XRB EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho

NZ ACCOUNTING STANDARDS BOARD

# Board Meeting Agenda

Wednesday 4 November 2020, Auckland
CPA Australia Offices, Level 9, 29 Customs Street West,
AMP Centre, Auckland

| Est Time | Item | Topic | Objective | | Page |
|---|---|---|---|---|---|
| **B: PUBLIC SESSION** | | | | | |
| **PBE Item for Approval** | | | | | |
| 11.45 am | **3** | **PBE Interest Rate Benchmark Reform—Phase 2** | (JS) | | |
| 20 mins | 3.1 | Cover memo | Note | Late paper | |
| | 3.2 | *PBE Interest Rate Benchmark Reform—Phase 2* | Approve | Late paper | |
| | 3.3 | Draft signing memorandum | Approve | Late paper | |
| | 3.4 | Placeholder for submissions received | Note | Late papers | |
| *12.05 pm* | | *Lunch* | | | |
| **PBE Item for Consideration** | | | | | |
| 12.50 pm | **4** | **PBE Policy Approach** | (GS/JP) | | |
| 20 mins | 4.1 | Cover memo – changes made to the PBE Policy Approach | Note | Paper | |
| | 4.2 | Memo – application of the PBE Policy Approach to IPSASB *COVID-19: Deferral of Effective Dates* | Consider | Paper | |
| | 4.2.1 | IPSASB *COVID-19: Deferral of Effective Dates* | Consider | Late paper | |
| | 4.3 | Memo – application of the PBE Policy Approach to IPSASB *Public Sector Specific Financial Instruments* | Consider | Paper | |
| | 4.3.1 | IPSASB *Public Sector Specific Financial Instruments* | Consider | Late paper | |
| | 4.4 | PBE Policy Approach (August 2020) | Note | Supp paper | |
| **For-profit Item for Consideration** | | | | | |
| 1.10 pm | **5** | **Business Combinations—Disclosures, Goodwill and Impairment** | (GS) | | |
| 60 mins | 5.1 | Cover memo | Note | Paper | |
| | 5.2 | Draft comment letter | Consider | Paper | |
| | 5.2.1 | Submission from the OAG (sent directly to the IASB with a copy to the NZASB) | Note | Paper | |
| | 5.3 | IASB DP/2020/1 | Note | Supp paper | |

| Est Time | Item | Topic | Objective | | Page |
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| | 5.4 | Snapshot IASB DP/2020/1 | Note | Supp paper | |
| **Standards for Noting** | | | | | |
| 2.09 pm | **6** | **Standard Approved** | (VSF) | | |
| 1 min | 6.1 | Approval 129 *Interest Rate Benchmark Reform—Phase* 2 | Note | Paper | |

**Supporting Papers November 2020**

| Item | Document | Page |
|---|---|---|
| **B: PUBLIC SESSION** | | |
| **4** | **PBE Policy Approach** | |
| 4.4 | PBE Policy Approach (August 2020) | |
| **5** | **Business Combinations—Disclosures, Goodwill and Impairment** | |
| 5.3 | IASB DP/2020/1 *Business Combinations—Disclosures, Goodwill and Impairment* | |
| 5.4 | Snapshot IASB DP/2010/1 | |

Next NZASB meeting: Thursday 17 December 2020

NZ ACCOUNTING STANDARDS BOARD

**Memorandum**

| | |
|---|---|
| **Date:** | 23 October 2020 |
| **To:** | NZASB Members |
| **From:** | Gali Slyuzberg |
| **Subject:** | **Cover Memo – Changes made to the wording of the PBE Policy Approach** |

**Purpose and introduction**[1]

1. As part of the recently completed Targeted Review of the New Zealand Accounting Standards Framework (ASF), some refinements were made to the wording of the *Policy Approach to Developing the Suite of PBE Standards* (PBE Policy Approach).

2. The purpose of this agenda item is to provide the Board with a summary of the abovementioned refinements, as the Board is being asked at this meeting to apply the updated PBE Policy Approach for the first time (see agenda items 4.2 and 4.3).

**Recommendation**

3. The Board is asked to NOTE the content of this memo.

**Background**

4. The XRB Discussion Paper on the Targeted Review of the ASF included a specific matter for comment (SMC) on the importance of alignment between PBE Standards and IPSAS.

5. Responses received on this SMC were mixed, as outlined below.

   (a) The majority of respondents considered the prioritisation of local considerations to be more important than maintaining close alignment between PBE Standards and IPSAS, and supported a more flexible approach to the development of PBE Standards.

   (b) However, there was some support for maintaining close alignment between PBE Standards and IPSAS.

   (c) Some respondents who supported a more flexible approach also noted the importance of alignment with IPSAS in general and where appropriate.

[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) Some respondents that preferred close alignment with IPSAS (or thought the PBE Policy Approach was appropriate as it was) acknowledged the challenges arising from this strategy and suggested the following to address these challenges.

- A respondent noted that the existing 'development principle' (i.e. the factors that are considered when developing PBE Standards) and rebuttable presumptions in the PBE Policy Approach should be considered on a case-by-case basis; and
- A respondent recommended clarification of the current level of flexibility, particularly the circumstances in which it would be appropriate to modify or not adopt an IPSAS.

6. In response to the mixed feedback received, and taking into account the abovementioned specific recommendations made by some respondents, the XRB Board decided to introduce some refinements to the wording of the PBE Policy Approach.

7. The XRB Board has not made significant changes to the factors that are taken into account when considering a change in PBE Standards, or the rebuttable presumptions in the PBE Policy Approach. Rather, some clarifications have been made. The amendments clarify the existing approach – including the existing degree of flexibility to prioritise local considerations over close alignment with IPSAS where appropriate. Staff have also taken the opportunity to generally clarify the wording in certain areas of the PBE Policy Approach, where we thought clarification could be beneficial.

8. The updated PBE Policy Approach was published in August 2020, to be used by the NZASB from 1 October 2020.

**Key changes to the PBE Policy Approach**

9. The key changes to the PBE Policy Approach are summarised in the table below.

**Table 1 Key changes to the PBE Policy Approach**

| Description of change | PBE Policy Approach<br>(new text is underlined, deleted text is struck through) |
|---|---|
| Clarification of the meaning of 'acceptable timeframe', in relation to considering the IPSASB's likely response to a change in IFRS Standards<br>Plus: Updating the Summary page for completeness and consistency with the main body of the document – for example, by adding a reference to an "acceptable time frame" to the description of factor (c) of the development principle (this term was already used in the description of this factor in the main body of the document). | *Summary – The Development Principle (p. 5):*<br>[…] In considering whether to initiate a development, the NZASB shall consider the following factors: […]<br>(c) In the case of a potential development arising from the issue of a new or amended IFRS Standard that is relevant to PBEs, the IPSASB's likely response to the change (e.g. whether the IPSASB is ~~developing~~ expected to develop an IPSAS on the topic in an acceptable timeframe).[2]<br>---<br>[2] In this policy document, the term "acceptable timeframe" is considered from the perspective and expectations of users and preparers of PBE financial reports (including those that are mixed groups). The length of time that constitutes an acceptable timeframe will depend on the facts and circumstances in each case based on consideration of the factors in the development principle. |

| **Description of change** | **PBE Policy Approach**<br>**(new text is underlined, deleted text is struck through)** |
|---|---|
| Clarification that the factors of the development principle and whether the rebuttable presumptions are rebutted should be considered on a case-by-case basis | *Paragraph 20:*<br>The NZASB will need to exercise judgement in balancing the factors in the development principle ~~because, in~~ on a case-by-case basis. In many cases, there will need to be a trade-off between ~~these factors.~~ the benefits of improvements in the quality of the resulting financial reports and the associated costs. […].<br>*Paragraph 21:*<br>The following sections are designed to assist with the application of the factors in the development principle on a case-by-case basis. […] |
| Clarification of what is meant by a rebuttable presumption (that is, a presumption reflects certain expectations, but if there are reasons to the contrary, the presumption can be rebutted). | *Paragraph 23:*<br>This rebuttable presumption is based on the expectation that the IPSASB's due process has considered the needs of the wide range of users of public sector financial statements in developing and issuing a new or amended IPSAS.[6] Therefore, it is ~~expected~~ presumed that a new or amended IPSAS will lead to higher quality financial reporting by PBEs in New Zealand ~~and the factors in the development principle are presumed to be met~~ in accordance with factors (a) and (b) of the development principle, in the absence of reasons to the contrary (refer to paragraph 25).<br>---<br>[6] The rebuttable presumption is also based on the XRB's understanding of the IPSASB's strategic focus – that is, the development of high-quality financial reporting standards and guidance for the public sector. |
| Clarification that the circumstances in which it may be appropriate to modify the requirements of an IPSAS (as suggested by a respondent), by:<br>• Adding footnote 7 to paragraph 24(a), to explain further when it may be appropriate to amend the requirements of an IPSAS with a view to improve quality in the NZ context, and;<br>• Adding sub-paragraph 24(c), to ensure that all the factors of the development principle are covered in the description of those circumstances when it is appropriate to modify the requirements of an IPSAS [paragraph 24(c)]. | *Paragraph 24:*<br>Depending on the circumstances, it may be appropriate to amend a recently issued new or amended IPSAS in the process of adoption in New Zealand. Examples of possible amendments include:<br>(a) improving the quality of the IPSAS in the New Zealand context by, for example, adding guidance or making changes to enhance the clarity and consistency of the requirements to enable public sector PBEs and NFP PBEs to apply the standard consistently;[7]<br>(b) adding guidance to assist NFP PBEs in applying the standard, given that the standard has been developed for application by public sector PBEs;<br>(c) amending as necessary to reduce any significant costs for mixed groups in the New Zealand context, to the extent that these costs can be reduced while still meeting the needs of users of PBE financial statements (see paragraph 18);[8]<br>[…]<br>---<br>[7] For example, amendments of this nature may be necessary where the guidance in IPSAS does not fully address certain transactions that are prevalent for New Zealand PBEs.<br>[8] The significance of any costs to mixed groups will be assessed through constituent outreach activities and any amendments will be weighed up against other factors in the development principle. |

| **Description of change** | **PBE Policy Approach**<br>**(new text is underlined, deleted text is struck through)** |
|---|---|
| Clarification of when it is appropriate not to adopt a new or amended IPSAS – by clarifying the reference to the cost/benefit criterion | *Paragraph 25*<br>Depending on the circumstances, it may be appropriate to rebut the presumption in paragraph 22 and thereby not adopt a new or amended IPSAS, or part(s) thereof. Given that PBE Standards are based primarily on IPSAS, a decision to rebut the presumption is expected to occur only in exceptional circumstances. Examples of such circumstances include where the NZASB has significant concerns that, in the New Zealand context:<br>(a) adoption of a new or amended IPSAS would not be either appropriate or relevant (based on the development principle); and<br>(b) the costs of adoption of a new or amended IPSAS would outweigh the benefits to users of PBE financial reports.[9]<br>---<br>[9] As discussed in paragraphs 14–18 and giving consideration to the factors in the development principle, the primary benefit of a potential development to the suite of PBE Standards is to improve the information provided to users of PBE financial reports and to promote higher quality financial reporting by PBEs. |
| Clarification that when not adopting a new or amended IPSAS, the NZASB's report to the XRB should refer to the relevant factors of the development principle (this was in response to a specific comment from a respondent) | *Paragraph 26:*<br>In the event that the presumption to adopt a new or amended IPSAS is rebutted, this will require the NZASB to report to the XRB Board:<br>(a) its decision and rationale for the decision, including reference to the relevant factors of the development principle; and […] |
| General clarification of existing text – for example:<br>• clarifying the description of the rebuttable presumption in paragraph 34 (and the same presumption on page 5 under Application of the Development Principle, point (b)); and<br>• clarifying the wording in the related explanatory paragraphs 35 and 36. | *Paragraph 34 – 37 (other paragraphs included for context)*<br><br>*4.2.2 The IASB issues an IFRS Standard on a new topic*<br>33. An example of a new topic is where the IASB is considering issuing a standard on rate-regulated activities.<br><br>**34.** **~~There is a rebuttable presumption that the NZASB will not include an NZ IFRS that the IASB has issued on a new topic in the suite of PBE Standards unless the IPSASB addresses the issue~~. When the IASB issues an IFRS Standard on a new topic and there is no IPSAS on that topic, there is a rebuttable presumption that the NZASB will not include the new IFRS Standard in the suite of PBE Standards, unless the topic is relevant to PBEs and the IPSASB is not expected to develop a new standard on the same topic in an acceptable timeframe.** |

| Description of change | PBE Policy Approach<br>(new text is underlined, deleted text is struck through) |
|---|---|
| | 35. ~~As noted in paragraph 26, some NZ IFRS were included in the suite of PBE Standards to maintain current practice until the IPSASB addresses the related issues. This rationale does not apply to an NZ IFRS on a new topic. Also, given the PBE Standards are primarily based on IPSAS in accordance with the *New Zealand Accounting Standards Framework*, adding further PBE Standards based on NZ IFRS is unlikely to be consistent with the objectives of that Framework~~.<br>As noted below in paragraph 37, some NZ IFRS-based standards were included in the suite of PBE Standards when it was first developed. After the initial introduction of the suite of PBE Standards, the NZASB has applied the rebuttable presumption that an IFRS Standard on a new topic where there is no IPSAS is not included in the suite of PBE Standards, as discussed above. This approach is consistent with the *New Zealand Accounting Standards Framework*, which provides that IPSAS should be used as the primary basis for developing PBE Standards.<br><br>36. In considering whether to rebut the presumption that the NZASB will not include a new IFRS Standard in the suite of PBE Standards, the NZASB should:<br>~~consider whether the new standard both leads to a major improvement in the quality of financial reporting and fills a gap in the suite of PBE Standards (as distinct from a gap in NZ IFRS). This is unlikely to arise.~~<br>(a) firstly, consider whether the new IFRS Standard is relevant to PBEs and if so, whether the IPSASB is expected to develop a new standard on the same topic in an acceptable timeframe; and<br>(b) secondly, consider other factors in the development principle to assess the cost and benefits of including the new IFRS Standard in the suite of PBE Standards.<br><br>*4.2.3 An NZ IFRS that the NZASB has included in the suite of PBE Standards is changed*<br>37. The NZASB has included selected NZ IFRS-based standards in the suite of PBE Standards (see footnote 12) ~~to maintain current practice until the IPSASB addresses the related issues~~. These NZ IFRS-based standards were first added when the suite of PBE Standards was initially developed to maintain current practice for specific topics not addressed by IPSAS (for example, accounting for insurance contracts and interim reporting). Subsequently, additional NZ IFRS-based standards have been added to the suite of PBE standards (for example, PBE IFRS 17 *Insurance Contracts*) when a new NZ IFRS standard addresses a topic that is relevant to PBEs and the IPSASB is not expected to develop a new standard on the same topic in an acceptable timeframe. |

10. As previously noted, the above amendments are to clarify the existing approach to developing PBE Standards – including the existing considerations and rebuttable presumptions, and when the presumptions can be rebutted.

11. As there were no significant changes to the factors of the development principle or the substance of the rebuttable presumptions, these changes should not significantly change the Board's process for deciding whether and how to amend PBE Standards in response to triggers such as new or amended IPSAS or IFRS Standards. Rather, the amendments should assist the Board in applying this process.

**Attachments**

| | |
|---|---|
| Agenda item 4.2: | Memo – application of the PBE Policy Approach to IPSASB *COVID-19: Deferral of Effective Dates* |
| Agenda item 4.2.1 | IPSASB *COVID-19: Deferral of Effective Dates* (late paper) |
| Agenda item 4.3: | Memo – application of the PBE Policy Approach to IPSASB *Public Sector Specific Financial Instruments* |
| Agenda item 4.3.1 | IPSASB *Public Sector Specific Financial Instruments* (late paper) |
| Agenda item 4.4: | PBE Policy Approach – August 2020 (in supporting papers) |

NZ ACCOUNTING STANDARDS BOARD

**Memorandum**

| | |
|---|---|
| **Date:** | 23 October 2020 |
| **To:** | NZASB Members |
| **From:** | Gali Slyuzberg |
| **Subject:** | **PBE Policy Approach: IPSASB *COVID-19: Deferral of Effective Dates*** |

**Purpose**[1]

1. This memo applies the *Policy Approach for Developing the Suite of PBE Standards* (PBE Policy Approach) to the IPSASB's amending standard, *COVID-19: Deferral of Effective Dates*, which was recently approved for issue by the IPSASB and is expected to be issued prior to the NZASB November meeting.

2. The amending standard defers the effective dates of a number of pronouncements. Most of these deferrals are not relevant for PBE Standards (see Table 2 below). With respect to the IPSASB's decision to defer the effective date of IPSAS 41 *Financial Instruments* by one year, we recommend no change to the effective date of PBE IPSAS 41 *Financial Instruments*. This memo explains why.

**Recommendation**

3. We recommend that the Board:

   (a) NOTES that the IPSASB has recently approved for issue an amending standard, *COVID-19: Deferral of Effective Dates* which, defers the effective date of IPSAS 41 and certain other pronouncements by one year, from 1 January 2022 to 1 January 2023;

   (b) NOTES that except for the deferral of the effective date of IPSAS 41, the deferrals in the IPSASB's amending standard are not relevant for PBE Standards (see Table 2 below);

   (c) AGREES not to defer the effective date of PBE IPSAS 41 (which is 1 January 2022), for the reasons set out in this memo;

   (d) AGREES, given (b) and (c), not to adopt the IPSASB's amending standard, *COVID-19: Deferral of Effective Dates*, into PBE Standards;

   (e) AGREES to table a copy of this memo at a future XRB Board meeting to meet the requirements in paragraph 26 of the PBE Policy Approach.

