquisitions for which the information is disclosed, should be the information and those acquisitions that the company's chief operating decision maker reviews.[5] The Board expects that this would provide the most important information about the most important acquisitions.

IN23 The Board does not intend to prescribe specific metrics to be disclosed because, in its view, no single metric could provide investors with adequate information for evaluating the subsequent performance of all acquisitions.

IN24 The Board's preliminary view on disclosures is central to its package of preliminary views, the overall aim of which is for companies to provide investors with better information about acquisitions and with a better understanding of the economics of these transactions.

Can the impairment test be made more effective?

IN25 IAS 36 requires companies to test cash-generating units containing goodwill for impairment at least annually. However, some stakeholders told the Board that impairment losses on goodwill are sometimes recognised too late, long after the events that caused those losses. This could be because:

(a) estimates of cash flows may sometimes be too optimistic.

(b) goodwill is shielded from impairment by—for example, the headroom of a business with which an acquired business is combined. The headroom of a business is the amount by which its recoverable amount exceeds the carrying amount of its recognised net assets. This headroom can mask impairment of acquired goodwill when a company tests the combined business for impairment because any reduction in the recoverable amount of the combined business is first absorbed by that headroom.

IN26 The Board's view is that if estimates of cash flows are too optimistic, this is best addressed by auditors and regulators, not by changing IFRS Standards.

5 Paragraph 7 of IFRS 8 *Operating Segments* discusses the meaning of the term 'chief operating decision maker'.

What is goodwill?

IFRS 3 defines goodwill as an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognised.

A company can either generate goodwill internally or acquire goodwill in a business combination. However, a company recognises only acquired goodwill on its balance sheet. Internally generated goodwill is not recognised on the balance sheet as an asset.

A company recognises acquired goodwill on its balance sheet when the price the company pays for another company is more than the net value of the individual assets and liabilities of the acquired business that the acquirer recognises for accounting purposes on its balance sheet at the date of acquisition.

A company may be willing to pay more than the net value of the individually recognised assets and liabilities for several reasons including:

- the acquirer may expect the acquired business to continue generating returns beyond those future returns embodied in the value of the assets recognised individually on acquisition, through the ability of the acquired business to continue to develop new products and find new customers—for example, because of its established processes, competitive position and culture. This is often called going concern value.

- the acquirer may expect additional benefits from combining the acquired business with its own business. For example, the acquirer may expect to sell more of its own products in a particular country because of established sales and distribution networks of the acquired business. Alternatively, because of the purchasing power of the combined business, the acquirer may expect cost savings from future contract negotiations. These additional benefits are commonly called synergies.

In developing IFRS 3, the Board identified two principal components of goodwill which correspond to these reasons:

- the going concern component of the acquiree's business. The fair value of the going concern component is the excess value of the acquired business over the net value of the individual assets and liabilities of the acquired business. It represents the goodwill that was either generated internally by the acquiree or acquired by the acquiree in prior acquisitions.

continued...

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- the expected synergies and other benefits from combining the acquirer's and acquiree's businesses. The fair value of the expected synergies and other benefits represents the excess assembled value the acquirer expects the combination to create (paragraphs BC312–BC318 of the Basis for Conclusions on IFRS 3).

Although the amendments made to IAS 38 in 2004 and 2008 require more intangible assets to be recognised separately from goodwill in a business combination, some resources are included in goodwill—for example, an assembled workforce.

The Board has previously concluded that, because goodwill cannot be measured directly, it needs to be measured as a residual: the difference between the price a company agrees to pay and the net value of the individually recognised assets and liabilities of the acquired business (paragraph BC328 of the Basis for Conclusions on IFRS 3).

Because companies measure goodwill as a residual, the measurement of goodwill could include other items beyond the two principal components. For example, if the acquirer overpays or underpays for the acquired business, the measurement of goodwill includes that difference.

Measurement differences are another factor that can affect the amount of goodwill that is recognised on acquisition. For example, IFRS 3 requires defined benefit pension liabilities to be measured in accordance with IAS 19 *Employee Benefits* at an amount that is likely to be different from their fair value. The measurement of goodwill on acquisition includes this difference.

IN27 Some stakeholders may believe that the impairment test directly tests goodwill or that it should test goodwill directly, and this belief may have caused some of the concerns that the impairment test may not be effective. However, the impairment test only indirectly tests goodwill for impairment as part of the impairment test for cash-generating units that contain the goodwill.

IN28 Therefore, the Board considered whether it could design an impairment test that is still indirect, but targets the acquired goodwill more effectively by reducing the effect of shielding. After extensive work, the Board concluded that significantly improving the effectiveness of the impairment test for goodwill at a reasonable cost is not feasible.

IN29 Because goodwill does not generate independent cash flows and cannot be measured directly, it must be tested for impairment with other assets. Therefore, some shielding is always likely to occur.

IN30 Estimates of cash flows will always be subject to management judgement, but if applied well, the test is expected to meet its objective of ensuring that the combined assets, including goodwill, are carried at no more than their combined recoverable amount. Although the impairment test cannot always provide a timely signal that the performance of an acquisition is not meeting management's expectations, the absence of such a signal does not mean the

test has failed. The Board's preliminary view on disclosures discussed in paragraphs IN18–IN24 is intended to meet the need for timely information about the subsequent performance of acquisitions.

Amortisation

IN31 The Board concluded that it could not significantly improve the effectiveness of the approach in IAS 36 for testing goodwill for impairment at a reasonable cost. Information about the subsequent performance of an acquisition would be provided by implementing the Board's preliminary view on disclosures discussed in paragraphs IN18–IN24. The Board therefore considered whether to develop a proposal to reintroduce amortisation of goodwill.[6]

IN32 Amortisation could be a simple way for a company to reduce the carrying amount of goodwill and take some pressure off the impairment test. It could help resolve the concerns of stakeholders who believe the carrying amount of goodwill can be overstated because of the inherent limitations of any impairment test (see paragraphs IN25–IN30).

IN33 In considering whether to reintroduce amortisation of goodwill, different Board members place different weight on different arguments. Some of the main arguments Board members considered in reaching their views are summarised in paragraphs IN34–IN35.

IN34 In the view of some Board members, the Board should reintroduce amortisation because:

(a) it has not proved feasible to design an impairment test that is significantly more effective at recognising impairment losses on goodwill on a timely basis. In their view, the Board should reintroduce amortisation to respond to the PIR of IFRS 3 feedback that the impairment test is not robust enough to recognise impairment losses on goodwill on a timely basis.

(b) carrying amounts of goodwill around the world have been increasing. Some Board members see this as evidence that without amortisation management is not being properly held to account for its acquisition decisions and that amortisation is needed to maintain the integrity and reputation of financial reporting.

(c) goodwill is a wasting asset with a finite useful life, and reintroducing amortisation is the only way to depict that goodwill is being consumed.

IN35 In the view of other Board members, the Board should not reintroduce amortisation and should instead retain the impairment-only approach because:

(a) although the impairment test does not test goodwill directly, recognising an impairment loss provides important confirmatory information, even if delayed, that confirms investors' earlier assessments that those losses have occurred, helping hold

6 If the Board were to reintroduce amortisation, it would still be necessary to test whether goodwill is impaired.

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management to account. The useful life of goodwill cannot be estimated, so any amortisation expense would be arbitrary. Therefore, investors would ignore it and amortisation could not be used to hold management to account for its acquisition decisions.

(b) the Board should not reintroduce amortisation solely because of concerns that the impairment test is not being applied rigorously or simply to reduce goodwill carrying amounts. In the view of some Board members, goodwill could be increasing for many reasons—for example, because of the changing nature of the economy and greater value being generated by unrecognised intangible assets.

(c) the Board has no compelling evidence that amortising goodwill would significantly improve the information provided to investors or, particularly in the first few years after an acquisition, significantly reduce the cost of performing the impairment test.

IN36 Regardless of whether amortisation is reintroduced or the impairment-only approach is retained, accounting for goodwill cannot provide information about the success of an acquisition. The Board's preliminary view is that it should require disclosures on the subsequent performance of an acquisition (see paragraph IN20). These disclosures would provide investors with more direct information about an acquisition's success or lack of success. If the impairment-only approach is retained, the disclosures could help meet concerns that the impairment test is not designed to provide a timely signal about the performance of an acquisition. If amortisation is reintroduced, the disclosures could help meet concerns about any potential loss of useful information from the impairment test.

IN37 The Board accepts that both accounting models for goodwill—an impairment-only model and an amortisation model—have limitations. No impairment test has been identified that can test goodwill directly, and for amortisation it is difficult to estimate the useful life of goodwill and the pattern in which it diminishes.

IN38 The Board's preliminary view is that it should retain the impairment-only model and not reintroduce amortisation. However, the majority for this decision was small: eight of 14 Board members voted in favour. Therefore, the Board would particularly like stakeholders' views on this topic.

IN39 Stakeholders have always had strongly held and divergent views on whether goodwill should be required to be amortised. Simply repeating the well-known arguments for these views is unlikely to move the debate forward; therefore, the Board would welcome feedback that provides new practical or conceptual arguments, together with evidence for these arguments and suggestions identifying arguments which should be given more weight and why. The Board is also interested in whether stakeholders' views depend on other components of the package of the Board's preliminary views as discussed in paragraphs IN50–IN53.

IN40 Feedback on this Discussion Paper will help the Board decide whether it has compelling evidence that it should change IFRS Standards again regarding this topic. To fulfil its role as a standard-setter, the Board needs to be satisfied that any decisions it makes now will not be reopened again within a few years—frequent changes back and forth between the different approaches would not help any stakeholders.

Highlighting the impact of goodwill

IN41 In the Board's preliminary view, companies should be required to present on their balance sheets the amount of total equity excluding goodwill, as illustrated in the Appendix to this Discussion Paper. This improved transparency would be expected to enhance investors' understanding of a company's financial position. The Board considers this improved transparency important because the impairment test cannot test goodwill directly and because goodwill is different from other assets—for example, goodwill cannot be sold separately or measured directly.

Relief from the annual impairment test

IN42 The Board's preliminary view is that it should remove the requirement for a company to perform an annual quantitative impairment test for cash-generating units containing goodwill. A company would not be required to perform a quantitative test unless there is an indication that an impairment may have occurred. A company would still need to assess at the end of each reporting period whether there is any such indication. The Board expects that this relief would reduce the cost of testing goodwill for impairment.

IN43 Some Board members favour providing such relief only if the Board also reintroduces amortisation of goodwill. In their view, removing the requirement for an annual test of goodwill would make impairment tests less robust.

IN44 Nevertheless, a small majority of Board members favours this relief even though the Board's preliminary view is that it should not reintroduce amortisation. In the view of those Board members, providing relief would reduce the cost of the test while making the test only marginally less robust. This is because performing the test every year cannot remove the shielding that can occur in an impairment test for cash-generating units. The benefits of testing for impairment when there is no indicator of impairment are minimal and so do not justify the cost in those cases.

Value in use

IN45 The Board's preliminary view is that it should improve the way companies estimate value in use:

(a) so that companies include cash flows from a future uncommitted restructuring or from improving or enhancing an asset's performance; and

(b) to allow companies to use post-tax cash flows and post-tax discount rates.

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IN46 These improvements would be expected to reduce the cost and complexity of performing impairment tests and to provide more useful and understandable information. The improvements could also make the test easier to perform and therefore could make the impairment test easier to audit and enforce.

Intangible assets

IN47 IFRS 3 and the amendments to IAS 38 broadened the range of intangible assets recognised separately in an acquisition, rather than being included in goodwill. Stakeholders' views differ on the benefits of recognising identifiable intangible assets separately, particularly in relation to customer relationships and brands.

IN48 Some say separate recognition helps to explain what companies have bought. Others question whether the information is useful, because similar intangible assets generated internally are not recognised and because some intangible assets are difficult to value. The views of preparers of financial statements (preparers) on the cost of separate recognition also vary.

IN49 Because of the varying views on how useful and costly this information is, the Board has no compelling evidence that it should change the range of intangible assets recognised in an acquisition.

Costs and benefits

IN50 The Board's preliminary views set out in this Discussion Paper form a package and are interconnected. The Board considered the links when considering the package and whether it would meet the project's objective. The Board asks that when stakeholders assess what best meets the project's objective, they also consider these links. For example:

(a) views on amortisation may partly depend on views on whether the impairment test is effective at the timely recognition of impairment losses on goodwill, or can be made more effective.

(b) views on whether to keep the mandatory annual quantitative impairment test may partly depend on views on whether amortisation of goodwill should be reintroduced.

(c) views on whether to introduce changes that may reduce costs to companies by providing relief from the mandatory annual quantitative impairment test may partly depend on views on whether to require additional disclosures about an acquisition and its subsequent performance; providing such disclosures would increase costs to companies.

(d) views on amortisation and on simplifications of the impairment test may partly depend on views on whether to require additional disclosures about an acquisition and its subsequent performance. These disclosures could reduce reliance on the impairment test to provide information about the performance of an acquisition.

(e) views on whether to include some intangible assets in goodwill may partly depend on views on whether amortisation of goodwill should be reintroduced.

IN51 In reaching its preliminary views, the Board considered the expected benefits and expected costs of the overall package. Moreover, although the Board's preliminary views would, if implemented, meet the project's objective in paragraph IN3, some of these preliminary views would also have drawbacks which the Board has had to consider in reaching its preliminary views. For example:

(a) introducing the new disclosures would increase costs for companies;

(b) applying the relief from the annual quantitative impairment test could reduce the robustness of the impairment test and could result in the loss of disclosures linked to the impairment test; and

(c) changing the method of estimating value in use to include cash flows from a future uncommitted restructuring or from improving or enhancing an asset's performance could increase the risk that management may use inputs that are too optimistic in estimating value in use.

IN52 The Board expects that this package of preliminary views would, if implemented, provide investors with more useful information about acquisitions. This information would help investors to assess performance and more effectively hold management to account for its acquisition decisions. These improvements can be achieved at a reasonable cost when taken together with other elements of the package that, in the Board's view, would help to reduce the cost and complexity of the impairment test, without depriving investors of useful information.

IN53 In the Board's view this package of preliminary views is the most cost-effective response to the range of views expressed by stakeholders in the PIR of IFRS 3 about investor needs, benefits and costs in accounting for acquisitions and goodwill. This Discussion Paper contains the Board's preliminary assessment of the benefits and costs of its preliminary views. The Board would welcome feedback that helps it make this assessment more complete.

What are the next steps?

IN54 The views expressed in this Discussion Paper are preliminary and may change. The Board will consider the comments received in response to this Discussion Paper before deciding whether to develop an exposure draft containing proposals to implement any or all of its preliminary views.

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Invitation to comment

The Board invites comments on its Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment*, particularly on the questions set out below and repeated in the relevant sections of the Discussion Paper. Comments are most helpful if they:

(a) answer the questions as stated;

(b) indicate the specific paragraphs of the Discussion Paper to which they relate;

(c) contain a clear rationale and provide evidence to support that rationale;

(d) identify any wording in the proposals that is difficult to translate; and

(e) include any alternative the Board should consider, if applicable.

The Board is requesting comments only on matters addressed in this Discussion Paper.

Questions for respondents

Question 1

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?

(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?

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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.

(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?

(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).

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Question 2

(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?

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?

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?

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?

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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?

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?

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Question 7	
(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?

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?

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?

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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.

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?

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?

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?

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?

Deadline

The Board will consider all comments received in writing by 15 September 2020.

How to comment

We prefer to receive your comments online. However, you may submit comments using any of the following methods:

Online	Visit the 'Open for comment documents' page at: https://www.ifrs.org/projects/open-for-comment/
By email	Send to: commentletters@ifrs.org
By post	IFRS Foundation Columbus Building 7 Westferry Circus Canary Wharf London E14 4HD United Kingdom

Your comments will be on the public record and posted on our website unless you request confidentiality and we grant your request. We do not normally grant such requests unless they are supported by a good reason, for example, commercial confidence. Please see our website for details on this policy and on how we use your personal data.

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Section 1—Introduction

Background

1.1 The Board issued IFRS 3 *Business Combinations* in 2004 and revised it in 2008. The Board also made related amendments to IAS 27 *Consolidated and Separate Financial Statements* (as IAS 27 was then titled), IAS 36 *Impairment of Assets* and IAS 38 *Intangible Assets*.

1.2 This Discussion Paper considers matters relating to the following changes made by the Board in 2004 and 2008:

(a) the removal of the previous requirement to amortise goodwill, replacing this with a requirement for an annual quantitative test for impairment;

(b) the removal of the previous requirement to amortise all intangible assets, replacing this with a requirement for intangible assets with indefinite useful lives not to be amortised and to be subject to an annual quantitative test for impairment; and

(c) the broadening of the range of intangible assets recognised separately in an acquisition, rather than included in goodwill.

1.3 In 2013 and 2014 the Board carried out a Post-implementation Review (PIR) of IFRS 3 to assess whether IFRS 3 was working as the Board intended. The PIR of IFRS 3 also covered the related amendments to IAS 27, IAS 36 and IAS 38. The findings were summarised in the Report and Feedback Statement *Post-implementation Review of IFRS 3 Business Combinations* issued in 2015.[7]

1.4 Stakeholders raised concerns about some aspects of the accounting for acquisitions. Thus, as a result of the PIR of IFRS 3, the Board started:

(a) a project that clarified and narrowed the definition of a business. That definition determines when the requirements of IFRS 3 apply. The Board completed this project in 2018 by issuing *Definition of a Business* (Amendments to IFRS 3).

(b) a research project on Goodwill and Impairment, which is the subject of this Discussion Paper.

What has the Board learned from stakeholders?

1.5 Table 1.1 summarises feedback on the PIR of IFRS 3 in the areas considered in this Discussion Paper. The Board has subsequently received similar feedback from meetings with a range of stakeholders.

7 See http://cm.ifrs.org/-/media/project/pir-ifrs-3/published-documents/pir-ifrs-3-report-feedback-statement.pdf.

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Table 1.1 Feedback from the PIR of IFRS 3

Area	Feedback
Disclosures	Many investors said they often have difficulty assessing the subsequent performance of an acquisition. Some investors wanted pro forma prior year comparative information for trend analyses. Many preparers found it difficult to disclose the pro forma revenue and profit or loss of the combined entity as though the acquisition had occurred at the start of the reporting period because information on periods prior to acquisition is not always readily available.
Impairment of goodwill and intangible assets with indefinite useful lives	Stakeholders had different views on the impairment-only approach to goodwill. Some investors said this approach provided useful information, because it helped them assess management's stewardship. They also said the information provided by the impairment test had confirmatory value. Many stakeholders described the impairment test as complex, time-consuming and expensive and said it requires companies to make difficult judgements. Many stakeholders said there is a time lag between an impairment occurring and recognition of an impairment loss in a company's financial statements. Many stakeholders suggested reintroducing amortisation.
Recognition of intangible assets separately from goodwill	Investors had mixed views on the usefulness of recognising intangible assets separately from goodwill. Some investors said identifying and measuring additional intangible assets is highly subjective. However, others said it provides insight into the components of the acquired business and the reasons for the acquisition. Stakeholders said that identifying some intangible assets is difficult. They also said valuation methods are complex and subjective.

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Objective of the Goodwill and Impairment research project

1.6 In response to stakeholder feedback, the Board researched whether:

(a) companies can provide better information on acquisitions to investors, in particular, information on the subsequent performance of an acquisition (Section 2);

(b) it could make the impairment test more effective at recognising impairment losses on goodwill on a timely basis at a reasonable cost (Section 3);

(c) it should reintroduce amortisation of goodwill (Section 3);

(d) it should amend the impairment test to reduce its cost and complexity (Section 4); and

(e) it should include some intangible assets within goodwill (Section 5).

1.7 The Board's overall objective is to explore whether companies can, at a reasonable cost, provide investors with more useful information about the acquisitions those companies make. Better information would help investors assess the performance of companies that have made acquisitions. Better information would also be expected to help investors more effectively hold a company's management to account for management's decisions to acquire those businesses.

Terms used in this Discussion Paper

1.8 The following terms used in this Discussion Paper are already defined or described in IFRS Standards:

acquiree	the business or businesses that the acquirer obtains control of in a business combination.
acquirer	the entity that obtains control of the acquiree.
business combination	a transaction or other event in which an acquirer obtains control of one or more businesses.
carrying amount	the amount at which an asset or liability is recognised in the statement of financial position.
cash-generating unit	the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or group of assets.
chief operating decision maker	a function that allocates resources to and assesses the performance of the operating segments of an entity; often the chief operating decision maker of a company is its chief executive officer or chief operating officer but, for example, it may be a group of executive directors or others.

costs of disposal	the incremental costs directly attributable to the disposal of an asset, excluding finance costs and income tax expense.
fair value	the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.
goodwill	an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognised.
impairment loss	the amount by which the carrying amount of an asset or a cash-generating unit exceeds its recoverable amount.
material information	information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial reports make on the basis of those reports, which provide financial information about a specific reporting entity.
recoverable amount of an asset or cash-generating unit	the higher of its fair value less costs of disposal and its value in use.
restructuring	a programme that is planned and controlled by management, and materially changes either: (a) the scope of a business undertaken by an entity; or (b) the manner in which that business is conducted.
value in use	the present value of the future cash flows expected to be derived from an asset or cash-generating unit.

1.9 The following terms are also used in the Discussion Paper, but are not defined in IFRS Standards:

headroom	the amount by which the recoverable amount of a cash-generating unit exceeds the carrying amount of its recognised net assets. Headroom comprises: (a) internally generated goodwill; (b) unrecognised differences between the carrying amounts of recognised assets and liabilities and their recoverable amounts; and (c) unrecognised assets and liabilities.

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subsequent performance of an acquisition	the performance after the acquisition of the acquired business together with the performance of any other part of the acquirer's business where synergies arise because of the acquisition.

Questions for respondents

Question 1
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? (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?

Section 2—Improving disclosures about acquisitions

Section highlights

- Investors want to understand how an acquisition is performing relative to management expectations.
- A company should be required to provide investors with the information that the company's management uses to monitor acquisitions.
- Investors could use this information to assess management's decisions to acquire businesses.

2.1 This section discusses the Board's preliminary view that it should amend IFRS 3 *Business Combinations* to:

(a) add disclosure requirements about the subsequent performance of an acquisition. These are intended to help investors understand whether the objectives that management set for an acquisition are being met (see paragraphs 2.4–2.45).

(b) make targeted improvements to the disclosure objectives and requirements of IFRS 3 (see paragraphs 2.46–2.91).

2.2 By making these changes, the Board would respond to feedback from investors who said they need better information to help them understand an acquisition and, in particular, the subsequent performance of the acquisition. Better information would help investors to assess performance and more effectively hold management to account for its decisions to acquire businesses.

2.3 Providing investors with better information about acquisitions is the primary objective of the Board's preliminary views in this Discussion Paper.

Subsequent performance of acquisitions

What is subsequent performance of an acquisition?

The term 'subsequent performance of an acquisition' refers in this Discussion Paper to the performance after acquisition of the acquired business together with the performance of any other part of the acquirer's business affected by the acquisition.

The performance of other parts of the acquirer's business may be affected by the acquisition if synergies arise because of the acquisition.

If the acquired business is integrated with the acquirer's business, information about the subsequent performance of the acquisition used by management may be based on the combined business.

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What is the issue?

2.4 Investors have said that companies typically do not provide enough information to help investors understand the subsequent performance of an acquisition. Investors cannot assess whether management's objectives for the acquisition are being met—for example, whether the synergies management expect from an acquisition are being realised.

How did the Board reach its preliminary view?

2.5 Investors want to know whether management's objectives for an acquisition are being met. This information would help them assess management's ability to realise the expected benefits from an acquisition and assess whether an acquisition's subsequent performance indicates that management paid a reasonable price for the acquired business. Information about whether management's objectives are being met would allow investors to assess performance and more effectively hold management to account for its decision to acquire the business. Hence, investors would use the information to assess management's stewardship of the company's economic resources.

2.6 IFRS 3 does not specifically require disclosure of information about the subsequent performance of an acquisition. Nevertheless, limited information may come from:

(a) the requirement in IFRS 3 to disclose the revenue and profit or loss of the acquired business from the acquisition date to the end of the reporting period.[8] However, that information is available only for that period and companies are not required to provide information about whether the revenue or profit or loss of the acquired business has met or exceeded management's expectations.

(b) impairment losses. However, because goodwill does not generate cash flows independently and cannot be measured directly, it has to be tested for impairment in conjunction with other assets. The objective of the impairment test for goodwill, which is explained further in paragraphs 3.12–3.19, is to ensure the combined assets including goodwill are carried at no more than their combined recoverable amount. The impairment test cannot inform investors whether an acquisition is meeting management's objectives for the acquisition because, for example:

(i) the recognition of an impairment loss can sometimes be a signal of failure, but if no impairment loss has been recognised, that does not automatically mean the acquisition has been a success.

(ii) the outcome of an impairment test cannot communicate the extent of success or failure of an acquisition because the carrying amount of acquired goodwill does not necessarily depict how much of the originally expected benefits from the acquisition still remain.

8 Paragraph B64(q)(i) of IFRS 3.

(iii) an impairment loss may result from an external market factor that affects the whole of a company. This impairment loss may not indicate that an acquisition has failed.

(c) segment reporting for segments that include the acquisition. However, the information may be limited because segments tend to be larger than individual acquisitions. Moreover, management may allocate the acquired business to more than one segment and it may not be clear to investors what part of the acquired business has been allocated to each segment.

(d) management commentary provided alongside the financial statements, if a company is required or chooses to produce it. However, not all companies provide enough information in their management commentary for investors to assess the performance of the acquisitions in which investors are interested.

2.7 In reaching its preliminary view, the Board considered the following questions:

(a) what information should companies be required to provide about management's objectives for an acquisition (paragraphs 2.8–2.12)?

(b) what information should companies be required to provide to show whether the objectives are being met (paragraphs 2.13–2.32)?

(c) should companies be required to provide this information for all material acquisitions (paragraphs 2.33–2.40)?

(d) for how long should companies be required to provide this information (paragraphs 2.41–2.44)?

What information should companies be required to provide about management's objectives for an acquisition?

2.8 To understand whether management's objectives for an acquisition are being met, investors need to know what those objectives are.

2.9 IFRS 3 requires a company to disclose the primary reasons for an acquisition.[9] This disclosure requirement may result in companies providing some information about management's objectives, but this information is unlikely to be specific enough to form the basis of the information that would help investors to assess the subsequent performance of the acquisition.

2.10 The Board's preliminary view is that it should propose replacing the requirement to disclose the primary reasons for an acquisition with a requirement to disclose:

(a) the strategic rationale for undertaking an acquisition; and

(b) management's objectives for the acquisition at the acquisition date.

9 Paragraph B64(d) of IFRS 3.

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2.11 The Board expects that:

(a) the description of the strategic rationale would link the rationale for the acquisition to the company's overall business strategy. The business strategy is often set out elsewhere in a company's financial reports—for example, in its management commentary. A description of the strategic rationale is likely to be broad (for example, 'to expand the company's geographical presence in Region Z by acquiring Company B, which trades in Territory Y in Region Z') and this would link to the company's overall business strategy (for example, 'to become the leading company in Region Z'). Linking the description of the rationale to the stated overall business strategy may help to make the information provided more useful.

(b) management's objectives would be more specific financial or non-financial aims for the acquisition (for example, 'to achieve additional sales of the company's own Product W in new Territory Y using the acquired sales channels of Company B'). The objectives would be more detailed than the strategic rationale but would be linked to the strategic rationale. Management is likely to have more than one objective for each acquisition that needs to be achieved before management considers the acquisition a success. Companies would then be expected to describe the targets that management has set for these objectives and how those targets are to be measured (metrics). Through these targets, management will determine whether those objectives have been met. Those metrics would need to be specific enough so that it is possible to verify whether the objectives are being met and the metrics would also need to be disclosed (paragraphs 2.13–2.17). In this example the metric might be 'additional revenue of CU100 million of Product W in Territory Y in 202X'.[10] The metrics could be financial or non-financial.

2.12 Management's objectives, being the objectives of the acquisition that management considers must be achieved for the acquisition to be a success, would form the basis of the information to help investors assess the subsequent performance of the acquisition. Information about those objectives would also help investors understand why the company bought that business and what assets, synergies and other benefits it paid for. Investors would be able to use the information to assess whether the price for the acquired business appears reasonable.

What information should companies be required to provide to show whether the objectives are being met?

2.13 In the Board's view no single metric could provide investors with adequate information for evaluating the subsequent performance of all acquisitions. Companies acquire businesses to meet various objectives and companies may incorporate acquired businesses into their business in various ways. Feedback from investors and preparers supports the Board's view.

10 CU=Currency Unit.

2.14 Because the cost of an acquisition is often large relative to the value of the acquiring company, and the implications of failure are therefore often significant, the Board presumes that the management of an acquiring company monitors acquisitions internally and is aware of how well an acquisition is performing against management's expectations for it.

2.15 Thus, the Board's preliminary view 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 against the objectives of the acquisition. This approach is analogous to the management approach used for segment reporting in IFRS 8 *Operating Segments*. A company would be required to disclose the information management is using to monitor whether an acquisition is meeting its objectives.

2.16 In reaching this preliminary view, the Board concluded that:

(a) disclosing the information about an acquisition that a company's management uses may have the following advantages:

(i) information that is used for decision-making and that is prepared and monitored regularly for management's use may be scrutinised more closely than information generated solely for external reporting once or twice a year; and

(ii) this approach may minimise the cost of providing this information.

(b) this approach would not give companies a free choice about the type of information they disclose—they would be required to disclose the information their management uses to monitor progress in meeting the objectives of an acquisition (the metrics that management uses to monitor an acquisition's performance and subsequent progress measured using those metrics).

(c) the information disclosed could differ from information disclosed by other companies. However, the primary reason for disclosing this information is not to provide comparability with other companies' acquisitions, but to help investors understand how an acquisition is progressing against the objectives a company's management set for it and understand how management monitors and manages the performance of the acquisition.

(d) a company's management is likely to pursue several objectives when acquiring a business and use several metrics for measuring progress towards those objectives. These metrics could be financial—for example, amounts of synergies, profit measures, returns on capital—or non-financial—for example, market share, retention of staff, product launches—or both.

(e) if management does not monitor an acquisition, disclosing that fact could be useful for investors.

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2.17 The objective of the disclosure is to provide investors with information to help them understand the extent to which management's objectives for an acquisition are being met. Although some stakeholders may have concerns about the verifiability of the information, the Board expects the following to be verifiable:

(a) whether the information disclosed is the information that management receives to monitor the acquisition;

(b) whether there is an adequate explanation of how the information has been prepared; and

(c) whether the information faithfully represents what it purports to represent.

2.18 The following paragraphs discuss:

(a) whether a company should be required to disclose a specified set of metrics if its management is not monitoring an acquisition (paragraphs 2.19–2.20);

(b) whether a company should be required to change the metrics it discloses if, over time, management changes the metrics it uses to monitor subsequent performance (paragraph 2.21); and

(c) possible concerns about disclosing such information (paragraphs 2.22–2.32).

2.19 Some preparers say they do not monitor the performance of acquisitions against the targets set at the acquisition date for those acquisitions. Instead, management sets targets as part of the business planning cycle. Management then revises these targets in each subsequent planning cycle and monitors the performance of the business against these updated targets. Management does not monitor the business against the original targets and is therefore not monitoring whether the objectives of the acquisition are being met.

2.20 If a company's management does not monitor an acquisition against its original expectations, the Board concluded that requiring the company to disclose a specified set of metrics would not always produce useful information, as discussed in paragraph 2.13. The Board expects investors may be surprised that management is not monitoring an acquisition in this way, and would want to know this. The Board therefore suggests that a company should be required to disclose the fact that management is not monitoring the acquisition against management's original expectations, and the reasons why it does not do so.

2.21 The metrics that management uses to monitor the progress of an acquisition may change over time—for example, when a company is reorganised. The Board considers it unreasonable to require a company to continue disclosing metrics that no longer provide useful information to management and may no longer be available internally. However, changing the metrics without disclosing the reasons for that change could allow poor performance to be masked. To balance these concerns, the Board's preliminary view is that it should not require a company to continue disclosing a metric it no longer uses

internally. Instead, when a company makes such a change, it should be required to disclose that it made the change together with the reasons for the change and then disclose the revised metrics.

2.22 The Board has heard concerns from stakeholders that the information about management's objectives discussed in paragraph 2.11, or the metrics used by management to monitor performance, may be:

(a) impossible to provide because the acquired business is being integrated (paragraphs 2.23–2.26);

(b) commercially sensitive (paragraphs 2.27–2.28); or

(c) forward-looking (paragraphs 2.29–2.32).

2.23 Acquired businesses are often integrated soon after acquisition. Integration can make it hard to isolate the acquisition's subsequent performance and to collect useful information about the acquisition in isolation.

2.24 The Board assumes that even when an acquired business has been integrated, the acquirer's management understands how the acquisition is performing, at least in the early period. Some acquisition agreements contain clauses that legally oblige companies to measure the subsequent performance of an acquired business—for example, earn-out clauses. In that case, companies would find a way to meet these reporting obligations even if they have to make some assumptions about the performance of the acquired business.

2.25 The Board's preliminary view would require companies to disclose information management uses to monitor the subsequent performance of an acquisition. If management plans to integrate an acquired business, it is possible that management plans to monitor the subsequent performance of the acquisition using information about the combined business. Companies would be required to disclose this combined information because management is using this combined information to understand how the acquisition is performing.

2.26 Depending on the relative sizes of the acquired business and the business into which it is integrated, management may receive some commentary explaining what the information about the combined business signals about the performance of the acquisition. This commentary would be provided so that management can understand whether the objectives set for the acquisition are being met. Companies would also be required to disclose this commentary if investors need it to understand whether those objectives are being met, because it is part of the information management is using to monitor the performance of the acquisition.

2.27 Some stakeholders, mainly preparers, have expressed concerns that detailed disclosure of a company's post-acquisition intentions together with precise targets could be commercially sensitive. However, some investors suggest that the information they need to understand management's objectives and to hold management to account against those objectives may not need to be as detailed and precise as other stakeholders initially thought. Thus, companies

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may be able to provide useful information in a way that limits the disclosure of commercially sensitive information.

2.28 Nevertheless, if concerns over commercial sensitivity remained, in the Board's view, this is not a sufficient reason to prevent disclosure of information that investors need.

2.29 Some stakeholders have expressed concerns that information about management's objectives for an acquisition along with detailed targets could, in some jurisdictions, be considered to be forward-looking information that could risk litigation. These stakeholders said the information should be provided outside the financial statements—for example, in management commentary—to reduce the risk of litigation.

2.30 In the Board's view, information about the strategic rationale, objectives and related targets for an acquisition is not forward-looking information. The information reflects management's target at the time of the acquisition. It is not a forecast of the expected outcome at the time the company prepares its financial statements.

2.31 Management uses the metrics to monitor how actual performance in subsequent years compares with that historical view, to assess to what extent the original acquisition objective has been met. However, for a full understanding of whether the objective is being met, management and investors are likely to need further information about whether the original objective is still expected to be met. The Board expects companies can provide this information in a way that does not constitute forward-looking information—for example, by providing a qualitative statement.

2.32 Moreover, not all companies produce a management commentary and not all management commentaries may be available to investors on the same terms as the financial statements. The Board takes the view that all companies should provide this information on the same terms. Therefore, the Board's preliminary view is that companies should be required to disclose information about the strategic rationale, objectives and related targets in the financial statements.

Should companies be required to provide this information for all material acquisitions?

2.33 Some stakeholders have expressed concerns about providing information about subsequent performance for all material acquisitions. They fear that the volume of disclosures could be onerous, particularly for companies that make many acquisitions. They suggested that this information should be provided only for 'major' or 'fundamental' acquisitions. These acquisitions could perhaps be defined using thresholds similar to those set by jurisdictions that require additional disclosures for acquisitions above a specified threshold.

2.34 Other stakeholders did not agree with introducing what is effectively another level of materiality, because materiality already requires judgement.

2.35 Some investors have also said that the information about the subsequent performance of acquisitions is needed only for 'major' or 'fundamental' acquisitions. Hence, it is possible that only information about the subsequent performance of these acquisitions is material.

2.36 The Board's preliminary view discussed in paragraphs 2.8–2.32 is that it should require disclosures about management's objectives for an acquisition and its subsequent performance using the metrics that management uses to monitor an acquisition's performance and subsequent progress against those metrics. The Board's preliminary view is that this information should be required only for those acquisitions monitored by a company's chief operating decision maker (CODM), as described in IFRS 8.[11] The information provided for those acquisitions would be the objectives the CODM has set for the acquisition and the information the CODM uses to monitor whether those objectives are being met.

2.37 The role of the CODM is to allocate resources to operating segments and assess their performance. In the Board's view, the role is likely to include monitoring the performance of acquisitions. This is because the performance of the operating segments, which the CODM would monitor, would include the performance of the acquisition, and deciding to acquire a business would involve allocating resources to those operating segments that include the acquisition.

2.38 Requiring disclosure about subsequent performance only for those acquisitions monitored by the CODM would have the following advantages:

(a) this approach is a logical extension of the management approach discussed in paragraphs 2.13–2.32, which bases the information provided on what the CODM uses to monitor an acquisition.

(b) basing the information on what the CODM uses to monitor an acquisition may help minimise the costs of preparing the information, focusing on the most important information about the most important acquisitions.

(c) stakeholders will be familiar with this approach from applying IFRS 8.

(d) the Board would not need to provide guidance on what is meant by 'management' and 'monitors'. 'Monitors' would mean the same as the role the CODM plays in assessing performance described in IFRS 8, based on the information the CODM reviews for this purpose.

2.39 However, there may be drawbacks to requiring these disclosures only for those acquisitions monitored by the CODM. Investors may not receive material information on acquisitions if those acquisitions are not monitored by the CODM.

11 Paragraph 7 of IFRS 8 discusses the meaning of the term 'chief operating decision maker'.

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2.40 Nevertheless, the Board's preliminary view is that this approach strikes a reasonable balance between meeting the needs of investors and making it feasible for companies to produce the information at a cost that is justified by the benefits to investors. Feedback on this Discussion Paper from stakeholders will help the Board assess whether this approach would result in investors receiving all the material information they need and whether concerns about the volume of disclosures are justified.

For how long should companies be required to provide this information?

2.41 Stakeholders told the Board that the information about subsequent performance discussed in paragraphs 2.8–2.32 becomes less relevant after a short period. The acquired business eventually becomes indistinguishable from the rest of the acquiring company's business when integration occurs.

2.42 Despite this, the Board expects management to be aware of how well an acquisition is performing in the first few years after acquisition, even if an acquired business is integrated. The Board also expects that if an acquisition does not subsequently meet management's objectives, management is still likely to identify this fact in the first few years. If management is not monitoring the acquisition in this early period, the Board suggests that a company should be required to disclose that fact and the reasons why it did not monitor the acquisition.

2.43 On the other hand, in some cases, management may not expect an objective of an acquisition to be met for several years. In these cases, information about the subsequent performance of the acquisition would still be useful for several years for both management and investors to help them understand the extent to which an acquisition is meeting its objectives.

2.44 The Board's preliminary view is that, if management (CODM) continues to monitor whether the objectives of the acquisition are being met, a company should be required to provide information about the acquisition's subsequent performance for as long as the information remains necessary for investors to assess whether the original objectives of an acquisition are being met. If management stops monitoring the acquisition 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 stopped monitoring the acquisition.

The Board's preliminary view

2.45 The Board's preliminary view is that it should develop proposals to:

(a) amend paragraph B64(d) of IFRS 3, replacing the requirement to disclose the primary reasons for an acquisition with a requirement for a company to disclose:

(i) the strategic rationale for undertaking an acquisition; and

(ii) management's (CODM's) objectives for the acquisition.

(b) add a requirement for companies to disclose:

   (i) in the year in which an acquisition occurs, the metrics that management (CODM) will use to monitor whether the objectives of the acquisition are being met;

   (ii) the extent to which management's (CODM's) objectives for the acquisition are being met using those metrics, for as long as management (CODM) monitors the acquisition against its objectives;

   (iii) if management (CODM) does not monitor whether its objectives for the acquisition are being met, that fact and the reasons why it does not do so;

   (iv) if management (CODM) stops monitoring whether its objectives for the acquisition are being met before the end of the second full year after the year of acquisition, that fact and the reasons why it has done so; and

   (v) if management (CODM) changes the metrics it uses to monitor whether management's (CODM's) objectives for the acquisition are being met, the new metrics and the reasons for the change.

Other targeted improvements

What is the issue?

2.46 Some investors said companies applying IFRS 3 do not disclose enough information for investors to understand fully how acquisitions affected companies in the year of acquisition.[12] In particular, these investors said that:

(a) a qualitative description of the factors that make up the acquired goodwill is often generic and not useful.

(b) in assessing the return on total capital employed in an acquisition it is sometimes difficult to determine the amount of debt and pension liabilities acquired as part of the acquired business. For these investors, this information is needed to calculate the total capital employed because they view these liabilities as part of the total capital employed in the transaction by the acquirer.

(c) they need information on the operating performance of the acquisition —specifically, the revenue and operating profit of the acquired business in prior periods.

2.47 Investors want to understand the benefits a company had expected when it acquired a business to enable them to assess whether the price the company paid for the acquired business was reasonable.

12 Academic research shows that the information provided to fulfil IFRS 3 and IAS 36 *Impairment of Assets* disclosure requirements varies in quality and completeness across entities, industries and countries. See I. Tsalavoutas, P. André and D. Dionysiou, 'Worldwide Application of IFRS 3, IAS 38 and IAS 36, Related Disclosures, and Determinants of Non-Compliance', *ACCA Research Report 134*, 2014, https://ssrn.com/abstract=2603572, (accessed 4 February 2020).

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2.48 Preparers generally expressed the view that the disclosure requirements in IFRS 3 are excessive. They also commented on the requirement to disclose revenue and profit or loss of the combined entity for the current period as though the acquisition had occurred at the beginning of the reporting period. They said satisfying this requirement is difficult because the information for the period prior to the acquisition is not always readily available. This could be because, for example, adjustments are needed to align the historic financial information of the acquired business with the acquirer's accounting policies.

Current requirements

2.49 The disclosure objectives of IFRS 3 set out in paragraphs 59 and 61 of the Standard are as follows:

> **59 The acquirer shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of a business combination that occurs either:**
>
> **(a) during the current reporting period; or**
>
> **(b) after the end of the reporting period but before the financial statements are authorised for issue.**
>
> ...
>
> **61 The acquirer shall disclose information that enables users of its financial statements to evaluate the financial effects of adjustments recognised in the current reporting period that relate to business combinations that occurred in the period or previous reporting periods.**

2.50 Furthermore, paragraph 63 of IFRS 3 states:

> 63 If the specific disclosures required by this and other IFRSs do not meet the objectives set out in paragraphs 59 and 61, the acquirer shall disclose whatever additional information is necessary to meet those objectives.

2.51 IFRS 3 contains disclosure requirements in paragraphs B64–B67 of the Standard. This section of this Discussion Paper focuses on the following requirements:

> B64 To meet the objective in paragraph 59, the acquirer shall disclose the following information for each business combination that occurs during the reporting period:
>
> ...
>
> (e) 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, intangible assets that do not qualify for separate recognition or other factors.
>
> ...

(i) the amounts recognised as of the acquisition date for each major class of assets acquired and liabilities assumed.

...

(q) the following information:

(i) the amounts of revenue and profit or loss of the acquiree since the acquisition date included in the consolidated statement of comprehensive income for the reporting period; and

(ii) the revenue and profit or loss of the combined entity for the current reporting period as though the acquisition date for all business combinations that occurred during the year had been as of the beginning of the annual reporting period.

If disclosure of any of the information required by this subparagraph is impracticable, the acquirer shall disclose that fact and explain why the disclosure is impracticable. This IFRS uses the term 'impracticable' with the same meaning as in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

How did the Board reach its preliminary view?

2.52 The Board considered making targeted improvements to the disclosure objectives and disclosure requirements of IFRS 3 in the following areas:

(a) more specific disclosure objectives (paragraphs 2.53–2.60);

(b) factors that make up goodwill (paragraphs 2.62–2.68);

(c) financing and defined benefit pension liabilities (paragraphs 2.69–2.71);

(d) contribution of the acquired business (paragraphs 2.72–2.87); and

(e) other aspects of disclosure (paragraphs 2.88–2.89).

More specific disclosure objectives

2.53 Feedback from stakeholders suggests that companies often use the current disclosure requirements of IFRS 3 mechanically as a checklist. The resulting disclosures can be 'boilerplate' and can provide insufficient information for investors, even though the information required is extensive.

2.54 The Board considered whether the generic nature of the disclosure objectives in IFRS 3 (see paragraph 2.49) could be the reason for this feedback.

2.55 The Board's preliminary view is that setting more specific disclosure objectives would clarify why investors need particular information. This could help companies to provide information that is more useful to investors. This would also be consistent with guidance the Board is developing in its Targeted Standards-level Review of Disclosures project.[13]

13 See https://www.ifrs.org/projects/work-plan/standards-level-review-of-disclosures/.

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2.56 Although the Board did not perform a comprehensive review of the disclosure objectives of IFRS 3, it considered amending the disclosure objectives of IFRS 3 to explain the main reasons why investors need the information that companies are required to disclose.

2.57 In the Board's view, investors need information so they can understand why a company acquired a business, and what assets, synergies and other benefits it paid for. They use this information to assess whether the price for the acquired business is reasonable.

2.58 As discussed in paragraphs 2.4–2.45, investors also want to understand whether management's objectives for an acquisition are being met. They use this information to assess management's ability to realise the expected benefits from an acquisition. Investors also want to assess whether an acquisition's subsequent performance indicates that management has paid a reasonable price for the acquired business. This information would allow investors to assess performance and more effectively hold management to account for its decision to acquire the business.

2.59 The Board's preliminary view is that it should develop a proposal to add further disclosure objectives that require companies to provide information to help investors to understand:

(a) the benefits that a company's management expected from an acquisition when agreeing the price to acquire a business; and

(b) the extent to which management's (CODM's) objectives for a business combination are being met.

2.60 Table 2.1 shows how the possible new disclosure requirements discussed in this section would meet these new disclosure objectives.

Table 2.1 How would the new disclosure requirements meet the new disclosure objectives?

Disclosure requirement	Paragraph	Helps to meet disclosure objective	
		Benefits from acquisition (paragraph 2.59(a))	Subsequent performance (paragraph 2.59(b))
Strategic rationale	2.8–2.12	✓	
Management's (CODM's) objectives	2.8–2.12	✓	✱
Management's (CODM's) metrics	2.13–2.44	✓	✓
Are the objectives being met?	2.13–2.44		✓
Expected synergies	2.62–2.68	✓	
Financing and pension liabilities	2.69–2.71	✓	
Contribution of acquired business	2.72–2.87		✓

✱ The information from this disclosure requirement does not directly meet this disclosure objective but is necessary for the understanding of other information that would be disclosed to meet this disclosure objective.

2.61 The rest of this subsection discusses potential changes to the disclosure requirements of IFRS 3 in the light of the issues raised by stakeholders, with the aim of making the information provided by companies in the year of acquisition more useful to investors.

Factors that make up goodwill

2.62 Investors have said that the requirement for a company to provide a qualitative description of the factors that make up goodwill often results in companies providing a generic description that is not useful. Investors have said the information they want is not about goodwill itself, but information that gives them a better understanding of why a company paid the price it did for the acquired business.

2.63 IFRS 3 gives expected synergies as one example of the factors that might be disclosed by companies. Achieving synergies is often an important objective of an acquisition. Investors have said that information on the nature, timing and amount of expected synergies is important. It would allow them to understand better the benefits a company's management expected when agreeing the price to acquire a business. This information would help investors to assess whether the price paid was reasonable. The information would also help investors hold management to account for its progress in achieving those synergies.

2.64 The Board's preliminary view is that it should require a company to disclose in the year an acquisition occurs:

(a) a description of the synergies expected from combining the operations of the acquired business with the company's business;

(b) when the synergies are expected to be realised;

(c) the estimated amount or range of amounts of the synergies; and

(d) the estimated cost or range of costs to achieve those synergies.

2.65 When material synergies are expected in an acquisition that the CODM monitors, the proposed requirement to disclose the CODM's objectives for an acquisition is likely to result in some disclosure about synergies. The more specific disclosure requirement described in paragraph 2.64 would go further, requiring companies to provide the detailed information for all acquisitions with material expected synergies.

2.66 Stakeholders have told the Board that synergies are often difficult to quantify. However, the Board expects that management would have already made an estimate of expected synergies in agreeing the price for an acquired business. For example, when companies make acquisitions that require shareholders' approval, the information provided to shareholders requesting that approval often sets out synergies that management expects from the acquisition. A company would not be required to provide a single point estimate, but could provide a range.

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2.67 Stakeholders have also said that disclosures about expected synergies could be commercially sensitive. However, the Board does not intend to require companies to disclose detailed plans on how they intend to realise the synergies. Therefore, the Board expects the information it would require a company to disclose to have limited commercial sensitivity. The information on expected synergies could also be considered to be forward-looking in some jurisdictions. As discussed in paragraphs 2.29–2.32, the Board considers that the information would reflect management's targets at the time of the acquisition and would not be forward-looking information.

2.68 Stakeholders told the Board that it is not possible to quantify all the different factors that constitute goodwill, especially because goodwill cannot be measured directly and is measured as a residual. The Board would continue to require companies to provide a qualitative description of the other factors that make up the goodwill recognised. Companies would need to consider whether this qualitative description provides enough information for investors to understand the benefits that management considered when agreeing the price to acquire the business. A company would need to consider whether the information provided by all of its disclosures meets the new disclosure objective discussed in paragraph 2.59(a) and whether it helps investors to assess whether the acquisition price is reasonable.

Financing and defined benefit pension liabilities

2.69 IFRS 3 requires companies to disclose amounts recognised for each major class of assets acquired and of liabilities assumed.[14] In applying that requirement, some companies do not disclose financing and defined benefit pension liabilities separately. As explained in paragraph 2.46(b), some investors would like companies to disclose the amounts of those liabilities because they view them as part of the total capital employed in the transaction by the acquirer.

2.70 Other IFRS Standards require companies to disclose the amounts of liabilities arising from financing activities and defined benefit pension liabilities acquired as part of the acquired business.[15,16] However, those Standards do not require separate disclosure of the amounts for each acquisition.

2.71 The Board's preliminary view is that it should develop proposals to specify that liabilities arising from financing activities and defined benefit pension liabilities are major classes of liabilities. As a result, companies would need to disclose separately the amount of such liabilities acquired as part of the acquired business for each acquisition, if the information is material. That information would be useful for investors and is likely to be readily available to companies because these items are required to be recognised and measured at the date of the acquisition.

14 Paragraph B64(i) of IFRS 3.

15 Paragraph 44B of IAS 7 *Statement of Cash Flows*.

16 Paragraph 141(h) of IAS 19 *Employee Benefits*.

Contribution of the acquired business

2.72 IFRS 3 requires companies to disclose, to the extent practicable:

(a) the amounts of revenue and profit or loss of the acquired business since the acquisition date; and

(b) the revenue and profit or loss of the combined entity for the current reporting period as though the acquisition date had been at the beginning of the annual reporting period (sometimes called pro forma information).[17]

2.73 The information is intended to help investors:

(a) in the current period—to compare the company's financial performance with its performance in the previous period. To do this, investors need to know the effect of the acquired business after the acquisition date.

(b) in the next reporting period—to compare the company's financial performance, which will include the acquired business for a full year, with its financial performance in the current period. To do this, investors need information about the financial performance of the acquired business from the beginning of the current period to the acquisition date.

(c) estimate the future contribution of the acquired business to the future financial performance and future cash flows of the combined entity.

2.74 During and after the Post-implementation Review of IFRS 3, other stakeholders commenting on pro forma information have said that:

(a) the information is not useful because it is hypothetical;

(b) there is a lack of guidance on how to prepare the information and therefore companies prepare the information in different ways; and

(c) information about the revenue and profit of the acquired business before the acquisition is not always readily available.

2.75 Some say it is costly to produce the pro forma information—for example, because there is a need to align accounting policies. However, others say it is simple to produce. This difference in views could reflect the diversity in how the information is prepared.

2.76 The Board investigated whether it could better define the information companies are required to provide and so improve the information provided to investors while making the information easier for companies to prepare. The Board also investigated whether companies could provide the information investors obtain from the pro forma information in a different way to resolve the issues stakeholders had raised.

17 Paragraph B64(q) of IFRS 3.

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2.77 The Board reached a preliminary view that it should:

(a) replace the term 'profit or loss' in paragraph B64(q) of IFRS 3 with the term 'operating profit before deducting acquisition-related costs and integration costs' (see paragraphs 2.78–2.80). Operating profit or loss would be defined as in the Exposure Draft *General Presentation and Disclosures*;

(b) add to paragraph B64(q) a requirement to disclose cash flows from operating activities (see paragraph 2.81); and

(c) after the revisions in (a) and (b), retain the requirement for the information to be disclosed for the combined entity as if the acquisition had occurred at the start of the reporting period (pro forma information) (see paragraphs 2.82–2.87).

2.78 The Board expects that a measure based on operating profit would:

(a) provide investors with information about the operating performance of the main business activities of the acquired business that is independent of how the acquired business is financed; and

(b) avoid the need for companies to make subjective allocations of finance costs and tax expenses if the acquired business has been integrated.

2.79 Although 'operating profit' is not currently defined in IFRS Standards, the Board proposed a definition of the term in its Exposure Draft *General Presentation and Disclosures* published in December 2019.