[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**

4. This memo is set out as follows.

    (a) Background

    (b) Application of the PBE Policy Approach

    (c) Next steps

**Background**

5. Table 1 summarises relevant events between July 2020 and now.

**Table 1 Lead up to *COVID-19: Deferral of Effective Dates***

| Date | Comment |
|---|---|
| January 2017 | PBE IFRS 9 *Financial Instruments* was issued, effective 1 January 2021 (subsequently deferred to 1 January 2022).<br>PBE IFRS 9 was developed so that mixed groups could apply PBE IFRS 9 and NZ IFRS 9 *Financial Instruments* at the same time, and to give PBEs the opportunity to apply the newer financial instrument requirements, including the newer hedging requirements.<br>NZ IFRS 9 was effective from 1 January 2018. The Government first applied PBE IFRS 9 in the consolidated *Financial Statements of the Government of New Zealand* for the year ended 30 June 2019. In addition to central government entities, a number of other entities consolidated in those financial statements and some local authorities have also chosen to adopt PBE IFRS 9.<br>Most of the entities that did not early adopt PBE IFRS 9 have continued to apply PBE IPSAS 29 *Financial Instruments: Recognition and Measurement*.<br>PBE IFRS 9 was always intended to be an interim standard, pending the development of IPSAS 41 and PBE IPSAS 41. |
| August 2018 | IPSAS 41 was issued, effective 1 January 2022.<br>IPSAS 41 is based on IFRS 9. |
| March 2019 | PBE IPSAS 41 was issued, effective 1 January 2022.<br>Most requirements in PBE IPSAS 41 are identical, or almost identical, to the requirements in PBE IFRS 9. |
| July 2020 | **The IPSASB issued ED 73 *COVID-19: Deferral of Effective Dates*.**<br>The ED proposed to defer the effective date of IPSAS 41 (and certain other pronouncements that are not relevant for PBE Standards – see Table 2) by one year, from 1 January 2022 to 1 January 2023.<br>The ED had a 30-day comment period. |
| July 2020 | We sought TRG feedback on ED 73.<br>The TRG supported the staff view that the effective date of PBE IPSAS 41 should not be deferred. TRG comments included the following.<br>• In New Zealand, we are already far along the track towards adoption of PBE IPSAS 41.<br>• Based on experience in the for-profit sector, for those PBEs that have not yet adopted PBE IFRS 9 the impact of adopting PBE IPSAS 41 is likely to be minimal. Such entities might appreciate educational materials about the possible impact of adoption. |

**Table 1 Lead up to *COVID-19: Deferral of Effective Dates***

| Date | Comment |
|---|---|
| August 2020 | ED 73 was made available to New Zealand constituents on the XRB website.<br>The website noted that the proposal to defer the effective date of IPSAS 41 would not necessarily be relevant for New Zealand PBEs, some of whom had already adopted the newer requirements in PBE IFRS 9 or PBE IPSAS 41, and the lead in time already given for PBE IPSAS 41. |
| August 2020 | The Board agreed not to comment on ED 73 (August 2020, NZASB agenda paper 2.7).<br>The Board also tentatively agreed not to propose to defer the effective date of PBE IPSAS 41 *Financial Instruments* (subject to application of the PBE Policy Approach to the final amendments). |
| September 2020 | The IPSASB considered the three responses to ED 73.<br>Two respondents supported all the proposals in ED 73.<br>The Public Sector Accounting Standards Board, Kenya (PSASB) disagreed with the deferral of IPSAS 41 on the basis that IPSAS 41 and the related amendments were necessitated by the 2008 global financial crisis. The PSASB also noted that compared to IPSAS 29 *Financial Instruments: Recognition and Measurement*, IPSAS 41 and the related amendments may provide more relevant financial information regarding impairment, as well as the timing and uncertainty of cash flows which could be impacted by COVID-19.<br>The IPSASB noted that early adoption of IPSAS 41 was still possible and approved the amendments for issue. |
| October 2020 | **The IPSASB approved *COVID-19: Deferral of Effective Dates*.**<br>This amending standard defers the effective date of IPSAS 41 and certain other pronouncements by one year. See Table 2. |

6. Table 2 below shows that the only amendment in *COVID-19: Deferral of Effective Dates* that is immediately relevant for PBE Standards is the deferral of the effective date of IPSAS 41.

**Table 2 *COVID-19: Deferral of Effective Dates* – Relevance for PBE Standards**

| IPSASB amendments defer effective dates from 1 January 2022 to 1 January 2023 | PBE Standards |
|---|---|
| • IPSAS 41 *Financial Instruments* | PBE IPSAS 41 is effective for PBEs from 1 January 2022.<br>Staff recommend no change to the effective date of PBE IPSAS 41. |
| • *Long-term Interests in Associates and Joint Ventures* (Amendments to IPSAS 36) and *Prepayment Features with Negative Compensation* (Amendments to IPSAS 41) | Not applicable – these requirements are already in PBE IPSAS 41. |
| • *Improvements to IPSAS, 2019* – but only in relation to amendments to IPSAS 41. | Not applicable – equivalent requirements are already in PBE IPSAS 41. |
| • IPSAS 42 *Social Benefits* | Not immediately relevant for PBE Standards. |

**Table 2** ***COVID-19: Deferral of Effective Dates*** **– Relevance for PBE Standards**

| IPSASB amendments defer effective dates from 1 January 2022 to 1 January 2023 | PBE Standards |
|---|---|
| • *Collective and Individual Services* (Amendments to IPSAS 19). | The Board has deferred its consideration of these topics until the IPSASB has completed its project on transfer expenses. |

## Application of the PBE Policy Approach

7. The PBE Policy Approach contains a rebuttable presumption that a new IPSAS or changes to an existing IPSAS will be incorporated into PBE Standards. In light of the IPSASB's decision to defer the effective date of IPSAS 41 by one year, the Board needs to consider whether it should also propose to defer the effective date of PBE IPSAS 41.

8. The IPSASB issued ED 73 as a general response to the impact of COVID-19 on entities that apply IPSAS. We accept that, for some governments, the adoption of IPSAS 41 will be a major exercise – and, given the disruption caused by COVID-19, such governments may welcome additional time to implement the standard. However, we consider that New Zealand's situation is different. Our reasons for not proposing to defer the effective date of PBE IPSAS 41 are set out in Table 3.

**Table 3 Reasons for not deferring the effective date of PBE IPSAS 41**

| General comments |
|---|
| • IFRS 9 was developed in response to events in the global financial crisis and to address the deficiencies of the previous standard. It was intended to provide better information to users of financial statements. The same applies to PBE IPSAS 41, which is closely based on IFRS 9.<br>o The section of the PBE Policy Approach that discusses the rebuttable presumption uses better reporting as a justification for the presumption. Paragraph 23 states that "it is presumed a new or amended IPSAS will lead to higher quality reporting by PBEs… in the absence of reasons to the contrary". Deferring the effective date of PBE IPSAS 41 would delay better reporting.<br>o One of the IPSASB's respondents to ED 73 disagreed with the deferral of the effective date of IPSAS 41 on the grounds that this would delay better accounting for financial instruments (see Table 1, September 2020).<br>• We do not regard aligning the effective dates of PBE Standards with IPSAS as critical. The effective dates of PBE Standards sometimes lag IPSAS. Similarly, we do not see any issue with PBE IPSAS 41 becoming effective before IPSAS 41.<br>• PBE IFRS 9 (which has the same key requirements as IPSAS 41 and PBE IPSAS 41) was issued some time ago (in January 2017). It has already been adopted by the New Zealand Government as a whole. It has also been applied by a few local authorities and other public sector entities.<br>• Other entities have had a reasonable lead in period to prepare for the adoption of PBE IPSAS 41 (PBE IPSAS 41 was issued in March 2019 and effective from 1 January 2022).<br>• There are practical difficulties in maintaining three financial instruments standards.[2]<br>o From a staff perspective, each set of new amendments that affects the financial instruments standards creates challenges. Other standards and amendments have been issued since PBE IPSAS 41 (and more are in the process of being finalised). Tailoring amendments for entities that have early adopted PBE IFRS 9 or PBE IPSAS 41 and for those that have not becomes untenable over time. |

[2] PBE IPSAS 29 *Financial Instruments: Recognition and Measurement*, PBE IFRS 9 and PBE IPSAS 41.

<table>
<tr><td colspan="2">o From a constituent perspective, the long lead in time for PBE IFRS 9 and PBE IPSAS 41 means that it is difficult to identify the related presentation and disclosure requirements. Deferring the effective date of PBE IPSAS 41 would prolong this difficulty for constituents. Our current plans are to make an updated version of PBE IPSAS 30 Financial Instruments: Disclosures available on the website at the beginning of next year.<br>• We have had a number of years of multiple financial instrument standards. It would be good to bring this transitional period to a close and have all Tier 1 and 2 PBEs applying the same standard as (i) each other and (ii) as Tier 1 and 2 for-profit entities.</td></tr>
<tr><td colspan="2">Comments about types of PBEs</td></tr>
<tr><td>Central Government PBEs</td><td>• Central government entities are already applying PBE IFRS 9, which has the same key requirements as PBE IPSAS 41.<br>• A number of entities that are consolidated into the financial statements of the New Zealand Government early adopted PBE IFRS 9 to align their accounting policies with the Crown.<br>• Deferring the effective date of PBE IPSAS 41 would be of limited benefit for these entities (there are a few additional requirements in PBE IPSAS 41, but it is substantively the same as PBE IFRS 9).</td></tr>
<tr><td>Larger PBEs outside central Government</td><td>• PBEs in this category – such as large local authorities and large not-for-profit (NFP) PBEs – may also hold complex financial instruments as well as a wider range of financial instruments.<br>• The majority of these entities have not adopted PBE IFRS 9. Instead they have chosen to wait for PBE IPSAS 41 to become effective.<br>• We believe that these entities have had sufficient time to prepare for the application of PBE IPSAS 41, and they still have time to do so given the current effective date of 1 January 2022.<br>• PBE IPSAS 41 is expected to lead to higher quality reporting on financial instruments, as compared to the requirements in PBE IPSAS 29. These benefits are as important, if not more important, in the current COVID-19 environment.</td></tr>
<tr><td>Smaller PBEs outside central Government</td><td>• PBEs in this category – such as smaller local authorities and NFPs – have relatively limited resources and most of them have not adopted PBE IFRS 9.<br>• Although PBE IPSAS 41 is a large and complex standard, many smaller PBEs are likely to hold simpler financial instruments – for example, their financial instruments are likely to predominantly consist of receivables and non-complex loans to others. Therefore, we do not think that the transition to PBE IPSAS 41 for such entities would be overly onerous.<br>• These entities have had a reasonable time to prepare for the adoption of PBE IPSAS 41.<br>• There may be merit in providing some education material to these entities over the next few months, to remind them of the requirements in PBE IPSAS 41.</td></tr>
</table>

*Rebutting the presumption that an amendment to IPSAS will be incorporated into PBE Standards*

9. Having set out our reasons for not proposing to change the effective date of PBE IPSAS 41, we now focus on the requirements of paragraphs 25 and 26 of the PBE Policy Approach (see extracts below). These paragraphs provide guidance on when it is appropriate to rebut the presumption that an amendment to IPSAS will be incorporated into PBE Standards. We have also included paragraph 19 of the PBE Policy Approach, which sets out the ‘development principle’, i.e. the factors that the NZASB considers when deciding whether to introduce or amend a PBE Standard.

**Extracts from the PBE Policy Approach**

## 3. The Development Principle

19. **In accordance with the *New Zealand Accounting Standards Framework*, the primary purpose of developing the suite of PBE Standards is to better meet the needs of PBE user groups (as a whole). In considering whether to initiate a development, the NZASB shall consider the following factors:[5]**

    (a) **Whether the potential development will lead to higher quality financial reporting by public sector PBEs and NFP PBEs, including public sector PBE groups and NFP PBE groups, than would be the case if the development was not made; and**

    (b) **Whether the benefits of a potential development will outweigh the costs, considering as a minimum:**

    (i) ***relevance to the PBE sector as a whole*: for example, where the potential development arises from the issue of a new or amended IFRS Standard, whether the type and incidence of the affected transactions in the PBE sector are similar to the type and incidence of the transactions addressed in the change to the NZ IFRS;**

    (ii) ***relevance to the NFP or public sector sub-sectors*: whether there are specific user needs in either of the sub-sectors, noting that IPSAS are developed to meet the needs of users of the financial reports of public sector entities;**

    (iii) ***coherence*: the impact on the entire suite of PBE Standards (e.g. can the change be adopted without destroying the coherence of the suite);**

    (iv) ***the impact on mixed groups*; and**

    (c) **In the case of a potential development arising from the issue of a new or amended IFRS Standard that is relevant to PBEs, the IPSASB's likely response to the change (e.g. whether the IPSASB is expected to develop an IPSAS on the topic in an acceptable time frame).**

…

*Rebutting the presumption and not adopting a new or amended IPSAS*

25. Depending on the circumstances, it may be appropriate to rebut the presumption in paragraph 22 and thereby not adopt a new or amended IPSAS, or part(s) thereof. Given that PBE Standards are based primarily on IPSAS, a decision to rebut the presumption is expected to occur only in exceptional circumstances. Examples of such circumstances include where the NZASB has significant concerns that, in the New Zealand context:

    (a) adoption of a new or amended IPSAS would not be either appropriate or relevant (based on the development principle); and

    (b) the costs of adoption of a new or amended IPSAS would outweigh the benefits to users of PBE financial reports.[9]

26. In the event that the presumption to adopt a new or amended IPSAS is rebutted, this will require the NZASB to report to the XRB Board:

    (a) its decision and rationale for the decision, including reference to the relevant factors of the development principle; and

    (b) what, if any, action(s) it plans to take in relation to the new or amended IPSAS, for example, whether a domestic standard will be developed and whether parts of the new or amended IPSAS will be incorporated into that domestic standard.

…

5 In applying the development principle and rebuttable presumptions in this policy document, the NZASB will consider the costs and benefits of initiating a new development and the relevance of a topic to PBEs based on consultation with constituents.

9 As discussed in paragraphs 14–18 and giving consideration to the factors in the development principle, the primary benefit of a potential development to the suite of PBE Standards is to improve the information provided to users of PBE financial reports and to promote higher quality financial reporting by PBEs.

10. Table 4 applies paragraphs 25 and 26 of the PBE Policy Approach to the IPSASB's amending standard, *COVID-19: Deferral of Effective Dates*.

| **Table 4 Comments on paragraphs 25 and 26 of the PBE Policy Approach** | |
|---|---|
| Para 25 | Paragraph 25 has been written with whole standards in mind, not deferrals of effective dates. In this instance the Board has already issued a PBE Standard based on IPSAS 41.<br>It is difficult to apply the development principle to the deferral of an effective date. Nevertheless, we have considered some of the factors in the development principle. Paragraph references to the specific factors considered are shown in square brackets.<br>• Deferring the effective date of PBE IPSAS 41 would not lead to higher quality reporting. In fact, it would delay higher quality reporting by those entities that have not yet adopted PBE IFRS 9 or PBE IPSAS 41. [Paragraph 19(a)]<br>• There will be costs associated with adoption of PBE IPSAS 41, but deferring the effective date would merely delay those costs. Many PBEs (those that have already adopted PBE IFRS 9) have already incurred most of the costs of transitioning to the newer requirements. As noted by the TRG, the impact of PBE IPSAS 41 on smaller PBEs that have not early adopt PBE IFRS 9 is expected to be minimal. [Paragraph 19(b)]<br>• Delaying the effective date of PBE IPSAS 41 would have a negative effect on the coherence of PBE Standards. It has been difficult to maintain three standards on financial instruments in the period leading up to the PBE IPSAS 41 becoming effective. [Paragraph 19(b)(iii)] |
| Para 26 | In terms of reporting to the XRB Board, we suggest that a copy of this memo be tabled at a future XRB Board meeting, along with a brief cover memo noting the Board's decision.<br>No further actions are required in relation to the IPSASB's amending standard, *COVID-19: Deferral of Effective Dates.* |

**Questions for the Board**

Q1. Does the Board agree, for the reasons set out in this memo, not to adopt the IPSASB's amending standard, *COVID-19: Deferral of Effective Dates,* into PBE Standards?

Q2. Does the Board agree that a copy of this memo should be tabled at a future XRB Board meeting?

**Next steps**

11. If the Board agrees with our recommendations, we will arrange for a copy of this memo to be tabled at the next XRB Board meeting, along with a brief cover memo noting the Board's decision.

**Attachment**

Agenda item 4.2.1: IPSASB *COVID-19: Deferral of Effective Dates* (late paper)

NZ ACCOUNTING STANDARDS BOARD

**Memorandum**

| | |
|---|---|
| **Date:** | 23 October 2020 |
| **To:** | NZASB Members |
| **From:** | Judith Pinny |
| **Subject:** | ***PBE Policy Approach: Public Sector Specific Financial Instruments*** |

**Purpose**[1]

1. This memo applies the *Policy Approach for Developing the Suite of PBE Standards* (PBE Policy Approach) to *Amendments to IPSAS 41, Financial Instruments* which was recently approved for issue by the IPSASB and is expected to be issued by the IPSASB prior to the NZASB November meeting.

2. This amending standard amends the Implementation Guidance and the Illustrative Examples that accompany IPSAS 41 *Financial Instruments* to clarify the accounting treatment of the following public sector specific financial instruments:

   (a) Monetary gold: The IPSASB has decided that monetary gold does not meet the definition of a financial asset and has added implementation guidance to IPSAS 41 to reflect this.

   (b) Currency in circulation: The IPSASB is of the view that, depending on the arrangements in a jurisdiction, issuing currency as legal tender may or may not create a financial liability for the issuer. The IPSASB has added implementation guidance to IPSAS 41 to reflect this position.

   (c) International Monetary Fund (IMF) Special Drawing Rights (SDRs): SDRs are international reserve assets created by the IMF and allocated to members to supplement reserves. The IPSASB is of the view that SDR holdings are regarded as a financial asset. SDR allocations are a contractual obligation to deliver cash and are therefore regarded as a financial liability. The IPSASB has added implementation guidance on SDR holdings and allocations to IPSAS 41.

   (d) IMF quota subscriptions: On joining the IMF members are assigned a quota and pay a subscription based on this quota. The IPSASB considers that IMF quota subscriptions come under a current illustrative example and has amended this example to clarify this.

[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**

3. We recommend that the Board:

   (a) AGREES to propose the adoption of the amending standard, *Amendments to IPSAS 41, Financial Instruments* into the PBE Standards;

   (b) AGREES to request that staff draft an exposure draft (ED) and Invitation to Comment (ITC) for a future meeting based on *Amendments to IPSAS 41, Financial Instruments*;

   (c) AGREES to propose that the effective date of *Amendments to IPSAS 41, Financial Instruments* when it is introduced be 1 January 2023, with early adoption allowed; and

   (d) AGREES not to propose equivalent amendments to PBE IFRS 9.

**Structure of this memo**

4. This memo is set out as follows.

   (a) Background

   (b) Application of the PBE Policy Approach

   (c) Effective date

   (d) Consideration of PBE IFRS 9

   (e) Next steps

**Background**

5. ED 69 *Public Sector Specific Financial Instruments: Amendments to IPSAS 41, Financial Instruments* was issued in September 2019 with comments due to the IPSASB by 31 December 2019. The NZASB did not submit a comment letter on ED 69. The IPSASB reviewed the 19 comment letters it received on ED 69 at its July 2020 meeting and approved the final pronouncement for issue in September 2020. The release of the final amending standard was imminent at the time of writing this agenda paper.

6. On the release of ED 69 we wrote to the Reserve Bank of New Zealand (Reserve Bank) and the Treasury to advise them of the proposals.

7. We received an e-mail response from Reserve Bank staff, who indicated that they were comfortable with the proposals relevant to the Reserve Bank, being currency in circulation, and they had been in communication with Treasury when the consultation paper was issued in 2017.

8. According to the IMF website[2] New Zealand has been a member of the IMF since 1961. New Zealand has SDRs of 869.64 million and an SDR quota of 1252.1 million upon which its IMF subscription is calculated. These amounts are also recorded on the Reserve Bank's website.[3]

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2 https://www.imf.org/en/Countries/NZL
3 https://www.rbnz.govt.nz/statistics/e2

Consequently we understand that the IPSASB's clarifications are relevant to PBEs in New Zealand.

### Application of the PBE Policy Approach

9. The PBE Policy Approach contains a rebuttable presumption that a new IPSAS or changes to an existing IPSAS will be incorporated into PBE Standards (see paragraphs 23 and 24 in the table below). We have also included paragraph 19 of the PBE Policy Approach, which sets out the 'development principle', i.e. the factors that the NZASB considers when deciding whether to introduce or amend a PBE Standard.

**Extract from the PBE Policy Approach**

**3. The Development Principle**

**19. In accordance with the *New Zealand Accounting Standards Framework*, the primary purpose of developing the suite of PBE Standards is to better meet the needs of PBE user groups (as a whole). In considering whether to initiate a development, the NZASB shall consider the following factors:[5]**

**(a) Whether the potential development will lead to higher quality financial reporting by public sector PBEs and NFP PBEs, including public sector PBE groups and NFP PBE groups, than would be the case if the development was not made; and**

**(b) Whether the benefits of a potential development will outweigh the costs, considering as a minimum:**

**(i) *relevance to the PBE sector as a whole*: for example, where the potential development arises from the issue of a new or amended IFRS Standard, whether the type and incidence of the affected transactions in the PBE sector are similar to the type and incidence of the transactions addressed in the change to the NZ IFRS;**

**(ii) *relevance to the NFP or public sector sub-sectors*: whether there are specific user needs in either of the sub-sectors, noting that IPSAS are developed to meet the needs of users of the financial reports of public sector entities;**

**(iii) *coherence*: the impact on the entire suite of PBE Standards (e.g. can the change be adopted without destroying the coherence of the suite);**

**(iv) *the impact on mixed groups*; and**

**(c) In the case of a potential development arising from the issue of a new or amended IFRS Standard that is relevant to PBEs, the IPSASB's likely response to the change (e.g. whether the IPSASB is expected to develop an IPSAS on the topic in an acceptable time frame).**

…

**22. There is a rebuttable presumption that the NZASB will adopt a new or amended IPSAS.**

23. This rebuttable presumption is based on the expectation that the IPSASB's due process has considered the needs of the wide range of users of public sector financial statements in developing and issuing a new or amended IPSAS.[6] Therefore, it is presumed that a new or amended IPSAS will lead to higher quality financial reporting by PBEs in New Zealand in accordance with factors (a) and (b) of the development principle, in the absence of reasons to the contrary (refer to paragraph 25).

*Amending a new or amended IPSAS*

24. Depending on the circumstances, it may be appropriate to amend a recently issued new or amended IPSAS in the process of adoption in New Zealand. Examples of possible amendments include:

    (a) improving the quality of the IPSAS in the New Zealand context by, for example, adding guidance or making changes to enhance the clarity and consistency of the requirements to enable public sector PBEs and NFP PBEs to apply the standard consistently;[7]

    (b) adding guidance to assist NFP PBEs in applying the standard, given that the standard has been developed for application by public sector PBEs;

    (c) amending as necessary to reduce any significant costs for mixed groups in the New Zealand context, to the extent that these costs can be reduced while still meeting the needs of users of PBE financial statements (see paragraph 18);[8]

    (d) amending as necessary to maintain the coherence of the suite of PBE Standards;

    (e) excluding options that are not relevant in the New Zealand context; or

    (f) amending the scope of an IPSAS if the IPSAS conflicts with a legislative requirement, or a legislative requirement addresses the same issue for public sector entities. However, in these circumstances, it may be appropriate to adopt the IPSAS for NFP PBEs.

[5] In applying the development principle and rebuttable presumptions in this policy document, the NZASB will consider the costs and benefits of initiating a new development and the relevance of a topic to PBEs based on consultation with constituents.

[6] The rebuttable presumption is also based on the XRB's understanding of the IPSASB's strategic focus – that is, the development of high-quality financial reporting standards and guidance for the public sector.

[7] For example, amendments of this nature may be necessary where the guidance in IPSAS does not fully address certain transactions that are prevalent for New Zealand PBEs.

[8] The significance of any costs to mixed groups will be assessed through constituent outreach activities and any amendments will be weighed up against other factors in the development principle.

10. Due to the specific nature of the amendments and our consultation during the IPSASB's exposure draft stage, staff believe that the amending standard would be relevant only for the Reserve Bank and the Treasury (in preparing the consolidated *Financial Statements of the Government of New Zealand*). We believe that the clarifications will enhance the quality of reporting under PBE IPSAS 41. Although we are not aware of the existence of monetary gold in New Zealand, we would still recommend the inclusion of this clarification, as it explains why monetary gold is excluded as a financial asset.

11. Consequently, we recommend that the NZASB agree to request that the staff draft an ED and ITC for a future meeting based on *Amendments to IPSAS 41, Financial Instruments*.

**Effective date**

12. The effective date of *Amendments to IPSAS 41, Financial Instruments* is 1 January 2023.

13. Staff note that the IPSASB has recently issued another amending standard, *COVID-19: Deferral of Effective Dates* which, amongst other things, defers the effective date of IPSAS 41 by one year, to 1 January 2023. However, the recommendation of staff in agenda item 4.2 is not to defer the effective date of PBE IPSAS 41 i.e. remain with 1 January 2022.

14. As these amendments to IPSAS 41 are clarifications, rather than new requirements, we recommend following the IPSASB effective date of 1 January 2023, with early adoption allowed, so that we are aligned with the IPSASB date for this amending standard.

**Consideration of PBE IFRS 9**

15. Staff note that both the New Zealand Government and the Reserve Bank have early adopted PBE IFRS 9.

16. Staff propose no change to PBE IFRS 9 *Financial Instruments* as it is an interim standard with a limited life. From 1 January 2022 both the New Zealand Government and the Reserve Bank will be adopting PBE IPSAS 41.

**Questions for the Board**

Q1. Does the Board agree to propose the adoption of the amending standard, *Amendments to IPSAS 41, Financial Instruments* into the PBE Standards?

Q2. Does the Board agree to request staff to draft an ED and ITC for a future meeting based on *Amendments to IPSAS 41, Financial Instruments*?

Q3. Does the Board agree that the effective date of the *Amendments to IPSAS 41, Financial Instruments* when introduced should be 1 January 2023 with early adoption allowed?

Q4. Does the Board agree not to propose equivalent changes to PBE IFRS 9?

**Next steps**

17. If the Board agrees with our recommendations we will develop the ED and ITC based on *Amendments to IPSAS 41, Financial Instruments* to be considered at a future Board meeting.

**Attachment**

Agenda item 4.3.1: IPSASB *Public Sector Specific Financial Instruments* (late paper)

NZ ACCOUNTING STANDARDS BOARD

**Memorandum**

| | |
|---|---|
| **Date:** | 23 October 2020 |
| **To:** | NZASB Members |
| **From:** | Gali Slyuzberg |
| **Subject:** | **Cover Memo – IASB DP *Business Combinations – Disclosure Goodwill and Impairment*** |

**Recommendations**[1]

1. Staff have prepared a first draft of the Board's comment letter on the IASB Discussion Paper *Business Combinations – Disclosures, Goodwill and Impairment* (the DP). The Board is asked to PROVIDE FEEDBACK on the draft comment letter.

**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. The DP discusses the IASB's preliminary views on the following.
   (a) disclosures about business acquisitions (including proposals to introduce new disclosures on management's objectives for an acquisition and how the acquisition performs against these objectives in subsequent years)
   (b) the subsequent accounting for goodwill; and
   (c) other related topics.

4. The Board decided to comment on the DP. Comments on the DP are due to the NZASB by 2 November 2020 and to the IASB by 31 December 2020.

[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).

5. The table below shows the timing of the Board's discussion of the DP topics to date.

**Table 1 DP topics and timing of Board discussion**

| NZASB meeting | DP topic | DP reference |
|---|---|---|
| February 2020[2] | • Simplifying the impairment test – simplifications to the VIU calculation | Section 4<br>(paragraphs 4.35–4.56 and questions 10–11) |
| May 2020 | • Goodwill impairment and amortisation (also covering the proposed presentation of equity excluding goodwill) | Section 3<br>(paragraphs 3.1–3.115 and questions 6–8) |
| | • Simplifying the impairment test, focusing only on relief from the annual impairment test | Section 4<br>(paragraphs 4.5–4.34, question 9) |
| | • Intangible assets | Section 5<br>(paragraphs 5.1–5.28 and question 12) |
| June 2020 | • Improving disclosures on acquisitions | Section 2<br>(paragraphs 2.1–2.91 and questions 2–5) |
| | • Whether the IASB's package of preliminary views meet the objectives of the project, and whether any questions are interdependent | Section 1<br>(paragraphs 1.1–1.9 and question 1) |
| | • Other recent publications | Section 6<br>(paragraphs 6.1–6.16 and questions 13 and 14) |

6. As part of our outreach activities on this project, we have discussed the DP with the TRG, XRAP and the NZAuASB. We also ran a webinar on the DP (presented by staff) and held a virtual Outreach Event presented by Sue Lloyd (IASB Vice Chair) and Tim Craig (IASB technical staff member – Goodwill and Impairment project lead).

**Draft comment letter**

7. Staff have prepared the first draft of the comment letter on the DP. The draft comment letter seeks to reflect the feedback provided by the Board at previous meetings and, where appropriate, feedback received during outreach activities and the submissions received to date.

8. In our previous discussions with the Board, there were certain topics where Board members had mixed views (whether to reintroduce goodwill amortisation, whether to move to an

[2] Preliminary discussion – the DP was not yet issued

indicator-based approach for goodwill impairment testing, and whether to remove the restrictions on the inclusion of cash flows from future asset enhancements and uncommitted restructures). For questions relating to these topics, we have drafted two versions of the response, so that the Board can see both options and decide which view to reflect in the comment letter.

9. The draft comment letter is structured as follows:

**Table 2 Structure of comment letter**

| | |
|---|---|
| Cover letter | As discussed with the Board in May, the cover letter notes:<br>• our support for a holistic review of IAS 36, as suggested by the recent AASB research report AASB Research Report 9 *Perspectives on IAS 36: A Case for Standard Setting Activity*, and;<br>• that we understand that such a review is outside the scope of the DP, and we have focused our responses on the specific issues discussed in the DP.<br>The cover letter will also include a summary of key matters that we have raised in response to the DP questions. This part of the cover letter will be drafted after the November meeting. |
| Appendix | The Appendix includes our draft answers to the DP questions.<br>For each question, the following is included:<br>• The question, copied directly from the DP<br>• Summary of Board discussions to date – for the Board's information (this will be deleted in the final version of the comment letter)<br>• Summary of feedback from outreach – for the Board's information (this will be deleted in the final version of the comment letter)<br>• Draft response to the DP question<br>• For certain topics: Questions for the Board – to ascertain which view the Board prefers to reflect in the comment letter (this will be deleted in the final version of the comment letter) |

**Next steps**

10. At the November meeting, we will update the Board on any submissions that we receive before the meeting (comments are due to the NZASB by 2 November).

11. After the meeting, we will update the comment letter as per the Board's feedback. We will seek the Board's approval of the comment letter at the Board's December meeting.

**Attachments**

Agenda item 5.2: Draft comment letter

Agenda item 5.2.1 Submission from the OAG (sent directly to the IASB with a copy to the NZASB)

Agenda item 5.3: IASB DP *Business Combinations – Disclosures, Goodwill and Impairment*

Agenda item 5.4: IASB Snapshot *Business Combinations – Disclosures, Goodwill and Impairment*

XRB EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho

NZ ACCOUNTING STANDARDS BOARD

[date]

Mr Hans Hoogervorst
Chairman of the International Accounting Standards Board
IFRS Foundation
7 Westferry Circus
Canary Wharf
London E14 4HD
**United Kingdom**

Submitted to: www.ifrs.org or By email: commentletters@ifrs.org

Dear Hans

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

Thank you for the opportunity to comment on the Discussion Paper DP/2020/1 *Business Combinations – Disclosure, Goodwill and Impairment* (the DP). The DP has been exposed for comment in New Zealand and some New Zealand constituents may comment directly to you.

Our comments should be read in the following context.

- Section 6 of the DP refers to the 2019 research report by the Australian Accounting Standards Board (AASB), entitled AASB Research Report 9 *Perspectives on IAS 36: A Case for Standard Setting Activity* (AASB Research Report). The AASB Research Report notes that the ongoing application issues relating to IAS 36 *Impairment of Assets* demonstrate a consistent divergence in preparers', users', auditors' and regulators' understanding of the impairment requirements. Consequently, the AASB Research Report recommends a holistic review of IAS 36.

- Section 6 of the DP notes that such a holistic review is beyond the scope of this project. 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.

- While we have focused our responses to the specific matters discussed in the DP, we would support a holistic review of IAS 36 and intend to make a recommendation to that effect when we comment on the IASB's forthcoming agenda consultation.

[The main points of our detailed response will be noted here – to be completed after the November meeting]

Our recommendations and responses to the specific questions for respondents are provided in the Appendix to this letter. If you have any queries or require clarification of any matters in this letter, please contact Gali Slyuzberg (gali.slyuzberg@xrb.govt.nz) or me.

Yours sincerely

Michael Bradbury
**Acting Chair – New Zealand Accounting Standards Board**

**Appendix:**

**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?

| Summary of NZASB discussion to date |
| --- |
| • Some Board members agree that the preliminary views in the DP will help provide better information for investors – however, these Board members noted that it would be important to consider the costs of implementing the proposals.<br>• As to whether the DP questions are interlinked, the Board noted that this will be considered once we have a draft of the comment letter. |

| Summary of feedback received to date |
| --- |
| TRG<br>• A TRG member noted that the DP would introduce some improvements. However, that member and several others noted that the new disclosures on acquisitions as suggested in the DP would be challenging for preparers – in terms of cost as well as commercial sensitivity. One member questioned whether the proposed disclosures would provide useful information to investors, and whether it is current or future investors that should be the main focus of disclosure requirements.<br>• Members also said that it would be good to see what the full package of the IASB's proposals would look like – including enhancements to impairment indicators if the IASB proceeds with proposing an indicators-based approach for goodwill impairment. |

***Draft response to Question 1:***

1. We agree that, in general – with the exception of those preliminary views that we disagree with – the package of preliminary views as discussed in the DP would help investors assess the performance of acquisitions and hold management to account for their acquisition decisions. However, as noted in our response to Question 2 below, we think it would be important to consider and analyse the costs of the suggested disclosures on the objectives for an acquisition and the subsequent performance of acquisitions, and to ensure that the cost is justified by the expected benefits, before deciding whether to require these disclosures. Field tests could be useful in this regard.

2. We think that in general, the IASB's views work well together. For example, the IASB is of the view that it is not feasible to make the impairment test for goodwill significantly more effective at recognising impairment in a timely manner. However, the IASB is proposing to introduce new disclosures on the subsequent performance of acquisitions, which should help inform investors in a more timely manner that an acquisition is not performing as well as expected.

3. As to whether our answers to the questions in the DP are interlinked, we think that in general the answers to each topic tend to stand on their own, but some questions are interlinked. For example, we do not support retaining the existing requirements to disclose the 'pro forma' performance information currently required by IFRS 3 *Business Combinations*, mainly because of the IASB's proposal to introduces new disclosures on the subsequent performance of acquisitions.

**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).

(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?

Summary of NZASB discussion to date

- Some Board members thought that proposed disclosures on the subsequent performance of acquisitions could result in better information for investors.
- However, the following concerns were raised by Board members.
    - The disclosures suggested in the DP would lead to increased costs for preparers – especially for highly acquisitive companies, and particularly if they must report on every individual acquisition that is monitored by the CODM.
    - Commercial sensitivity concerns could lead to entities disclosing 'bland' information that would not be useful to users of financial statements.
    - It could be challenging to audit the proposed disclosures.
- Board members also noted the following.
    - According to the DP, an entity would need to disclose the fact that it stopped monitoring an acquisition and the reason for this only if monitoring stopped within two years. However, there is merit in requiring such disclosure whenever monitoring of an acquisition stops, even if this happens more than two years after the acquisition. Moreover, two years is a relatively short time – it can take many years to realise the expected benefits of an acquisition.
    - Some entities monitor the performance of their acquisitions against a budget prepared after the acquisition, rather than against the estimated targets that existed as at the acquisition date.
    - It is necessary to consider the existing continuous disclosure requirements for listed companies, and how these requirements would interact with the proposed disclosures.

Summary of feedback received to date

TRG

| Comments in favour of proposed disclosures | Challenges and concerns relating to the proposed disclosures |
|---|---|
| • The disclosures would provide useful information to users of financial statements about major transactions of the entity.<br>• The disclosures could shed light on unsuccessful acquisitions and lead to impairment of excessive goodwill balances, particularly for Tier 2 for-profit entities.<br>• The disclosures would provide insight into management's thought process behind acquisitions, and would encourage management to consider more carefully the objectives for the acquisition at the time of the transaction (rather than after the fact). It could also encourage management to re-think some acquisitions.<br>• In light of the discussion on materiality in the DP, the proposal that disclosures on subsequent performance should be provided for acquisitions that are monitored by the CODM seems sensible. | • The disclosures could help identify unsuccessful acquisitions and lead to goodwill impairment. While this was identified as a benefit, this could also be a reason for some preparers to strongly oppose the proposals.<br>• When an acquired business is integrated into the existing business, it can be difficult to track the acquisition's performance separately.<br>• Commercial sensitivity could be a big concern. Entities would be concerned about their competitors having access to the information that the proposals would require. The commercial sensitivity argument is perhaps stronger in New Zealand than in other countries.<br>• The proposals aim to address investors' needs, but it is uncertain how much they would ultimately affect investment decisions – plus, there would be additional compliance costs for preparers. When speaking to New Zealand constituents, it is important to be clear about the benefits of the proposals and who is expected to benefit. |

XRAP

| Comments in favour of proposed disclosures | Challenges and concerns relating to the proposed disclosures |
|---|---|
| • The disclosures could be useful for judging management's performance regarding acquisitions, and how they are likely to perform in future acquisition.<br>• The disclosures could help investors differentiate between businesses based on the performance of their acquisitions. | • There may be challenges in auditing the proposed disclosures.<br>• When acquisitions are integrated into the existing business, the proposed disclosures can lose value.<br>• Some entities may be reluctant to disclose the strategic rationale and objectives for acquisitions, as there is a risk that these expectations will not be achieved.<br>• The proposals would require a lot of disclosures on the performance of acquisitions, but not about the core business. |

| | |
|---|---|
| | • The focus of the proposals seems too narrow. That is, the proposed disclosures would provide information on only one type of investment: the acquisition of businesses. There are other types of investments that entities make to provide value to stakeholders. The proposals should be broader to cover such investments. |

NZAuASB

| Comments in favour of proposed disclosures | Challenges and concerns relating to the proposed disclosures |
|---|---|
| • When some companies make acquisitions, they focus on 'closing the deal' and do not always consider or report on the consequences of integrating the acquired business into the group. The proposed disclosure requirements on subsequent performance of acquisitions and on synergies (see the next sub-topic in this memo) could be useful in this regard. | • Acquisitions get absorbed into the existing business, therefore it can be difficult to track the subsequent performance of acquisitions.<br>• The ability to audit the proposed disclosures would depend on entities having sufficient documentation of the rationale for acquisitions and systems that can track the performance of acquisitions.<br>• Entities will be able to avoid providing disclosures on the subsequent performance of acquisition simply by explaining that they are not monitored by the CODM.<br>• The requirement to report against those objectives that were set at acquisition date does not take into account that much can change since the date of acquisition.<br>• It would be important to clearly articulate the difference between the strategic rationale for the acquisition and the objectives for the acquisition, otherwise some will find it challenging to distinguish between the two terms. |

Webinar

Just over half of those attendees who participated in the polling questions thought that the proposed disclosures on the subsequent performance of acquisitions would provide useful information to users of financial statements. About a third of attendees were unsure, and 15% thought that the disclosures would not be useful.

Goodwill and Impairment Outreach Event:

Of those attendees who participated in the polling questions, the majority thought that:

- Management monitors whether business combinations meet management's expectations;
- Entities should share with investors the information that management uses to monitor the performance of business combinations, and;
- Entities are unlikely to voluntarily disclose the abovementioned information.

Some attendees wanted to know whether the disclosures proposed in the DP should be provided in the financial statements or in the management commentary section of the annual report. The IASB

project lead noted that the IASB heard some support for including the proposed disclosures in management commentary, rather than in the financial statements, due to the strategic nature of this information. However, while the IASB has a Practice Statement on management commentary, that statement does not constitute mandatory requirements. The IASB has heard that entities are unlikely to voluntarily provide the disclosures outlined in the DP, and this view is reflected in the results of the polling questions at this event (see above).

An attendee noted that it would be important for the IASB to consider the level of detail that would need to be disclosed.

Another attendee noted that the expected payback period is likely to be a key indicator of management's objectives of an acquisition. The IASB presenters noted that if management monitors the performance of an acquisition using a payback period, then this would be disclosed under the proposed disclosure requirements in the DP.

The IASB presenters also clarified that the proposed disclosures on acquisition in the DP are not necessarily disclosures about goodwill, and that investors do not necessarily specifically consider the goodwill balance when assessing the performance of acquisitions. Rather, the proposed disclosures aim to help investors understand what benefits management had expected when they decided to acquire the business, and how the acquisition is performing against these expectations.