2.80 The Board's preliminary view is that the measure based on operating profit should refer to operating profit or loss before acquisition-related costs and integration costs incurred in the reporting period. Although acquisition-related costs are defined in paragraph 53 of IFRS 3, the Board has not yet discussed how to define integration costs. However, both types of cost directly relate to an acquisition that has already occurred, and once incurred those costs cannot recur for that acquisition. Thus, excluding them would provide a more suitable base for comparison with operating profit for future years.

2.81 The Board expects that the disclosure of cash flows from operating activities would help those investors who use cash flow measures in their analysis.

2.82 In reaching its preliminary view, the Board considered whether it could find better alternatives to such pro forma information. In many cases, investors could use the information about the revenue, operating profit and cash flows from operating activities of the acquired business since the date of acquisition to assess how much the business could have contributed to the combined business over a full year. For example, investors could prorate the information as a starting point in forming an estimate of the annual contribution of the acquired business to future financial performance and future cash flows.

2.83 However, when the acquired business is seasonal, the acquisition is completed close to the reporting date or there are material one-off items, these disclosures may not provide sufficient relevant information and a company may need to disclose additional information to meet the disclosure objective, for example:

(a) information about how seasonality affects the financial performance and cash flows of the acquired business;

(b) the unadjusted revenue, operating profit and cash flows from operating activities from the most recent annual financial statements of the acquired business; or

(c) the amounts of the material one-off items.

2.84 The Board considered whether to replace the requirement to disclose pro forma information with a requirement for companies to provide additional information, when necessary, to help investors assess how much the acquired business could have contributed to the combined business over a full year.

2.85 The advantages of the approach described in paragraphs 2.82–2.84 are that it would:

(a) eliminate the risk of investors misunderstanding the nature and significance of pro forma information;

(b) be based on actual rather than hypothetical information; and

(c) be simpler to prepare.

2.86 However, the Board is unconvinced that the additional information described in paragraphs 2.83–2.84 would be sufficient to help investors assess the potential full-year contribution of the acquired business. Investors continue to say that the pro forma information is important to them even with its limitations. Therefore, the Board's preliminary view is that it should retain the requirement to disclose pro forma information.

2.87 The Board could provide specific guidance for companies about how to prepare the pro forma information required by IFRS 3, or the Board could require companies to disclose how they have prepared the pro forma information. The Board will consider these possibilities once it has reviewed the feedback on this Discussion Paper and has understood better the information investors need and how best to provide that information.

Other aspects of disclosure

2.88 In considering how to improve the disclosure requirements of IFRS 3, the Board has not reviewed all of the requirements. Preparers have told the Board that those requirements are excessive. As a next step in this project, the Board intends to investigate whether it could remove any of the disclosure requirements from IFRS 3 without depriving investors of material information.

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2.89 The Board may also consider whether to add or amend disclosure requirements if it develops further the preliminary views set out in other sections of this Discussion Paper.

The Board's preliminary view

2.90 The Board's preliminary view is that it should develop proposals to add disclosure objectives to IFRS 3 that require companies to provide information to help investors to understand:

(a) the benefits that a company's management expected from an acquisition when agreeing the price to acquire the business; and

(b) the extent to which management's (CODM's) objectives for an acquisition are being met.

2.91 The Board's preliminary view is that it should develop proposals to make targeted improvements to the disclosure requirements of IFRS 3:

(a) to amend paragraph B64(e) of IFRS 3 to require a company to disclose:

(i) a description of the synergies expected from combining the operations of the acquired business with the company's business;

(ii) when the synergies are expected to be realised;

(iii) the estimated amount or range of amounts of the synergies; and

(iv) the estimated cost or range of costs to achieve those synergies;

(b) to amend paragraph B64(i) of IFRS 3 to specify that liabilities arising from financing activities and defined benefit pension liabilities are major classes of liabilities;

(c) to replace the term 'profit or loss' in paragraph B64(q) of IFRS 3 with the term 'operating profit before deducting acquisition-related transaction and integration costs'. Operating profit or loss would be defined as in the Exposure Draft *General Presentation and Disclosures*; and

(d) to add to paragraph B64(q) of IFRS 3 a requirement to disclose the cash flows from operating activities of the acquired business after the acquisition date, and of the combined entity on a pro forma basis for the current reporting period.

Questions for respondents

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.

(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?

(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).

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...continued

Question 2
(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?

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?

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?

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?

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Section 3—Goodwill impairment and amortisation

Section highlights

- Goodwill can be tested for impairment only indirectly.
- Preliminary view to retain impairment-only model—no compelling evidence that a change is needed.
- Both methods of accounting for goodwill—impairment-only and amortisation with impairment—have limitations. Which method would more effectively hold management to account?
- Do stakeholders have new information to help the Board?

3.1 This section discusses the Board's preliminary view that:

(a) it is not feasible to design a different impairment test for goodwill that is significantly more effective at recognising impairment losses on goodwill on a timely basis at a reasonable cost (paragraphs 3.2–3.54);

(b) the Board should not develop a proposal to reintroduce amortisation of goodwill—nevertheless the Board would welcome feedback from stakeholders that provides new practical or conceptual arguments, together with evidence for these arguments and suggestions identifying arguments which should be given more weight and why (paragraphs 3.55–3.94); and

(c) the Board should develop a proposal to require companies to present on their balance sheets the amount of total equity excluding goodwill (paragraphs 3.107–3.115).

Can the impairment test be made more effective?

What is the issue?

3.2 Many stakeholders have said that impairment losses on goodwill are sometimes recognised too late, long after the events that caused those losses.[18] They urged the Board to make the impairment test more effective at recognising impairment losses on goodwill on a timely basis.

3.3 Some stakeholders have said recognising impairment losses on goodwill provides useful information. Even if the impairment loss often lags market assessments of an acquisition's performance, recognising the impairment loss confirms investors' earlier assessments that those losses have occurred. In some cases, the impairment test reveals impairment losses that investors had not previously identified.

18 This view is supported by some academic research. See for example H. Amiraslani, G. Iatridis and P. Pope, 'Accounting for Asset Impairment: A Test for IFRS Compliance Across Europe: A Research Report by the Centre for Financial Analysis and Reporting Research', 2013, https://www.cass.city.ac.uk/__data/assets/pdf_file/0019/160075/CeFARR-Impairment-Research-Report.pdf, (accessed 4 February 2020).

3.4 Stakeholders have said the fact that an impairment loss has been recognised is more useful information than the amount of the loss. This information helps investors assess management's stewardship of the company's resources and assess the company's future cash flows.

Current requirements

3.5 Applying IAS 36 *Impairment of Assets*, companies are required to test cash-generating units containing goodwill for impairment at least annually, even if there is no indication that the cash-generating units may be impaired.

3.6 The Board introduced the requirement for an annual impairment test in 2004 when it issued IFRS 3 *Business Combinations*. Previously, IAS 22 *Business Combinations* had required companies to amortise goodwill over its useful life, presumed not to exceed 20 years, although companies could rebut that presumption. An impairment test was also required:

(a) when there was an indication that the goodwill may be impaired, if the useful life of the goodwill was 20 years or less; or

(b) annually, if the useful life of the goodwill was more than 20 years, even if there was no indication that the goodwill may be impaired.

3.7 When the Board introduced new requirements in 2004, it concluded that:

(a) it is generally not possible to predict the useful life of goodwill and the pattern in which it diminishes. As a result, the amount of amortisation in any given period can be described as, at best, an arbitrary estimate of the consumption of goodwill during that period.

(b) straight-line amortisation of goodwill over an arbitrary period fails to provide useful information.

(c) it had devised a rigorous and operational impairment test. Thus, more useful information would be provided to investors by not amortising goodwill, but instead testing it for impairment at least annually.

3.8 Because goodwill does not generate cash flows independently, it is tested for impairment within the cash-generating units expected to benefit from the acquisition. The impairment test assesses whether the combined recoverable amount of the assets of those cash-generating units, including the goodwill, is higher than their combined carrying amount.

3.9 Companies allocate goodwill to groups of cash-generating units at the lowest level at which the goodwill is monitored for internal management purposes. These groups of cash-generating units shall not be larger than an operating segment, as defined by IFRS 8 *Operating Segments*.

3.10 If a group of cash-generating units contains goodwill and the recoverable amount of that group exceeds its carrying amount, neither the group of cash-generating units nor the goodwill allocated to that group is impaired, and no impairment loss is recognised.

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3.11 If the recoverable amount is lower than the carrying amount, the group of cash-generating units is impaired and a company recognises an impairment loss. This loss is allocated first to reduce the carrying amount of any goodwill allocated to the cash-generating units. Then, if the carrying amount of goodwill is zero, any remaining impairment loss reduces the carrying amounts of other assets of the cash-generating units in the scope of IAS 36. The impairment test therefore tests goodwill only indirectly.

What is the purpose of the impairment test?

3.12 Some stakeholders say that the impairment test is 'broken', is 'not working properly' or has 'failed'. In the Board's view, some of these views may arise, at least partly, from unrealistic expectations of what the impairment test can do or of what any feasible impairment test for goodwill could reasonably be expected to do.

3.13 The objective of the impairment test in IAS 36 is to ensure that a company's assets are carried at no more than their recoverable amounts.

3.14 Goodwill does not generate cash flows independently. Thus, the impairment test focuses on the cash-generating unit, rather than the individual asset—the appropriate approach when an asset does not generate largely independent cash inflows but jointly contributes to the generation of future cash flows with other assets. This focus on the cash-generating unit is consistent with the Board's conclusion in developing IFRS 3 that goodwill is measured as a residual because it cannot be measured directly.[19]

3.15 The impairment test compares the carrying amount of cash-generating units containing goodwill with the recoverable amount of those cash-generating units. The recoverable amount is based on estimates of the cash flows that the goodwill jointly contributes to generating, together with the other assets of the cash-generating units.

3.16 Goodwill often contributes to cash flows in combination with several groups of assets and is therefore often allocated to groups of cash-generating units. A company allocates acquired goodwill to the cash-generating units it expects to benefit from the acquisition and that represent the lowest level within the company at which the goodwill is monitored for internal management purposes.

3.17 Allocating goodwill to cash-generating units in this way prevents an allocation of goodwill to a lower level that could only be done arbitrarily. It also aligns the goodwill testing to how a company's management monitors its operations. An arbitrary allocation would limit the value of the information provided to investors by the impairment test.

19 Paragraph BC328 of the Basis for Conclusions on IFRS 3.

3.18 As noted in paragraph 3.11, if an impairment loss is recognised, it is allocated to goodwill and the other assets within the cash-generating units. Goodwill is therefore not tested directly—the unit of account for the impairment test is the cash-generating unit, not the goodwill.[20]

3.19 Even though the purpose of the impairment test is to test the recoverability of the combined carrying amount of the assets within the cash-generating units —rather than test the recoverability of the acquired goodwill directly— stakeholders expressed concerns that impairment losses are not recognised on a timely basis. Hence, the Board considered whether it could change the test to make it more effective at recognising impairment losses on goodwill on a timely basis.

How did the Board reach its preliminary view?

3.20 The Board identified two broad reasons for concerns about the possible delay in recognising impairment losses on goodwill:

(a) management over-optimism—some stakeholders have concerns that management may sometimes be too optimistic in making the assumptions needed to carry out the impairment test (see paragraphs 3.22–3.30).

(b) shielding—a cash-generating unit, or group of cash-generating units, containing goodwill, typically contains headroom. The headroom shields acquired goodwill against the recognition of impairment losses (see paragraphs 3.31–3.52).

3.21 It may also be that some stakeholders believe the impairment test directly tests goodwill, or that it should test goodwill directly. Testing goodwill directly would require the recoverable amount of goodwill to be measured directly, but as discussed in paragraph 3.14, the Board concluded that goodwill cannot be measured directly. Paragraphs 3.12–3.19 discuss the purpose of the test, which is a test of cash-generating units containing goodwill, and thus is an indirect test of goodwill.

Management over-optimism

3.22 Estimates of the recoverable amount of a cash-generating unit depend inevitably on subjective assumptions and judgements and therefore inevitably result in measurement uncertainty. The recoverable amount, as defined by IAS 36, is the higher of value in use and fair value less costs of disposal. Estimates of both value in use and fair value less costs of disposal will be subject to measurement uncertainty.

20 In rejecting a proposal relating to the impairment testing of individual assets in a cash-generating unit, paragraph B101 of the Basis for Conclusions on IAS 36 (1998) explains why the Board's predecessor, the International Accounting Standards Committee, concluded that an impairment loss should be considered for a cash-generating unit as a whole and, consequently, individual assets within a cash-generating unit should not be considered separately. The 'headroom approach' discussed in paragraphs 3.31–3.52 would have amended this conclusion.

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3.23 Management may have incentives to make optimistic assumptions and judgements. Academic research suggests that some managers use their discretion in recognising impairment in ways that are potentially favourable to themselves.[21]

3.24 Regulators often raise the use of appropriate assumptions and methodology in impairment testing as an enforcement focus area or as a source of audit quality issues. Regulators say impairment testing is a difficult area to enforce.

3.25 In March 2019, the Australian Accounting Standards Board published Research Report 9 *Perspectives on IAS 36: A case for standard setting activity*. The Research Report includes a summary of enforcement focus areas and audit quality issues from a selection of international regulators. Section 6 of this Discussion Paper contains a summary of this Research Report.

3.26 IAS 36 already contains several requirements to reduce the risk that cash flow forecasts used by management could be too optimistic. IAS 36 requires companies to use reasonable and supportable assumptions that represent management's best estimate of the range of economic conditions that will exist over the remaining useful life of the asset, with greater weight given to external evidence. The assumptions are required to be based on the most recent financial budgets or forecasts approved by management (paragraphs 33(a) and 33(b) of IAS 36). Paragraph 38 of IAS 36 requires companies to consider whether the information from financial budgets or forecasts reflects reasonable and supportable assumptions and represents management's best estimate of the set of economic conditions that will exist over the remaining useful life of the asset.

3.27 Paragraph 34 of IAS 36 requires management to assess the reasonableness of those assumptions by examining the causes of differences between past cash flow projections and actual cash flows.

3.28 Paragraph BCZ20 of the Basis for Conclusions on IAS 36 explains that the Board's predecessor, the International Accounting Standards Committee (IASC), considered that these requirements were sufficient to prevent a company from using assumptions that were different from the market without justification.

3.29 The risk of over-optimism cannot be avoided, given the nature of the estimates required. If estimates of cash flows are sometimes too optimistic in practice, the Board considers that this is best addressed by auditors and regulators, not by changing IFRS Standards. Academic research suggests that the recognition of goodwill impairment losses tends to be more timely for companies in countries with high levels of enforcement, supporting the view that enforcement can play an important role.[22]

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21 See the Report and Feedback Statement *Post-implementation Review of IFRS 3 Business Combinations* for more details. See https://cdn.ifrs.org/-/media/project/pir-ifrs-3/published-documents/pir-ifrs-3-report-feedback-statement.pdf.

22 See for example M. Glaum, W.R. Landsman and S. Wyrwa, 'Goodwill Impairment: The Effects of Public Enforcement and Monitoring by Institutional Investors', *The Accounting Review*, vol. 93, no. 6, 2018, pp. 149–180, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3092658, (accessed 4 February 2020).

3.30 Paragraphs 2.4–2.45 discuss possible requirements for companies to disclose management's objectives for an acquisition and then to disclose information to enable investors to understand whether those objectives are being met. These disclosures could help auditors and regulators by providing them with information that could indicate an impairment may have occurred.

Shielding

3.31 As discussed in paragraphs 3.12–3.19 goodwill is tested for impairment as part of the cash-generating unit or the group of cash-generating units to which the goodwill has been allocated. Therefore, headroom of a cash-generating unit can shield acquired goodwill against impairment. The headroom of a cash-generating unit is the amount by which its recoverable amount exceeds the carrying amount of its recognised net assets—including goodwill.

3.32 The following paragraphs discuss:

(a) how headroom arises and how it can shield goodwill from impairment (paragraphs 3.33–3.37);

(b) an approach (the 'headroom approach') the Board investigated to assess whether it could reduce the shielding effect (paragraphs 3.38–3.42);

(c) how the impairment calculated by the 'headroom approach' could be allocated to acquired goodwill (paragraphs 3.43–3.46);

(d) the costs associated with the 'headroom approach' (paragraphs 3.47–3.48); and

(e) the Board's conclusions on the 'headroom approach' and whether the impairment test could be made significantly more effective at recognising impairment losses on goodwill on a timely basis at a reasonable cost (paragraphs 3.49–3.52).

3.33 Headroom is made up of items not recognised on the balance sheet: internally generated goodwill, unrecognised assets, and unrecognised differences between the carrying amount of recognised assets and liabilities and their recoverable amounts. Headroom can arise from:

(a) items that are already present in a business at the date it acquires another business if goodwill is allocated to the combined business.

(b) items generated after the acquisition. Moreover, if the acquired business has been combined with the acquirer's business for impairment testing, headroom could be generated by the acquired business, the acquirer's business or both.

3.34 In the discussion that follows, the term 'total goodwill' is used for the total of the amount of unrecognised headroom and the carrying amount of recognised acquired goodwill.

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3.35 Shielding arises because, applying current requirements, all reductions in total goodwill are allocated first to the unrecognised headroom. An impairment loss is recognised only when the recoverable amount of the cash-generating unit falls below the carrying amount of the recognised assets and liabilities of the cash-generating unit. This means that a company recognises an impairment loss on acquired goodwill only once that headroom is reduced to zero.

3.36 An acquisition could therefore underperform against management's expectations, but the company would recognise no impairment of acquired goodwill if it has sufficient headroom to absorb the reduction in value. Shielding of the acquired goodwill with, for example, headroom that was in the acquirer's business before the acquisition and that is therefore unrelated to the acquired business, could be why some stakeholders say that impairment losses on acquired goodwill are not recognised on a timely basis.

3.37 Recognising impairment losses on acquired goodwill on a more timely basis could resolve the concerns of stakeholders who want the impairment test to:

(a) provide a timely signal about whether the performance of an acquisition is meeting expectations, improving the information provided by the impairment test.

(b) reduce carrying amounts of acquired goodwill when those carrying amounts are consumed or are no longer expected to provide future benefits. In their view the impairment test in IAS 36 fails to do this.

3.38 The Board investigated whether it could incorporate the estimate of headroom into the design of the impairment test, and by doing so:

(a) reduce the shielding effect;

(b) target the acquired goodwill more effectively; and

(c) require companies to recognise impairment losses on acquired goodwill on a more timely basis.

3.39 The approach the Board investigated (the 'headroom approach') attempted to allocate at least some of the reduction in the value of cash-generating units containing goodwill to the acquired goodwill, rather than allocating it all first to the unrecognised headroom in the impairment test in IAS 36.

3.40 The 'headroom approach' would compare:

(a) the recoverable amount of the cash-generating units; with

(b) the sum of:

(i) the carrying amount of the recognised assets and liabilities of the cash-generating units; and

(ii) the headroom of the cash-generating units at the previous impairment testing date.[23]

23 For the first impairment test after the acquisition, this would be the headroom, at the acquisition date, of the cash-generating unit(s) to which the goodwill has been allocated.

If (b) is greater than (a), then impairment has occurred. This calculation is illustrated by a simple example in Table 3.1.

Table 3.1—'Headroom approach' to impairment testing

	31 December 20X1	31 December 20X0
	CU	CU
Carrying amount		
– acquired goodwill (AG)	100	100
– other recognised assets less liabilities	510	525
Carrying amount of recognised assets and liabilities (CA)	610	625
Recoverable amount (RA)	695	730
Unrecognised headroom (RA – CA)	85	105
Total goodwill (RA - CA) + AG	185	205

The company is performing its annual impairment test for cash-generating units containing goodwill at 31 December 20X1.

'Headroom approach'

Applying the 'headroom approach' in paragraph 3.40, the company compares:

(a) the recoverable amount of the cash-generating units CU695; with

(b) the sum of:

(i) the carrying amount of the recognised assets and liabilities of the cash-generating units CU610; and

(ii) the headroom of the cash-generating units at the previous impairment testing date CU105 (CU730 – CU625).

An impairment of CU20 has occurred: CU695 - (CU610 + CU105).

This impairment reflects a reduction in the total goodwill from CU205 in 20X0 to CU185 in 20X1. How much of this reduction is allocated to the acquired goodwill and recognised as an impairment loss would still need to be determined. See paragraphs 3.43–3.46 for discussion on this topic.

Impairment test in IAS 36

Under the test in IAS 36 no impairment loss would be recognised at 31 December 20X1 because the recoverable amount (CU695) is greater than the carrying amount of recognised assets and liabilities (CU610).

3.41 Figure 3.1 (after paragraph 3.45) shows how acquired goodwill can be shielded from impairment by headroom and how the 'headroom approach' could remove that shielding effect, using another example. Under the impairment model in IAS 36 the headroom absorbs the reduction in the recoverable amount. In this simple example, that reduction arises solely because the performance of the acquisition is not meeting expectations. The 'headroom

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approach' calculates a reduction in total goodwill. The amount to be recognised as an impairment loss still needs to be determined by allocating the reduction in total goodwill between acquired goodwill and the unrecognised headroom (see paragraphs 3.43–3.46).

3.42 As explained in paragraph 3.35, if the total goodwill has reduced since the previous testing date, the impairment test in IAS 36 allocates that reduction first to the unrecognised headroom. Hence an impairment loss is not recognised until the headroom has been reduced to zero. The 'headroom approach' seeks to attribute at least some of that reduction to the acquired goodwill, when appropriate. This approach would reduce but not necessarily eliminate the shielding caused by headroom.

3.43 The 'headroom approach' would not identify whether the cause of any reduction in total goodwill was a reduction in the value of the acquired goodwill or a reduction in a component of the unrecognised headroom. Thus, if the Board were to adopt this approach it would need to specify how companies would allocate this reduction in total goodwill. The Board considered the following methods:

(a) allocating the reduction pro rata to both the acquired goodwill and the unrecognised headroom;

(b) always allocating the reduction first to the acquired goodwill, whereas in the impairment test in IAS 36 the reduction is always allocated to the unrecognised headroom first; or

(c) presuming the reduction is attributable to the acquired goodwill unless the company rebuts that presumption with specific evidence that all or part of the reduction is not attributable to the acquired goodwill.

3.44 A pro rata allocation would be consistent with the view that all goodwill within a cash-generating unit is a single unit of account and that goodwill cannot be measured independently. Under that view, any distinction between acquired goodwill and goodwill subsequently generated internally does not portray any real economic phenomenon.

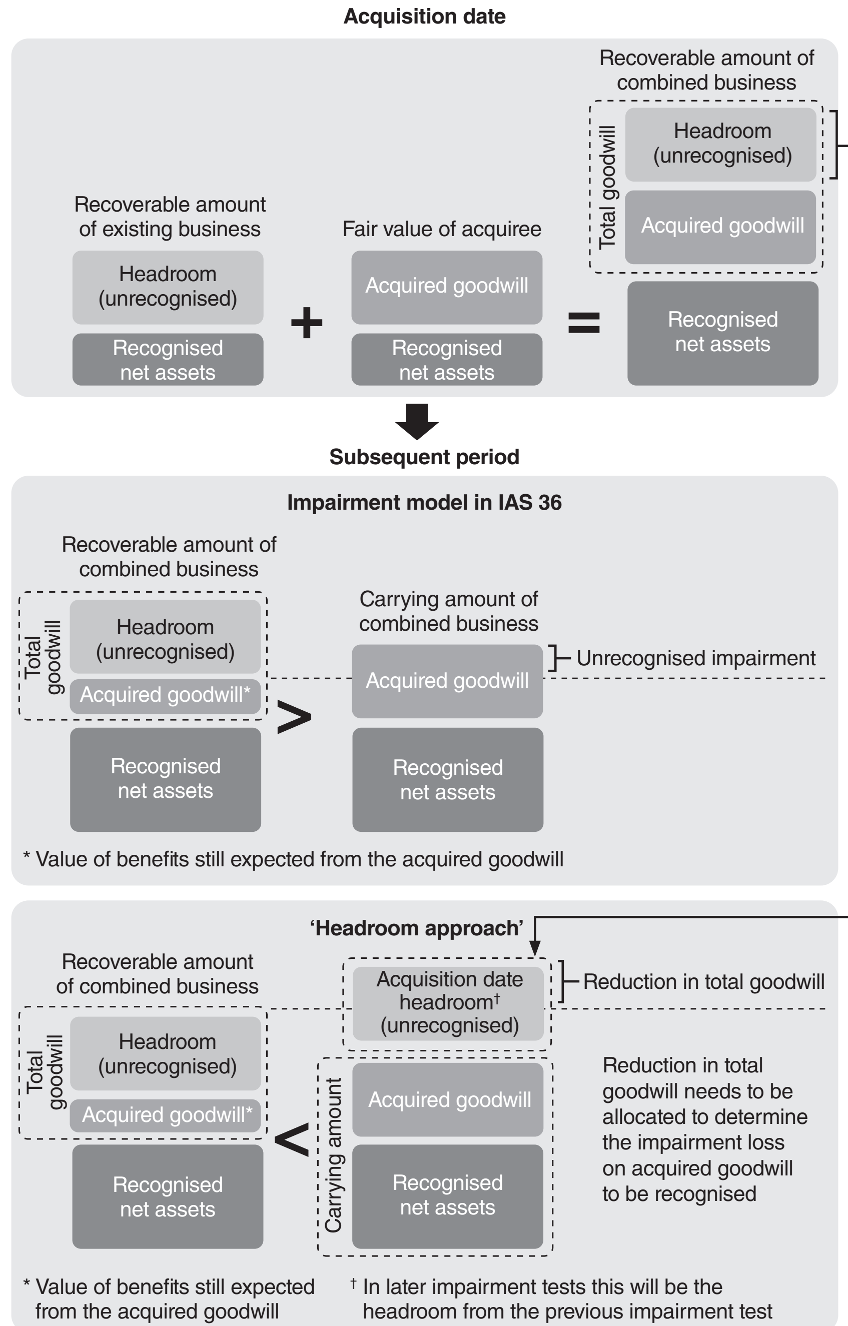
3.45 However, for those who view acquired and internally generated goodwill to be distinct, a pro rata allocation or an allocation of all the reduction to the acquired goodwill may sometimes produce a result that is inconsistent with the performance of an acquisition and therefore would not provide a faithful representation of that performance, for example:

(a) when a decrease in total goodwill is clearly caused by something not related to the acquired business, such as a decline in an unrecognised gain on land owned by the business before the acquisition; or

(b) if after total goodwill has increased for several years since the acquisition because of outperformance by the acquired business, total goodwill then reduces because the performance of the acquired business declines, but remains at or above the level expected at the time of the acquisition.

Figure 3.1 Illustration of shielding effect

In this simple example, it is assumed that both the recognised net assets and unrecognised headroom of the combined business remain unchanged after the acquisition. Thus, the only change in total goodwill is a reduction in the economic benefits originally expected from the acquired goodwill. In a more realistic example, the benefits from the acquired goodwill would probably not be measurable directly.



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3.46 An allocation based on a 'rebuttable presumption' could target the performance of an acquisition more precisely. However, such an allocation would probably introduce more subjectivity, cost and complexity, and would depend on identifying the reasons for the reduction, which may be possible only in simple situations.