Submissions to date:

The OAG made a submission on the DP directly to the IASB with a copy to the NZASB. The OAG is generally supportive of the IASB's view that it should improve disclosures about acquisitions – including introducing disclosure requirements for information about management's objectives for acquisitions and how acquisitions have performed against those objectives. The OAG believe that such disclosures would help users assess the performance of entities that have made acquisitions, and hold management to account for acquisition decisions.

However, the OAG had concerns that in some cases, it may be impossible to provide the proposed disclosures because the acquired business has been integrated, or because the information is commercially sensitive.

The OAG noted that it is important that entities have clarity over the disclosures that will be expected from them in various circumstances.

Furthermore, the OAG notes the following: "As far as possible, permitting entities to provide reasons for nondisclosure about how acquisitions have performed against management's original expectations/objectives should be avoided. This is because such disclosures do not provide the same information content as information about the performance of the acquisitions against management's original expectations/objectives".

***Draft response to Question 2***

*Question 2(a)–(b): General comments on the proposed disclosures on the subsequent performance of acquisitions*

4. We think that the proposed disclosures on the strategic rationale and objectives for an acquisition and on the subsequent performance of the acquisitions against these objectives would provide useful information to investors. This information will help investors better understand the rationale for an acquisition, what benefits management intended to achieve by acquiring the business for the price that it paid – and in subsequent years, how successful the acquisition has been.

5. We note that the accounting for goodwill – be it the impairment-only model or amortisation – is unlikely to provide the above information to investors. As noted in the DP, it is not the purpose of the goodwill impairment test to inform investors on how successful an acquisition has been. As long as the recoverable amount of the cash generating unit (CGU) to which goodwill is allocated is higher than the CGU's carrying amount, a deterioration in the performance of the acquisition would not result in impairment. Similarly, if the IASB was to reintroduce goodwill amortisation, information on the annual amortisation of goodwill would not indicate whether an acquisition is successful. Therefore, whether the IASB reintroduces goodwill amortisation or retains the impairment-only model for goodwill, we think the proposed disclosures on the subsequent performance of acquisitions would be useful to investors for assessing the subsequent performance of an acquisition, and management's ability to realise the benefits expected from the acquisition.

6. Furthermore, we think the proposed disclosures would have the added benefit of focusing management's attention on how a business acquisition would fit into the entity's overall strategy, how and when the acquired business will be integrated into the existing business, what benefits will the acquired business generate for the entity – and, in later years, whether these expected benefits are being achieved. This could encourage acquisitions that create more value for the entity and its investors, and encourage better stewardship by management and greater accountability to investors.

7. We also think that the additional transparency around acquisitions that the disclosures will bring could provide an additional safeguard against the risk of management over-optimism in relation to the goodwill impairment test (as discussed in Section 3 of the DP).

8. However, we would recommend a careful consideration of the expected costs that preparers would incur in providing these disclosures. We appreciate that the IASB has taken steps to ensure that costs to preparers would be reasonable – by proposing that disclosures be based on information used by management internally and by requiring disclosures only for those acquisitions that are managed by the CODM. Nevertheless, we have heard concerns that despite these measures, the costs of providing the proposed disclosures may be high. Costs could arise, for example, from having to 'sanitise' internally used metrics and targets so that they can be disclosed without giving away commercially sensitive information, and from obtaining assurance over the new disclosures. A careful consideration of the costs of the disclosures in practice – for example, by running field tests – could help confirm the IASB's view that the benefits of the disclosures would outweigh the costs to preparers.

9. We also recommend that the IASB consider the following matters in relation to disclosures on the subsequent performance of acquisitions.

    (a) Paragraph 2.45(b) of the DP notes the following proposed disclosures:

    > (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;

[…]

(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

Some entities monitor the performance of their acquisitions against a budget prepared shortly after the acquisition, rather than against the estimated targets for the acquisition that existed as at the acquisition date. It would be useful to clarify which set of metrics should be used to satisfy the proposed requirements in (i) and (ii) above: those that existed as at the acquisition date (in which case the updated metrics would constitute a change in the metrics as per paragraph 2.45(v) of the DP), or the updated metrics established shortly after the acquisition?

(b) According to the DP, an entity would need to disclose the fact that it stopped monitoring an acquisition and the reason for this, but only if monitoring stopped within two years from the year of acquisition. However, we think there is merit in requiring such disclosure whenever monitoring of an acquisition stops, even if this happens more than two years after the acquisition – and providing this disclosure would not be onerous.

(c) It may be useful to consider whether to allow aggregation of disclosures about acquisitions of a similar nature – particularly if the CODM monitors these acquisitions in aggregate. For highly acquisitive entities, the ability to aggregate disclosures about similar acquisitions could make these disclosure requirements less onerous, and would avoid potentially voluminous disclosures that investors may find difficult to engage with. We note that for most of the existing disclosure requirements on acquisitions, paragraph B65 of IFRS 3 permits aggregation of information for acquisitions that are not material individually. However, we expect that acquisitions monitored by the CODM are likely to be material.

(d) A relatively common concern that we have heard during outreach is that it is difficult to track the performance of an individual acquisition because it is often integrated into the existing business quickly. The DP explains that if the acquired business is integrated with the acquirer's business, information about the subsequent performance of the acquisition may be based on the combined business. Therefore, we think the proposed disclosures could provide useful information on the subsequent performance of acquisitions, even in cases where the acquired business is integrated into the existing business soon after acquisition. However, we think it would be important to clearly explain in any forthcoming Exposure Draft and in the final standard that the disclosures on the subsequent performance of acquisitions can be provided for the integrated business if that is how management plans to measure – and measures – the performance of the acquisition.

10. Regarding the auditability of the proposed disclosures, we agree with the IASB that the following information should be verifiable by an auditor:

(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;

(c) and whether the information faithfully represents what it purports to represent.

11. However, we have heard concerns that the proposed disclosures may be difficult to audit. Therefore, we recommend that the IASB consider working with the International Auditing and Assurance Standards Board (IAASB) with a view to clarify what auditors' responsibilities would be in relation to the proposed disclosures.

*Question 2(c): Whether the information provided should be based on information and acquisitions that the entity's CODM reviews*

12. We agree with the IASB that requiring the proposed disclosures for those acquisitions that are reviewed by the CODM, and using the metrics the CODM uses, strikes a reasonable balance between providing investors with information that is important to them, avoiding disclosure overload, and making it feasible for preparers to provide information to investors.

13. We also agree that this approach is superior to requiring disclosures for 'major' or 'fundamental' acquisitions. Those approaches would have effectively introduced a new level of materiality, whereas the IASB's proposed approach builds on existing concepts that are already used under IFRS 8 Segment Reporting.

14. We also think that auditing disclosures on acquisitions that are monitored by the CODM could be easier than auditing disclosures on all material acquisitions, as it would be easier to ascertain whether an acquisition is monitored by the CODM as compared to whether an acquisition is material.

15. Having said this, we are aware that under this 'CODM approach', there is a risk that investors will not receive material information on acquisitions that are not monitored by the CODM but are nevertheless material. However, if an acquisition is not monitored by the CODM, we note that the IASB proposes to require entities to explain why that is the case. We think this proposed requirement could somewhat guard against entities omitting material information on acquisitions.

*Question 2(d): Whether concerns about commercial sensitivity could inhibit entities from providing the proposed disclosures*

16. Commercial sensitivity was a common concern that constituents expressed during our outreach activities – particularly in the context of New Zealand's relatively small economy.

17. Concerns about commercial sensitivity could arise particularly for privately held companies. While listed companies arguably already share some information of a strategic nature with investors and provide some information about acquisitions beyond the current accounting requirements, for example, when it is appropriate to do so under the continuous disclosure requirements of the stock exchange, privately held companies would perhaps be less accustomed to sharing such information with the users of their financial statements.

18. We think commercial sensitivity would be a factor that entities would take into account when determining the nature of information and level of detail that they are prepared to provide under the proposed disclosure requirements. However, we think it should be possible to achieve a balance between providing investors with the information they need under the proposed disclosures and not causing unnecessary damage to an entity's competitive position.

19. Nevertheless, there is a risk that due to concerns about commercial sensitivity, some preparers might provide disclosures that are so general so as not to be useful to investors. Furthermore, some preparers who do not wish to provide the disclosures for reasons other than commercial sensitivity (for example, due to concerns that the objectives for the acquisition might not be achieved) may refer to commercial sensitivity as a justification for lack of disclosure or for overly general disclosures. To mitigate this risk, we think it would be important to clarify the level of detail that would be acceptable when providing the disclosures proposed in the DP. This could include examples of disclosures about the strategic rationale for the acquisition and metrics for measuring subsequent performance – like the example provided in paragraph 2.11 of the DP.

*Question 2(e): Whether disclosures on the objectives for the acquisition and related metrics constitute forward-looking information, and possible constraints on the ability to provide these disclosures*

20. The DP notes that information about management's strategic rationale, objectives and related targets for an acquisition reflects management's targets *at the time of the acquisition*; therefore, information about the objectives for the acquisition and relevant metrics is not forward-looking information.

21. While targets are not necessarily predictions of future outcomes, we think that targets by their nature represent expectations of future performance. Therefore, in the year of acquisition, we think there would be a forward-looking element to the disclosure of management's objectives and targets for the acquisition.

22. We have heard during outreach that some entities may be reluctant to disclose the objectives for the acquisition, as the expected performance may not be achieved. To our knowledge, failure to achieve the objectives for an acquisition would not necessarily lead to litigation in New Zealand, but it may lead to criticism of management.

23. We note that disclosures about expectations for the future are already required in IFRS Standards. For example, IAS 36 requires information about growth rates used to determine forecast cash flows, and IFRS 7 *Financial Instruments: Disclosures* requires information on expected credit losses for certain financial assets. However, not achieving the objectives of an acquisition may possibly attract greater criticism of management as compared to not achieving the expected growth rate disclosed under IAS 36 or actual credit losses on a financial instrument being different to those disclosed under IFRS 7.

24. However, we think that the risks of not achieving objectives and targets is not necessarily a reason to not provide investors with the information they need to be able to assess the performance of acquisitions.

| **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:<br>• the benefits that a company's management expected from an acquisition when agreeing the price to acquire a business; and<br>• the extent to which an acquisition is meeting management's (CODM's) objectives for the acquisition.<br>Do you agree with the Board's preliminary view? Why or why not? |

| Summary of NZASB discussion to date |
|---|
| The Board did not seem to have any concerns with the IASB's proposal to enhance the disclosure objectives of IFRS 3. However, one Board member noted that despite the enhanced disclosure objectives, some entities may still provide 'boiler plate' disclosures. |

***Draft response to Question 3:***

We support the IASB's proposal to update the disclosure objectives in IFRS 3 to specifically refer to providing information on benefits expected from an acquisition and the extent to which these benefits are being realised. This is consistent with the IASB's proposed new disclosure requirements on the subsequent performance of acquisitions and on expected synergies at the time of acquisition.

**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?

| Summary of NZASB discussion to date |
| --- |
| Regarding the proposals around more specific disclosures on synergies, there were some concerns about commercial sensitivity, the ability to audit these disclosures and also that the calculation of synergies might not easily reconcile to the final purchase price of the acquired business.<br>Also, the importance of 'telling the story' of the acquisition was emphasised (rather than just disclosing numbers). |

| Summary of feedback received to date |
| --- |
| TRG<br>• Some TRG members think the proposed disclosures on synergies will be difficult to audit. A TRG member hoped that auditors will not be expected to confirm the reasonableness of projections relating to synergies.<br>• There were concerns about commercial sensitivity.<br>• There is a strong regulatory influence on disclosures about acquisitions. Therefore, disclosures in this area are and will be subject to judgement and trade-offs.<br>NZAuASB<br>An NZAuASB member noted that disclosures on synergies could be useful, as they would help understand the consequences of integrating the acquired business into the group. However, another member noted that that providing and auditing these disclosures would depend on the entity having systems that can quantify synergies. |

***Draft response to Question 4:***

*Proposed disclosures about synergies*

25. We agree that the IASB's proposals to require more specific disclosures on synergies should help provide investors with more useful information about the expected benefits of the acquisition and the rationale for the transaction price (and therefore the value of goodwill on acquisition). Therefore, we agree with proposing these disclosures.

26. However, we are aware of concerns around the commercial sensitivity of these disclosures, and such concerns could affect the level of detail that entities are prepared to provide regarding expected synergies. Clarification as to the acceptable level of disclosures – possibly by way of examples – could be useful in this regard.

27. We also note that while disclosures about expected synergies would help explain the rationale for the acquisition and its transaction price, they would not necessarily equal to – or be easily reconcilable to – the transaction price itself. It is important to make this clear, to avoid an expectation to the contrary from users and auditors.

28. Furthermore, we would like to emphasise the importance of qualitative disclosures on the expected synergies and other expected benefits of the acquisition – in addition to quantitative disclosures. Qualitative disclosures could complement and add context to the quantitative disclosures on the range of expected synergies, etc.

29. We are also heard concerns in relation to the audit of disclosures on expected synergies – including concerns that auditors may be expected to opine on whether the expectations around synergies are reasonable. If the proposed disclosures are introduced, we think it would be important to clarify, through discussions with the IAASB, the auditor's role regarding assurance over the disclosures over synergies.

*Proposal to specifically require disclosure of the acquiree's liabilities from financing activities and defined benefit pension liabilities*

30. We note that paragraph B64 of IFRS 3 requires disclosure of the amounts as at acquisition date for major classes of assets and liabilities assumed in a business combination. Therefore, under the current requirements, whether the acquiree's liabilities from financing activities and/or defined benefit pension plan are disclosed or not depends on whether they are considered to be major classes of transaction.

31. We note that the proposed requirement to disclose the acquiree's liabilities from financing activities and defined benefit pension liability is a rather specific requirement, as compared to the more principles-based requirements usually found in IFRS Standards. However, if investors find disclosures about the acquiree's liabilities from financing activities and defined benefit pension liabilities useful, then we support the IASB's proposal to specifically require these disclosures. We note that IFRS 3 already includes other specific disclosure requirements in relation to receivables such as loans and finance leases (paragraph B64(h)), and in relation to recognised contingent liabilities (paragraph B64(i)), so there is precedent to requiring such specific disclosures in IFRS 3. We also note that, as with all disclosure requirements in

IFRS Standards, the disclosures proposed by the IASB on the acquiree's liabilities from financing activities and defined benefit pension liabilities would be subject to materiality, and preparers would not need to disclose these liabilities if they are not material.

**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?

| Summary of NZASB discussion to date |
| --- |
| Board members disagreed with retaining the existing pro-forma disclosures and with the proposed enhancements to these disclosures. It was noted that the pro-forma information that is currently required is difficult to calculate, and this would also be the case for the proposed new requirements on pro-forma cash flows. It is unlikely that the benefits of these disclosures outweigh the costs to preparers.<br>Regarding the proposal 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: The Board noted that the determination of integration costs would be highly subjective. |

| Summary of feedback received to date |
|---|
| TRG<br>There was a general preference among TRG members to remove the requirement to disclose the abovementioned pro-forma information. Members noted that this disclosure would not be needed if the proposed additional disclosures on the subsequent performance of acquisitions are introduced. It was also noted that preparing this disclosure can be difficult, and that the usefulness of this disclosure to investors is questionable. |

***Draft response to Question 5:***

32. We do not agree with the IASB's preliminary view in relation to disclosures about the contribution of the acquiree to the acquired business in the year of acquisition. Our preference would be to remove the existing requirement to disclose 'pro forma' information on the revenue and profit of the combined business as if the acquisition occurred at the start of the year, and not to require the proposed additional disclosures on operating cash flows.

33. If the IASB introduces the proposed disclosures on subsequent performance of acquisitions as discussed in the DP, then we think it is unlikely that the above disclosures would be needed by investors. Furthermore, we are aware that it is often difficult for preparers to provide the abovementioned pro-forma information. Removing these disclosures would also help address some preparers' concerns on the amount of disclosures currently required by IFRS 3, as noted in the DP.

34. Regarding the proposal to use term 'operating profit before acquisition-related transaction and integration costs' instead of 'profit or loss': We note that the determination of integration costs can be highly subjective. Therefore, if the IASB retains the existing pro-forma requirements and proposes the new disclosures on cash flows as per its preliminary view, using the term 'operating profit before acquisition-related transaction and integration costs' will add a layer of subjectivity to these disclosures. As noted above, we prefer that these disclosures be removed in the first place.

**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?

| Summary of NZASB discussion to date |
|---|
| In general, Board members agreed with the IASB that:<br>• it is not feasible to design an impairment test that would be significantly more effective at recognising goodwill impairment losses in a timely manner and at a reasonable cost, and;<br>• management over-optimism and 'shielding' of goodwill within CGUs are the main reasons for the concern that goodwill impairment losses are recognised too late.<br>However, a Board member noted that within the shielding issue there is a bundle of issues, including issues relating to the allocation of goodwill to CGUs.<br>That Board member also noted that another concern in relation to the goodwill impairment test is that for start-up entities, it is often very difficult to estimate future cash flows reliably.<br>Also, while the following was discussed as part of the topic of simplifying the value-in-use calculation, it may be useful in relation to management over-optimism:<br>When discussing simplifications to the VIU calculation with the Board, staff had suggested (based on a recommendation from a now former Board member) to recommend that the IASB put greater emphasis on the requirement to base cash flows on "reasonable and supportable" assumptions in IAS 36. Please refer to paragraph 40 below for more detail. |

| Summary of feedback received to date |
| --- |
| TRG<br>There was general agreement with the IASB's preliminary views that:<br>• it is not feasible to design an impairment test that is significantly more effective at recognising impairment losses in a timely manner at a reasonable cost, and;<br>• the key reasons for the concern that goodwill impairment losses are recognised too late are management overoptimism and shielding within cash-generating units (CGUs).<br>The following points were noted in relation to shielding.<br>• Shielding is not purely a goodwill-related issue. Other poor-performing assets that are tested for impairment as part of a CGU can also be shielded from impairment by well-performing assets within the same CGU.<br>• Shielding can be exacerbated when CGUs are not identified at the appropriate level. Some entities default to identifying CGUs at the operating segment level (which is the maximum CGU size allowed by IAS 36). Proper application of IAS 36 to the identification of CGUs can reduce shielding. However, shielding cannot be fully eliminated.<br>In general, members agreed that management over-optimism in performing the impairment test is an issue that is best addressed by auditors and regulators. A member noted that IAS 36 already contains restrictions aimed to avoid the risk of management over-optimism (such as the requirement to use approved budgets covering a maximum period of five years), and that it may be useful to consider whether these restrictions could be enhanced.<br><br>NZAuASB<br>NZAuASB members agreed that management over-optimism is a key reason for the concern that goodwill impairment losses are recognised too late (the NZAuASB was not specifically asked to discuss shielding). It was noted that it is appropriate for auditors to guard against management over-optimism, and that good disclosures on the assumptions used in the goodwill impairment test can somewhat mitigate this risk. However, several members supported re-introducing goodwill amortisation to address this issue.<br>Goodwill and Impairment Outreach Event<br>Of those attendees who answered the polling question on this topic, the majority agreed with the IASB that it is not possible to make the impairment test significantly more effective at a reasonable cost.<br>An attendee noted that the shielding argument ignores synergies achieved by the acquisition, and that if the acquisition has been truly integrated, it is not possible to tell where the headroom within the CGU is coming from (i.e. whether it relates to the acquired goodwill or to internally generated goodwill and other assets). |

***Draft response to Question 6:***

*Questions 6(a) and (b): Whether it is possible to design a significantly more effective impairment test*

35. 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.