3.47 The 'headroom approach' requires only one additional input to the impairment test: the amount of the headroom determined in the previous impairment test. Because IAS 36 requires a company to test for impairment each year, that input could be available from the previous year's test. Nevertheless, stakeholders have said this approach would add significant cost to performing the impairment test. Companies would incur additional costs because companies would be required to determine the recoverable amount more precisely than may have been needed at the date of that previous test. This could be the case if, for example:

(a) the previous test concluded that the recoverable amount was higher than the carrying amount but did not quantify precisely how much higher it was.

(b) the previous test estimated only value in use or only fair value less costs of disposal. Because that amount was higher than the carrying amount, the company did not need to estimate the other amount, which may be higher.

(c) a company restructures its cash-generating units or disposes of part of its cash-generating units, so that additional estimates of recoverable amount would be needed at that date.

3.48 Paragraphs 4.5–4.34 discuss possible relief from the requirement to perform an annual quantitative impairment test for cash-generating units containing goodwill. The 'headroom approach' could limit the benefit of that relief. Because the headroom from the previous impairment test would not shield goodwill from impairment, a company would conclude more frequently that an impairment loss may have occurred, thus requiring the company to perform the quantitative test.

3.49 The Board concluded that the 'headroom approach' would reduce shielding but not eliminate it, because:

(a) as discussed in paragraphs 3.43–3.46, the allocation of any reduction in total goodwill is imperfect; and

(b) if the acquired business is performing poorly, better performance from other elements of the combined business could still shield the acquired goodwill from impairment.

3.50 Moreover, the 'headroom approach' could result in recognising impairments that are, in some circumstances, difficult to understand (see paragraphs 3.45–3.46) and the approach would add cost.

3.51 Because goodwill does not generate cash flows independently and cannot be measured directly, it must be tested for impairment with other assets. The Board has concluded that it is not feasible to significantly improve the effectiveness of the impairment test for goodwill at a reasonable cost, and therefore some shielding is always likely to occur.

3.52 Estimates of cash flows will always be subject to management judgement but, if applied well, the test is expected to meet its objective of ensuring that the combined assets, including goodwill, are carried at no more than their combined recoverable amount. Although the impairment test cannot always provide a timely signal that the performance of an acquisition is not meeting management's expectations, the absence of such a signal does not mean the test has failed. Paragraphs 2.4–2.45 discuss possible disclosure requirements that would be intended to meet the need for timely information about the subsequent performance of acquisitions.

The Board's preliminary view

3.53 For the reasons summarised in paragraphs 3.49–3.52, the Board's preliminary view is that it is not feasible to design a different impairment test that is significantly more effective than the impairment test in IAS 36 at recognising impairment losses on goodwill on a timely basis at a reasonable cost.

3.54 Nevertheless, the Board would welcome any suggestions stakeholders have for making the impairment test more effective at recognising impairment losses on goodwill on a timely basis and in a cost-effective manner.

Should amortisation of goodwill be reintroduced?

What is the issue?

3.55 Having concluded that the approach in IAS 36 for testing goodwill for impairment cannot be significantly improved at a reasonable cost, the Board considered whether to develop a proposal to reintroduce amortisation of goodwill.[24] This is because amortisation could:

(a) take some pressure off the impairment test, which may make the impairment test easier and less costly to apply.

(b) provide a simple mechanism that targets the acquired goodwill directly. By reducing the carrying amount of acquired goodwill, amortisation might help resolve the concerns of those stakeholders who believe the carrying amount of goodwill can be overstated because of management over-optimism (see paragraph 3.20(a)) or because goodwill is not tested for impairment directly (see paragraph 3.18).

How did the Board reach its preliminary view?

3.56 In reaching its preliminary view, the Board considered the following arguments for reintroducing amortisation and for retaining the impairment-only model.

24 If the Board were to reintroduce amortisation, it would still be necessary to test whether goodwill is impaired.

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Arguments for reintroducing amortisation

3.57 Proponents of reintroducing amortisation generally give one or more of the following arguments:

(a) the Post-implementation Review (PIR) of IFRS 3 suggests that the impairment test is not working as the Board intended (paragraph 3.58);

(b) carrying amounts of goodwill are overstated and, as a result, a company's management is not held to account for its acquisition decisions (paragraphs 3.59–3.62);

(c) goodwill is a wasting asset with a finite useful life, and amortisation would reflect the consumption of goodwill (paragraphs 3.63–3.65); and

(d) amortisation would reduce the cost of accounting for goodwill (paragraphs 3.66–3.67).

3.58 The Board's decision in 2004 to implement an impairment-only model for goodwill was based on the conclusion that this approach would provide more useful information to investors than an amortisation and impairment approach, and that the impairment test would be rigorous and operational. Some stakeholders say the feedback from the PIR of IFRS 3, and the findings of the Board's research project, call those conclusions into question because:

(a) impairment losses are not recognised on a timely basis, in the view of those stakeholders. Thus, the impairment test may not be as rigorous as the Board initially expected it to be.

(b) although some stakeholders believe the impairment test provides useful information, its value is limited, often being only confirmatory and the information is provided too late to have predictive value.

(c) the impairment test is complex and costly to perform. Thus, the impairment test may not be as operational as the Board had expected it to be.

3.59 Some argue that because goodwill can only be tested for impairment as part of a cash-generating unit, the resulting shielding by headroom (explained in paragraphs 3.31–3.37) causes too high a risk that carrying amounts of acquired goodwill could be overstated. Others argue that the unique nature of goodwill requires the rigorous impairment test the Board envisaged in 2004. In their view, because the Board has concluded that it is not feasible to significantly improve the impairment test, amortisation is necessary to reduce goodwill carrying amounts.

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3.60 These views are somewhat supported by the fact that impairment losses are recognised relatively infrequently, despite evidence that a significant percentage of acquisitions fail.[25,26] Stakeholders with this view therefore argue the carrying amount of goodwill does not faithfully represent the future benefits still expected from the acquisition.

3.61 Not recognising an impairment loss when an acquisition fails to meet its objectives may mislead investors into thinking that the acquisition continues to be a success. Thus, some stakeholders take the view that the impairment test is not effective at holding management to account for the significant amounts of goodwill recognised in acquisitions. They argue that an amortisation expense in the income statement would hold management to account more effectively than an impairment test because amortisation would show that a company needs to generate profits to recover that expense.

3.62 A US study from 2013 found that the allocation of purchase price to goodwill was higher when management compensation relied more on earnings-based cash bonuses.[27] They concluded that non-amortisation of goodwill provides an incentive for managers to record higher amounts for goodwill, likely increasing post-acquisition earnings and bonuses. Some argue that amortisation would reduce incentives for this type of behaviour.

3.63 Some argue that acquired goodwill is a wasting asset with a finite useful life. They consider that, for example:

(a) competitive forces erode its ability to provide economic benefits over a finite period.

(b) its economic benefits have a finite useful life—for example, the acquired assembled workforce will leave or retire over time.

(c) the future costs that maintain a company's reputation and competitiveness would generate new goodwill internally rather than maintain the acquired goodwill. The acquired goodwill is continually consumed and replaced by internally generated goodwill.

3.64 If acquired goodwill is consumed, investors would find it useful for the company to inform them about that consumption by recognising an amortisation expense in the income statement in the same period as the company obtains the benefits from consuming the goodwill. Stakeholders with this view argue amortisation is necessary because:

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25 For example, according to Duff & Phelps, '2018 European Goodwill Impairment Study', February 2019, using data from companies in the STOXX® Europe 600 Index, the impairment losses recognised in 2017 represented 1% of the carrying amount of goodwill of all companies in the study. See https://www.duffandphelps.co.uk/insights/publications/goodwill-impairment/2018-european-goodwill-impairment-study, (accessed 4 February 2020).

26 For example, according to Deloitte, 'The State of the Deal, M&A Trends 2019', in a survey of 1,000 executives at US headquartered and private equity firms, about 40% of survey respondents say that half their deals failed to generate the value they expected at the onset of the transaction. See https://www2.deloitte.com/content/dam/Deloitte/us/Documents/mergers-acqisitions/us-mergers-acquisitions-trends-2019-report.pdf, (accessed 4 February 2020).

27 R. Shalev, I. Zhang, and Y. Zhang, 'CEO Compensation and Fair Value Accounting: Evidence from Purchase Price Allocation', *Journal of Accounting Research*, vol 51, no. 4, 2013, pp. 819–854, https://onlinelibrary.wiley.com/doi/abs/10.1111/1475-679X.12015, (accessed 4 February 2020).

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(a) it provides more useful information and would more effectively hold management to account because it would show that the acquisition is not successful if it does not generate economic benefits in excess of this cost.

(b) it prevents internally generated goodwill being recognised implicitly, replacing acquired goodwill that has been consumed. Preventing that is necessary because IFRS Standards prohibit the recognition of internally generated goodwill.

(c) an impairment-only model does not identify the consumption of goodwill separately and thus all reductions in the carrying amount of goodwill, including those caused by consumption of goodwill, are labelled as impairment losses.

3.65 Some stakeholders say it is possible to estimate the useful life of goodwill and the pattern in which it diminishes, and management's estimates of useful life can provide investors with useful information.

3.66 Amortisation could also help to reduce the cost of testing cash-generating units containing goodwill for impairment. Over time, as amortisation reduces the carrying amount of goodwill, the likelihood of a material impairment loss decreases until it becomes negligible. As a result, a company needs to devote less effort to the impairment test, because it becomes easier to conclude that no impairment has occurred.

3.67 Reintroducing amortisation would not remove the need for an impairment test. Thus, the test may still provide useful information about the acquisition, particularly in the earlier years of the acquisition. In later years, although amortisation would ultimately remove the goodwill from the balance sheet, its removal would not cause a loss of useful information. This is because it may occur at a time when any impairment loss recognised under the impairment-only model would provide little or no information about the performance of the acquisition because it is now indistinguishable from the rest of the business.

3.68 In summary, in the light of the arguments in this subsection, some consider that it would be appropriate to reintroduce amortisation because, in their view, the benefits of the impairment-only model are limited and do not justify its cost. Some consider that the impairment test is not rigorous and does not reduce the carrying amount of goodwill appropriately, and so amortisation is needed to avoid overstatement. Some also consider goodwill to be a wasting asset with a finite useful life and therefore view amortisation as necessary to depict the consumption of goodwill's economic benefits. They also suggest that the new disclosures on subsequent performance (discussed in paragraphs 2.4–2.45) would help investors understand better whether an acquisition has been a success. They consider that those disclosures would offset any limited loss of information caused by moving from the impairment-only model, allowing the Board to explore amortisation as a less costly model for the subsequent accounting for goodwill.

Arguments for retaining the impairment-only model

3.69 Proponents of retaining the impairment-only model generally give one or more of the following arguments:

(a) the impairment-only model provides more useful information than amortisation (paragraphs 3.70–3.74).

(b) if applied well, the impairment test achieves its purpose. The PIR of IFRS 3 and the Board's subsequent research have not found new evidence that the test is not sufficiently robust (paragraphs 3.75–3.80).

(c) acquired goodwill is not a wasting asset with a finite useful life, nor is it separable from goodwill subsequently generated internally (paragraphs 3.81–3.82).

(d) reintroducing amortisation would not save significant cost (paragraph 3.83).

3.70 Proponents of retaining the impairment-only model consider that the evidence continues to confirm the view the Board had when finalising IFRS 3: an amortisation expense provides investors with no useful information if determining the useful life of goodwill is arbitrary. Although the feedback from the PIR of IFRS 3 suggests that the benefit of the information provided to investors by the impairment-only model may be somewhat less than the Board had expected when developing IFRS 3, that model nevertheless provides some useful information.

3.71 Some investors have said the information provided by the impairment test is useful, even if it only has confirmatory value.[28] Moreover, an unexpected impairment loss may lead to a significant negative effect on a company's share price, which suggests an impairment loss at times provides new information.

3.72 Some would argue an amortisation expense is unlikely to provide information of similar value, especially if the useful life of goodwill cannot be determined objectively. It is possible that companies would behave in a way consistent with this view by adding back the amortisation expense in their management performance measures.[29]

3.73 Some also argue that amortisation of goodwill could make the information provided less useful. Amortisation could reduce the likelihood of an impairment loss being recognised because the reduction in carrying amount makes it less likely that the carrying amount would not be recoverable. In effect, amortisation could further shield acquired goodwill against impairment losses by mislabelling some or all impairment losses as

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28 Many academic studies conclude that impairment losses recognised in the financial statements are value-relevant for investors. See A. d'Arcy and A. Tarca, 'Reviewing IFRS Goodwill Accounting Research: Implementation Effects and Cross-Country Differences', *The International Journal of Accounting*, vol 53, no.3, 2018, pp. 203–226, https://www.sciencedirect.com/journal/the-international-journal-of-accounting/vol/53/issue/3, (accessed 4 February 2020).

29 Management performance measures are defined in the Exposure Draft *General Presentation and Disclosures*. See https://cdn.ifrs.org/-/media/project/primary-financial-statements/exposure-draft/ed-general-presentation-disclosures.pdf.

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consumption. Additionally, in subsequent periods, amortisation could obscure the amount originally paid and so make it more difficult to assess stewardship for those investors that do this by analysing returns on invested capital.

3.74 In 2014 the European Financial Reporting Advisory Group, Accounting Standards Board of Japan and Organismo Italiano di Contabilità published the discussion paper *Should goodwill still not be amortised? Accounting and disclosure for goodwill.* An investor group responding to that discussion paper commented that if goodwill were amortised, investors would add the amortisation expense back, whether the useful life was considered to be arbitrary or not, because the amortisation expense would not help their assessment of performance.

3.75 Some argue the impairment test is rigorous and operational, and that the PIR of IFRS 3 and the Board's subsequent research have not provided evidence that the impairment test is not working properly. They argue that if issues arise because of the application of the impairment test, this should be addressed through enforcement rather than through standard-setting. In their view, the impairment test is working as the Board intended when it designed the impairment test in 2004, because the Board was already aware of the shielding effect (see paragraphs 3.31–3.37).

3.76 The Board showed its awareness of shielding in 2002, in paragraph C38 of the Exposure Draft *Proposed Amendments to IAS 36*. The Board had considered whether to remove the headroom created when the acquired business is combined with a business that contained internally generated goodwill at the acquisition date. That headroom would have been removed by including it within the measure of the cash-generating unit's net assets.

3.77 The Board rejected that approach because it would not result in the impairment test capturing only decreases in the value of acquired goodwill. No impairment test can discern whether the pre-existing internally generated goodwill, rather than the acquired goodwill, has been impaired and replaced by goodwill generated after the acquisition.

3.78 Paragraph BC135 of the Basis for Conclusions on IAS 36 further explains the Board's conclusions that:

(a) it is not possible to measure separately goodwill generated internally after an acquisition;

(b) the carrying amount of goodwill will always be shielded from impairment by that internally generated goodwill; and

(c) therefore, the objective of the goodwill impairment test could at best be to ensure that the carrying amount of goodwill is recoverable from future cash flows expected to be generated by both acquired goodwill and goodwill generated internally after the acquisition.

3.79 The purpose of the test is discussed in paragraphs 3.12–3.19. If the test is performed well, it would be expected to meet its objective of ensuring that the carrying amount of acquired goodwill is recoverable from cash flows it is expected to generate jointly with other assets.

3.80 As discussed in paragraph 3.60, some consider that because goodwill is not tested for impairment directly, the carrying amount of goodwill does not faithfully represent the future benefits still expected from the acquisition. However, others consider that determining how much of the benefits originally expected still remains is not possible, and therefore determining by how much to reduce the carrying amount of goodwill is also not possible. An arbitrary reduction, through amortisation, of the carrying amount of goodwill would not provide a faithful representation of the originally expected benefits that remain.

3.81 Some also question whether goodwill is always a wasting asset with a finite useful life. They regard some elements that constitute goodwill as having an indefinite useful life, for example:

(a) cost savings that are expected to be recurring; and

(b) the knowledge and processes to generate future returns beyond the timeframe of the recognised assets of the business.

They argue that companies acquiring businesses do so with the expectation that the acquired goodwill will be maintained indefinitely, and amortisation would not be appropriate when goodwill has an indefinite useful life.[30]

3.82 Moreover, some consider that distinguishing between acquired goodwill and goodwill subsequently generated internally does not portray any real economic phenomenon. Therefore, they reject the argument, made by some proponents of amortisation, that acquired goodwill is continually consumed and replaced by internally generated goodwill.

3.83 Reintroducing amortisation would not eliminate the need for impairment testing. Consequently, some argue that amortisation is unlikely to reduce the cost of impairment testing significantly, particularly in the first few years after an acquisition, unless amortisation is over an unrealistically short period. Furthermore, if a robust amortisation model is developed, applying that model could increase the complexity of the accounting for goodwill. For example, estimating the useful life would probably require judgement and rely on some of the same estimates underlying the future cash flows used in testing goodwill for impairment.

3.84 In summary, in the light of the arguments in this subsection, some stakeholders consider it appropriate to retain the impairment-only model because, in their view, the impairment test provides more useful information than amortisation. Although no impairment test for cash-generating units containing goodwill can be guaranteed to result in the recognition of an impairment loss as soon as the benefits associated with acquired goodwill are no longer expected to be received, that fact does not mean the test has failed.

30 A recent publication discussing this view is International Valuation Standards Council, 'Is Goodwill a Wasting Asset?', 2019, https://www.ivsc.org/news/article/is-goodwill-a-wasting-asset, (accessed 21 January 2020).

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3.85 Moreover, the objective of the test is to ensure the carrying amounts of the assets, including goodwill, of cash-generating units containing goodwill are expected to be recovered from the cash flows they generate jointly. Although an impairment loss may provide some information that an acquisition is not meeting management's expectations, the accounting for goodwill (regardless of whether amortisation is reintroduced or the impairment-only approach is retained) cannot provide information about the success of an acquisition. To provide information about whether an acquisition has been a success, the Board's preliminary view is that it should develop proposals to require disclosures on subsequent performance, as discussed in paragraphs 2.4–2.45.

The Board's preliminary view

3.86 The topic of accounting for goodwill has always been the subject of strongly held and divergent views. To fulfil its role as a standard-setter, the Board needs to be satisfied that any decisions it makes now will not be reopened again in a few years—frequent changes back and forth between the different approaches would not help any stakeholders.

3.87 In the context of a PIR, the Board will propose changing IFRS requirements only if it has enough information to conclude that a change to the Standard is necessary. The Board will also need to decide that the benefits of such a change would outweigh the cost and disruption that would be caused by changing the requirements again.

3.88 There are different views on whether there is a sufficient reason to change. Different Board members place different weight on different arguments. Some of the main arguments Board members considered in reaching their views were as follows:

(a) those who favoured reintroducing amortisation argued that:

(i) it has not proved feasible to design an impairment test that is significantly more effective at recognising impairment losses on goodwill on a timely basis. In their view, the Board should reintroduce amortisation to respond to the PIR of IFRS 3 feedback that the impairment test is not robust enough to recognise impairment losses on goodwill on a timely basis.

(ii) carrying amounts of goodwill around the world have been increasing. Some Board members see this as evidence that without amortisation management is not being properly held to account for its acquisition decisions and that amortisation is needed to maintain the integrity and reputation of financial reporting.

(iii) goodwill is a wasting asset with a finite useful life, and reintroducing amortisation is the only way to depict that goodwill is being consumed.

(b) those who favoured retaining the impairment-only approach argued that:

(i) although the impairment test does not test goodwill directly, recognising an impairment loss provides important confirmatory information, even if delayed, that confirms investors' earlier assessments that those losses have occurred, helping hold management to account. The useful life of goodwill cannot be estimated, so any amortisation expense would be arbitrary. Therefore, investors would ignore it and amortisation could not be used to hold management to account for its acquisition decisions.

(ii) the Board should not reintroduce amortisation solely because of concerns that the impairment test is not being applied rigorously or simply to reduce goodwill carrying amounts. In the view of some Board members, goodwill could be increasing for many reasons—for example, because of the changing nature of the economy and greater value being generated by unrecognised intangible assets.

(iii) the Board has no compelling evidence that amortising goodwill would significantly improve the information provided to investors or, particularly in the first few years after an acquisition, significantly reduce the cost of performing the impairment test.

3.89 A small majority (eight out of 14 Board members) reached a preliminary view that the Board should retain the impairment-only model.

3.90 The Board accepts that both accounting models for goodwill—an impairment-only model and an amortisation model—have limitations. No impairment test has been identified that can test goodwill directly, and for amortisation it is difficult to estimate the useful life of goodwill and the pattern in which it diminishes.

3.91 The Board reached a preliminary view that it should retain an impairment-only approach, but this was by a small majority and so the Board would particularly like stakeholders' views on this topic.

3.92 Many stakeholders hold firm views that have been well known for many years. Simply repeating the well-known arguments for these views is unlikely to move the debate forward; therefore, the Board would welcome feedback that provides new practical or conceptual arguments, together with evidence for these arguments and suggestions identifying arguments which should be given more weight and why.

3.93 The Board would especially welcome feedback that helps it understand:

(a) why stakeholders have concerns that recognition of impairment losses on goodwill is not timely, and whether amortisation could and should resolve those concerns; and

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(b) what information best helps investors to hold companies' management accountable for acquisition decisions at a reasonable cost.

3.94 Such feedback will help the Board when it decides whether and how to move forward with the project.

Other considerations

3.95 If the Board decides to reintroduce amortisation, it will need to consider more detailed topics, including:

(a) how the useful life of goodwill should be determined;

(b) whether that useful life should have an upper limit;

(c) how the amortisation method should be determined;

(d) whether annual reassessment of the amortisation method and useful life should be required;

(e) whether intangible assets with indefinite useful lives should also be required to be amortised;

(f) how to allocate impairment losses to carrying amounts of goodwill arising from different acquisitions;

(g) how to allocate goodwill arising from different acquisitions on disposal or reorganisation;

(h) what transitional arrangements should apply; and

(i) what related presentation and disclosure requirements should apply—for example, for the amortisation expense.

3.96 Although the Board has not fully discussed the topics listed in paragraph 3.95, some decisions that the Board could make on these topics could influence stakeholders' views on the reintroduction of amortisation. This is particularly true of how the useful life of goodwill should be determined.

3.97 Some stakeholders argue that a reasonable estimate of the useful life of goodwill can be made and that investors would find information about the useful life of goodwill useful if it is based on management's judgement. However, some stakeholders are concerned that determining the useful life of goodwill based on management's judgement would introduce further subjectivity, cost and complexity. On the other hand, if the useful life of goodwill were to be specified as an arbitrary fixed period, such as 10 years, the arbitrary amortisation expense that results would have no informational value, although this method would be much simpler and less subjective.

3.98 Stakeholders will have different views on how important it is to use a simple approach to determine the useful life of goodwill and on the value of the information that can result from selecting an appropriate useful life. Their views may depend partly on whether they consider it possible to make a reliable estimate of the useful life of goodwill. The approach to determine the useful life of goodwill may affect whether some stakeholders support the reintroduction of amortisation or not.

Other approaches considered

3.99 The Board has also considered two other approaches for accounting for goodwill:

(a) immediate write-off of goodwill (paragraphs 3.101–3.104); and

(b) separating goodwill into components and accounting for the components separately (paragraphs 3.105–3.106).

3.100 One other possibility is a hybrid approach, using an impairment-only approach for the first few years and then amortising goodwill in later years. This may have the advantage discussed in paragraph 3.67, that an impairment test is performed when the information from it is most helpful. However, some of the concerns discussed in paragraph 4.26 would also apply to this approach, namely that the time period selected for the impairment-only approach may not be appropriate for all companies and that additional guidance may also be required.

Immediate write-off of goodwill

3.101 Some stakeholders suggested the Board should consider the immediate write-off of goodwill. Any goodwill acquired in an acquisition would be recognised immediately as an expense in profit or loss, or in other comprehensive income or directly in equity.

3.102 This approach would eliminate the need to test goodwill for impairment, thus eliminating cost and complexity. It would also eliminate the risk that the carrying amount of goodwill would not be recoverable and would help to achieve consistency between acquired goodwill and internally generated goodwill.

3.103 Companies had the option to adjust goodwill against shareholders' interest immediately on acquisition in the original IAS 22 *Accounting for Business Combinations*, issued by the IASC in 1983. The IASC removed this option in 1993, concluding that goodwill is an asset.

3.104 The Board did not pursue the idea of immediate write-off because:

(a) requiring an immediate write-off would be inconsistent with the Board's conclusion in IFRS 3 that goodwill is an asset that should be recognised and with management's view when deciding to acquire the business that it has paid for something that is expected to generate future economic benefits;[31]

(b) recording a write-off directly in equity would not be a faithful representation, because it would inappropriately portray the acquirer as having made a distribution to its owners;

(c) investors would no longer receive the information, albeit limited, provided by the impairment test for cash-generating units containing goodwill; and

31 Paragraphs BC313–BC327 of the Basis for Conclusions on IFRS 3.

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(d) some investors use the carrying amount of goodwill in their analysis and in their assessment of management's stewardship.

Separating goodwill into components and accounting for the components separately

3.105 Goodwill comprises various components.[32] Different accounting treatments could be applied to each component, reflecting the nature of that component. For example, amortisation may be more appropriate for some components than for others, or it may be appropriate to write-off some components immediately. If companies identified separate components, they might be able to allocate the components to cash-generating units in a more meaningful way.

3.106 The Board rejected this approach because:

(a) it would increase the complexity and subjectivity of the subsequent accounting for goodwill; and

(b) goodwill cannot be measured directly and, therefore, the different components of goodwill could probably not be measured reliably.

Presentation of total equity excluding goodwill

3.107 The Board considered whether to require companies to present on their balance sheets the amount of total equity excluding goodwill. Goodwill is different from other assets because:

(a) goodwill cannot be measured directly and it is therefore initially measured as a residual.

(b) goodwill cannot be sold separately and, because its value often disappears quickly when a business is in difficulty, it is harder to convert into cash than many other assets on liquidation of the company.

(c) goodwill is often allocated to groups of cash-generating units for impairment testing whereas other assets are tested for impairment individually or as part of a single cash-generating unit. Some of the unavoidable limitations of the impairment test occur when goodwill is allocated to groups of cash-generating units.

3.108 The Board considered whether to exclude not just goodwill but also some or all intangible assets in determining this amount. Although some intangible assets share some of the characteristics of goodwill, there are different views on which intangible assets should be excluded in determining this amount. The Board decided to focus on goodwill given its unique nature.

32 Paragraph BC313 of the Basis for Conclusions on IFRS 3.

3.109 The Board has already proposed in its Exposure Draft *General Presentation and Disclosures* to require goodwill to be presented as a separate line item on the balance sheet.[33] Presenting the amount of total equity excluding goodwill would provide further transparency about the effect of goodwill and so contribute further to investors' understanding of a company's financial position.[34]

3.110 Presenting this amount could help to highlight those companies for which goodwill is a significant portion of their total equity. Although it is simple for investors to calculate this amount, the Board considers that presenting this amount separately would give it more prominence. The Board considered whether the amount could be presented either as a subtotal within the structure of the balance sheet, or as a free-standing amount on the balance sheet.

3.111 Presenting total equity excluding goodwill as a subtotal within the structure of the balance sheet could highlight the subtotal's relationship with other items in the financial statements, indicate simply what the amount includes, and make the amount more prominent. However, it could be difficult to fit that amount within the structure of the balance sheet for various reasons:

(a) IAS 1 *Presentation of Financial Statements* requires a company to present at least non-controlling interests, and issued capital and reserves attributable to owners of the parent, as line items within equity. Thus, it may be impossible to draw a subtotal that presents total equity excluding goodwill when there are non-controlling interests.

(b) even if it is possible to draw such a subtotal, local requirements or local customs may mean that companies are required or want to present other components of equity—for example, share capital, retained earnings or other reserves—as line items. If companies do that, it may not always be possible to present this amount as a subtotal.

3.112 Changing the structure of the financial statements to allow the presentation of this subtotal could be too disruptive. Therefore, the Board does not intend to pursue such a change.

3.113 Thus, total equity excluding goodwill would need to be presented as free-standing information that does not form part of the structure of the balance sheet. One precedent for presenting information this way in a primary financial statement is the requirement to present earnings per share in the income statement.

3.114 Two illustrations of presenting total equity excluding goodwill are included in the Appendix to this Discussion Paper:

33 Exposure Draft *General Presentation and Disclosures* published in December 2019. See https://cdn.ifrs.org/-/media/project/primary-financial-statements/exposure-draft/ed-general-presentation-disclosures.pdf.

34 Paragraph 55 of IAS 1 *Presentation of Financial Statements* requires that an entity should present additional line items (including by disaggregating listed line items), headings and subtotals in the statement of financial position when such presentation is relevant to an understanding of the entity's financial position.

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(a) the first illustration presents the free-standing amount in parentheses attached to the label for total equity; and

(b) the second illustration shows the free-standing amount below the total for total equity and liabilities.

The Board's preliminary view

3.115 The Board's preliminary view is that it should develop a proposal to help investors better understand companies' financial positions by requiring companies to present on their balance sheets the amount of total equity excluding goodwill.

Questions for respondents

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?

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?

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Question 7	
(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?

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?

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Section 4—Simplifying the impairment test

Section highlights

- Performing a quantitative test annually does not necessarily make the test more effective when there is no indicator of impairment.
- Simplifications would reduce the cost and complexity of performing the test.
- Some of the same simplifications would also make value in use more understandable.

4.1 Section 3 discussed how the Board concluded that it could not make the impairment test significantly more effective at recognising impairment losses on goodwill on a timely basis at a reasonable cost.

4.2 Having reached that conclusion, the Board investigated whether it could simplify the test without making it significantly less robust.

4.3 This section discusses the Board's preliminary view that it should develop the following proposals intended to make the impairment test less costly and less complex, while improving some aspects of the information it provides, by:

(a) providing relief from the requirement to perform a quantitative impairment test annually for goodwill (paragraphs 4.5–4.26), and extending this relief to intangible assets with indefinite useful lives and intangible assets not yet available for use (paragraphs 4.27–4.31);[35]

(b) amending the requirements on estimating value in use by removing the restriction on including cash flows from future restructurings, improvements or enhancements (paragraphs 4.35–4.45); and

(c) allowing the use of post-tax cash flows and discount rates in estimating value in use (paragraphs 4.46–4.54).

4.4 This section also discusses other simplifications the Board considered but decided not to pursue (paragraphs 4.55–4.56).

Relief from the annual impairment test

What is the issue?

4.5 Some stakeholders have said:

(a) the impairment test is complex, time-consuming, costly and requires significant judgements; and

(b) because goodwill is not tested for impairment directly (see Section 3), the benefits of the impairment test are limited and may, therefore, not always justify its cost.

35 In this section, the term 'impairment test' refers only to the quantitative test of whether an asset, or a cash-generating unit, is impaired. Companies would still need to assess at each reporting date whether there is an indication that a cash-generating unit containing goodwill may be impaired and to carry out a quantitative test if any such indicator is present.

4.6 Stakeholders have said that one reason why the impairment test is costly and complex is the requirement to perform the test annually even if there is no indication of impairment. Stakeholders providing this feedback suggest that a company should not be required to perform an impairment test for goodwill unless there is an indication that an impairment may have occurred (an indicator-based approach).

Current requirements

4.7 A company is required to test cash-generating units containing goodwill for impairment each year, even if there is no indication that the cash-generating units may be impaired (see paragraph 3.5). This requirement also applies to intangible assets with an indefinite useful life and to intangible assets not yet available for use.

4.8 For all other assets and groups of assets in the scope of IAS 36 *Impairment of Assets*, a company is not required to perform an impairment test unless there is an indication that an impairment may have occurred.

4.9 In IAS 22 *Business Combinations* (which IFRS 3 *Business Combinations* replaced), the Board had required an annual impairment test for goodwill if a company amortised goodwill over a useful life of more than 20 years (see paragraph 3.6). In developing IFRS 3 in 2004, the Board saw a rigorous and operational impairment test as a necessary condition for removing the requirement to amortise goodwill and intangible assets with indefinite useful lives. At that time, the Board viewed an annual impairment test for these assets, and cash-generating units containing these assets, as an important part of making the test sufficiently rigorous and operational.

4.10 In amending IAS 36 in 2004, the Board provided companies with a simplification allowing them to use the most recently calculated recoverable amount in the current period's impairment test for a cash-generating unit containing goodwill if:

(a) the assets and liabilities making up the unit have not changed significantly since the most recent calculation;

(b) the most recently calculated recoverable amount exceeded the carrying amount of the unit by a substantial margin; and

(c) based on an analysis of events that have occurred and circumstances that have changed since the most recent recoverable amount calculation, the likelihood that a current recoverable amount determination would be less than the current carrying amount of the unit is remote (paragraph 99 of IAS 36).

This simplification also applies to intangible assets with indefinite useful lives (paragraph 24 of IAS 36).

4.11 Feedback from stakeholders on the cost of performing the test suggests this simplification is not providing significant relief from having to perform the impairment test for these assets annually. Respondents to the European Financial Reporting Advisory Group Discussion Paper *Goodwill Impairment Test:*

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Can it be Improved? published in 2017 also commented that companies rarely use this relief because it is subject to strict conditions.

How did the Board reach its preliminary view?

4.12 In reaching a preliminary view that it should provide relief from the annual impairment test, the Board considered:

(a) the cost savings from providing that relief (paragraphs 4.14–4.21);

(b) whether that relief would make the impairment test less robust (paragraphs 4.22–4.23);

(c) other factors (paragraphs 4.24–4.26); and

(d) whether the same relief should apply for intangible assets with indefinite useful lives and intangible assets not yet available for use (paragraphs 4.27–4.31).

4.13 Although a company would not need to perform an annual impairment test, it would still need to assess whether there is an indication that the cash-generating unit or group of cash-generating units containing goodwill may be impaired at each reporting date, and perform an impairment test if there is an indication that the units may be impaired.

Cost savings

4.14 The Board understands that performing an annual impairment test for goodwill gives rise to costs associated with:

(a) setting up the valuation model to be used for the impairment test;

(b) gathering inputs used in that valuation model to determine the recoverable amount, and the internal and external review of those inputs to confirm they are reasonable and supportable;

(c) changing the valuation model when a company's circumstances change—for example after a restructuring; and

(d) disclosing information about the impairment test even if no impairment loss has been recognised.[36]

4.15 Removing the requirement for an annual impairment test would reduce the costs in paragraphs 4.14(b) and 4.14(d) when there is no indication of impairment. However, it would not reduce the costs mentioned in paragraphs 4.14(a) and 4.14(c).

4.16 To perform an annual impairment test for goodwill allocated to a group of cash-generating units, a company may need to estimate the recoverable amounts of each of those individual cash-generating units, if, for example, its forecasting process is on a 'bottom-up' basis. These estimates are required even if the company has no reason to suspect that any of those individual cash-generating units may be impaired. An indicator-based impairment model, however, would not require a company to make those estimates if it

36 Paragraphs 134 and 135 of IAS 36.

has no indication that an impairment may have occurred. Thus, if companies allocate goodwill to a group of many cash-generating units—for example, numerous retail outlets in a geographical location—relief from the annual impairment test could provide a significant cost saving.

4.17 In assessing how much cost the relief could save, the Board considered how stakeholders have implemented the optional qualitative test (Step Zero) introduced in US generally accepted accounting principles (US GAAP) in 2011.[37] Step Zero differs from the indicator-based impairment test the Board is considering. If a company opts to apply Step Zero, rather than carrying out a quantitative impairment test every year, it first assesses whether it is more likely than not that the fair value of a reporting unit would be less than its carrying amount. In making this assessment, a company would look for indications of impairment. A company needs to perform an impairment test if it concludes that impairment is more likely than not.

4.18 Publicly available surveys show a steady increase in the number of public companies electing to use Step Zero. For example, in the United States, 29% of public companies surveyed in 2013 applied the qualitative test; this rose to 59% in 2016.[38] Sixty-three per cent of all companies surveyed (public and private) agreed that the optional qualitative assessment had helped to reduce costs.

4.19 Although the majority of survey respondents agreed that the optional qualitative assessment reduced cost, a significant number disagreed. They gave the following reasons:

(a) assessing whether there are indications of impairment and accumulating evidence for a robust application of a qualitative test is sometimes more costly than performing a quantitative impairment test;

(b) companies may still have to gather some of the inputs needed for an impairment test when assessing whether there may be an indication of impairment; and

(c) companies may need to calibrate their models periodically to fully understand the effect of assumptions on an asset's recoverable amount.

4.20 Overall, the evidence for the extent of potential cost savings is mixed. Some stakeholders believe an indicator-based approach would save cost whereas others think it would offer modest cost savings at best. Stakeholders' views on the extent of the cost savings could depend on, for example, their industry, the complexity of their business or how their assets and cash-generating units are organised.

37 The Financial Accounting Standards Board, Accounting Standards Update No. 2011-08, *Intangibles —Goodwill and Other (Topic 250): Testing Goodwill for Impairment*.

38 Duff & Phelps, '2016 U.S. Goodwill Impairment Study', Financial Executives Research Foundation, Inc., 2016, https://www.duffandphelps.com/insights/publications/goodwill-impairment/2016-us-goodwill-impairment-study, (accessed 4 February 2020).

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4.21 The impairment test in US GAAP differs from that in IAS 36, hence the cost of performing an impairment test may differ. Nevertheless, information on the application in the US of Step Zero could provide useful insights into the cost savings that may arise if the Board introduces an indicator-based approach.

Robustness of the impairment test

4.22 The principal concern about the relief is whether it would make the impairment test less robust. Removing the requirement for an annual test could delay the recognition of impairment losses on goodwill, which some stakeholders consider are already recognised too late, and so reduce the value of the information these impairment losses provide because:

(a) identifying whether indications of impairment are present may require greater management judgement, particularly when events that ultimately lead to an impairment occur gradually over time;

(b) greater scope for management judgement may make it easier for companies to behave opportunistically to avoid recognising an impairment loss for goodwill; and

(c) if companies do not perform an impairment test regularly, their expertise in performing the test is likely to decline.

4.23 However, there are different views on how much less robust the impairment test would become if the test is not required annually. For example:

(a) a company would still need to perform a test if there is an indication that there may be an impairment and the company would need to assess at the end of each reporting period whether there is any such indication. Some consider that the events that lead to the recognition of impairment losses using the current impairment test are usually significant, and that management is therefore unlikely to fail to identify a qualitative indicator of impairment in those cases, so there may be little difference in outcome.

(b) performing an annual impairment test cannot remove the shielding effect resulting from unrecognised headroom (see paragraphs 3.31–3.54).

Other factors

4.24 In reaching its preliminary view, the Board considered that:

(a) some stakeholders, including some preparers, regard carrying out an impairment test every year as a good governance mechanism. Performing the test prompts management to assess the cash-generating processes within its business, promoting good stewardship.

(b) some investors have commented that the disclosures relating to the impairment test are useful, particularly information about the test's assumptions and sensitivities. IAS 36 requires these disclosures to be provided for all impairment tests of cash-generating units containing significant amounts of goodwill or intangible assets with indefinite

useful lives, even if no impairment loss has been recognised. IAS 36 requires a company to provide the information on sensitivities if a reasonably possible change in a key assumption could result in an impairment. This information would no longer be provided in years when no impairment test is performed.

4.25 The Board also explored variations of an indicator-based approach that would require a company to perform an impairment test in some years, even if there is no indication of impairment, for example:

(a) annually for the first few years after an acquisition (perhaps three to five years), then with an indicator-based approach in subsequent years; or

(b) less often than annually (for example once every three years), then with an indicator-based approach in the intervening periods.

4.26 Although such approaches may be marginally more robust than an indicator-based approach, the Board did not pursue them because:

(a) requiring that a test be performed for a fixed number of years may not work equally well for companies in different industries; and

(b) such a test would add complexity and could need guidance, for example in cases:

(i) when a company restructures its operations; or

(ii) when goodwill arose from different acquisitions at different times and is allocated to the same cash-generating unit that is then partly subject to an annual test and partly subject to the indicator-based approach.

Intangible assets

4.27 The Board considered whether to apply the same relief to those intangible assets that are subject to an annual impairment test—intangible assets with indefinite useful lives and intangible assets not yet available for use.

4.28 Although the feedback on the effectiveness of the impairment test largely focused on goodwill, stakeholders raised similar concerns for intangible assets with indefinite useful lives. However, the extent of the shielding effect for these assets is not clear. Because these intangible assets are identifiable, the shielding effect may be less than for goodwill if these assets are capable of generating largely independent cash inflows or are allocated to a smaller group of cash-generating units.

4.29 As a result, a quantitative test could be more likely to detect an impairment of these assets—making an indicator-based approach more likely to fail to reveal an impairment than an annual impairment test. Thus, the disadvantages of the relief may be more likely to exceed the advantages for these intangible assets than for goodwill.

4.30 On the other hand, the Board considers that:

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(a) because the same logic underpins the requirement for an annual impairment test for goodwill and for these types of intangible assets, the Board's conclusions on testing goodwill for impairment could also be valid for these intangible assets;

(b) introducing a difference in the subsequent accounting for these two categories of assets could create scope for accounting arbitrage when determining which intangible assets are recognised separately in an acquisition; and

(c) if the accounting model applied to goodwill differs from that applied to these types of intangible assets, an identifiable (intangible) asset would be tested for impairment more often than an asset that is not identifiable (goodwill)—which is counterintuitive.

4.31 On balance, the Board concluded that the reasons to apply the same kind of impairment test for intangible assets with indefinite useful lives and intangible assets not yet available for use outweigh the reasons for applying different tests. Therefore, the Board's preliminary view is that the removal of the requirement to perform an annual impairment test should also be proposed for such intangible assets.

The Board's preliminary view

4.32 The Board's preliminary view is that it should develop a proposal to remove the requirement for a company to perform an annual impairment test for cash-generating units containing goodwill if there is no indication that the cash-generating units may be impaired. As explained in paragraph 4.31, that proposal would also apply to intangible assets with indefinite useful lives and intangible assets not yet available for use. A company would still need to assess at the end of each reporting period whether there is any indication that there may be an impairment.

4.33 Board members have different views on how much cost such a change would save, and on how much it may reduce the robustness of the impairment test. Some Board members' conclusion on this issue is linked to their conclusion on the amortisation of goodwill:

(a) Some Board members favour retaining the requirement for an annual impairment test. In their view, the reduction in robustness would outweigh any cost reduction. They also consider it counterintuitive for the Board to take any action that would make the test less robust, given stakeholders' feedback that the test is not effective enough.

(b) Some Board members may be prepared to remove the requirement for an annual impairment test, but only if the Board also reintroduces amortisation of goodwill. In their view, reintroducing amortisation would reduce reliance on the impairment test and justify removing the requirement for an annual impairment test.

(c) A narrow majority (eight out of 14 Board members) favour removing the requirement for an annual impairment test, even though the Board's preliminary view is that it should not reintroduce amortisation. They agree that removing the requirement would make the test marginally less robust. However, they also consider that when the company has no indicator of impairment the benefits of testing for impairment are minimal and so do not justify the cost in those cases.

4.34 Because moving to an indicator-based approach would place more reliance on identifying indicators of impairment, the Board plans to assess whether it needs to update the list of indicators in paragraph 12 of IAS 36. For example, a failure to meet the objectives of an acquisition as disclosed applying the Board's preliminary view on disclosure (see paragraphs 2.4–2.45) could be a candidate for a new indicator of a possible impairment.

Value in use—future restructuring or enhancement

What is the issue?

4.35 In determining value in use, companies are required to exclude cash flows expected to arise from a future restructuring or enhancement. Some stakeholders have explained that this requirement can cause cost and complexity because excluding such cash flows requires management to adjust its financial budgets or forecasts. For example, management can find it challenging to distinguish maintenance capital expenditure from expansionary capital expenditure in these budgets or forecasts. Management also finds it challenging to identify which subsequent cash flows need to be excluded because they result from expansionary capital expenditure.

Current requirements

4.36 In measuring value in use, IAS 36 requires a company to estimate cash flow projections for an asset in its current condition. IAS 36 restricts these cash flow projections: they are required to exclude future cash flows expected to arise from a future restructuring to which the company is not yet committed, or to arise from improving or enhancing the asset's performance. IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* provides guidance on determining when a company is committed to a restructuring.

4.37 When it developed IAS 36 in 1998, the International Accounting Standards Committee (IASC), the Board's predecessor, stated that this restriction was consistent with the requirement that companies should estimate future cash flows for an asset in its current condition and with proposals that subsequently became IAS 37.

How did the Board reach its preliminary view?

4.38 The Board expects that removing the restriction on these cash flows would:

(a) reduce cost and complexity.

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(b) make the impairment test less prone to error because estimates of value in use would probably be based on cash flow projections which are prepared, monitored and used internally for decision-making regularly, rather than forecasts produced solely for external financial reporting once or twice a year.

(c) make the impairment test easier to understand. The measurement of value in use would be more consistent with how fair value (and hence, fair value less costs of disposal) is determined when an asset, or cash-generating unit, contains potential to be restructured, improved or enhanced. Fair value reflects that potential if it is present and if market participants would pay for it. If the potential is available to the company that currently controls the asset and were also to be included in value in use, the recoverable amount would equal the higher of the two different measures of the same asset. This is more logical than the recoverable amount being equal to the higher of measures of two different assets—one asset including that potential, and one excluding it.

(d) make the test easier to perform and therefore could make the impairment test easier to audit and enforce.

4.39 The Board also considered the requirement to exclude particular cash flows for which the recognition criteria for a liability are not yet met. This is currently the case for cash flows associated with a future restructuring. The value in use of an asset—and indeed its fair value—reflects many expected cash outflows for which a company has no liability at the measurement date. In the Board's view the recognition criteria for a liability should play no role in determining which cash flows should be included in estimating an asset's value in use.

4.40 However, simply removing the restriction on these cash flows could increase the risk that management may use inputs that are too optimistic in estimating value in use.[39] Therefore, the Board considered whether it should propose requiring discipline, in addition to that already required by IAS 36, in preparing estimates of these cash flows by:

(a) setting a probability threshold to determine when these cash flows should be included—for example a 'more likely than not' threshold; or

(b) requiring additional qualitative disclosures about the measurement uncertainty associated with estimates of the amount, timing and uncertainty of these particular cash flows.

4.41 The Board's preliminary view is that it does not need to set a probability threshold or require additional qualitative disclosures, for the following reasons:

39 Some respondents to the European Financial Reporting Advisory Group Discussion Paper *Goodwill Impairment Test: Can it be Improved?* published in 2017, which also proposed removing the restriction on the inclusion of cash flows from planned future restructurings, called for some level of safeguard on the inclusion of these cash flows.

(a) IAS 36 already requires companies to use reasonable and supportable assumptions as summarised in paragraphs 3.26–3.27; and

(b) paragraphs 134(d) and 134(f) of IAS 36 require companies to disclose information about the assumptions on which management based its estimates of the recoverable amount.[40]

4.42 In the Board's view the requirements summarised in paragraph 4.41 would be expected to provide sufficient discipline over cash flows expected to arise from a future uncommitted restructuring or expected to arise from improving or enhancing the asset's performance. If some companies make estimates of cash flows that are too optimistic, this over-optimism would be addressed more effectively by auditors or regulators.

The Board's preliminary view

4.43 The Board's preliminary view is that it should develop a proposal to remove from IAS 36 the restriction on including cash flows arising from a future restructuring to which a company is not yet committed or from improving or enhancing an asset's performance.

4.44 This proposal would apply not only to cash-generating units containing goodwill but to all assets and cash-generating units within the scope of IAS 36.

4.45 The Board's preliminary view is that setting a probability threshold or requiring additional qualitative disclosures is unnecessary for these cash flows. These cash flows would still be subject to the same requirements that apply to all cash flows included in estimates of value in use—companies would be required to use reasonable and supportable assumptions based on the most recent financial budgets or forecasts approved by management.

Value in use—post-tax cash flows and discount rates

What is the issue?

4.46 Stakeholders said determining pre-tax discount rates is costly and complex. They explained that a pre-tax discount rate is hard to understand, is not observable and does not provide useful information because it is generally not used for valuation purposes. In practice, valuations of assets are generally performed on a post-tax basis.

Current requirements

4.47 In measuring value in use, IAS 36 requires a company to estimate pre-tax cash flows and discount them using pre-tax discount rates. It also requires disclosure of the pre-tax discount rates used.

40 Paragraph 125 of IAS 1 would also require additional information if these cash flow forecasts were a major source of estimation uncertainty.

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How did the Board reach its preliminary view?

4.48 The Board expects removing the requirement to use pre-tax cash flows and pre-tax discount rates would:

(a) make the test easier to understand by aligning it with common valuation practice. Companies will pay tax upon the cash flows they receive from assets and therefore a post-tax approach is easier to understand.

(b) not require companies to calculate pre-tax discount rates solely to satisfy the disclosure requirements of IAS 36.

(c) provide investors with more useful information, because companies generally use post-tax discount rates as an input in estimating value in use. The disclosure of a post-tax discount rate would be more useful information for investors than disclosure of a pre-tax discount rate, which generally is not understandable or observable.

(d) better align value in use in IAS 36 with fair value in IFRS 13 *Fair Value Measurement*. IFRS 13 does not specify whether a company is required to use pre-tax or post-tax cash flows and discount rates in a present value technique used in measuring fair value. Instead, it requires companies to use internally consistent assumptions about cash flows and discount rates. Thus, companies would discount post-tax cash flows with post-tax discount rates and pre-tax cash flows with pre-tax discount rates. There is no obvious reason to adopt a different approach for value in use.

(e) maintain consistency with an amendment made in 2008 to IAS 41 *Agriculture* (for the discount rate) and an amendment to IAS 41 (for cash flows) proposed in 2019.[41]

4.49 When it issued IAS 36, the IASC decided to require companies to determine value in use by using pre-tax future cash flows and a pre-tax discount rate. This was because companies' estimates of post-tax future cash flows would need to exclude the effect of future tax cash flows resulting from temporary differences in order to avoid double counting.[42] The IASC considered that this would be burdensome.

4.50 In paragraph BC94 of the Basis for Conclusions on IAS 36, the Board observed that, conceptually, discounting post-tax cash flows at a post-tax discount rate and discounting pre-tax cash flows at a pre-tax discount rate would be expected to give the same result—as long as the pre-tax discount rate is the post-tax discount rate adjusted to reflect the specific amount and timing of future tax cash flows.

41 In the Exposure Draft *Annual Improvements to IFRS Standards 2018–2020*. See https://cdn.ifrs.org/-/media/project/annual-improvements-2018-2020/ed-annual-improvements-2018-2020.pdf?la=en.

42 Double counting could occur because some tax cash flows may be reflected in measurements of deferred tax liabilities or assets. Including those cash flows in value in use as well would result in double counting.

4.51 Whether a company uses a pre-tax discount rate with pre-tax cash flows or a post-tax discount rate with post-tax cash flows, the resulting current value is a post-tax value of the asset. The IASC's concerns about double counting (see paragraph 4.49) arise regardless of whether companies use a pre-tax or post-tax discount rate.

4.52 Some stakeholders may have questions about how to avoid double counting of future tax consequences. However, in making a similar change to IAS 41 the Board simply deleted 'pre-tax' and did not add any further guidance. The Board intends to adopt the same approach in this case.

The Board's preliminary view

4.53 The Board's preliminary view is that it should develop a proposal to:

(a) remove the explicit requirement to use pre-tax cash flows and pre-tax discount rates in estimating value in use;

(b) require a company to use internally consistent assumptions for cash flows and discount rates regardless of whether value in use is estimated on a pre-tax or post-tax basis; and

(c) retain the requirement for companies to disclose the discount rates used but remove the requirement that the discount rate disclosed should be a pre-tax rate.

4.54 This proposal would apply not only to cash-generating units containing goodwill but to all assets and cash-generating units within the scope of IAS 36.

Simplifications not pursued

4.55 The Board considered whether to provide the following simplifications and guidance for the impairment test:

(a) adding more guidance on the difference between entity-specific inputs used in value in use and market-participant inputs used in fair value less costs of disposal.

(b) mandating only one method for estimating the recoverable amount of an asset (either value in use or fair value less costs of disposal), or requiring a company to select the method that reflects the way the company expects to recover an asset.

(c) allowing companies to test goodwill at the entity level or at the level of reportable segments rather than requiring companies to allocate goodwill to groups of cash-generating units that represent the lowest level at which the goodwill is monitored for internal management purposes. Many stakeholders have said that allocating goodwill to cash-generating units is one of the main challenges of the impairment test.

(d) adding guidance on identifying cash-generating units and on allocating goodwill to cash-generating units.

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4.56 The Board's preliminary view is that it should not develop proposals for any of these potential simplifications or guidance because the Board considers that:

(a) the guidance in IAS 36 and IFRS 13 is sufficient.[43]

(b) the IASC's reasons for basing the definition of recoverable amount on both value in use and fair value less costs of disposal when developing IAS 36 remain valid. In summary, if a company can generate greater cash flows by using an asset, basing its recoverable amount on market price would be misleading, because a rational company would not be willing to sell. Similarly, if an asset's fair value less costs of disposal is higher than its value in use, a rational company will dispose of the asset and an impairment loss would be unrelated to economic reality. But if management decides to keep the asset, the extra loss properly falls in later periods because it results from management's decisions in those later periods to keep the asset.

(c) testing goodwill at a higher level could delay further the recognition of impairment losses of goodwill by increasing the effect of shielding.

(d) it would be difficult to provide guidance on identifying cash-generating units and allocating goodwill that could apply to all companies.

Questions for respondents

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?