36. 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. Furthermore, unless and until the prohibition on recognising internally generated goodwill and certain other internally generated intangible items is removed, CGUs to which goodwill is allocated will often include unrecognised headroom from these items. Therefore, we agree that goodwill will inevitably be shielded by unrecognised headroom within the CGU, be it headroom generated before or after the acquisition.

37. We also agree that the IASB should not implement the alternative impairment method described as the 'headroom approach' in Section 3 of the DP – as this method would not eliminate the shielding of goodwill, there would be issues around allocating the impairment amount between acquired goodwill and unrecognised 'headroom' items, and the DP notes that it will be costly for preparers to implement this model.

*Question 6(c): Reasons for concern that goodwill impairment losses are recognised too late*

38. We agree with the IASB that overly optimistic estimates in performing the impairment test and the shielding of goodwill within CGUs are the main reasons for the concern that goodwill impairment is not recognised on a timely basis. Our specific comments on these two concerns are included below.

    Management over-optimism

39. There are already some requirements in IAS 36 that attempt to mitigate the risk of management over-optimism, and we agree that in general, any additional safeguards to mitigate against this risk should come from the work of auditors and regulators.

40. However, it may be worth considering whether there are opportunities to enhance the existing safeguards in IAS 36. For example, we would recommend considering whether more emphasis should be given to the requirement to base cash flow projections on 'reasonable and supportable information'. At the moment, IAS 36 requires cash flows in the VIU calculation to be based on "reasonable and supportable assumptions" (paragraph 33(a)), and also to be based on budgets or forecasts approved by management (paragraph 33(b)). However, these are presented as two separate requirements. Therefore, there could potentially be tension between these two requirements, and an entity could potentially put more emphasis on basing the cash flows on forecasts approved by management – and these forecasts could be over-optimistic. This risk could be somewhat mitigated if the standard puts more emphasis on the requirement around 'reasonable and supportable assumptions'.

Shielding

41. As noted above, we agree that shielding cannot be fully eliminated – because goodwill must be tested for impairment with a group of other assets, including certain intangible items that cannot be recognised on the balance sheet, and these can shield goodwill from impairment.

42. However, we note that the issue of shielding as described in the DP is compounded by issues around the identification of CGUs/groups of CGUs for the purpose of the impairment test and the allocation of goodwill to these CGUs. That is, allocating goodwill to excessively large CGUs can exacerbate the impact of shielding.

43. A CGU is defined in IAS 36 as the "smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets". However, we are aware that some entities default to identifying CGUs at the operating segment level, which is the maximum possible size under IAS 36 (paragraph 80(b)), and justify this by saying that this is the lowest level at which management monitors goodwill (paragraph 80(a) of IAS 36). Sometimes this means that the entire reporting entity is seen as a single CGU, and goodwill (sometimes from several acquisition) is tested for impairment together with all the assets and liabilities and unrecognised headroom of the whole reporting entity. While this might be appropriate in some cases, in other cases a more granular identification of CGUs would lead to a more meaningful goodwill impairment test, and would decrease the impact of shielding.

44. 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, the AASB Research Report notes that due to lack of clarity around the requirements in IAS 36 to allocate goodwill to CGUs, respondents said that these requirements are difficult to interpret and implement, require a high degree of subjectivity and result in diversity in application.

45. Therefore, we recommend considering whether additional guidance on allocating goodwill to CGUs or groups of CGUs could be provided.

*Question 6(d): Should the IASB consider any other aspects of IAS 36*

46. As noted above, we recommend that the IASB consider developing additional guidance on the identification of CGUs and the allocation of goodwill to CGUs. 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 7**

Paragraphs 3.86–3.94 summarise the reasons for the Board's preliminary view that it should not reintroduce amortisation of goodwill and instead should retain the impairment-only model for the subsequent accounting for goodwill.

(a) Do you agree that the Board should not reintroduce amortisation of goodwill? Why or why not? (If the Board were to reintroduce amortisation, companies would still need to test whether goodwill is impaired.)

(b) Has your view on amortisation of goodwill changed since 2004? What new evidence or arguments have emerged since 2004 to make you change your view, or to confirm the view you already had?

(c) Would reintroducing amortisation resolve the main reasons for the concerns that companies do not recognise impairment losses on goodwill on a timely basis (see Question 6(c))? Why or why not?

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

(e) If amortisation were to be reintroduced, do you think companies would adjust or create new management performance measures to add back the amortisation expense? (Management performance measures are defined in the Exposure Draft *General Presentation and Disclosures*.) Why or why not? Under the impairment-only model, are companies adding back impairment losses in their management performance measures? Why or why not?

(f) If you favour reintroducing amortisation of goodwill, how should the useful life of goodwill and its amortisation pattern be determined? In your view how would this contribute to making the information more useful to investors?

| Summary of NZASB discussion to date |
| --- |
| Based on discussions at Board meetings so far, more Board members have supported the reintroduction of goodwill amortisation. Reasons included the following.<br>• Goodwill stays on the balance sheet for excessively long periods, 'loses its identity' as the entity changes and restructures, and it then takes an extreme event (like COVID-19) to finally impair it.<br>• Some Board members think goodwill is a wasting asset, i.e. it gets consumed by the entity and replaced by internally generated goodwill.<br>• It was also noted that while IFRS Standards may assume that goodwill mainly consists of a 'going concern' element and synergies, the goodwill balance often includes other intangible items for which amortisation may be more appropriate.<br>However, some Board members supported retaining the impairment-only model (at least for now), for the following reasons.<br>• Whether to reintroduce amortisation should be considered as part of a more comprehensive review, rather than as part of this project, which has a relatively narrow scope. |

- If goodwill is amortised, there could possibly be a 'double-hit' to the P&L. For assets that are depreciated or amortised, it is possible to capitalise certain costs incurred in relation to these assets, whereas such capitalisation is not possible for goodwill.

The Board noted the importance of hearing from stakeholders before reaching a final view on this matter.

The following was also noted in relation to Question 7 of the DP:

- In practice it is difficult to distinguish between acquired goodwill and goodwill that is generated internally after the acquisition.
- If the IASB ends up requiring amortisation, the required amortisation period would need to be backed up by research – for example, academic research on how long the additive value of acquisitions tends to last. Some Board members mentioned 10 years or 20 years as possible timeframes for amortisation.

Summary of feedback received to date

<u>TRG</u>

*Questions 7(a)–(c)*

In terms of whether to introduce goodwill amortisation or retain the impairment-only model, there were mixed views among the TRG members, as well as their firms and clients.

Arguments for retaining the impairment-only model included the following.

- If amortisation was to be reintroduced, the amortisation period is likely to be arbitrary.
- In a recent article, the International Valuation Standards Council (IVSC) argue that goodwill has an indefinite useful life and is not a 'wasting' asset – which points in favour of the impairment-only model, rather than amortisation.
- By gradually reducing the goodwill balance over time, amortisation increases the risk of shielding and can mask poor performance. An impairment loss on goodwill signals to users that the acquisition was not successful or that the business is not doing well – but regular amortisation could mean that it will take longer before the problem is recognised and reported.
- While there are arguments both for and against re-introducing amortisation, there is not a strong enough argument for changing the status quo.

Arguments in support of amortisation included the following views.

- Goodwill does not have an indefinite useful life. Rather, acquired goodwill is consumed and replaced by internally generated goodwill.
- The impairment-only model is causing goodwill balances to stay on the balance sheet for too long. As a result, some entities' goodwill balances are too high. As an example, a member mentioned an entity who used to amortise its goodwill under Old GAAP, but even since the impairment-only model was introduced the entity's goodwill balance has not reduced at all.
- Amortisation is more appropriate from a cost/benefit perspective, especially for mid-sized companies. Such companies tend to require external expert advice when performing the impairment test, which is costly. Furthermore, such companies sometimes do not have a good budgeting process in place, and this – together with management over-optimism – has a negative effect on the robustness of the impairment test.
- In response to the argument in the previous paragraph that amortisation could mask poor performance: It could be argued that the impairment-only model is also not successful in

highlighting poor performance either, particularly if the CGUs identified by management are too large.

- While there may not be any new conceptual arguments in the amortisation vs impairment-only debate, the application of IAS 36 has given rise to some practical issues. For example, when an entity sells off one of its subsidiaries, some of the goodwill that the entity recognised when it purchased the subsidiary might stay on the entity's balance sheet, because that goodwill was allocated across multiple CGUs. This is an odd outcome.

A member also noted that some people question whether goodwill meets the recognition criteria of an asset in the first place.

*Question 7(d)*

TRG members noted that in practice it can be difficult to distinguish between acquired goodwill and goodwill generated internally after the acquisition. It was noted that the relationships and synergies embodied within goodwill, and it can be difficult to determine whether certain activities maintain the existing acquired goodwill or create new internally generated goodwill. A member noted that this difficulty is a weakness in the standard which may not be possible to resolve.

*Question 7(e)*

TRG members generally agreed that if goodwill amortisation were to be reintroduced, entities would adjust for amortisation in their management performance measures. However, one member noted that this would not be any different to current practice.

*Question 7(f)*

Several TRG members thought that if goodwill were to be amortised, there should be a cap on the estimated useful life of goodwill. A member noted that a shorter amortisation period would reduce the impact of shielding. Members suggested that the determination for the useful life of goodwill could be based on:

- the previous requirements and guidance under Old GAAP (FRS 36 *Accounting for Acquisitions Resulting in Combinations of Entities or Operations*) included guidance on determining the useful life of goodwill and capped useful at 20 years), or;
- the requirements of IFRS for SMEs (if useful life cannot be estimated reliably, it is capped at 10 years), or;
- valuers' research as to how long goodwill lasts in particular industries.

XRAP

An XRAP member noted that while he was not aware of new arguments in relation to the amortisation vs impairment-only debate, in his view there is no logical basis for amortising goodwill. If an entity invests in its brand, the value of goodwill could actually be rising – and the impairment test is the best way to deal with sharp decreases in value.

Another member noted that if goodwill were to be amortised, the estimate useful life of goodwill and therefore the amortisation expense amounts would be arbitrary.

A member wondered whether there should be an option to write goodwill off immediately upon acquisition, as this would increase comparability with entities who do not grow through acquisitions. However, another member noted that goodwill represents real value for the business, and writing it off immediately would have a perverse outcome. The member said that while some investors might exclude goodwill from their calculations, they would be missing some of the business' value. A third member noted that it would be beneficial to recognise on the balance sheet not just acquired goodwill but also internally generated goodwill – to emphasise that such goodwill exists and to prevent management from engaging in activities that destroy such goodwill.

NZAuASB

NZAuASB members noted that goodwill impairment is a challenging area for both auditors and management, that management sometimes recognises goodwill impairment too late, and when impairment is recognised there is a tendency to write off the entire goodwill balance. Therefore, NZAuASB members supported the reintroduction of goodwill amortisation.

In terms of the length of time over which goodwill should be amortised, one member mentioned five years and another mentioned ten years.

Goodwill and Impairment webinar

When attendees were asked whether they preferred the reintroduction of goodwill amortisation or retaining the impairment-only model, about 60% of attendees preferred amortisation and about 40% preferred impairment only.

Goodwill and Impairment Outreach Event

Attendees were asked whether their views on the subsequent accounting for goodwill (i.e. impairment-only vs amortisation) have changed since the impairment-only model was introduced in 2004. In summary, of the attendees who answered this question, about two thirds currently support amortisation and one third supports the impairment-only model. Specifically.

- 35% used to support the impairment only-model, but now support amortisation
- 32% have always supported amortisation
- 25% have always supported the impairment-only model
- 7% used to support amortisation, but now support the impairment-only model

An attendee asked whether the IASB considered providing an accounting policy choice to either amortise goodwill or use the impairment-only model. The IASB presenters noted that from an investor perspective, a policy choice would not be preferred because it could add to lack of comparability.

Another attendee asked about the hybrid method mentioned in the DP, whereby the impairment only model would apply for the first few years after the acquisition and amortisation would be required thereafter. The IASB presenters noted that this option was considered by the IASB, but the IASB decided not to pursue it.

An attendee noted that COVID-19 might be new evidence against amortisation.

Submissions to date:

The OAG, who made a submission directly to the IASB with a copy to the NZASB, was supportive of retaining the impairment-only model, as well as the IASB's other preliminary views in relation to the subsequent accounting for goodwill.

***Draft response to Question 7:***

***Option 1: Retain the impairment-only model for goodwill***

*Question 7(a): Do you agree that the IASB should not reintroduce amortisation of goodwill? Why or why not?*

47. We have heard mixed views from constituents regarding the subsequent accounting for goodwill, and like the IASB, we are aware that both the impairment-only model and the amortisation model have advantages and disadvantages.

48. Ultimately, we agree with the IASB that goodwill amortisation should not be reintroduced. We recommend retaining the impairment-only model for the following reasons.

    (a) We think that the core elements of goodwill as described in BC313–BC 318 of IFRS 3, i.e. synergies and the 'gong concern' element, generate economic benefits over an indefinite time period. Therefore, like other intangible assets with an indefinite life, the impairment-only model is appropriate for goodwill and the amortisation model is not.

    (b) According to a recent article[1] by the International Valuation Standards Council (IVSC), 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. For example, the IVSC note that synergies are included in the terminal value calculation in the pricing model for acquisition. Therefore, the amortisation method (which reflects the consumption of a 'wasting' asset over a finite period) 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.

    (c) Even if it is argued that the value of goodwill is consumed over a finite period, it is very difficult to reliably estimate the useful life of goodwill. The amortisation model is likely to result in an arbitrary amortisation expense amount being charged over an arbitrary time frame. Such arbitrary information is unlikely to provide useful information to users of financial statements, including investors. On the other hand, the impairment-only model provides useful information to investors – about the fact that impairment has occurred (if that is the case), and about the underlying assumptions used in determining whether goodwill is or is not impaired.

    (d) While amortisation would reduce the goodwill balance, it could reduce the likelihood of an *impairment loss* being recognised. The impairment test would still be performed under the amortisation method, but because of the regular decreases in the goodwill balance, it would be less likely that the carrying amount of CGUs to which goodwill is allocated would not be recoverable. Therefore, the amortisation method could lead to impairment losses being mislabelled as 'business as usual' amortisation.

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

(e) For most assets, while amortisation is mandatory it is also possible to capitalise certain costs incurred in relation to the asset. However, such capitalisation is not possible for goodwill. Therefore, under the amortisation method, there is a risk of a 'double-hit' to the P&L in the same year: once from expenditure incurred to enhance goodwill, and again from amortisation.

(f) While internally generated goodwill could possibly replace impaired or consumed amounts of acquired goodwill, in practice it is very difficult to distinguish between acquired goodwill and goodwill generated internally after the acquisition (see discussion further below). The extent to which internally generated goodwill replaces acquired goodwill could be limited, assuming that acquired goodwill generates benefits over an indefinite time period.

(g) The reintroduction of amortisation would be a major change in accounting requirements. While the amortisation method has some practical advantages over the impairment-only model, it also has some disadvantages as compared to impairment-only, and it is not clear that a change in model would lead to an overall improvement in the accounting for goodwill and the information that is provided to investors.

(h) This project has a relatively narrow scope in relation to impairment and accounting for goodwill, as it is based on a post-implementation review of IFRS 3 (which focuses on business combinations, rather than impairment or intangible assets). If the IASB was to reintroduce amortisation, this would require a wider scope project which would potentially consider other indefinite-lived assets, as well as possible amortisation methods and amortisation periods – which would require a lot of additional research. Therefore, we believe that the reintroduction of amortisation should be proposed only as part of a more comprehensive project on this subject – rather than as part of this project.

49. We have conducted a webinar on the DP, as well as an outreach event. In both outreach activities, there were mixed views expressed in relation to amortisation and the impairment-only model. While the majority of participants supported the reintroduction of amortisation, those majorities (about 60% and about two thirds respectively) were relatively narrow.

*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?*

50. At an outreach event, we asked New Zealand constituents whether their views on the subsequent accounting for goodwill have changed since 2004, when the impairment-only model was first introduced. About 40% of the attendees said that their views have changed, while about 60% have not changed their views. For the majority of those attendees whose views have changed since 2004, the change was in favour of amortisation – but about 7% of attendees changed their preference to impairment-only.

51. We are not aware of new conceptual arguments or significant new evidence that would support a move to the amortisation model.

*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?*

52. 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.

53. 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 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?*

54. We think that in practice, it is difficult to distinguish between acquired goodwill and goodwill generated internally after the acquisition. Specifically, it is difficult to determine whether certain activities maintain the value of the acquired goodwill or create internally generated goodwill. Furthermore, it can be difficult to determine whether future expected benefits from new customers, a new product line or a new brand are related to the acquired goodwill (i.e. part of the synergies from the acquisition, or part of the 'going concern' element of the acquired entity which allows finding new customers, developing new products, etc.) – or whether it is new, internally generated goodwill that is unrelated to any previous acquisition.

*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? Under the impairment-only model, are companies adding back impairment losses in their management performance measures? Why or why not?*

55. We think that companies are likely to adjust management performance measures to add back the amortisation expense.

*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?*

56. We do not favour the reintroduction of amortisation of goodwill.

***Option 2: Reintroduce goodwill amortisation***

*Question 7(a): Do you agree that the IASB should not reintroduce amortisation of goodwill? Why or why not?*

57. We have heard mixed views from constituents regarding the subsequent accounting for goodwill, and like the IASB, we are aware that both the impairment-only model and the amortisation model have advantages and disadvantages.

58. Ultimately, we disagree with retaining the impairment-only model for goodwill. We would recommend reintroducing goodwill amortisation for the following reasons.

    (a) We believe that the economic benefits embodied within goodwill do not last indefinitely; rather, they are consumed by the entity over a finite time period (and are replaced by internally generated goodwill – see below). This consumption would be best reflected by amortisation.

    (b) As goodwill is consumed, it is replaced by internally generated goodwill, which is different to the acquired goodwill. IFRS Standards prohibit the capitalisation of internally generated goodwill – but non-amortisation means that entities are effectively recognising the internally generated goodwill that replaces acquired goodwill.

    (c) An entity can be restructured several times after an acquisition that gives rise to goodwill. Without regular amortisation, goodwill stays on the balance sheet throughout these restructures (as long as the recoverable amounts of relevant CGUs exceed their carrying amounts) – even when the restructured entity bears very little resemblance to either the acquired business or the original business as it existed at the time of the acquisition.

    (d) By its nature, the goodwill impairment test is complex and requires a high degree of estimation, which is subject to error and management over-optimism. As a result of this – as well as due to the effect of shielding, which cannot be eliminated – there is a high risk that goodwill balances are overstated. Amortisation would be a simpler and more effective way to ensure that the goodwill balance is not overstated.

    (e) We heard concerns that goodwill impairment test is costly, particularly for medium-sized companies, who do not have the same level or resources and internal expertise as larger companies. For such companies in particular, amortisation would be a more cost-effective way of accounting for goodwill – including ensuring that goodwill is not overstated. Even though impairment testing would still be required under an amortisation model. The IASB's proposed move to an indicators-based approach for testing for impairment of goodwill, amortisation would mean that goodwill will need to be tested for impairment less often that it is currently, which will reduce costs for preparers.

(f) The Basis for Conclusions of IFRS 3 explain that the core components of goodwill are the 'going concern' element of the acquired business and the synergies expected from the acquisition. While it could possibly be argued that these components of goodwill have an indefinite life, in practice the goodwill balance sometimes contains other intangible items that have finite useful lives and for which amortisation would be appropriate.

(g) Determining the useful life of goodwill could be challenging and would require judgement, but it is not impossible. Before New Zealand adopted IFRS Standards, the standard on accounting for acquisitions (FRS 36 *Accounting for Acquisitions Resulting in Combinations of Entities or Operations*) included guidance on determining the estimated useful life of goodwill. In addition, the IASB could put a cap on the amortisation period, to reduce complexity and avoid overly optimistic estimation of useful life. Such caps could be based on academic research, the IFRS for SMEs standard, or another current or previous standard outside of IFRS that allows amortisation and has a cap on useful life.

59. We have conducted a webinar on the DP, as well as an outreach event. In both outreach activities, the majority of participants supported the reintroduction of amortisation.

*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?*

60. At an outreach event, we asked New Zealand constituents whether their views on the subsequent accounting for goodwill have changed since 2004, when the impairment-only model was first introduced. About 40% of the attendees said that their views have changed, while about 60% have not changed their views. For the majority of those attendees whose views have changed since 2004, the change was in favour of amortisation. Overall, about two thirds of attendees currently support amortisation.

61. While we are not aware of significant new conceptual arguments in favour of amortisation that the IASB is not already aware of, the practical issues that have been arising from applying the IAS 36 since the impairment-only model for goodwill was introduced could constitute a reason for reintroducing amortisation. Such practical issues included challenges around identifying CGUs and allocating goodwill to CGUs, the cost of performing the impairment test every year, the risk of management over-optimism in performing the impairment test, etc.

*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?*

62. While amortisation of goodwill would not necessarily cause impairment losses to be recognised on a more timely basis, it would help address the consequences of impairment losses being recognised too late. Late recognition of impairment losses leads to overstated goodwill balances. Amortisation will address this by systematically reducing the goodwill balance.

63. Furthermore, while the impairment test would still be affected by shielding and the risk of management over-optimism (because the amortisation model would not change the impairment test itself), the impact of these issues would be reduced under the amortisation model, because the impairment test would be applied to a steadily decreasing goodwill balance.

64. We acknowledge that the determination of the useful life of goodwill for the purpose of amortisation could be subject to management over-optimism. However, putting a cap on the amortisation period in the relevant standard would somewhat mitigate this risk.

*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?*

65. We think that in practice, it is difficult to distinguish between acquired goodwill and goodwill generated internally after the acquisition. Specifically, it is difficult to determine whether certain activities maintain the value of the acquired goodwill or create internally generated goodwill. Furthermore, it can be difficult to determine whether future expected benefits from new customers, a new product line or a new brand are related to the acquired goodwill (i.e. part of the synergies from the acquisition, or part of the 'going concern' element of the acquired entity which allows finding new customers, developing new products, etc.) – or whether it is new, internally generated goodwill that is unrelated to any previous acquisition.

66. However, while it is difficult to distinguish between acquired goodwill and internally generated goodwill, we think that acquired goodwill does not generate benefits indefinitely – it is consumed by the entity and replaced by internally generated goodwill.

*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? Under the impairment-only model, are companies adding back impairment losses in their management performance measures? Why or why not?*

67. We think that companies are likely to adjust management performance measures to add back the amortisation expense. However, we do not think that this is a reason not to reintroduce amortisation.

*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?*

68. We would recommend that the IASB introduce a [Board to select one of the following, if any: cap on amortisation/rebuttable fixed amortisation period/a mandatory fixed amortisation period]. We believe that this [cap/period] should be based on research, such as academic research on the lifespan of acquisitions' additive value. Introducing such a [cap/period] would mitigate the risk of over-optimistic estimations of the amortisation period and would simplify the amortisation requirements for preparers.

69. Information about the amortisation period would help investors understand how long the acquired goodwill is expected to generate benefits for the entity.

70. While the yearly amortisation expense amount may be of limited usefulness to investors, amortisation would lead to a more accurate goodwill balance and overall financial position (as it would ensure that goodwill is not overstated) – which will be useful to investors.

| **Questions for the Board – Draft response to Question 7 (impairment-only vs amortisation)** |
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| Q1. Which option would you prefer to reflect in the comment letter:<br>• Option 1: retain the impairment only model for goodwill) or;<br>• Option 2: reintroduce goodwill amortisation, or;<br>• A hybrid of the two options?<br>Q2. In terms of the list of arguments provided under your chosen option, are there any argument that you would like to delete, add or change?<br>Q3. If the Board prefers the reintroduction of amortisation, would the Board prefer the IASB introduce a cap on the permitted amortisation period, a rebuttable presumption that a certain fixed period be used, a mandatory fixed amortisation period, or none of these? |

| **Question 8** |
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| 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).<br>(a) Should the Board develop such a proposal? Why or why not?<br>(b) Do you have any comments on how a company should present such an amount? |

| Summary of NZASB discussion to date |
|---|
| The Board disagreed with the IASB's proposal that entities should be required to present equity excluding goodwill on the balance sheet. Board members noted the following.<br>• Presenting equity excluding goodwill on the balance sheet would imply that goodwill is not an asset.<br>• Goodwill is already required to be disclosed separately, so investors can easily deduct it from equity if they wish. |

| Summary of feedback received to date |
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| <u>TRG</u><br>The TRG also disagreed with the proposal to present equity excluding goodwill on the balance sheet, for the same reasons as those noted by the Board. In addition, the TRG noted that having two equity numbers may be confusing for users – they would wonder which one is the 'real' equity amount. |

***Draft response to Question 8:***

71. We disagree with the IASB's proposal to require entities to disclose the amount of equity excluding goodwill on the balance sheet.

72. We appreciate that that the IASB's intention in making this proposal was to provide more transparency around goodwill, and help investors identify companies in which goodwill forms a large part of the equity balance. However, we disagree with the IASB's proposal for the following reasons.

    (a) We acknowledge that goodwill has certain characteristics that make it different to most other assets (as discussed in the DP) – but it is nevertheless an asset for the purpose of IFRS Standards. Presenting the amount of equity excluding goodwill could imply that goodwill is not an asset and should not be recognised on the balance sheet.

    (b) If the amount of equity excluding goodwill is useful information for investors, it would be easy for investors to calculate that amount themselves, without that amount being presented on the balance sheet. Separate disclosure of goodwill (either on the balance sheet or in the notes) is already required in IFRS Standards. Moreover, the IASB ED

*General Presentation and Disclosures* proposed that goodwill be presented as a separate line item on the balance sheet.

(c) Having two equity balances may be confusing for some users of financial statements – and they may question which amount represents the 'true' equity position of the entity.

**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?

| Summary of NZASB discussion to date |
| --- |
| Board members had mixed views on the proposal to move to an indicator-based approach for goodwill impairment.<br>• Some members supported the proposed relief from the annual impairment test, noting that there is no reason to trust management less in relation to the impairment of goodwill as compared to other assets, and that it is already current practice to look at key indicators when there is large headroom.<br>• However, other members preferred to retain the annual goodwill impairment test. These members thought that the discipline of carrying out the goodwill impairment test every year is beneficial, that some robustness could be lost if annual impairment testing is not required, and that removing this requirement would not reduce costs significantly. |

| Summary of feedback received to date |
| --- |
| TRG<br>One member expressed concern about the IASB's suggestion to move to an indicators-based approach for goodwill impairment test. That member was concerned about management over-optimism.<br>Four members, two of whom expressly agreed with the IASB's suggested move to an indicators-based approach for goodwill impairment, noted that if the IASB implements this proposal then the requirements and guidance around impairment indicators in IAS 36 would need to be enhanced.<br>Another member noted that amortisation overlayed with an indicators-based approach to impairment testing – which is the approach used for most assets – is a model that works well.<br>XRAP<br>A member indicated that there are mixed views on this subject. Some argue that if it is obvious that large amounts of headroom exist, an annual impairment test is not needed. However, performing the impairment test every year means that the impairment test calculation gets refined over time and tends to be a well thought-out process – and this benefit could be lost if goodwill is tested for impairment only at times of financial stress, etc. |

| Summary of feedback received to date |
| --- |
| Another member was supporting of the proposed move to an indicator-based approach, but noted that this view is from the perspective of a listed company that is subject to continuous disclosure requirements (which would therefore keep track of indicators of impairment and highlight them to investors when they arise). |
| NZAuASB |
| Some NZAuASB members expressed concern over the proposed move to an indicator-based approach to goodwill impairment. It was noted that goodwill impairment is an inherently risky area, and that under the existing requirements on impairment indicators in IAS 36 it would be easy for an entity to argue that there are no indicators of impairment. If the IASB was to more to an indicators-based approach for goodwill impairment, the requirements around indicators of impairment in IAS 36 would need to be enhanced. |
| Webinar |
| Of those attendees who answered the polling question, 80% agreed with moving to an indicator-based approach for goodwill impairment, and 20% preferred to retain the requirement for an annual goodwill impairment test. |
| Goodwill and Impairment Outreach Event |
| About half of the attendees who answered the polling question agreed with the IASB's proposal to move to an indicator-based approach to goodwill impairment testing, and had no concerns with this approach. The other half had concerns about moving to an indicator-based approach. The most common concern was that moving to such an approach would provide more opportunities for entities to avoid impairment if they wished – for example, auditors would find it harder to challenge management's indicator reviews. |

***Draft response to Question 9:***

**Option 1: Support move to indicator-based approach**

73. We agree with the IASB's proposal to move to an indicator-based approach for goodwill impairment testing (and for the impairment testing of intangible assets with indefinite useful life and those that are not yet available for use).

74. This proposal would bring the requirements around the timing of the goodwill impairment test in line with other assets, and could decrease costs associated with performing the impairment test.

75. However, if the IASB implements an indicators-based approach for goodwill impairment testing, we recommend that the IASB consider enhancing the requirements and guidance in IAS 36 around the indicators of impairment. This could include developing new indicators specifically in relation to goodwill, developing specific guidance on applying existing indicators to goodwill, or developing a list of indicators that must be present to presume that goodwill is not impaired. Such enhancement would provide greater clarity to preparers in applying the indicator-based approach to goodwill, and would reduce the risk of management over-optimism when applying this approach.

**Option 2: Prefer to retain the requirement for an annual goodwill impairment test**

76. We do not agree with the IASB's proposal to move to an indicator-based approach to goodwill impairment testing. We recommend retaining the current requirement to test goodwill for impairment every year.

77. Moving to an indicator-based approach could lead to some loss of robustness in the goodwill impairment process, because an indicator of impairment could be inadvertently missed (or ignored), which would result in not recognising impairment loss on time. This would exacerbate the concern over late recognition of impairment losses. By contrast, if goodwill must be tested for impairment every year, there is less risk that an impairment loss will be missed. There is good discipline in performing the goodwill impairment test every year.

78. Performing the impairment test every year means that the impairment model gets refined over time, and the entity's experience and expertise in relation to performing the impairment test is maintained. This benefit would not be available to entities that perform the impairment test only when there are indicators of impairment.

79. Cost saving from not performing the impairment test every year may be negated by the cost of assessing whether there are indicators of impairment – and the potential additional costs of preparing a goodwill impairment model when one has not been prepared for a long time and regaining expertise in performing the impairment test, etc.

80. If the IASB implements an indicators-based approach for goodwill impairment testing, we recommend that the IASB consider enhancing the requirements and guidance in IAS 36 around the indicators of impairment. [We would add here the remainder of paragraph 71].

| **Question for the Board – Draft response to Question 9 (relief from the annual goodwill impairment test)** |
| --- |
| Q1. Which option would you prefer to reflect in the comment letter:<br>• Option 1: support move to an indicator-based approach, or;<br>• Option 2: prefer to retain the requirement for an annual goodwill impairment test? |

**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.

| Summary of NZASB discussion to date |
| --- |
| <u>Allowing the use of post-tax inputs</u><br>• It was noted that entities are already doing this.<br>• However, it was also noted that there is a reason why pre-tax inputs are currently required, i.e. complexities around the treatment of deferred taxes and temporary tax differences in the VIU calculation. This would need to be addressed if post-tax inputs are allowed.<br><u>Removing the restriction on cash flows from future enhancements and uncommitted restructures</u><br>• There was some caution around management over-optimism in relation to this proposal. It was noted that there can be a lot of uncertainties around uncommitted restructuring plans, and that estimated cash flows about future enhancements to assets can be overly optimistic.<br>• On the other hand, there was also a view that a planned restructure to stop a business from failing should not be ignored when testing goodwill for impairment.<br>• Staff had suggested putting greater emphasis in IAS 36 on the requirement to base cash flows on "reasonable and supportable" assumptions, to mitigate the risk of management over-optimism if the IASB proceeds with the abovementioned proposal.<br>• There was some discussion around the term 'reasonable and supportable', and whether it was possible to improve this terminology.<br>• A Board member noted that if the IASB goes ahead with this proposal, it should clearly communicate that this is a removal of a restriction, rather than a positive invitation to include these cash flows |

| Summary of feedback received to date |
| --- |
| <u>TRG</u><br>TRG members agreed with the IASB's suggestion to allow the use of post-tax inputs in the VIU calculation. It was noted that this is how entities calculate VIU in practice.<br>However, there was general disagreement with the IASB's suggestion to remove restrictions on cash flows from future uncommitted restructurings and asset enhancements. Reasons included the following.<br>• It is difficult to make reliable estimates around future enhancements to assets – there is a lot of uncertainty and subjectivity.<br>• The impairment test is supposed to determine the value of the existing assets as they are today – not as they might be in the future.<br>• While the calculation of fair value less costs of disposal (FVLCD) is restricted to cash flows that a market participant would take into account, there is no such restriction for the VIU calculation. Cash flows included in VIU must be 'reasonable and supportable', but it is easy for entities to argue that a cash flow meets this threshold. Therefore, removing the restriction on cash flows from future asset enhancements and uncommitted restructurings would increase the risk of cash flows being inappropriately included in VIU.<br>A member noted that if the IASB removes the restriction on cash flows from future asset enhancements and uncommitted restructurings in the VIU calculation, this would make the VIU calculation very similar to FVLCD. Furthermore, if the IASB was to implement the abovementioned proposal, then the obvious way to add discipline to the VIU calculation would be to restrict cash flows to those that a market participant would consider – which is a key element of FVLCD. Therefore, if the IASB implements the abovementioned proposal, it would make sense to require a single model for calculating recoverable amount, rather than having two models.<br><u>XRAP</u><br>There was support for using post-tax inputs in the VIU calculation. It was noted that this is the only possible way to calculate VIU and entities already do this in practice.<br><u>NZAuASB</u><br>There was not much discussion on this topic at the NZAuASB meeting, but the member who commented on this topic was supportive of the proposed simplifications to the VIU calculation.<br><u>Webinar</u><br>The majority of attendees who answered the polling question agreed that the VIU calculation should be simplified. |

***Draft response to Question 10:***

*Question 10 (a): Allowing the use of post-tax inputs*

81. We agree that the IASB should allow the use of post-tax inputs in the VIU calculation. We note that this how VIU tends to be calculated in practice, with the pre-tax discount rate being calculated for disclosure purposes.

82. However, if the IASB implements this proposal, we recommend that the IASB consider whether any additional guidance would be needed on the treatment of deferred tax, temporary tax differences and similar items that are the reason behind the current requirement to use pre-tax inputs.

*Question 10(b): Removing the restriction on the inclusion of cash flows from future asset enhancements and uncommitted restructures*

Option 1: Agree to remove restriction and put more emphasis on 'reasonable and supportable'

83. We agree that the IASB should remove the restriction on the inclusion of cash flows from future asset enhancements and uncommitted restructures in the VIU calculation.

84. Removing this restriction will help simplify the VIU calculation. Also, provided that expected cash flows from future asset enhancements or planned restructures meet the 'reasonable and supportable' criterion in IAS 36, it could be argued that including these cash flows would provide a more accurate picture of the future cash flows expected from a CGU, which would lead to a more accurate goodwill impairment test.

85. However, to avoid the risk of management over-optimism when deciding whether to include the abovementioned cash flows in the VIU calculation, we recommend that the IASB consider putting more emphasis on the 'reasonable and supportable' requirement. As noted in our response to Question 6(c) above, at the moment, IAS 36 requires cash flows in the VIU calculation to be based on "reasonable and supportable assumptions" (paragraph 33(a)), and also to be based on budgets or forecasts approved by management (paragraph 33(b)). However, these are presented as two separate requirements. Therefore, there could potentially be tension between these two requirements, and an entity could potentially put more emphasis on basing the cash flows on forecasts approved by management – and these forecasts could be over-optimistic. This risk could be somewhat mitigated if the standard puts more emphasis on the requirement around "reasonable and supportable assumptions".

Option 2: Disagree with removing the restriction

86. We disagree with removing the restriction on the inclusion of cash flows from future asset enhancements and uncommitted restructures in the VIU calculation.

87. We think that removing this restriction would exacerbate the risk of impairment losses being recognised too late. It is often difficult to reliably estimate cash flows from future asset enhancements and uncommitted restructures – but it would be relatively easy to argue that the 'reasonable and supportable' criterion is met. Removing the restriction around these cash flows would make the VIU calculation more susceptible to subjectivity and over-optimistic estimates.

88. Furthermore, removing the abovementioned restriction would make the VIU calculation very similar to an income-based calculation of fair value less costs of disposal (FVLCD) – except that FVLCD allows the inclusion of only those cash flows that a market participant would consider, whereas VIU does not have this restriction. This raises the question as to whether both methods for calculating the recoverable amount of a CGU should be retained, or whether a single method should be mandated.

| **Question for the Board – Draft response to Question 10**<br>**(simplifications to the VIU calculation – removal of restriction on cash flows from future asset enhancements and uncommitted restructures)** |
|---|
| Q1. Which option would you prefer to reflect in the comment letter:<br>• Option 1: Agree to remove restriction and put more emphasis on 'reasonable and supportable', or;<br>• Option 2: Disagree with removing the restriction? |

**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?

*[Simplifications not pursed by the IASB as per paragraph 4.55 listed for the NZASB's information:]*

- 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.
- 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.
- 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.
- adding guidance on identifying cash-generating units and on allocating goodwill to cash-generating units.

(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?

| Summary of NZASB discussion to date |
| --- |
| While Board members did not specifically suggest additional simplifications to the impairment test, it was noted by a Board member that the allocation of goodwill to CGUs is an issue that contributes to the shielding of goodwill. Therefore, staff understand that adding guidance on identifying CGUs and on allocating goodwill to CGUs could be useful. |

| Summary of feedback received to date |
| --- |
| TRG:<br>• There was some support among TRG members for additional guidance on the identification of CGUs, as some entities default to the largest possible CGU size.<br>• A member noted that if the IASB removes the restrictions on cash flows from future asset enhancements and uncommitted restructurings, then it should mandate only one method for estimating recoverable amount. |

***Draft response to Question 11:***

89. As noted above, we recommend that the IASB consider developing additional guidance on the identification of CGUs and the allocation of goodwill to CGUs.

| **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.<br>(a) Do you agree that the Board should not develop such a proposal? Why or why not?<br>(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?<br>(c) Would your view change if amortisation of goodwill were to be reintroduced? Why or why not? |

| Summary of NZASB discussion to date |
|---|
| The general view was that any changes to the recognition requirements for intangible assets should be considered as part of a more comprehensive review of requirements for intangible assets. On this basis, the Board tended to agreed that the IASB should not change the requirement to recognise intangible assets acquired in a business combination separately from goodwill. |

| Summary of feedback received to date |
|---|
| <u>TRG</u><br>• TRG members agreed that the IASB should not change the current requirement to recognise intangible assets acquired in a business combination separately from goodwill. Members noted that recognising these assets separately encourages entities to consider what they have acquired as part of the business combination, and results in useful information to users about what has been acquired.<br>• Members noted that their view would not change if goodwill amortisation is reintroduced. They noted that intangible assets such as customer relationships would have a different amortisation period to goodwill, so it would not be appropriate to amortise them together as one asset. Furthermore, even if the amortisation period of these assets was the same as for goodwill, the nature of these assets is different to goodwill, so it would still be misleading to include these assets within goodwill. |

***Draft response to Question 12:***

90. We agree with the IASB that it should not change the current requirement to recognise identifiable intangible assets acquired in a business combination separately from goodwill. Our reasons for agreeing are as follows.