43 Paragraphs 30, 53A and Appendix A of IAS 36 provide guidance on value in use and there is also some discussion in paragraph BC60 of the Basis for Conclusions on IAS 36. Paragraphs 3, 11, 12, 16, 22, 23 and B2 of IFRS 13 *Fair Value Measurement*, in particular, provide guidance on fair value and, hence, on fair value less costs of disposal.

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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.

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?

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Section 5—Intangible assets

Section highlights

- Does separate recognition of *all* identifiable intangible assets in a business combination provide useful information?
- The Board found no compelling evidence that a change in the recognition requirements is needed.
- Stakeholders who want the Board to consider broader changes to the accounting for intangible assets can explain why in the 2020 Agenda Consultation.

5.1 Many respondents to the Post-implementation Review (PIR) of IFRS 3 *Business Combinations* identified challenges with the requirement to recognise separately from goodwill *all* identifiable intangible assets acquired in a business combination. The challenges relate to both costs and benefits. Some investors expressed concerns about the usefulness of the information provided. Other stakeholders said that identifying and measuring some of those identifiable intangible assets could be complex, subjective and costly.

5.2 This section discusses whether the Board should change the criteria for recognising intangible assets acquired in a business combination. The Board's preliminary view is that it should not make any changes.

5.3 Providing investors with more information about intangible assets is a frequent suggestion for improving financial reporting. This is a topic being considered by the Board in its Management Commentary project.[44] Stakeholders could also raise the topic in the Board's 2020 Agenda Consultation.

What is the issue?

5.4 Investors have expressed a variety of views about whether recognising intangible assets acquired in a business combination separately from goodwill provides useful information. Some investors say information provided by this approach is useful because:

(a) it illustrates more fully what the company purchased; and

(b) it helps investors to assess the company's prospects for future cash flows.

5.5 However, other investors question the usefulness of this information:

(a) some are concerned about the level of measurement uncertainty in estimating the carrying amounts of those intangible assets for which there is no active market, such as customer relationships and brands.

44 See https://www.ifrs.org/projects/work-plan/management-commentary/.

(b) others consider that amortising intangible assets that are difficult to separate from the overall business—for example, customer relationships and brands—leads to double counting, because subsequent costs incurred in maintaining these assets are recognised as an expense together with the amortisation expense. These investors add that it is often difficult for them to adjust for this effect in their own analyses because they cannot identify the amortisation expense for these particular intangible assets.

5.6 Research published by the UK's Financial Reporting Council (UK FRC) also reflects this variety of views.[45] Forty-five per cent of investors who responded to the UK FRC's questions agreed with the approach in IFRS 3 and IAS 38 *Intangible Assets* of recognising identifiable intangible assets separately on the balance sheet in an acquisition, but 52% said they would prefer a different approach.

5.7 The majority of other stakeholders—mainly preparers, auditors and standard-setters—responding to the PIR of IFRS 3 said that recognising intangible assets separately from goodwill provides useful information because:

(a) the information provides a better basis for understanding what a company has paid for; and

(b) separate recognition results in intangible assets with finite useful lives being amortised rather than being included in goodwill, which is not amortised.

5.8 However, several preparers and auditors questioned the usefulness of the information about intangible assets that are difficult to value reliably, such as customer relationships and brands.

5.9 These stakeholders said that:

(a) valuing intangible assets is complex, subjective and costly;

(b) distinguishing some intangible assets, such as brands and customer lists, from the rest of a business is difficult because doing so requires an arbitrary allocation of cash flows; and

(c) applying the separability criterion (see paragraph 5.13(a)) is often difficult.

5.10 Some stakeholders therefore questioned whether the separate recognition of some intangible assets justifies the cost.

45 'FRC ARP Staff Research Report—Investor Views on Intangible Assets and their Amortisation', 2014, https://www.frc.org.uk/getattachment/ca85acd9-4559-406b-ae96-5a7779772c6b/Research ProjectonintangibleassetsMarch2014.pdf, (accessed 4 February 2020).

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5.11 During the PIR of IFRS 3, the Board reviewed academic literature relating to the questions asked in the PIR of IFRS 3.[46] Academic literature provided some evidence to support recognising intangible assets separately, as is required by IFRS 3. However, the evidence varied between countries, possibly because of the varied national accounting practices in place before countries adopted IFRS Standards. This may in part explain the variety of views expressed during the PIR of IFRS 3.

Current requirements

5.12 Paragraph B31 of IFRS 3 requires an acquirer to recognise, separately from goodwill, all identifiable intangible assets acquired in a business combination.

5.13 An intangible asset is identifiable if it:

(a) is capable of being separated or divided from the acquiree and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability (separability criterion); or

(b) arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the acquiree or other rights and obligations (contractual-legal criterion).

5.14 IAS 38 sets out two conditions for recognising an intangible asset: that the fair value of the asset can be measured reliably, and that it is probable that any associated future economic benefits would flow to the company.

5.15 In amending IAS 38 in 2004 and 2008, the Board added a statement that these two conditions are always met when an identifiable intangible asset is acquired in a business combination. Since the Board added this statement, companies have recognised more intangible assets separately from goodwill.

5.16 The Board expected that the separate recognition of intangible assets would provide investors with better information even if a significant degree of judgement is required to estimate the fair value of these intangible assets.

How did the Board reach its preliminary view?

5.17 Investors have expressed concerns that information about some intangible assets may not be useful, because:

(a) they have concerns about the level of measurement uncertainty in estimating the fair value of these items.

(b) some intangible assets are similar to goodwill.

46 See the Report and Feedback Statement *Post-implementation Review of IFRS 3 Business Combinations* for more details. A summary of findings from the academic literature review is available at: https://cdn.ifrs.org/-/media/feature/meetings/2014/september/iasb/ifrs-ic-issues/ap12g-pir-ifrs-3-business-combinations-academic-literature.pdf.

(c) some investors believe that amortising particular intangible assets results in double counting of expenses because subsequent costs incurred in maintaining these assets are recognised as an expense in the same period as the amortisation expense.

(d) amortising particular acquired intangible assets makes it difficult to make comparisons with companies that grow organically and that do not recognise internally generated intangibles. Some investors also link this concern to the double counting concern.

5.18 The Board considered stakeholder feedback about whether to permit or require companies to include in goodwill identifiable intangible assets acquired in a business combination meeting criteria such as the following (which partly overlap):

(a) specified types of intangible assets such as customer relationships, brands and non-compete agreements;

(b) intangible assets not already recognised in the acquired company's financial statements;

(c) intangible assets that would not have been recognised in the acquirer's financial statements if generated internally;

(d) intangible assets that do not meet the contractual-legal criterion;

(e) organically replaced intangible assets, as opposed to wasting assets (as suggested by respondents to the UK FRC's research in paragraph 5.6);[47] or

(f) intangible assets that have indefinite useful lives and are not already generating cash inflows largely independent of cash flows from other assets or groups of assets.[48]

5.19 Changing the requirements would reduce costs and complexity for companies by minimising the need to identify and value particular intangible assets. Given the feedback from some investors (see paragraph 5.5) that recognising some identifiable intangible assets may not provide useful information, some identifiable intangible assets could be included within goodwill. This could save costs for companies while perhaps not resulting in a loss of information for investors.

5.20 The Board considered how including in goodwill some intangible assets listed in paragraph 5.18 could resolve the investors' concerns listed in paragraph 5.17. Table 5.1 provides a brief summary.

47 The UK Financial Reporting Council's research explains a distinction that investors make between different types of intangible assets. Wasting intangible assets are separable from the company, have finite useful lives and lead to identifiable future revenue streams. Organically replaced intangible assets are not wasting intangible assets and are replenished on an ongoing basis through marketing expenditure.

48 If an intangible asset has an indefinite useful life, it is not amortised. Goodwill is also not amortised.

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Table 5.1 Would the various approaches resolve investors' concerns?

Intangible assets to be included in goodwill	Investors' concerns that could be resolved			
	Values uncertain	**Similar to goodwill**	**Double counting**	**Compare to organic**
	5.17(a)	5.17(b)	5.17(c)	5.17(d)
Specified types, such as brands (5.18(a))	✓	✓	✓	✓
Not recognised by acquired business (5.18(b))	✓	✓	✓	✓
Not recognised if internally generated (5.18(c))	✓	✓	✓	✓
Not meeting contractual-legal criterion (5.18(d))	✓		✓	
Organically replaced (5.18(e))	✓	✓	✓	✓
Indefinite useful lives (5.18(f))	✓	✓		

5.21 Investors have mixed views on whether separate recognition of identifiable intangible assets provides useful information. Their views also vary on how to determine which intangible assets should be recognised separately to provide useful information. All the approaches listed in paragraph 5.18 could result in some investors losing useful information. Those approaches reflect the variety of concerns in paragraph 5.17 and the different weights different investors place on those concerns.

5.22 The Board was not persuaded that concerns about double counting are valid. What some stakeholders perceive as double counting arises because two types of expense are recognised in the same period. Maintenance expenditure arises as a company maintains its assets. In contrast, the amortisation expense reflects the acquisition cost of the asset, and is recognised as the company consumes the asset. A company that has grown organically also recognises the acquisition cost of its assets as an expense, but does so as it is developing the assets rather than later as it consumes them.

5.23 The Board also considered the fact that if a company grows organically by generating intangible assets internally, it would recognise the cost of generating those assets as an expense. On the other hand, if a company grows by acquiring similar intangible assets in business combinations, often at a higher cost, and if these assets were recognised as part of goodwill and therefore not subsequently amortised, it would recognise no expense at all for the cost of acquiring the assets.

5.24 It is outside the scope of this research project to consider the concerns of investors who want to compare companies that grow by acquisitions more easily with those that grow organically. If stakeholders would like the Board to consider adding to its work plan a broader project on intangible assets,

either those acquired in a business combination or those generated internally, or both, they will have an opportunity to explain why during the Board's 2020 Agenda Consultation.[49]

5.25 The Board identified other disadvantages of the approaches listed in paragraph 5.18:

(a) goodwill would be commingled with identifiable intangible assets with different characteristics, leading to a loss of information about those assets.

(b) reducing the proportion of intangible assets recognised separately would not respond to the frequent calls to improve financial reporting by providing more information about intangible assets that are increasingly important in modern economies.

(c) if the Board does not reintroduce amortisation of goodwill, then including intangible assets with finite useful lives within goodwill would lead to a loss of information about the consumption of those intangible assets. If the Board reintroduces amortisation of goodwill, commingling these intangible assets with goodwill may make it even more difficult to determine an appropriate useful life for goodwill.

(d) some additional complexity could arise. For example, if identifiable intangible assets are included within goodwill and subsequently sold, what profit should a company recognise on sale?

5.26 Preparers have expressed varying views on the cost of implementing the current requirements.

5.27 Overall, the Board concluded it did not have compelling evidence that it should permit or require some identifiable intangible assets to be included in goodwill.

The Board's preliminary view

5.28 The Board's preliminary view is that it should not develop a proposal to change the recognition criteria for identifiable intangible assets acquired in a business combination.

49 See www.ifrs.org/projects/work-plan/2020-agenda-consultation/.

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Questions for respondents

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?

Section 6—Other recent publications

6.1 This section summarises the contents of an Invitation to Comment published by the US Financial Accounting Standards Board (FASB) in July 2019 and of a Research Report published by the Australian Accounting Standards Board (AASB) on IAS 36 *Impairment of Assets* in March 2019.

The FASB's Invitation to Comment

6.2 IFRS 3 *Business Combinations* was issued, and subsequently revised, as a result of a joint project between the Board and the FASB. Consequently, IFRS 3 is largely converged with the FASB Accounting Standards Codification® (ASC) Topic 805 *Business Combinations* (Topic 805). However, the standards for the impairment test for goodwill, IAS 36 and ASC Topic 350 *Intangibles—Goodwill and Other* are not converged.

6.3 In July 2019 the FASB issued the Invitation to Comment *Identifiable Intangible Assets and Subsequent Accounting for Goodwill*. The Board's research project and the FASB's project are separate and although the boards exchange information, they are not working jointly on the projects. Nevertheless, both boards have been monitoring each other's work because the projects focus on similar topics and because IFRS 3 and Topic 805 are largely converged.

6.4 The Invitation to Comment is a FASB staff document in which the FASB itself does not express any preliminary views. Prior to issuing the Invitation to Comment, the FASB received feedback from stakeholders, similar to the feedback the Board has received, that the benefits of information about some intangible assets and impairment losses on goodwill may not justify the cost of obtaining that information.

6.5 Feedback from the Post-implementation Review of Statement of Financial Accounting Standards No. 141 (revised 2007) *Business Combinations* in 2013 indicated concerns regarding the cost of performing the goodwill impairment test.[50] To resolve these concerns, the FASB issued several Updates.[51] Some were applicable to all companies and others were applicable only to private companies and not-for-profit entities.

6.6 Private companies and, more recently, not-for-profit entities, applying US generally accepted accounting principles (US GAAP) have had the option to amortise goodwill on a straight-line basis over 10 years (or less than 10 years if the company demonstrates that the useful life of goodwill is shorter). For companies that elect to amortise goodwill, impairment testing is performed only when a triggering event occurs, rather than annually. Impairment testing can also be performed at a company level or at a reporting-unit level.

50 FASB Accounting Standards Codification® Topic 805 *Business Combinations* was originally issued as Statement of Financial Accounting Standards No. 141 (revised 2007) *Business Combinations*.

51 The US Financial Accounting Standards Board (FASB) issues an Accounting Standards Update (Update or ASU) to communicate changes to the authoritative guidance from the FASB Accounting Standards Codification.

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6.7 Private companies and not-for-profit entities can also elect to include within goodwill the following types of intangible assets acquired in an acquisition, if the company also elects to amortise goodwill:

(a) customer-related intangible assets not capable of being sold or licensed independently from the other assets of the business; and

(b) non-compete agreements.

6.8 In its Invitation to Comment, predominantly for public business entities, the FASB sought stakeholders' views about whether to:

(a) change the subsequent accounting for goodwill;

(b) modify the requirements for recognising intangible assets acquired in business acquisitions; or

(c) add or change disclosures about goodwill and intangible assets.

6.9 On changing the subsequent accounting for goodwill (paragraph 6.8(a)), the FASB sought stakeholders' views on whether to reintroduce goodwill amortisation for public business entities or to further simplify the goodwill impairment test. Potential simplifications could include assessing goodwill for impairment following an event or change in circumstances that indicates goodwill is more likely than not impaired or providing an option to test goodwill at the company level.

6.10 With regard to modifying the recognition of intangible assets acquired in an acquisition (paragraph 6.8(b)), the FASB sought stakeholders' views on whether to:

(a) extend the private company option to public business entities (see paragraph 6.7);

(b) establish a new principle-based criterion to determine which identifiable intangible assets should be included in goodwill; or

(c) include all intangible assets in goodwill.

6.11 As to adding or changing disclosures about goodwill and intangible assets (paragraph 6.8(c)), the Invitation to Comment discussed providing information on the key performance targets supporting an acquisition and information about performance against those targets for several years after the acquisition. However, the Invitation to Comment sought stakeholders' views on other ideas for new or enhanced disclosures because of concerns about:

(a) the cost of providing such information;

(b) the complexity of integration; and

(c) the disclosure of forward-looking information.

6.12 The Invitation to Comment therefore covered similar topics to the Board's Discussion Paper. The comment period on the Invitation to Comment is now closed.

6.13 Some stakeholders have told the Board that maintaining convergence between IFRS Standards and US GAAP is important to them.

The AASB's Research Report

6.14 In March 2019 the AASB published Research Report 9 *Perspectives on IAS 36: A case for standard setting activity*. This report considers IAS 36 impairment testing for all assets, not just for goodwill. The recommendations in the report were to:

(a) review IAS 36 in its entirety with the aim of issuing a new standard that provides principles that enable investors, preparers, auditors and regulators to develop a common understanding of the practical aspects of undertaking the procedures applied to ensure that assets are carried at no more than their recoverable amount;

(b) clarify the purpose of the impairment testing requirements, and develop guidance explaining what the test is and is not intended to achieve;

(c) develop a modified single model approach, including specific amendments to:

  (i) remove the restrictions on value in use regarding future restructurings and asset enhancements and replace those restrictions with guidance on when it would be reasonable to include such cash flows in an impairment model;

  (ii) reserve the use of a 'fair value less costs of disposal' model for assets expected to be disposed of within the following financial reporting period;

  (iii) allow the use of a post-tax discount rate; and

  (iv) specifically permit the use of market-based assumptions within the value in use cash flow model, such as a forward curve for commodity prices and foreign exchange rates;

(d) redraft the guidance as to what constitutes a cash-generating unit or a group of cash-generating units, to strengthen the link with how a company's results are viewed and decisions are made internally; and

(e) implement enhanced disclosure proposals to:

  (i) provide further guidance on the definition of a key assumption, being an assumption to which the impairment model is most sensitive, to encourage more informative disclosure;

  (ii) revise the disclosure requirements of IAS 36 to provide more coherent disclosure principles regardless of the method chosen to determine recoverable amount; and

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(iii) incorporate an additional disclosure objective in IFRS 3 to provide information to help investors understand the subsequent performance of an acquisition, having regard to the commercially sensitive nature of the information.

6.15 The Board's preliminary views are similar to the report's recommendations listed in paragraphs 6.14(c)(i), 6.14(c)(iii) and 6.14(e)(iii). Paragraphs 3.12–3.19 set out the Board's view of the purpose of the impairment test for goodwill. The recommendations listed in paragraphs 6.14(c)(ii) and 6.14(d) are considered in paragraphs 4.55–4.56.

6.16 The Board is interested in feedback from stakeholders on whether, as the report recommends, the Board should review IAS 36 in its entirety and issue a new Standard in its place. Such a review is beyond the scope of this project. Therefore, the Board encourages stakeholders to respond to the Board's 2020 Agenda Consultation to help it decide whether it should add to its work plan a broader project to review IAS 36.[52]

Questions for respondents

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?

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?

52 See www.ifrs.org/projects/work-plan/2020-agenda-consultation/.

Appendix—Presenting total equity excluding goodwill

This appendix illustrates two ways of presenting total equity excluding goodwill as discussed in paragraphs 3.107–3.115.

The first illustration presents the free-standing amount in parentheses attached to the label for total equity and the second illustration shows a free-standing amount below the total for total equity and liabilities. For ease of reference, both have been shaded.

The illustrations are based on the example in the Guidance on implementing IAS 1 *Presentation of Financial Statements*. They do not reflect any changes that the Board proposes in the Exposure Draft *General Presentation and Disclosures*.

XYZ Group – Statement of financial position as at 31 December 20X7
(in thousands of currency units)

	31 Dec 20X7	31 Dec 20X6
ASSETS		
Non-current assets		
Property, plant and equipment	350,700	360,020
Goodwill	80,800	91,200
Other intangible assets	227,470	227,470
Investments in associates	100,150	110,770
Investments in equity instruments	142,500	156,000
	901,620	945,460
Current assets		
Inventories	135,230	132,500
Trade receivables	91,600	110,800
Other current assets	25,650	12,540
Cash and cash equivalents	312,400	322,900
	564,880	578,740
Total assets	1,466,500	1,524,200

continued...

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...continued

	31 Dec 20X7	31 Dec 20X6
EQUITY AND LIABILITIES		
Equity attributable to owners of the parent		
Share capital	650,000	600,000
Retained earnings	243,500	161,700
Other components of equity	10,200	21,200
	903,700	782,900
Non-controlling interests	70,050	48,600
Total equity		
(Total equity excluding goodwill: 31 Dec 20X7: 892,950 31 Dec 20X6: 740,300)	973,750	831,500
Non-current liabilities		
Long-term borrowings	120,000	160,000
Deferred tax	28,800	26,040
Long-term provisions	28,850	52,240
Total non-current liabilities	177,650	238,280
Current liabilities		
Trade and other payables	115,100	187,620
Short-term borrowings	150,000	200,000
Current portion of long-term borrowings	10,000	20,000
Current tax payable	35,000	42,000
Short-term provisions	5,000	4,800
Total current liabilities	315,100	454,420
Total liabilities	492,750	692,700
Total equity and liabilities	1,466,500	1,524,200
Total equity excluding goodwill	892,950	740,300

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IFRS® Standards
Discussion Paper

Snapshot

Business Combinations—Disclosures, Goodwill and Impairment

This Snapshot provides an overview of the Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment* published by the International Accounting Standards Board (Board).

The Board's objective:	To improve the information companies provide to investors, at a reasonable cost, about the acquisitions those companies make. Better information should help investors more effectively hold a company's management to account for its acquisition decisions.
Project stage:	The Board has published a Discussion Paper that sets out its preliminary views. The Board is seeking comments on whether: • its suggested disclosure requirements for acquisitions would provide useful information and are feasible; and • stakeholders have new evidence or new arguments on how companies should account for goodwill.
Next steps:	The Board will consider comments received on the Discussion Paper before deciding whether to develop an exposure draft containing proposals to implement any or all of its preliminary views.
Comment deadline:	15 September 2020

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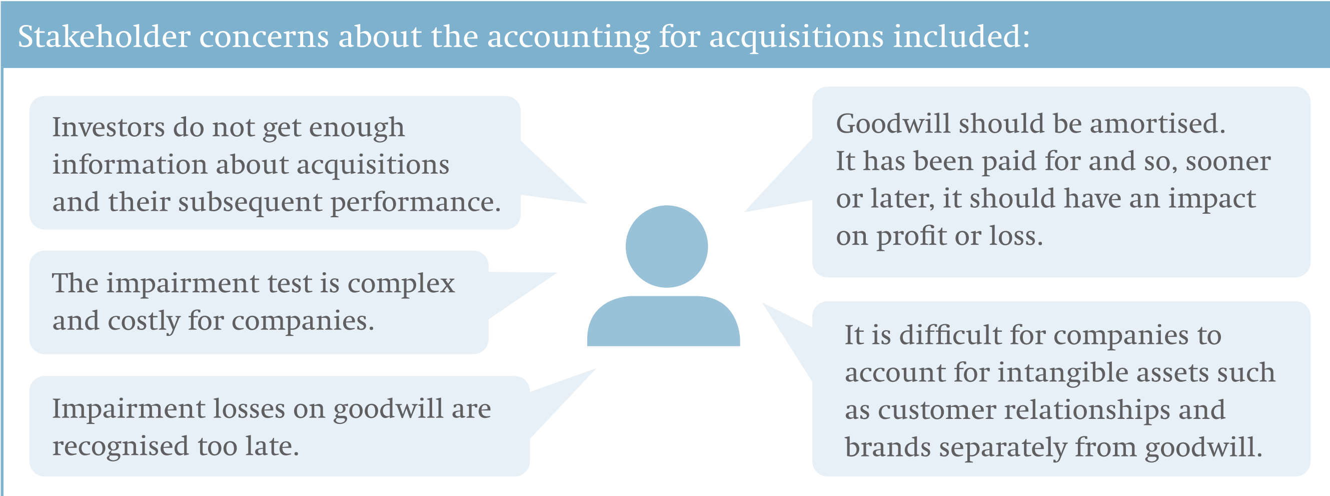
Why is the Board undertaking this project?

Mergers and acquisitions—referred to as 'business combinations' in IFRS Standards—are often large transactions for the companies involved. These transactions play a central role in the global economy. For example, deals announced in 2019 totalled $4 trillion.[1]

IFRS 3 *Business Combinations* sets out the accounting requirements for these transactions. A few years after issuing IFRS 3, the Board asked stakeholders whether the Standard was working as intended. Such an assessment is called a Post-implementation Review.

Stakeholders raised concerns about some aspects of the accounting for acquisitions. The Board has been exploring these concerns in a research project called 'Goodwill and Impairment'.

The Discussion Paper sets out the Board's preliminary views on how to respond to the concerns raised by stakeholders.



1 JPMorgan, 2020 Global M&A Outlook, January 2020.

The Board's preliminary views

1 Improving disclosures about acquisitions	Require companies to provide information that would help investors better understand an acquisition and its subsequent performance, including: • management's objectives for the acquisition, disclosed in the year of acquisition; and • how the acquisition has performed against those objectives in subsequent periods. (see pages 4–6)
2 Improving the accounting for goodwill	Background—What is goodwill and how is it tested for impairment? (see pages 7–8)
	A Can the impairment test be made more effective? — Not significantly, and not at a reasonable cost. (see pages 9–10)
	B Should goodwill be amortised? — No, retain the impairment-only model. (see page 11)
	C Can the impairment test be simplified? — Yes, provide relief from the quantitative annual impairment test and simplify how value in use is estimated. (see page 12)
3 Other topics	• Require companies to present on their balance sheets the amount of total equity excluding goodwill. • Do not change the range of intangible assets recognised in a business combination. (see page 13)

1 Improving disclosures about acquisitions

What is the issue?

Investors want information about acquisitions at the time of the transaction and about how well they perform afterwards. Investors want to be able to assess how effective a company's management is at acquiring businesses—at identifying targets, paying the right price, integrating the acquired business and realising the benefits from the transaction. Such information enables investors to hold management to account for its acquisition decisions.

However, IFRS Standards do not specifically require companies to disclose information about the subsequent performance of acquisitions.

The Board's preliminary view

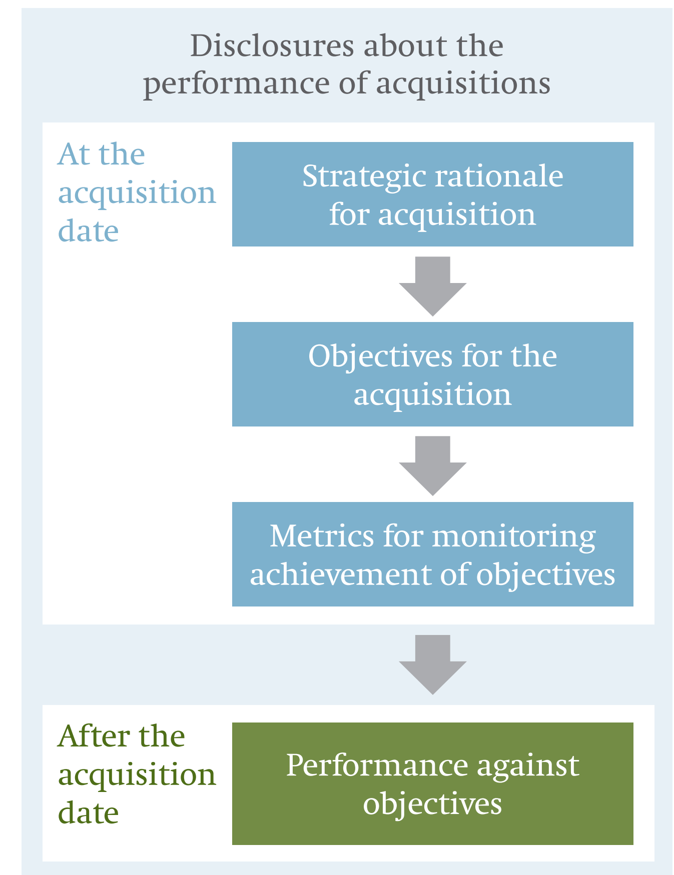
To provide investors with the information they need, companies should be required to disclose management's objectives for acquisitions and how acquisitions have performed against those objectives.