    (a) The current requirement to recognise identifiable intangible assets separately from goodwill in a business combination provides users of financial statements with a better understand of what has been acquired as part of the business combination.

    (b) Subsuming identifiable intangible assets within the goodwill balance could result in assets of dissimilar nature being combined together, which could be misleading for users of financial statements.

    (c) If the impairment-only model for goodwill is retained, including intangible assets within the goodwill balance would mean that some intangible assets that have a finite useful life and should be amortised are instead subject to the impairment-only model. Even if goodwill amortisation is reintroduced, including intangible assets in the goodwill balance would mean that assets with potentially different useful lives are being amortised together.

| **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? |

| Summary of NZASB discussion to date |
| --- |
| The Board agreed not to comment on this question, as alignment with US GAAP is unlikely to be an issue of concern in New Zealand. |

***Draft response to Question 13:***

We do not have any comments on this question. For most entities in New Zealand, alignment between IFRS Standards and US GAAP is not a major concern.

| **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? |

| Summary of NZASB discussion to date |
| --- |
| In the DP, this question comes after the summary of the matters discussed in the AASB Research Report. The Board previously agreed with staff's recommendation to say in the Cover Letter that we support a holistic review of IAS 36 as recommended in the AASB Research Report. The Board did not identify any other issues to note in response to this question. |

***Draft response to Question 14:***

We do not have any additional comments other than those already noted in this appendix and in the cover letter.

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10 September 2020

International Accounting Standards Board
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Submitted to: comentletters@ifrs.org

**Submission on Discussion Paper *Business Combinations – Disclosures, Goodwill and Impairment***

Thank you for the opportunity to comment on the International Accounting Standards Board's (IASB's) Discussion Paper *Business Combinations – Disclosures, Goodwill and Impairment.*

The Auditor-General is responsible for auditing all of New Zealand's public entities. Public entities in New Zealand include both public benefit entities and for-profit entities. We provide the New Zealand Parliament and the public independent assurance that public entities are operating and accounting for their performance as intended.

In general, we agree with the preliminary views that the IASB should:

- improve disclosures about acquisitions – including introducing disclosure requirements for information about management's objectives for acquisitions and how acquisitions have performed against those objectives;
- retain the impairment-only model for goodwill, rather than reintroducing amortisation of goodwill;
- provide relief from the mandatory annual impairment test of goodwill;
- amend how value in use is estimated, to simplify the impairment test;
- require the presentation of total equity excluding goodwill on the balance sheet, and
- retain the current requirements on the recognition of acquired intangible assets separately from goodwill.

We support the IASB exploring whether entities can, at a reasonable cost, provide users with better information about the acquisitions those entities make. We agree that better information would help users assess the performance of entities that have made acquisitions. Importantly, better information would help users more effectively hold an entity's management to account for management's decisions to acquire those businesses.

We are of the view that the IASB needs to ensure that it carries out sufficient consultation about the introduction of disclosure requirements for information about management's objectives for acquisitions and how acquisitions have performed against those objectives. This is because we have some concerns that the information about management's objectives, or the metrics used by management to monitor performance, in particular circumstances, may be:

- impossible to provide because the acquired business has been integrated; or
- commercially sensitive.

It is important that all entities acquiring businesses have clarity about the expected disclosures across the range of circumstances that they may face. As far as possible, permitting entities to provide reasons for non-disclosure about how acquisitions have performed against management's original expectations/objectives should be avoided. This is because such disclosures do not provide the same information content as information about the performance of the acquisitions against management's original expectations/objectives.

In our view, the IASB's proposed disclosures need to provide a level playing field for all entities, and provide information to users about whether management's expectations/objectives for acquiring businesses are being met.

If you have any questions about our submission, please contact Lay Wee Ng, Technical Specialist, at laywee.ng@oag.parliament.nz or +64 21 222 9752.

Yours sincerely

Todd Beardsworth
Assistant Auditor-General, Audit Quality

cc New Zealand Accounting Standards Board

EXTERNAL REPORTING BOARD
*Te Kāwai Ārahi Pūrongo Mōwaho*

# APPROVAL NZASB 129

**Approval to Issue *Interest Rate Benchmark Reform—Phase 2***

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 *Interest Rate Benchmark Reform—Phase 2;* 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 *Interest Rate Benchmark Reform—Phase 2* pursuant to section 12(a) of the Financial Reporting Act 2013.

Dated this 11th day of September 2020

…………………………..

Michele Embling
Chair
External Reporting Board

EXTERNAL REPORTING BOARD

*Te Kāwai Ārahi Pūrongo Mōwaho*

# Policy Approach to Developing the Suite of PBE Standards

Originally Issued September 2013

Updated August 2020

Approved by the XRB Board for application by the New Zealand Accounting Standards Board from 1 October 2020

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# Preface

1. In May 2013, the New Zealand Accounting Standards Board (NZASB) issued the PBE Standards – a new suite of standards for Tier 1 and Tier 2 public benefit entities. That initial set of standards, developed in accordance with the External Reporting Board's (XRB Board's) *New Zealand Accounting Standards Framework*, can be regarded as the "foundation suite" of PBE Standards. It is expected that the foundation suite will be enhanced and developed over time.

2. This *Policy Approach to Developing the Suite of PBE Standards* (the PBE Policy Approach) has been developed by the XRB Board and the NZASB to assist the NZASB in making consistent decisions when developing the suite of PBE Standards i.e. when considering enhancements and developments to the suite of PBE Standards in the future.

3. While primarily based on International Public Sector Accounting Standards, the foundation suite of PBE Standards was developed using a range of source standards: International Public Sector Accounting Standards, selected NZ IFRSs and domestic standards developed within New Zealand. Developments are likely to arise from each of these sources as changes are made to the international standards and as issues specific to New Zealand emerge.

4. Without a policy such as this, it would be possible for significant fluctuations in the NZASB's approach to developing the suite of PBE Standards to emerge over time. This PBE Policy Approach therefore provides constituents with some certainty about the likely future direction of the suite of PBE Standards, and provides a basis for assessing proposals for changes to the PBE Standards as they are issued by the NZASB. It also assists constituents to understand the likely implications of future changes to the suite of PBE Standards for public benefit entities (PBE) groups containing for-profit entities (commonly referred to as "mixed groups").

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# Summary

## The Development Principle

In accordance with the *New Zealand Accounting Standards Framework*, the primary purpose of developing the suite of PBE Standards is to better meet the needs of the PBE user groups (as a whole). In considering whether to initiate a development, the NZASB shall consider the following factors:

(a) Whether the potential development will lead to higher quality financial reporting by public sector PBEs and not-for-profit (NFP) PBEs, including public sector PBE groups and NFP groups, than would be the case if the development was not made; and

(b) Whether the benefits of a potential development will outweigh the costs, considering as a minimum:

    (i) *relevance to the PBE sector as a whole*: for example, where the potential development arises from the issue of a new or amended IFRS® Standard, whether the type and incidence of the affected transactions in the PBE sector are similar to the type and incidence of the transactions addressed in the change to the NZ IFRS;[1]

    (ii) *relevance to the not-for-profit or public sector sub-sectors*: whether there are specific user needs in either of the sub-sectors, noting that IPSAS are developed to meet the needs of users of the financial reports of public sector entities;

    (iii) *coherence*: the impact on the entire suite of PBE Standards (e.g. can the change be adopted without destroying the coherence of the suite);

    (iv) *the impact on mixed groups*; and

(c) In the case of a potential development arising from the issue of a new or amended IFRS Standard that is relevant to PBEs, the IPSASB's likely response to the change (e.g. whether the IPSASB is expected to develop an IPSAS on the topic in an acceptable timeframe).[2]

## Application of the Development Principle

The PBE Policy Approach includes a series of rebuttable presumptions in applying the development principle:

(a) The NZASB will adopt a new or amended IPSAS.

(b) When the IASB issues an IFRS Standard on a new topic and there is no IPSAS on that topic, the NZASB will not include that IFRS Standard in the suite of PBE Standards, unless the topic is applicable to PBEs and the IPSASB is not expected to develop a new standard on the same topic in an acceptable timeframe.

(c) In considering the impact on PBE Standards from a change to an NZ IFRS that relates to a topic for which there is an existing PBE Standard based on an IPSAS, the NZASB will consider the factors in the development principle in determining

[1] This policy 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] In this policy document, the term "acceptable timeframe" is considered from the perspective and expectations of users and preparers of PBE financial reports (including those that are mixed groups). The length of time that constitutes an acceptable timeframe will depend on the facts and circumstances in each case based on consideration of the factors in the development principle.

whether to initiate the development of a related change to the PBE Standards ahead of the IPSASB. Particular emphasis in this case needs to be placed on the IPSASB's likely response to the change and whether the IPSASB will address the change in an acceptable timeframe.

(d) The NZASB will not incorporate minor amendments to an NZ IFRS into the equivalent PBE Standard in advance of the IPSASB considering the change. However, the NZASB may issue an exposure draft that proposes the incorporation of these minor amendments into the equivalent PBE Standards at the same time as the IPSASB issues an exposure draft that proposes the incorporation of these minor amendments into IPSAS.

(e) In determining whether to initiate the development of a domestic standard for inclusion in the PBE Standards, the NZASB will first consider whether there is an international pronouncement addressing the relevant issue that is applicable in the New Zealand context, or whether an international pronouncement is expected to be developed within an acceptable timeframe.

# 1. Introduction

1. The PBE Policy Approach addresses the NZASB's approach to developing and enhancing the suite of PBE Standards. References to PBEs in this Policy include references to all PBEs: public sector PBEs and NFP PBEs, and public sector PBE groups and NFP PBE groups.

2. Triggers for possible changes to the PBE Standards are likely to come from three sources:

   (a) the IPSASB issuing a new IPSAS or a change to an existing IPSAS (section 4.1);

   (b) the IASB issuing a new IFRS Standard or a change to an existing IFRS Standard (section 4.2); and

   (c) domestic developments within New Zealand, including both exogenous events such as changes to the legislative framework and endogenous events where the NZASB considers that developments are warranted (section 4.3).

3. The PBE Policy Approach considers the implications of the *New Zealand Accounting Standards Framework* for developing the suite of PBE Standards and identifies an approach to be taken for each of the triggers for possible changes to PBE Standards.

# 2. Basis for Development of PBE Standards

4. The multi-standards approach in the *New Zealand Accounting Standards Framework* (issued in April 2012 and updated in December 2015) is designed to better meet the needs of users of the financial statements of PBEs.[3] Accounting Standards for Tier1 and Tier 2 entities are based on IPSAS.

   57. An explicit part of the multi-standards approach is the adoption of a set of accounting standards for PBEs other than one based on IFRS.

   58. The only set of international accounting standards, other than IFRS, is IPSAS. IPSAS provides a better basis for PBE reporting for entities in Tier 1 and Tier 2 than does IFRS because it is developed for a wider set of users, notably service recipients as well as resource providers.

   59. The XRB also considers that IPSAS is a credible set of standards. The historical concerns about IPSAS had been the lack of a conceptual framework and the lack of independent governance arrangements for IPSASB (at least compared to those applying to the IASB). These concerns have been addressed by both the IPSASB and the International Federation of Accountants (IFAC – the IPSASB's parent body). The IPSASB issued its conceptual framework General Purpose Financial Reporting by Public Sector Entities in late 2014 and an independent governance body for the IPSASB has been established for the first time in 2015.

   60. However, the XRB continues to consider that it is premature to adopt "pure" IPSAS (in the way that NZ IFRS reflects "pure" IFRS). This is because, among other matters, the IPSAS is developed for public sector entities and the requirements are not always appropriate for not-for-profit entities or do not necessarily fit with the New Zealand regulatory environment. Moreover, IPSAS does not currently represent a complete set of standards. Therefore, a set of PBE Standards has been developed that uses IPSAS as their base. PBE Standards modify IPSAS for any recognition, measurement or disclosure matters considered inappropriate in New Zealand. Such modifications are only made where the IPSAS requirement in question has a material impact on the financial position or performance being reported, and that impact would adversely detract from the financial statements' usefulness to users.

   61. Since the adoption of the initial Accounting Standards Framework, the XRB, in conjunction with its sub-Board, the New Zealand Accounting Standards Board (NZASB), has developed (and issued in September 2013) a *Policy Approach to Developing the Suite of PBE Standards* [footnote omitted]. The Policy Approach establishes an approach, based on a "development principle" and a series of "rebuttable presumptions", which are used by the NZASB to determine whether, and when, to make changes to PBE Standards.

   62. PBE Standards include other relevant standards (including domestic standards) appropriate for New Zealand and/or to address topics not covered in IPSAS.

   63. The PBE Standards are also modified to make them relevant, applicable and understandable to the not-for-profit sector preparers and users. Some modification is desirable to enhance their usefulness in the not-for-profit context.

   (*New Zealand Accounting Standards Framework*, paragraphs 57–63)

5. The PBE Policy Approach uses the term "development" to encompass any change to the suite of PBE Standards.

6. In considering the appropriateness of potential developments of the suite of PBE Standards, it is necessary to consider these developments in the context of the *New Zealand Accounting Standards Framework*, including the impact of any

[3] The New Zealand Accounting Standards Frameworks is available at https://www.xrb.govt.nz/reporting-requirements/accounting-standards-framework/

developments on the quality of the financial reporting arising from those standards and the trade-off between the benefits of improvements in the quality of the resulting financial reports and the associated costs.

## 2.1 Quality of Financial Reporting

7. The suite of PBE Standards is designed to meet users' needs by providing high quality financial reporting by PBEs. It follows that any development of PBE Standards should aim to improve the quality of financial reporting. The quality of financial reporting relies on meeting the needs of users of PBE general purpose financial reports (including financial statements), while endeavouring to ensure that the costs arising from a development do not outweigh the benefits.

8. In this context, high quality financial reporting is assessed by reference to the conceptual framework for PBEs, with primary emphasis on the objective of financial reporting and then the qualitative characteristics. A standard is more likely to lead to higher quality financial reporting if it adheres closely to the conceptual framework.

9. The categories of users of financial statements of PBEs and for-profit entities are different. Paragraph 1.2 of the New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting* (2018 *NZ Conceptual Framework*) identifies users of financial statements as suppliers of resources to the entity, and notes that the decisions that they make are related to providing resources to the entity.

10. In contrast, paragraphs 2.1–2.4 of the *PBE Conceptual Framework* (the New Zealand equivalent of the IPSASB *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*) considers a wider group of users of financial reports, being resource providers and service recipients and their representatives, and notes that information is needed for both accountability and decision-making purposes.

11. A development of the suite of PBE Standards will improve the quality of financial reports prepared in compliance with PBE Standards if it improves the accounting for specific transactions by better meeting the objective of financial reporting and the associated qualitative characteristics of financial reporting.

12. Further, high quality financial reporting depends on consistent treatment of similar transactions. For example, it would usually be inappropriate to require different measurement for similar liabilities in similar circumstances. As a result, any development of PBE Standards (including the conceptual framework for PBEs) should ensure that the suite is maintained as a coherent whole.

13. It follows that any developments should ensure that the needs of users are better met than they were prior to the development. Alternatively, the cost-benefit test (see next section) may be met where the needs of users are equally as well served, with a consequent benefit in some other way such as a reduction in the costs of preparing the financial statements.

## 2.2 Costs and Benefits

14. In considering a potential development of the suite of PBE Standards, the primary purpose and benefit is to improve the information provided to users of PBE financial reports.

15. Benefits need to be considered in relation to the suite of PBE Standards as a whole, in addition to the implications for a specific area of financial reporting. The benefit of aligning the PBE Standards with NZ IFRS to the extent possible is that this will reduce differences between the financial statements of PBEs and for-profit entities. This benefit is particularly relevant to entities that are members of mixed groups and users of PBE financial statements whose familiarity with financial statements arises from experience in the for-profit sector.[4] However, for other preparers that are not part of a mixed group, there may be additional preparation costs as a result of changes in accounting standards that might not otherwise arise.

16. The PBE Standards are largely based on IPSAS in accordance with the *New Zealand Accounting Standards Framework* and, therefore, careful consideration is required before making any change to a PBE Standard based on an IPSAS in circumstances other than as a consequence of the IPSASB issuing a new or amended IPSAS (as discussed further below in paragraph 30). In addition, the benefit of using IPSAS to the extent possible is that IPSAS are a suite of standards that comprise a coherent package. It also reduces standard-setting costs as the IPSASB documents are readily available for application in New Zealand with little additional work. Reducing the time spent on setting the base standards releases resources for working with the international standard setters and for necessary domestic projects.

17. In developing a coherent suite of PBE Standards, it will generally be relatively low cost to add additional guidance for all PBEs, or for sub-groups of PBEs such as NFP entities. However, it is expected that recognition and measurement requirements will be common to all PBEs. Further, using recognition and measurement requirements developed from a number of sources creates the potential for inconsistencies within the suite of PBE Standards, such as applying different measurement requirements to similar liabilities. Care should be taken to minimise the impact of such inconsistencies, if they cannot be eliminated.

18. At times, there is a tension between reducing the costs borne by preparers within mixed groups – that is the elimination of differences between PBE Standards and NZ IFRS that are not sector specific – and improving the suite of PBE Standards taken as a whole. This Policy takes the view that reducing the costs on preparers within mixed groups should be considered to the extent that these costs can be reduced whilst meeting the needs of the wider range of users of financial statements of public sector PBEs and NFP PBEs (including public sector and NFP groups) through a complete and coherent suite of PBE Standards.

[4] For the purposes of the PBE Policy Approach, a mixed group is a PBE group that includes at least one material for-profit subsidiary where that for-profit subsidiary applies accounting policies that differ from those of the mixed group and that may need to be adjusted under the consolidation standards.

# 3. The Development Principle

**19. In accordance with the *New Zealand Accounting Standards Framework*, the primary purpose of developing the suite of PBE Standards is to better meet the needs of PBE user groups (as a whole). In considering whether to initiate a development, the NZASB shall consider the following factors:[5]**

**(a) Whether the potential development will lead to higher quality financial reporting by public sector PBEs and NFP PBEs, including public sector PBE groups and NFP PBE groups, than would be the case if the development was not made; and**

**(b) Whether the benefits of a potential development will outweigh the costs, considering as a minimum:**

**(i) *relevance to the PBE sector as a whole:* for example, where the potential development arises from the issue of a new or amended IFRS Standard, whether the type and incidence of the affected transactions in the PBE sector are similar to the type and incidence of the transactions addressed in the change to the NZ IFRS;**

**(ii) *relevance to the NFP or public sector sub-sectors:* whether there are specific user needs in either of the sub-sectors, noting that IPSAS are developed to meet the needs of users of the financial reports of public sector entities;**

**(iii) *coherence:* the impact on the entire suite of PBE Standards (e.g. can the change be adopted without destroying the coherence of the suite);**

**(iv) *the impact on mixed groups*; and**

**(c) In the case of a potential development arising from the issue of a new or amended IFRS Standard that is relevant to PBEs, the IPSASB's likely response to the change (e.g. whether the IPSASB is expected to develop an IPSAS on the topic in an acceptable time frame).**

20. The NZASB will need to exercise judgement in balancing the factors in the development principle on a case-by-case basis. In many cases, there will need to be a trade-off between the benefits of improvements in the quality of the resulting financial reports and the associated costs. This policy provides a basis for making such a trade-off decision; it cannot replace the application of judgement by the NZASB when applying the development principle.

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[5] In applying the development principle and rebuttable presumptions in this policy document, the NZASB will consider the costs and benefits of initiating a new development and the relevance of a topic to PBEs based on consultation with constituents.