That information should be based on the information management uses to monitor acquisitions rather than on metrics specified by the Board because:

- the Board presumes that management monitors acquisitions internally and is aware of how well they are performing.
- objectives for acquisitions are company-specific. Therefore, no single set of metrics specified by the Board could provide useful information for all acquisitions.

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

Companies would be required to disclose information about acquisitions used by their chief operating decision maker, a term that is described in IFRS 8 *Operating Segments*. The Board is interested in stakeholders' views on whether such an approach would provide the information investors need.



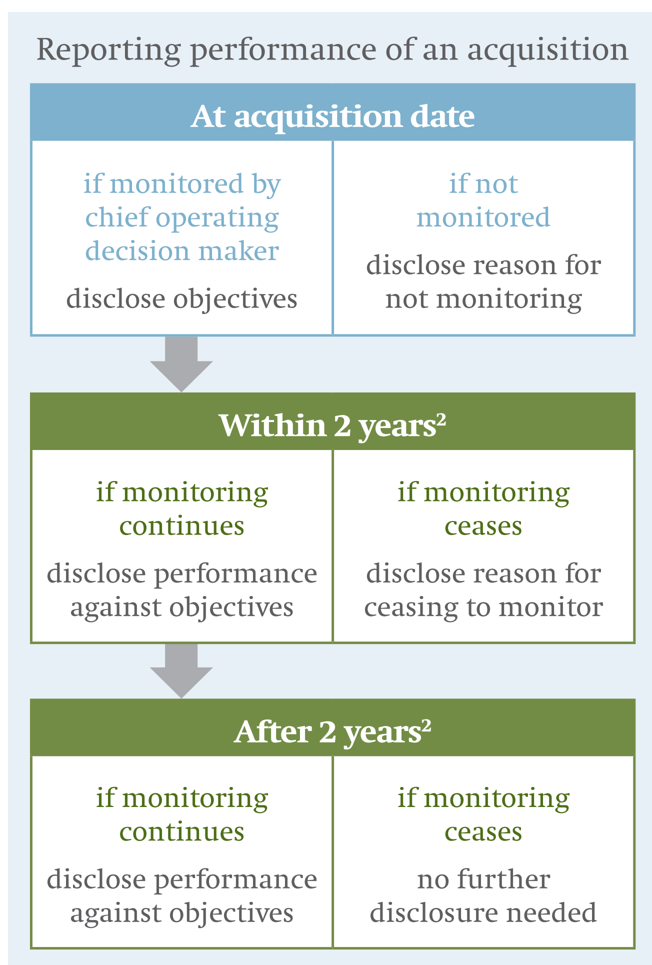
For how long do investors need information about the performance of acquisitions?

Stakeholders have said information about the subsequent performance of an acquisition becomes less relevant after a relatively short time, as the acquired business becomes indistinguishable from the rest of the acquirer's business.

Nevertheless, management is likely to be aware of how well an acquisition is performing in the first few years after acquisition, even if the acquired business is integrated.

Therefore, in the Board's preliminary view, a company should continue to provide information about an acquisition for as long as its chief operating decision maker continues to monitor the acquisition against its objectives.

If the chief operating decision maker does not monitor an acquisition or stops monitoring it shortly after the acquisition occurred, the company would be required to disclose this fact and explain why.



Further improvements to the disclosure requirements in IFRS 3

Stakeholders have said companies sometimes do not provide enough useful information about acquisitions. The Board is exploring targeted improvements to disclosures companies provide in the year of acquisition, including those on:

- **Expected synergies**
  Companies would be required to describe synergies management expected from an acquisition and disclose the estimated amount of synergies, or range of amounts. This information would help investors to better understand the factors that contributed to the acquisition price.
- **Defined benefit pension and debt liabilities of the acquired business**
  Companies would be required to disclose the amount of defined benefit pension and debt liabilities taken over in the acquired business, separately from other classes of liabilities. This information would help investors assess companies' return on capital employed.

2 Two full years after the year of acquisition.

Q&A—Disclosures about acquisitions and how well they perform

Q1 Would information about objectives be forward-looking information?

No. In the Board's view, such information reflects management's views and targets at the time of the acquisition. This information is not a forecast of the outcome of the acquisition at the time the company prepares its financial statements.

Q2 What happens if management changes the metrics it uses?

In such cases, a company would need to disclose the new metrics and the reasons for the change. A company would not be required to continue disclosing metrics the chief operating decision maker no longer uses internally.

Q3 Why do the Board's suggested requirements refer to the chief operating decision maker?

Monitoring the performance of an acquisition and deciding to allocate resources to acquire a business is likely to be part of the chief operating decision maker's role.

The Board believes that referring to the chief operating decision maker helps to focus the disclosures on the most important information about the most important acquisitions. Using this approach, the Board aims to provide investors with useful information but avoid excessive disclosures that may unnecessarily burden preparers.

The chief operating decision maker should be a familiar concept for companies applying IFRS 8.

Q4 What happens if the acquired business is integrated after acquisition?

Applying the Board's preliminary view, a company would disclose the information the chief operating decision maker uses to monitor the acquisition, which could be about the combined business.

In such cases, the chief operating decision maker may obtain further explanation of what the information about the combined business signals about the performance of the acquisition. If so, the company would also need to disclose such information if investors need it to understand whether the objectives of the acquisition are being met.

Q5 Would the information about the performance of acquisitions be too subjective to verify?

The Board expects that it would be possible to verify objectively whether such information:

- is indeed used by management for monitoring;
- has a clear basis for preparation; and
- faithfully represents the performance of the acquisition.

❷ Improving the accounting for goodwill

What are the issues?

Stakeholders have reported concerns that:

- impairment losses on goodwill are often recognised too late, long after the events that caused those losses; and
- the impairment test can be costly and complex to perform.

In view of these issues, the Board considered:

A. whether the impairment test could be made more effective (see pages 9–10);

B. whether goodwill should be amortised (see page 11); and

C. whether the impairment test could be simplified (see page 12).

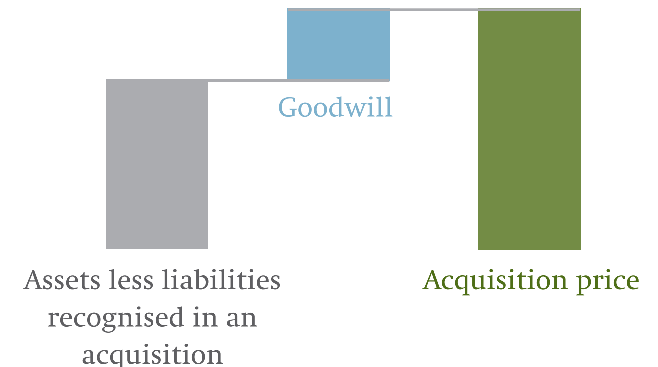
What is goodwill and how do companies account for it?

When a company buys a business, the company reports on its balance sheet the assets and liabilities acquired and, in most cases, an asset called goodwill.

At the date of the acquisition, the company measures goodwill as the amount by which the price paid for the business exceeds the fair values of the individual assets and liabilities recognised in an acquisition.

An acquirer pays this excess because it expects to achieve benefits from the acquisition, such as future synergies, that are not reported on the balance sheet separately as identifiable assets.

Before the Board issued IFRS 3 in 2004, companies were required to amortise goodwill—that is, goodwill was gradually written down over a fixed period (its 'useful life'). In 2004 the Board introduced a requirement to carry out an annual impairment test of goodwill and prohibited the amortisation of goodwill.



How does an impairment test work?

Applying IAS 36 *Impairment of Assets*, an impairment test assesses whether the value of an asset is lower than the amount recorded for it on the balance sheet (carrying amount).

A company estimates the value of an asset (recoverable amount) as the higher of:

- the amount of cash flows it expects to generate by continuing to use the asset (value in use); and
- the amount for which the company could sell the asset (fair value less costs of disposal).

If the value of an asset is lower than its carrying amount, the company would recognise an impairment loss. The impairment loss would reduce the amount on the balance sheet to the value of the asset. This impairment loss is recognised as an expense in profit or loss for that period.

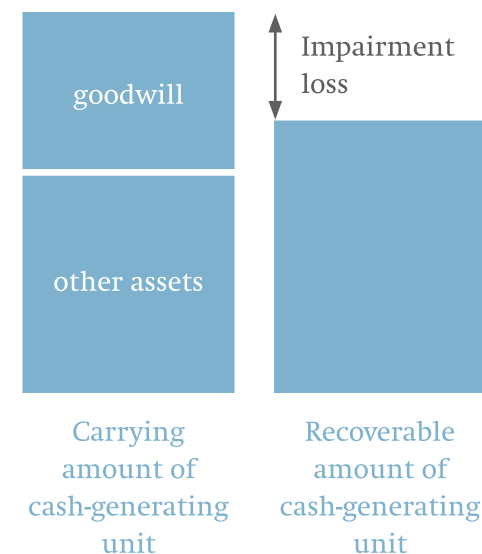
How is goodwill tested for impairment?

Many assets—for example, a building or a brand—can create value for a company only by working together with other assets to generate cash for the company from the goods they produce or services they provide.

Companies test these assets together for impairment as a group. Such groups of assets are called cash-generating units.

Goodwill is one such asset that can only be tested for impairment together with other assets.

When a company concludes that a group of assets is impaired, the impairment loss first reduces the carrying amount of any goodwill in the group, before reducing the carrying amount of any other asset. As a result, the impairment test cannot directly assess goodwill for impairment.



2 A Can the impairment test be made more effective?

What is the issue?

Some stakeholders have told the Board that the impairment test does not identify impairment of goodwill on a timely basis. This delay may occur because:

- management's estimates of future cash flows may be too optimistic (see page 10); or
- goodwill is 'shielded' from impairment by, for example, the headroom of a business with which an acquired business is integrated.

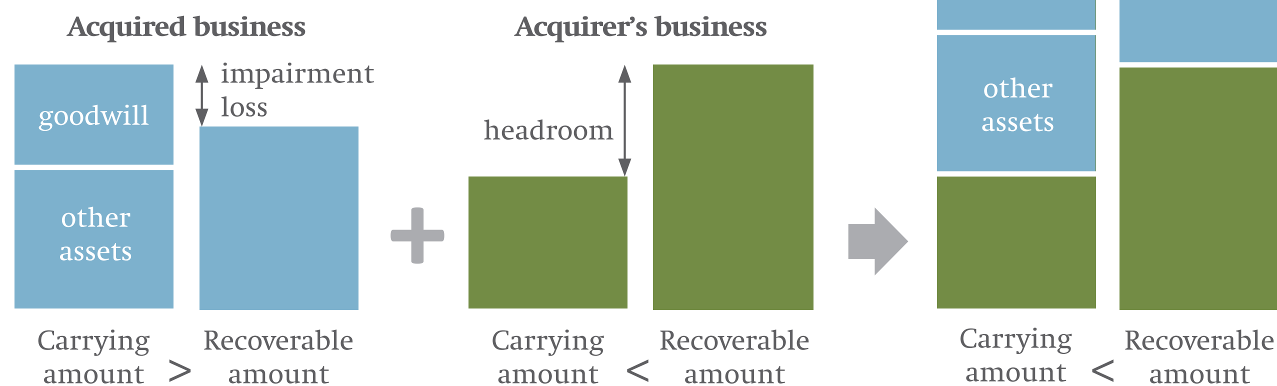
Headroom largely arises because not all of the value of a business is recognised on a company's balance sheet. For example, a company's balance sheet does not include some intangible assets that the company generates internally.

Shielding—illustration

In this example, the acquired business is not performing as well as expected. If the acquired business were run independently of the acquirer and tested for impairment separately, an impairment loss on goodwill would be recognised because the value (recoverable amount) of the acquired business is lower than its carrying amount.

However, if the acquired business is integrated with the acquirer's business, as is often the case, the impairment test looks only at the combined business.

In that case, despite the poor performance of the acquired business, no impairment loss is recognised because the recoverable amount of the combined business is higher than its carrying amount. The headroom of the acquirer's business absorbs the decline in the recoverable amount of the acquired business, thus shielding the goodwill from impairment.



The Board's preliminary view

The Board explored whether it could design an impairment test that reduces the effect of shielding, resulting in earlier recognition of impairment losses on acquired goodwill.

> After extensive work, the Board's preliminary view is that significantly improving the effectiveness of the impairment test for goodwill at a reasonable cost to companies is not feasible.

The Board's preliminary view is that it is not possible to eliminate shielding from the impairment test because goodwill has to be tested for impairment together with other assets and these groups of assets could contain headroom.

Therefore, the impairment test cannot always signal how well the acquired business is performing. The Board has developed the disclosures discussed on pages 4–5 to meet investors' need for timely information about the performance of acquisitions.

If the impairment test is performed well, the test can be expected to achieve its objective of ensuring that the carrying amount of a group of assets containing goodwill as a whole is not higher than its recoverable amount.

The Board's preliminary view is that if estimates of future cash flows are too optimistic (see page 9), this is best addressed by auditors and regulators, not by changing IFRS Standards. Companies are required by IAS 36 to use reasonable and supportable estimates when performing an impairment test.

✓ An impairment test seeks to assess

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

✕ 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.

2 B Impairment-only vs amortisation

Having concluded that the impairment test cannot be significantly improved at a reasonable cost (see page 10), the Board explored whether to reintroduce amortisation of goodwill,[3] as some stakeholders had suggested.

The Board's preliminary view

There have always been strongly held and divergent views on whether goodwill should be amortised or should only be tested for impairment. Each approach has its limitations.

In the Board's preliminary view, the impairment-only model should be retained. In the view of the majority of Board members there is no compelling evidence that amortising goodwill would result in a significant improvement in financial reporting. The majority for this decision was small, so the Board is interested in stakeholders' views on this topic.

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

The Board has heard the following arguments from stakeholders who support either of the two approaches:

Amortising goodwill	Retaining the impairment-only model
some say ...	others say ...
Goodwill amounts on the balance sheet 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 test cannot do.	The impairment-only model provides useful confirmatory information to investors. Although amortisation is simple, it leads to arbitrary outcomes that would be ignored by many investors and many companies would exclude it from performance measures they provide to investors.
Feedback suggests the impairment test is not working as well as the Board intended and does not always write goodwill down when it has lost value.	If applied well, the impairment test works as the Board intended, ensuring that, as a group, goodwill and other assets of a business are not overstated.
Goodwill is a wasting asset, which reduces as the benefits are consumed. Amortisation is the only way to show the consumption of goodwill.	The benefits of goodwill are maintained for an indefinite period, so goodwill is not a wasting asset.
Amortising goodwill would ultimately make the impairment test easier and less costly to apply because amortisation would reduce the carrying amount of goodwill, making an impairment less likely.	Amortising goodwill would not significantly reduce the cost of impairment testing, especially in the first few years.

3 Companies would still be required to perform impairment tests of goodwill, even if goodwill is amortised.

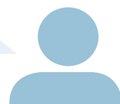
2 C Simplifying the impairment test

The Board is seeking to simplify the impairment test to address some of the concerns raised by stakeholders, without making the test significantly less robust.

Relief from an annual impairment test

IAS 36 requires companies to perform annual quantitative impairment tests even when they have no reason to suspect that an impairment might have occurred. Stakeholders have said that:

> The annual test adds cost for companies but provides little useful information to investors when there is no indication of impairment.



The Board's preliminary view is that it should no longer require a company to carry out an annual quantitative impairment test of cash-generating units containing goodwill if the company has no indication that an impairment has occurred. A company would still be required to assess whether any such indication exists.

The change would reduce the cost of performing the impairment test.

The Board believes the change would not make the test significantly less robust because:

- when there is no indication of impairment it is unlikely that the quantitative test would identify large impairment losses; and
- performing the test every year cannot remove shielding (see page 9).

Simplifying value in use estimates

IAS 36 requires companies to estimate value in use (see page 8) on a pre-tax basis and to exclude from their forecasts cash flows from future uncommitted restructurings or asset enhancements. Stakeholders have said that:

> Working out which cash flows to exclude makes the test costly. Pre-tax discount rates are not observable; that is why the test is usually performed on a post-tax basis.

The Board's preliminary view is that it should:

- remove the restriction on including cash flows from uncommitted future restructurings or asset enhancements. The cash flow forecasts would still need to be reasonable and supportable.
- allow the use of post-tax discount rates and post-tax cash flows.

These changes would:

- reduce the cost and complexity of performing impairment tests by aligning cash flow estimates with companies' internal forecasts; and
- produce more useful and understandable information that is aligned with management estimates and industry practice.

❸ Other topics

Total equity excluding goodwill

The Board's preliminary view is that companies should present on the balance sheet the amount of total equity excluding goodwill.

Goodwill is different from other assets. It can only be measured indirectly—as part of a business valuation—and it cannot be sold separately.

Presenting the amount of total equity excluding goodwill on the balance sheet would make the amount more prominent and could draw investors' attention to companies whose goodwill constitutes a significant portion of their net assets.

The amount of total equity excluding goodwill may not fit easily into all balance sheet formats as a subtotal. However, there could be other ways a company could present the amount on the balance sheet. For example, the amount of total equity excluding goodwill could be presented on the balance sheet as a free-standing amount.

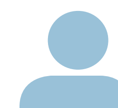
Recognising acquired intangible assets separately from goodwill

The Board's preliminary view is that it should retain the requirements in IFRS 3 and IAS 38 *Intangible Assets*.

When it issued IFRS 3, the Board broadened the range of acquired intangible assets recognised separately from goodwill, such as brands. Stakeholders' views on that approach differ. Companies' views on the cost of separate recognition also differed.

Because of the different views on how useful and costly this information is, the Board has no compelling evidence that it should change the range of intangible assets recognised in a business combination.

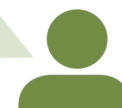
Considering whether to align the accounting treatments for acquired and internally generated intangible assets is beyond the scope of this project.



Separate recognition helps to explain what companies have bought. 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.



If stakeholders would like the Board to consider adding to its work plan a broader project on intangible assets, they can provide their inputs to the Board's 2020 Agenda Consultation.

Summary of the Board's preliminary views

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

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

For each of the possible changes the Board considered, the table on the right summarises:

- whether the change would help to achieve the objectives, if implemented; and
- the Board's preliminary view on whether to make the change.

The Board also considered whether the impairment test could be made significantly more effective, at a reasonable cost to companies. Its preliminary view is that this is not feasible (see page 10).

	Possible changes the Board considered	Objectives		Board's preliminary view
		More useful information	Reduce cost	
1	Improve disclosures about acquisitions	✓	✗	Yes, change
2	Amortise goodwill	✗	✓	No, do not change
	Provide relief from mandatory annual impairment test	...	✓	Yes, change
	Amend how value in use is estimated	✓	✓	Yes, change
3	Present total equity excluding goodwill	✓	...	Yes, change
	Include some intangible assets in goodwill	✗	✓	No, do not change

✓ In line with objective ✗ In conflict with objective ... No significant impact

Further information

The deadline for comments on the Discussion Paper is 15 September 2020.

Stakeholders are invited to respond to the questions in the Discussion Paper. The Board will welcome responses even if stakeholders do not comment on all questions.

To stay up to date with the latest developments in this project and to sign up for email alerts, please visit www.ifrs.org/projects/work-plan/goodwill-and-impairment/.

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NZ ACCOUNTING STANDARDS BOARD

Memorandum

Date:	24 April 2020
To:	NZASB Members
From:	Vanessa Sealy-Fisher
Subject:	**For-profit RDR**

Purpose and introduction[1]

1. The purpose of this agenda item is to seek the Board's views on whether to align the disclosure requirements for Tier 2 for-profit entities (NZ IFRS RDR) with the new disclosure requirements recently issued by the Australian Accounting Standards Board (AASB) in AASB 1060 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities* (AASB 1060).

2. NZ IFRS RDR was introduced in November 2012 as part of the new Accounting Standards Framework. The disclosure concessions were harmonised with the Reduced Disclosure Requirements (RDR) developed by the AASB in 2010 for application by Tier 2 entities in Australia. A driver of this harmonised project was to achieve an objective of the Joint Statement of Intent: Single Economic Market Outcomes signed by the Prime Ministers of Australia and New Zealand (August 2009) that for-profit entities operating in both jurisdictions need to prepare only one set of financial statements.

3. The approach taken to developing RDR was to draw on the disclosure requirements in the IASB's *IFRS for SMEs* Standard when the Tier 2 recognition and measurement requirements are the same as those under the *IFRS for SMEs* Standard. When the recognition and measurement requirements are not the same, the 'user needs' and 'cost-benefit' principles applied by the IASB in developing its *IFRS for SMEs* Standard are applied to the disclosure requirements in Australian Accounting Standards (AAS) and NZ IFRS. That is, a top-down approach is used which starts with the full disclosure requirements in AAS and NZ IFRS and then identifies those which can be removed. One of the concerns with this approach is that there could be a tendency to retain disclosures where a direct comparison of the disclosures in AAS/NZ IFRS with the disclosures in the *IFRS for SMEs* Standard is not possible.

4. This memo outlines the RDR project undertaken jointly by the AASB and the NZASB over the period 2015–2017, the IASB's current project *Disclosure Initiative—Subsidiaries that are SMEs* (Subsidiaries that are SMEs), the recent AASB project which has resulted in the issue of AASB 1060, and options for the Board to consider regarding the future direction of NZ IFRS RDR.

[1] This memo refers to the work of the International Accounting Standards Board (IASB) and uses registered trademarks of the IFRS Foundation (for example, IFRS® Standards, IFRIC® Interpretations and IASB® papers).

Recommendation

5. We recommend that the Board:

   (a) AGREES to wait for the IASB to develop and issue an exposure draft (ED) on its project *Disclosure Initiative—Subsidiaries that are SMEs* and then consider whether to explore harmonisation of NZ IFRS RDR with the IASB's proposals or with AASB 1060; and

   (b) AGREES to recommend to the XRB Board that a temporary hold is put on the harmonisation of presentation and disclosure requirements with Australia for Tier 2 for-profit entities.

Structure of this memo

6. The remaining sections in this memo are:

   (a) Joint AASB/NZASB RDR project 2015–2017;

   (b) IASB project *Disclosure Initiative—Subsidiaries that are SMEs*;

   (c) AASB project 2019–2020;

   (d) Targeted Review of the Accounting Standards Framework;

   (e) Options for NZ IFRS RDR;

   (f) Next steps;

   (g) Appendix A: Summary of changes to Australian RDR; and

   (h) Appendix B: Summary of significant decisions made by the AASB in developing the disclosures in AASB 1060.

Joint AASB/NZASB RDR project 2015–2017

7. In March 2015 AASB staff and NZASB staff started a project to jointly review the disclosure requirements for Tier 2 for-profit entities. During 2015 and 2016 the AASB and the NZASB considered agenda papers prepared jointly by AASB staff and NZASB staff. These agenda papers comprised several iterations of principles to be used for determining RDR, a proposed RDR framework and a draft joint Australian and New Zealand Policy Statement for Determining RDR for Tier 2 Entities.

8. In January 2017 the AASB issued AASB ED 277 *Reduced Disclosure Requirements for Tier 2 Entities* (ED 277). During the comment period the AASB held roundtable discussions in Melbourne, Sydney and Canberra. AASB staff also obtained additional feedback from preparers of Tier 2 financial statements through targeted outreach.

9. In January 2017 the NZASB issued ED NZASB 2017-1 *Amendments to RDR for Tier 2 For-profit Entities* (ED NZASB 2017-1). During the comment period feedback on the proposals was sought from the Technical Reference Group (TRG) and a webinar was held.

10. Comments on the EDs were due at the end of May 2017. The AASB received 14 submissions on ED 277 and the NZASB received eight submissions on ED NZASB 2017-1. A high-level analysis of the submissions received was tabled at the August 2017 meetings of the AASB and the NZASB.

11. The responses to the EDs indicated support for the proposed joint policy statement which was included with the EDs. However:
    (a) several respondents provided suggestions for improving the proposed RDR framework;
    (b) requests were made for the AASB and the NZASB to reconsider the outcome of the application of the RDR framework to the disclosures in AAS/NZ IFRS; and
    (c) some respondents disagreed with the proposed RDR framework, mainly on the basis that there were no significant reductions to the disclosures currently required under RDR.

12. Although it was intended that this project would progress, further work was put on hold by the AASB following (AASB 1060.BC22):
    (a) the issue of the IASB's revised *Conceptual Framework for Financial Reporting* in May 2018; and
    (b) the AASB's decision to reform the Australian Financial Reporting Framework and propose removing the ability for entities to prepare special purpose financial statements (SPFS) when required to comply with AAS by legislation or otherwise.

13. In February 2019 the IASB decided to develop a new Tier 2 disclosure standard, rather than proceeding with the joint AASB/NZASB RDR project (see paragraph 27 below).

IASB project *Disclosure Initiative—Subsidiaries that are SMEs*

14. In 2016, following comments received on the previous agenda consultation, the IASB included in its research pipeline a project on disclosures for subsidiaries that are SMEs. In March 2019 IASB staff reported to the IASB that the research project had become active. We have been actively monitoring this project since September 2019.

15. The objective of the research stage of the project was to assess whether it would be feasible to permit subsidiaries that are SMEs to apply the recognition and measurement requirements of IFRS Standards with the disclosure requirements of the *IFRS for SMEs* Standard.[2] The research stage provided the IASB with evidence to move the project to standard setting.

16. The objective of the project is to develop a reduced disclosure IFRS Standard that would apply on a voluntary basis to subsidiaries that are SMEs. The starting point for the disclosures will be those from the *IFRS for SMEs* Standard, amended as appropriate.

[2] The *IFRS for SMEs* Standard is intended for application by small and medium-sized entities that (a) do not have public accountability, and (b) publish general purpose financial statements for external users.

17. The table below outlines the matters considered by the IASB in respect of this project and the tentative decisions made to date.

Date of meeting	***Matters considered/tentative decisions made***[3]
September 2019	• Received an update on the research project. • Discussed the results of the research on whether a standard, if developed, would be adopted and applied.
October 2019	• Considered whether it could, with only minimal tailoring, adapt the disclosure requirements of the *IFRS for SMEs* Standard for use by subsidiaries that are SMEs that apply the recognition and measurement requirements of IFRS Standards. • Considered the staff's example disclosure requirements for five IFRS Standards (see below for further detail). • Tentatively decided to follow Approach 2.
November 2019	• Discussed the benefits for preparers from the project on Subsidiaries that are SMEs and the scope of the project. • Decided to consider the scope of the project only after it has compared most IFRS Standards with their corresponding sections in the *IFRS for SMEs* Standard.
December 2019	• Received an update on the AASB's project from the Chair of the AASB.
January 2020	• Decided to move the project from the research programme to the standard-setting programme. • Decided to continue identifying necessary tailoring by analysing IFRS Standards and relevant Sections in the *IFRS for SMEs* Standard, and develop a consultative document (ED or discussion paper—to be determined at a later meeting) as soon as possible.

18. IASB staff are seeking the IASB's views on the following matters at the April meeting:[4]

(a) The proposed project plan for 2020

Q2 Presentation: should the reduced disclosure IFRS Standard require presentation from IFRS Standards or from the *IFRS for SMEs* Standard?

Q3 Sundry issues (for example, wording of the compliance statement required by an entity applying the reduced disclosure IFRS Standard, and disclosure requirements in the *IFRS for SMEs* Standard that have been removed from IFRS Standards).

Q4
- Scope: should the scope remain subsidiaries that are SMEs or be extended to all SMEs or somewhere between the two?
- Should the consultation document be an ED or a discussion paper?
- Seek permission to begin the balloting process.

(b) The staff recommendation that the presentation requirements of IFRS Standards should be applied by subsidiaries that are SMEs that apply the standard being developed in this project.

[3] Summaries per the IASB Update from the relevant meeting available at https://www.ifrs.org/news-and-events/updates/iasb-updates/#2019-english and https://www.ifrs.org/news-and-events/updates/iasb-updates/#2020-english

[4] Agenda papers available at https://www.ifrs.org/news-and-events/calendar/2020/april/international-accounting-standards-board/?f1=2020&f2=April&f3=

19. We will provide a verbal update regarding the discussions on this project from the April IASB meeting at the May Board meeting.

20. At its October 2019 meeting the IASB considered the staff's example disclosure requirements for the following five IFRS Standards:

IFRS Standard	**Relationship with the *IFRS for SMEs* Standard**
IFRS 8 *Operating Segments*	Not dealt with in the *IFRS for SMEs* Standard
IFRS 16 *Leases*	A new standard which replaced IAS 17. Section 20 of the *IFRS for SMEs* Standard is aligned with IAS 17
IAS 10 *Events after the Reporting Period*	Section 32 of the *IFRS for SMEs* Standard is aligned with IAS 10
IAS 36 *Impairment of Assets*	Section 27 of the *IFRS for SMEs* Standard is aligned with IAS 36
IAS 38 *Intangible Assets*	IAS 38 contains some different recognition and measurement requirements to Section 18 of the *IFRS for SMEs* Standard

21. We have compared the IASB staff proposals for disclosures with the disclosures in AASB 1060 and NZ IFRS RDR for the above standards. Except for leases, the disclosures are substantively similar under all three frameworks. (A copy of the comparison is available from staff if Board members wish to see the detail.)

22. Based on the IASB staff proposed project plan for this project, we do not expect the IASB to publish an ED until early 2021.

Comprehensive Review of the IFRS for SMEs Standard

23. The IASB is currently carrying out a comprehensive review of the *IFRS for SMEs* Standard. As part of the first phase of the review the IASB has issued for comment a Request for Information—Comprehensive Review of the IFRS for SMEs Standard (RfI). The comment date was originally 20 July 2020 but has been extended to 27 October 2020 at the 17 April IASB meeting.[5]

24. The RfI is requesting views on whether and, if so, how the *IFRS for SMEs* Standard should be updated to take account of new IFRS Standards and amendments not currently incorporated into the *IFRS for SMEs* Standard (for example, FRS 7 *Financial Instruments Disclosures* and IFRS 9 *Financial Instruments*, IFRS 15 *Revenue from Contracts with Customers* and IFRS 16 *Leases*).

25. After reviewing feedback on the RfI if the IASB identifies possible amendments to the *IFRS for SMEs* Standard, it will issue an ED inviting comments on its proposals. The IASB has not indicated expected timings for an ED. The IASB will need to consider any proposed amendments to the *IFRS for SMEs* Standard as part of its *Disclosure Initiative—Subsidiaries that are SMEs* project.

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[5] https://www.ifrs.org/projects/work-plan/2019-comprehensive-review-of-the-ifrs-for-smes-standard/comment-letters-projects/request-for-information/

AASB project 2019–2020

26. As previously mentioned in paragraph 12 above, the AASB put the joint AASB/NZASB RDR project on hold.

27. In February 2019 the AASB decided to develop a new Tier 2 disclosure standard, rather than proceeding with the joint AASB/NZASB RDR project. This decision was based on:

    (a) feedback received on ED 277 that the proposed disclosures under the joint project were still too many for Tier 2 entities;

    (b) feedback received on the March 2018 Consultation Paper ITC 39 *Applying the IASB's Revised Conceptual Framework and Solving the Reporting Entity and Special Purpose Financial Statement Problems*; and

    (c) the need to cater for for-profit private sector entities that would no longer be able to prepare SPFS under the amended Australian Financial Reporting Framework.

28. The approach adopted to develop the new Tier 2 disclosure standard was based on the disclosures in the *IFRS for SMEs* Standard. However, the approach taken to identifying the disclosure requirements differs from the approach under Australian RDR. Under the new Tier 2 disclosure standard, the approach taken is a bottom-up approach, that is, the starting point is the existing disclosures in the *IFRS for SMEs* Standard rather than the disclosures in AAS. Rather than deciding which disclosures in AAS should be removed for Tier 2 entities, the decision is what, if any, additional disclosures are needed. An advantage of this approach is that it avoids the tendency to retain disclosures in circumstances where a direct comparison is not possible.

29. In August 2019 the AASB issued:

    (a) ED 295 *GPFS Simplified Disclosures for FP and NFP Tier 2 Entities*, which proposed to replace the existing RDR with a new separate disclosure standard; and

    (b) ED 297 *Removal of SPFS for certain for-profit entities*, which proposed to remove the ability of certain for-profit entities to publicly lodge SPFS.

30. Comments on the EDs were due at the end of November 2019. During the comment period extensive outreach was conducted on the proposals in the EDs.

31. At its meeting in March 2020 the AASB:

    (a) considered the feedback received on the proposals in ED 295;

    (b) considered a pre-ballot draft of the new accounting standard; and

    (c) agreed some minor amendments to the draft new standard.

32. In March 2020 the AASB issued AASB 1060 with an effective date of annual reporting periods beginning on or after 1 July 2021. A summary of the disclosures removed from RDR and new disclosures added as a result of the *IFRS for SMEs* Standard is included at Appendix A. For clarity, the new disclosure framework is referred to as the Simplified Disclosures Framework.

33. The AASB acknowledges in the Basis for Conclusions that accompanies AASB 1060 that adopting the standard will result in a divergence from the New Zealand RDR Framework.

> BC30 However, the Board noted that adopting this Standard will result in a divergence form the New Zealand RDR Framework. The AASB's *For-Profit Entity Standard-Setting Framework* sets out the differences between accounting Standards issued in Australia and New Zealand for for-profit entities should be minimised wherever possible to reduce the costs for entities operating trans-Tasman. This divergence could cause inconvenience for entities operating trans-Tasman. Notwithstanding this, the Board noted that the R&M requirements for entities applying the Tier 2 reporting frameworks in Australia and New Zealand would remain consistent and given the current situation of many Australian entities not complying with full R&M requirements, the overall outcome is likely to be more consistency with NZ requirements than currently. The Board further noted that the NZ XRB has asked its stakeholders about the importance of harmonisation with Australia in their Targeted Review of the Accounting Standards Framework in July 2019 and the NZASB will consider the feedback in future discussions on whether and how to respond to the developments in Australia and internationally.[6]

34. While developing ED 295 the AASB was aware that the IASB had added a research project on Subsidiaries that are SMEs to its agenda, and that this project was moved to the standard-setting agenda in January 2020. The AASB was aware that AASB 1060 might ultimately be replaced with the standard developed by the IASB. However, the AASB could not wait for the IASB to complete its project because a revised disclosure framework was needed in time for the removal of SPFS from 1 July 2021. The AASB continues to monitor the progress of the IASB's project.

Comparison of AASB 1060 and NZ IFRS RDR

35. We have compared the disclosure requirements under NZ IFRS RDR with the disclosure requirements in AASB 1060. (A copy of the comparison is available from staff if Board members wish to see the detail.) Generally speaking, NZ IFRS RDR requires Tier 2 for-profit entities to provide ***more*** disclosures than are required under AASB 1060. However, AASB 1060 does require some disclosures that were not required under Australian RDR.

36. A significant number of the differences between NZ IFRS RDR and the disclosure requirements in AASB 1060 are a consequence of the *IFRS for SMEs* Standard not having been updated for new IFRS Standards, and the different approaches taken to developing AASB 1060 and NZ IFRS RDR.

37. Appendix A contains a high-level summary of the changes to Australian RDR as a consequence of AASB 1060. As Australian RDR is substantively harmonised with NZ IFRS RDR, this appendix will help provide Board members with a high-level summary of the disclosures that have been removed from Australian RDR and the new disclosures that are included in AASB 1060.

38. For Board members' information, we have included a summary of significant decisions made by the AASB in developing the disclosures in AASB 1060 in Appendix B.

[6] R&M means recognition and measurement

Targeted Review of the Accounting Standards Framework

39. Paragraph 27 of the New Zealand Accounting Standards Framework states that Tier 2 Accounting Requirements are harmonised with Australia as appropriate.

40. The Targeted Review of the Accounting Standards Framework (the Targeted Review) conducted by the XRB in 2019 sought feedback on the importance of harmonisation with Australia for Tier 2 for-profit disclosures.

41. The following high-level summary is taken from agenda item 9.2 from the February 2020 Board meeting.

    46. While the majority of respondents were of the view that continued harmonisation with Australia for Tier 2 for-profit disclosures is important, we (NZASB staff) note the following.

        (a) Among the respondents that are preparers, only one respondent (R15) identified as a for-profit preparer within a group that contains Australian entities. While that respondent was of the view that harmonisation with Australia is important, the respondent also noted that some divergence in disclosure requirements can be acceptable.

        (b) Among the accounting firms and professional accounting bodies (whose clients/constituents include Tier 2 for-profit entities) there were mixed views as to the importance of harmonisation with Australia for Tier 2 for-profit disclosures and as to whether the XRB should wait for the IASB to finalise its project in this area.

        (c) Many of the respondents who considered continued alignment with Australia to be important did not specifically refer to the upcoming changes in the Australian Tier 2 regime or to the IASB's work on a reduced disclosure requirements regime, and therefore might not have considered these developments.

Options for NZ IFRS RDR

42. With the issuance of AASB 1060 and the IASB developing a disclosure standard for subsidiaries that are SMEs it is necessary for us to consider the options for NZ IFRS RDR going forward. Those options are:

    (a) Option 1: undertake a project now to explore harmonising NZ IFRS RDR with AASB 1060; or

    (b) Option 2: wait for the IASB to develop and issue an ED on its project *Disclosure Initiative—Subsidiaries that are SMEs* and then consider whether to explore alignment of NZ IFRS RDR with the IASB's proposals or with AASB 1060.

43. We recommend option 2, wait for the IASB to develop and issue an ED proposing disclosure requirements for subsidiaries that are SMEs, for the following reasons.

    (a) Whichever option is followed, NZ IFRS RDR will not be harmonised with Australia in the short term. Even if we develop an ED to harmonise with Australia, the effective date of the requirements in New Zealand would be later than 1 July 2021.

(b) Although the majority of respondents to the Targeted Review supported harmonisation of disclosures for Tier 2 for-profit entities in Australia and New Zealand, and thought harmonisation is important, the following comments were also made.

  (i) Some respondents were of the view that it would be beneficial to await the outcome of the IASB's project and then decide whether New Zealand should harmonise with the Australian requirements or the IASB's requirements.

  (ii) Several respondents were concerned about harmonising with Australia and then making subsequent changes to harmonise with the IASB's requirements (if these were considered appropriate), and the costs that would be imposed on preparers.

  (iii) The respondent that identified as a for-profit preparer within a group that contains Australian entities was of the view that some divergence in disclosure requirements can be acceptable.

(c) Using the IASB's disclosure requirements under its Subsidiaries that are SMEs project as a basis for disclosure requirements for Tier 2 for-profit entities would:

  (i) result in disclosure requirements for Tier 2 entities that are converged with the disclosure requirements for similar entities in other jurisdictions that adopt the IASB's approach;

  (ii) reduce compliance costs for entities with international and trans-Tasman reporting obligations; and

  (iii) increase comparability for users of Tier 2 for-profit financial statements with similar entities in other jurisdictions (when such financial statements are available).

(d) At the April IASB meeting, IASB staff are recommending that a disclosure standard for subsidiaries that are SMEs contains only disclosures and not presentation requirements. This means that subsidiaries that are SMEs would apply the presentation requirements in IAS 1 *Presentation of Financial Statements* and IAS 7 *Statement of Cash Flows*. This would be different to AASB 1060, which has used the presentation requirements from sections 3–8 of the *IFRS for SMEs* Standard rather than the requirements in AASB 101 *Presentation of Financial Statements* and AASB 107 *Statement of Cash Flows*. The IASB staff recommended approach is more consistent with the current NZ IFRS RDR approach.

(e) The IASB's proposed project plan indicates approval to begin the balloting process will be sought in Q4 of 2020 (that is, October–December). Even though we do not expect an ED to be issued until early 2021, we see no urgency to propose amendments to NZ IFRS RDR until we see the IASB's proposals.

44. We acknowledge the close economic ties between Australia and New Zealand, and that differences in Tier 2 for-profit disclosures for entities operating in both jurisdictions is not ideal. However, we note the following.

(a) NZ IFRS RDR was initially developed later than Australian RDR so different disclosure requirements for Tier 2 for-profit entities is not something new.

(b) Respondents to the Targeted Review had mixed views on the impact of consolidation of different disclosure requirements for Tier 2 entities. Some respondents were of the view that harmonised disclosure requirements make the consolidation process less costly and more efficient. Another respondent commented that parent entities tend to issue group reporting packages which detail the disclosures required, and that these disclosures 'often exceed' what is required under RDR.

(c) There will continue to be no recognition and measurement differences for entities that operate in both Australia and New Zealand. Under AASB 1060 and NZ IFRS RDR Tier 2 for-profit entities continue to be required to comply with all recognition and measurement requirements in AAS and NZ IFRS respectively.

45. One respondent to the Targeted Review suggested that the XRB should work with the AASB to establish specific details around the number of entities that are likely to be affected if disclosure requirements are not harmonised. Although we do not currently have these details, for the reasons noted above, we support waiting for the IASB to develop and issue an ED regarding disclosures for subsidiaries that are SMEs and then consider whether to explore harmonisation of NZ IFRS RDR with the IASB's proposals or with AASB 1060.

Question for the Board

1. Does the Board agree with the staff recommendation to wait for the IASB to develop and issue an ED on its project *Disclosure Initiative—Subsidiaries that are SMEs* and then consider whether to explore harmonisation of NZ IFRS RDR with the IASB's proposals or with AASB 1060?

46. If the Board agrees with our recommendation to wait for the IASB to publish an ED, we plan to seek the XRB Board's approval to put a temporary hold on the harmonisation of disclosure requirements with Australia for Tier 2 for-profit entities.

Question for the Board

2. Does the Board agree that we should seek the XRB Board's approval to put a temporary hold on the harmonisation of presentation and disclosure requirements with Australia for Tier 2 for-profit entities?

Next steps

47. We will continue to actively monitor the IASB's project *Disclosure Initiative—Subsidiaries that are SMEs*.

48. If the Board agrees with our recommendations, we will seek the XRB Board's approval to put a temporary hold on the harmonisation of disclosure requirements with Australia for Tier 2 for-profit entities.

49. If the Board is of the view that we should harmonise NZ IFRS RDR with AASB 1060, we would need to seek the Board's views on issues such as what to do about presentation requirements, and how to 'package' the disclosure requirements.

Appendix A

Summary of changes to Australian RDR

The following tables contain a high-level summary of changes to Australian RDR as a consequence of AASB 1060. The tables are taken from the AASB Key facts: AASB 1060 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Entities*.[7]

Disclosures removed from RDR

Topic	Details
Primary financial statements	Option to omit the statement of changes in equity in certain circumstances and present statement of income and retained earnings instead.
Revenue	• Separate disclosure of revenue from contracts with customers from other revenue and impairment losses on receivables or contract assets; • Information about assets recognised from costs to obtain or fulfil a contract with a customer; • Use of practical expedients; and • Disclosure of specific judgements made (however may be caught by general requirement to disclose significant judgements).
Other income and expenses	• Individually material income or expense items (however separate disclosure of each material class of similar items is still required); and • Certain gains and losses relating to reclassified financial assets.
Financial assets and financial liabilities	• Detailed disclosures about measurement bases (accounting policy still required); • Information about reclassified financial assets; • Loss allowance recognised in relation to financial assets at fair value through other comprehensive income; • Compound financial instruments with multiple embedded derivatives; • Transferred assets – not derecognised in their entirety (less detail); and • Transferred assets – derecognised in their entirety (no disclosures).
Hedging	Overall less details required, but some additional disclosures (see below)
Lessee disclosures	• Amounts recognised by a lessee (only required to disclose lease payments recognised as expense, and additions to and depreciation of right-of-use assets); • Additional qualitative and quantitative information (only required to disclose general description of leasing arrangements); • Application of recognition exemption for short-term and low value leases; and • Additional disclosures relating to variable lease payments, extension options or termination options, and residual value guarantees
Lessor disclosures	• Disclosures for finance and operating leases (no disclosure of selling profit or loss for finance leases and lease income for operating leases); and • Information about how lessor manages risks associated with rights retained.
Impairment	• Impairment losses & reversals (no separate disclosure of impairment losses & reversals for revalued assets); and • Recoverable amount of individual assets or cash-generating unit (CGU) for which an impairment loss has been recognised.
Share capital	Reconciliation of shares not required for comparative period.
Business combinations	Less details required about the acquired entity/operation.

[7] Available at https://www.aasb.gov.au/admin/file/content102/c3/AASB1060_KeyFacts_03-20_1585193851825.pdf

Topic	Details
Discontinued operations	• Tax expense relating to discontinued operations; and • Cash flows of discontinued operations.
Interests in other entities	• Judgements and assumptions made disclose only in control with <50% of voting rights (but may be caught by general requirement to disclose significant judgements); • Simplified disclosures about the composition of the group; • Significant restrictions (no disclosure of carrying amounts of assets and liabilities to which the restrictions apply); • Risks associated with interests in consolidated entities; • Investments entities and interests in unconsolidated subsidiaries; and • Information about interests in joint arrangements and associates (no disclosure of names, ownership interest etc.).

New disclosures added as a result of the IFRS for SMEs

Topic	Details
General information	Information about domicile and legal form etc.
Hedging disclosures	For cash flow hedges and hedges of a net investment in a foreign operation – the periods when the cash flows are expected to occur and when they are expected to affect profit or loss.
Investments in associates and joint ventures	• For associates accounted for at cost: amount of dividends and other distributions recognised as income; and • For equity-accounted associates and joint ventures: separate disclosure of share of discontinued operations
Business combinations	Qualitative description of factors that make up goodwill.
Leases	• Lessees: maturity analysis of future lease payments; • Lessors with operating leases: variable lease payments recognised as income; and • Lessors with finance leases: loss allowance for lease receivables.
Employee benefits	• For defined benefit plans: amounts recognised in profit or loss as expense, actual return on plan assets; and • For termination benefits: information about the nature of the benefits, amounts of obligation and extent of funding (not required under full IGRS/Australian Accounting Standards).
Related parties	Disclosure of parent-subsidiary relationship by government-related entities
First-time adoption disclosures	Explanation of how transition has affected reported amounts, description of the nature of each change in accounting policy, reconciliation of profit or loss with separate identification of errors and, where applicable, a statement that the entity did not present financial statements for previous periods; and **But note disclosure relief provided by AASB 2020-2**.

New disclosures added for other reasons

Topic	Details
Audit fees	To assist in improving auditor independence and accountability, thereby increasing users' confidence in the quality of companies' financial reports
Imputation credits	To provide useful information to investors about dividend and future earnings potential.

Appendix B

Summary of significant decisions made by the AASB in developing the disclosures in AASB 1060

This Appendix contains a summary of the significant decisions made by the AASB in developing the disclosures in AASB 1060. More detail can be found in paragraphs BC54–BC88 of AASB 1060.[8]

1. Standards that deal exclusively with presentation and disclosure requirements in their entirety have been replaced with the corresponding requirements in AASB 1060.[9] Those corresponding requirements are equivalent to sections 3–8 of the *IFRS for SMEs* Standard.
2. To prevent possible differences in presentation requirements to full AAS, the AASB added some specific paragraphs from AASB 101 *Presentation of Financial Statements* (the prohibition to depart from a requirement in AAS, the specific prohibition to offset assets and liabilities or income and expenses unless required or permitted by an AAS), AASB 107 *Statement of Cash Flows* (the option to present the net cash from operating activities under the indirect method by showing the revenue and expenses disclosed in the statement of comprehensive income and the changes during the period in inventories and operating receivables and payables, options to report certain cash flows on a net basis) and AASB 124 *Related Party Disclosures* (the exemption from the disclosure of key management personnel compensations where the entity obtains key management personnel services from another entity) to AASB 1060.
3. To avoid any potential recognition and measurement recognition and measurement (R&M) differences, the definition of materiality in the *IFRS for SMEs* Standard has been replaced with the recently updated definition of material in AAS.
4. Consistent with the basic approach of minimising differences between the disclosures in AASB 1060 and the *IFRS for SMEs* Standard, the option in the *IFRS for SMEs* Standard has been retained where an entity need not present a statement of changes in equity if the only changes to equity during the periods for which financial statements are presented arise from profit or loss, payment of dividends, corrections of prior period errors and changes in accounting policy.
5. The investment entity exemption from consolidation creates an R&M difference to the *IFRS for SMEs* Standard. AASB 1060 does not require disclosures regarding this exemption. The IASB discussed the investment entity exception in the context of its 2020 comprehensive review of the *IFRS for SMEs* Standard and concluded that few entities eligible to apply the *IFRS for SMEs* Standard would be investment entities.

Judgements made in adding, removing or adapting disclosures in the IFRS for SMEs *Standard*

6. In considering the R&M differences for leases the AASB noted that the accounting for all leases held by lessees under AASB 16 *Leases* is broadly similar to the accounting for finance leases in the *IFRS for SMEs* Standard. As a consequence, the disclosures for finance leases have been used as a basis, and only adapted for different terminology used in AASB 16 (for example, variable lease payments instead of contingent rents).

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[8] AASB 1060 is available at https://www.aasb.gov.au/admin/file/content105/c9/AASB1060_03-20.pdf

[9] Those standards are AAASB 7 *Financial Instruments: Disclosures*, AASB 12 *Disclosure of Interest in Other Entities*, AASB 101 *Presentation of Financial Statements*, AASB 107 *Statement of Cash Flows* and AASB 124 *Related Party Disclosures*.

7. The current disclosures in the *IFRS for SMEs* Standard for operating leases have been adapted to apply to short-term leases and leases of low value assets that have not been recognised as right-of-use assets as permitted by AASB 16. However, the disclosures about operating lease commitments are more extensive in the *IFRS for SMEs* Standard than those required under AASB 16. Because AASB 16 is a more recent standard than the *IFRS for SMEs* Standard, the AASB replaced the disclosures about operating lease commitments in the *IFRS for SMEs* Standard with those in AASB 16.

8. In considering the R&M differences regarding revenue recognition the AASB noted that while the differences may affect the amount and timing of the revenue recognised, revenue is recognised either at a point in time or over time under both AASB 15 *Revenue from Contracts with Customers* and the *IFRS for SMEs* Standard. The AASB decided to adopt the disclosures in the *IFRS for SMEs* Standard to reflect the different terminology used in AASB 15 but without adding unnecessary details.

9. Based on the principle of avoiding differences to the *IFRS for SMEs* Standard as much as possible, the AASB decided to retain certain disclosures even though they were not required under RDR (for example, disclosures about termination benefits; the entity's domicile and other general information; the qualitative factors that make up goodwill; adjusting events that occurred after the end of the reporting period; parent-subsidiary relationships where an entity applies the exemption from providing related party disclosures for government-related entities; disclosures about hedging, investments in associates and leasing where some disclosures were added but many others were removed; and a number of disclosures in relation to transition to Australian Accounting Standards – Simplified Disclosures.

10. The AASB removed disclosures about specific components of capitalised defined benefit cost, group plans and other long-term benefits from the disclosures proposed in ED 295 as these disclosures had been included in full IFRS Standards when the *IFRS for SMEs* Standard was first issued but have since been removed from full IFRS Standards.

Other matters

11. For public policy reasons AASB 1060 requires the disclosure of audit fees, imputation credits and a numerical tax reconciliation to explain the relationship between tax expense (income) and accounting profit. The disclosure of audit fees and imputation credits are currently not required under NZ RDR.[10]

IFRS Standards not dealt with in AASB 1060

12. Some of the differences in disclosures between NZ RDR and AASB 1060 are the result of some standards not being dealt with in the *IFRS for SMEs* Standard and, therefore, AASB 1060.

13. AASB 14 *Regulatory Deferral Balances* is only relevant for entities that have recognised regulatory deferral account balances under their current accounting policy (for example, where an entity prepared SPFS without complying with the R&M of full AAS). NZ Tier 2 for-profit entities that apply NZ IFRS 14 *Regulatory Deferral Balances* are required to provide all the disclosures.

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[10] AASB staff and NZASB staff recently had discussions regarding the disclosure of audit fees with the objective of undertaking a joint project on this topic.

14. AASB 134 *Interim Financial Reporting* is applicable for the specific purpose of preparing interim financial reports. AASB 1060 is intended to be used in the preparation of annual GPFS. The AASB considered that AASB 134 is not relevant in relation to the disclosures in AASB 1060. NZ IAS 34 *Interim Financial Reporting* includes some disclosure concessions for Tier 2 for-profit entities that prepare interim financial reports.

15. IFRS 13 *Fair Value Measurement* is not included in the *IFRS for SMEs* Standard. The amendments made to the *IFRS for SMEs* Standard in 2015 permit an entity to subsequently measure property, plant and equipment at fair value. An entity is required to disclose the methods and significant assumptions applied in estimating the items' fair value, and this disclosure is required under AASB 1060. NZ IFRS 13 *Fair Value Measurement* contains disclosures for NZ Tier 2 for-profit entities.

16. The section of the *IFRS for SMEs* Standard dealing with employee benefits is based on the version of IAS 19 *Employee Benefits* that was effective before the revised IAS 19 issued in 2011. The disclosures in AASB 1060 for this topic are based on the disclosures in the *IFRS for SMEs* Standard instead of those in AASB 119 *Employee Benefits*.

EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho

APPROVAL NZASB 116

Approval to Issue *Classification of Liabilities as Current or Non-current*

In accordance with the protocols established between the New Zealand Accounting Standards Board (NZASB) and the External Reporting Board (XRB Board), the NZASB has:

- approved for issue *Classification of Liabilities as Current or Non-current;* and
- provided a signing memo outlining the due process followed before reaching that decision, and other related information.

I have reviewed the signing memo and am satisfied with the information provided. Accordingly, the NZASB is hereby authorised to issue *Classification of Liabilities as Current or Non-current* pursuant to section 12(a) of the Financial Reporting Act 2013.

Dated this 2nd day of April 2020

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Michele Embling
Chair
External Reporting Board