# 4. Application of the Development Principle

21. The following sections are designed to assist with the application of the factors in the development principle on a case-by-case basis. They consider, in turn, potential developments of the suite of PBE Standards that might arise from developments in IPSAS and NZ IFRS as well as addressing issues that might arise within New Zealand. Although the PBE Policy Approach treats each of these developments separately, it is likely that specific developments will need to be considered from a number of perspectives. For example, the NZASB may have planned to continue to update PBE IAS 34 *Interim Financial Reporting* in line with developments of NZ IAS 34 *Interim Financial Reporting* to retain consistent interim reporting across all sectors (section 4.2). However, if the IPSASB were to issue a standard addressing interim reporting, this new IPSAS would be considered as a development resulting from an enhancement to IPSAS (section 4.1).

## 4.1 New or Amended IPSAS

**22. There is a rebuttable presumption that the NZASB will adopt a new or amended IPSAS.**

23. This rebuttable presumption is based on the expectation that the IPSASB's due process has considered the needs of the wide range of users of public sector financial statements in developing and issuing a new or amended IPSAS.[6] Therefore, it is presumed that a new or amended IPSAS will lead to higher quality financial reporting by PBEs in New Zealand in accordance with factors (a) and (b) of the development principle, in the absence of reasons to the contrary (refer to paragraph 25).

*Amending a new or amended IPSAS*

24. Depending on the circumstances, it may be appropriate to amend a recently issued new or amended IPSAS in the process of adoption in New Zealand. Examples of possible amendments include:

    (a) improving the quality of the IPSAS in the New Zealand context by, for example, adding guidance or making changes to enhance the clarity and consistency of the requirements to enable public sector PBEs and NFP PBEs to apply the standard consistently;[7]

    (b) adding guidance to assist NFP PBEs in applying the standard, given that the standard has been developed for application by public sector PBEs;

    (c) amending as necessary to reduce any significant costs for mixed groups in the New Zealand context, to the extent that these costs can be reduced while

[6] The rebuttable presumption is also based on the XRB's understanding of the IPSASB's strategic focus – that is, the development of high-quality financial reporting standards and guidance for the public sector.

[7] For example, amendments of this nature may be necessary where the guidance in IPSAS does not fully address certain transactions that are prevalent for New Zealand PBEs.

still meeting the needs of users of PBE financial statements (see paragraph 18);[8]

(d) amending as necessary to maintain the coherence of the suite of PBE Standards;

(e) excluding options that are not relevant in the New Zealand context; or

(f) amending the scope of an IPSAS if the IPSAS conflicts with a legislative requirement, or a legislative requirement addresses the same issue for public sector entities. However, in these circumstances, it may be appropriate to adopt the IPSAS for NFP PBEs.

*Rebutting the presumption and not adopting a new or amended IPSAS*

25. Depending on the circumstances, it may be appropriate to rebut the presumption in paragraph 22 and thereby not adopt a new or amended IPSAS, or part(s) thereof. Given that PBE Standards are based primarily on IPSAS, a decision to rebut the presumption is expected to occur only in exceptional circumstances. Examples of such circumstances include where the NZASB has significant concerns that, in the New Zealand context:

    (a) adoption of a new or amended IPSAS would not be either appropriate or relevant (based on the development principle); and

    (b) the costs of adoption of a new or amended IPSAS would outweigh the benefits to users of PBE financial reports.[9]

26. In the event that the presumption to adopt a new or amended IPSAS is rebutted, this will require the NZASB to report to the XRB Board:

    (a) its decision and rationale for the decision, including reference to the relevant factors of the development principle; and

    (b) what, if any, action(s) it plans to take in relation to the new or amended IPSAS, for example, whether a domestic standard will be developed and whether parts of the new or amended IPSAS will be incorporated into that domestic standard.

## 4.2 New or Amended NZ IFRS

27. The issuance of a new or amended NZ IFRS will require the NZASB to consider whether to initiate a development of the PBE Standards in the following circumstances:[10]

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[8] The significance of any costs to mixed groups will be assessed through constituent outreach activities and any amendments will be weighed up against other factors in the development principle.

[9] As discussed in paragraphs 14–18 and giving consideration to the factors in the development principle, the primary benefit of a potential development to the suite of PBE Standards is to improve the information provided to users of PBE financial reports and to promote higher quality financial reporting by PBEs.

[10] An amendment to an NZ IFRS can fall into more than one of the above categories, for example, an NZ IFRS on a new topic might also result in changes to other NZ IFRS that fall into category (a) and/or (c).

(a) an IFRS Standard that the IPSASB has used as the basis for an IPSAS is changed;[11]

(b) the IASB issues an IFRS Standard on a new topic; and

(c) there is a change to an NZ IFRS that has been used as the basis for a PBE Standard.[12]

### *4.2.1 An IFRS Standard that the IPSASB has used as the basis for an IPSAS is changed*

28. As noted earlier, the PBE Standards are primarily based on IPSAS. In turn, many IPSAS are primarily based on IFRS Standards. Examples of such standards are PBE IPSAS 16 *Investment Property* and PBE IPSAS 17 *Property, Plant and Equipment*, which are based on IAS 40 *Investment Property* and IAS 16 *Property, Plant and Equipment*, respectively. Accordingly, there are likely to be many instances in which a new or amended NZ IFRS relates to a topic covered by an existing IPSAS standard that has been incorporated into the PBE Standards.

29. **In considering a change to an NZ IFRS that relates to a topic for which there is an existing PBE Standard based on an IPSAS, the NZASB will consider the factors in the development principle in determining whether to initiate a development of the PBE Standards. Particular emphasis in this case needs to be placed on the IPSASB's likely response to the change, including whether the IPSASB is expected to address the change in an acceptable timeframe.**

30. Given the rebuttable presumption in paragraph 22 that any IPSAS issued by the IPSASB will be included in the PBE Standards, there are considerable potential costs and risks associated with "getting ahead of the IPSASB". Therefore, the NZASB needs to decide whether to develop a PBE Standard ahead of the IPSASB or to wait for the IPSASB's response. If the issue is already on the IPSASB's active work plan, the NZASB would normally wait for the IPSASB to complete its work, unless the NZASB is of the view that there is an urgent need for action in New Zealand or the NZASB is of the view that the IPSAS is unlikely to be appropriate in the New Zealand context.

31. **Furthermore, in the case of limited-scope amendments or amendments to an NZ IFRS that the NZASB considers are minor, there is a rebuttable presumption that the change should not be incorporated into the equivalent PBE Standard in advance of the IPSASB considering the change.** This is because minor amendments are less likely to meet the cost-benefit test,

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[11] This includes instances where an IFRS Standard that the IPSASB has used as the basis for an IPSAS has been superseded by a newly issued IFRS Standard.

[12] NZ IFRS that the NZASB has included in the suite of PBE Standards are:

- PBE IFRS 3 *Business Combinations* (subsequently superseded by PBE IPSAS 40 *PBE Combinations*)
- PBE IFRS 4 *Insurance Contracts* and PBE IFRS 17 *Insurance Contracts* (the latter applies to NFPs only)
- PBE IFRS 5 *Non-current Assets Held For Sale and Discontinued Operations*
- PBE IAS 12 *Income Taxes* (and amendments based on NZ IFRIC 23 *Uncertainty over Income Tax Treatments*)
- PBE IAS 34 *Interim Financial Reporting*
- NZ IFRIC 12 *Service Concession Arrangements* and NZ-SIC 29 *Service Concession Arrangements: Disclosures* (which are the basis for PBE FRS 45 *Service Concession Arrangements: Operator*).

particularly when the potential costs and risks associated with getting ahead of the IPSASB are taken into account. However, the NZASB may issue an exposure draft that proposes the incorporation of these minor amendments into the equivalent PBE Standards at the same time as the IPSASB issues an exposure draft that proposes the incorporation of these minor amendments into IPSAS.

32. Where there is a major change to an IFRS Standard for which there is an existing IPSAS and where the IPSASB is unlikely to address the change in an acceptable time frame, the NZASB could either develop a domestic modification to the PBE Standard or assist the IPSASB to develop an IPSAS. Options for assisting the IPSASB include offering to provide staff resources for the IPSASB or partnering with the IPSASB to update a specific IPSAS in the light of the major change. It may be more effective to assist the IPSASB because any uncertainties about the IPSASB's approach to the issue will be resolved sooner rather than later. However, the level of effort required to develop an IPSAS based on an IFRS Standard for international use is likely to be significantly higher than developing a PBE Standard based on an IFRS Standard or its equivalent NZ IFRS for use in New Zealand. The IPSASB's due process, multi-constituency reach and less regular meetings leads to a standards development process for the IPSASB that is more time consuming and complex.

#### *4.2.2 The IASB issues an IFRS Standard on a new topic*

33. An example of a new topic is where the IASB is considering issuing a standard on rate-regulated activities.

**34. When the IASB issues an IFRS Standard on a new topic and there is no IPSAS on that topic, there is a rebuttable presumption that the NZASB will not include the new IFRS Standard in the suite of PBE Standards, unless the topic is relevant to PBEs and the IPSASB is not expected to develop a new standard on the same topic in an acceptable timeframe.**

35. As noted below in paragraph 37, some NZ IFRS-based standards were included in the suite of PBE Standards when it was first developed. After the initial introduction of the suite of PBE Standards, the NZASB has applied the rebuttable presumption that an IFRS Standard on new topic where there is no IPSAS is not included in the suite of PBE Standards, as discussed above. This approach is consistent with the *New Zealand Accounting Standards Framework*, which provides that IPSAS should be used as the primary basis for developing PBE Standards.

36. In considering whether to rebut the presumption that the NZASB will not include a new IFRS Standard in the suite of PBE Standards, the NZASB should:

    (a) firstly, consider whether the new IFRS Standard is relevant to PBEs and if so, whether the IPSASB is expected to develop a new standard on the same topic in an acceptable timeframe; and

    (b) secondly, consider other factors in the development principle to assess the costs and benefits of including the new IFRS Standard in the suite of PBE Standards.

### 4.2.3 *An NZ IFRS that the NZASB has included in the suite of PBE Standards is changed*

37. The NZASB has included selected NZ IFRS-based standards in the suite of PBE Standards (see footnote 12). These NZ IFRS-based standards were first added when the suite of PBE Standards was initially developed to maintain current practice for specific topics not addressed by IPSAS (for example, accounting for insurance contracts and interim reporting). Subsequently, additional NZ IFRS-based standards have been added to the suite of PBE Standards (for example, PBE IFRS 17 *Insurance Contracts*) when a new NZ IFRS standard addresses a topic that is relevant to PBEs and the IPSASB is not expected to develop a new standard on the same topic in an acceptable timeframe.

**38. In considering a change to an NZ IFRS-based standard that is included in the suite of PBE Standards, the NZASB shall consider the factors in the development principle in determining whether to initiate a development of the PBE Standards.**

39. However, in situations where there is no equivalent IPSAS on the topic and the IPSASB is not expected to create such a standard in the foreseeable future, the IPSASB's likely response to the change would be less relevant. This will impact on the overall assessment of the costs and benefits of including the NZ IFRS development in the PBE Standards. This is because the potential problems associated with "getting ahead of the IPSASB" (as discussed in paragraph 30 above) are less likely to arise.

40. An implication of this policy is that those PBE Standards based on an NZ IFRS (see footnote 12) may need to be updated or replaced to align with the current equivalent NZ IFRS.

## 4.3 Domestic Developments

41. Domestic developments include developing standards or amendments to standards to meet specific requirements in New Zealand.

42. The suite of PBE Standards contains standards directly addressing issues relevant to New Zealand, including PBE FRS 42 *Prospective Financial Statements*, PBE FRS 43 *Summary Financial Statements* and PBE FRS 48 *Service Performance Reporting*. Further domestic standards may be developed where a need arises when an issue of importance in New Zealand is not addressed in a standard issued by the IPSASB (section 4.1) or the IASB (section 4.2).

**43. In determining whether to initiate the development of a domestic standard for inclusion in the suite of PBE Standards, the NZASB will consider the factors in the development principle. Assuming the NZASB determines that the development of a domestic standard would improve the quality of financial reporting by PBEs, the NZASB will first consider whether there is an international pronouncement addressing the relevant issue that is applicable in the New Zealand context, or whether such an international pronouncement is expected to be developed within an acceptable timeframe.**

44. The *New Zealand Accounting Standards Framework* presumes that the NZASB will use international standards or guidance as a starting point for developing PBE Standards rather than developing domestic standards whenever possible, for a range of reasons, including:

    (a) the quality derived by an international due process;

    (b) the prospect of international comparability; and

    (c) the limited resources available for the domestic development of standards.

45. It follows that the NZASB will develop domestic standards or guidance that result in a material improvement in information available to users of financial statements when:

    (a) there is no other source of material available internationally; or

    (b) the available international guidance is not targeted specifically towards addressing New Zealand issues.

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# Business Combinations—Disclosures, Goodwill and Impairment

Comments to be received by 31 December 2020

Comment deadline changed from 15 September 2020 because of the covid-19 pandemic

IASB®

# Business Combinations—Disclosures, Goodwill and Impairment

*Comments to be received by 31 December 2020*
*Comment deadline changed from 15 September 2020 because of the covid-19 pandemic*

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 **31 December 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

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).

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.

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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?

**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 |
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| (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?<br><br>(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?<br><br>(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 |
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| 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:<br><br>• the benefits that a company's management expected from an acquisition when agreeing the price to acquire a business; and<br><br>• the extent to which an acquisition is meeting management's (CODM's) objectives for the acquisition.<br><br>Do you agree with the Board's preliminary view? Why or why not? |

| **Question 4** |
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| Paragraphs 2.62–2.68 and paragraphs 2.69–2.71 explain the Board's preliminary view that it should develop proposals:<br><br>• to require a company to disclose:<br>  ○ a description of the synergies expected from combining the operations of the acquired business with the company's business;<br>  ○ when the synergies are expected to be realised;<br>  ○ the estimated amount or range of amounts of the synergies; and<br>  ○ the expected cost or range of costs to achieve those synergies; and<br>• to specify that liabilities arising from financing activities and defined benefit pension liabilities are major classes of liabilities.<br><br>Do you agree with the Board's preliminary view? Why or why not? |

| **Question 5** |
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| 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.<br><br>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.<br><br>(a) Do you agree with the Board's preliminary view? Why or why not?<br><br>(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?<br><br>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.<br><br>Paragraphs 2.78–2.81 explain the Board's preliminary view that it should develop proposals:<br><br>• 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*.<br><br>• 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.<br><br>(c) Do you agree with the Board's preliminary view? Why or why not? |


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| **Question 6** |
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| 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? |

*continued...*

*...continued*

| **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).<br>(a) Should the Board develop such a proposal? Why or why not?<br>(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.<br>(a) Should the Board develop such proposals? Why or why not?<br>(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.<br>(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).<br><br>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 31 December 2020. The deadline has changed to 31 December 2020 because of the covid-19 pandemic; previously it was 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:<br>https://www.ifrs.org/projects/open-for-comment/ |
| By email | Send to:<br>commentletters@ifrs.org |
| By post | IFRS Foundation<br>Columbus Building<br>7 Westferry Circus<br>Canary Wharf<br>London E14 4HD<br>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.

**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.<br><br>Some investors wanted pro forma prior year comparative information for trend analyses.<br><br>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.<br><br>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.<br><br>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.<br><br>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.<br><br>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.<br><br>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:<br>(a) the scope of a business undertaken by an entity; or<br>(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:<br>(a) internally generated goodwill;<br>(b) unrecognised differences between the carrying amounts of recognised assets and liabilities and their recoverable amounts; and<br>(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.<br><br>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.<br><br>(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?<br><br>(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.

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(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).

*continued...*


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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:<br>• the benefits that a company's management expected from an acquisition when agreeing the price to acquire a business; and<br>• the extent to which an acquisition is meeting management's (CODM's) objectives for the acquisition.<br>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).

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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.

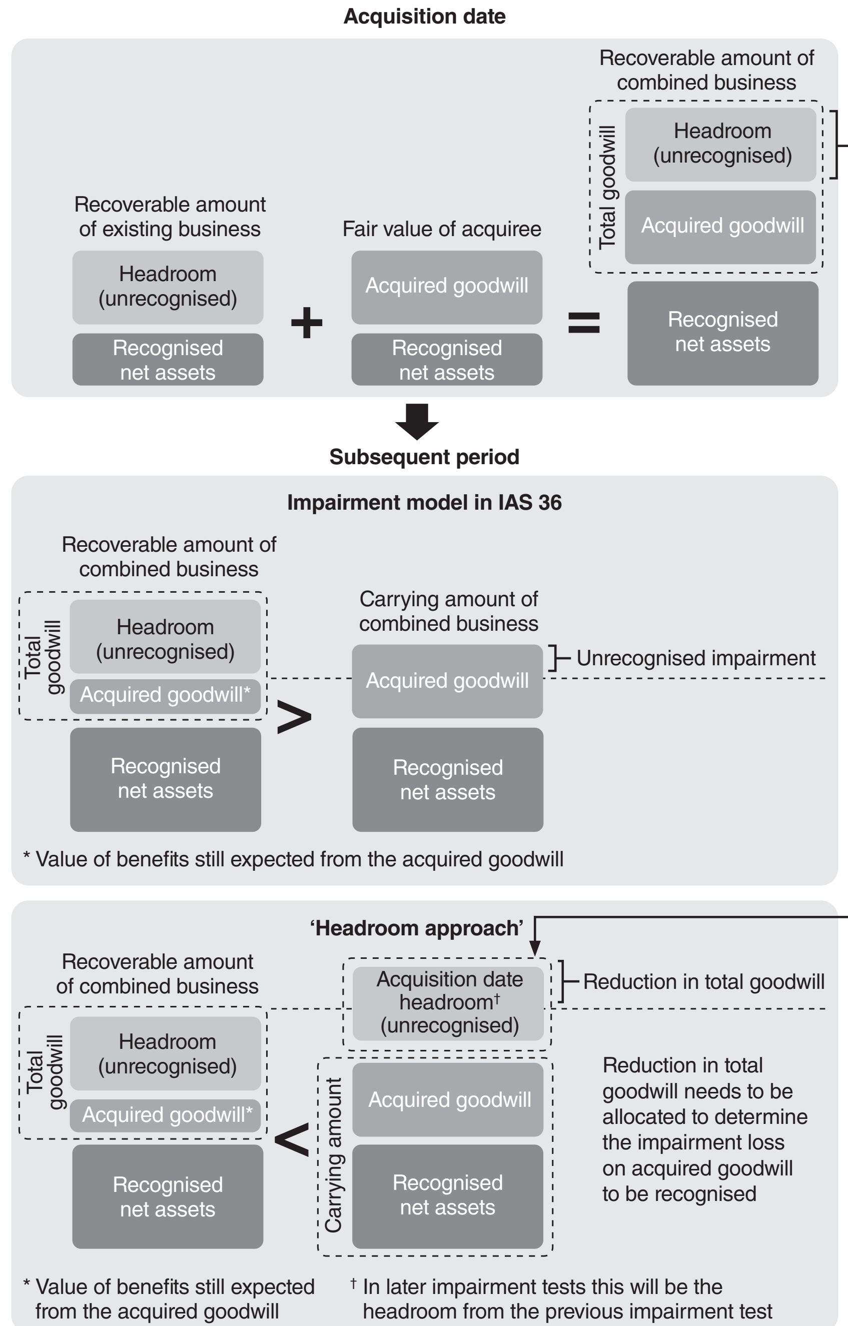
3.45 However, for those who view acquired and internally generated goodwill to be distinct, a pro rata allocation or an allocation of all the reduction to the acquired goodwill may sometimes produce a result that is inconsistent with the performance of an acquisition and therefore would not provide a 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.

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.

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### *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:

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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.<br>(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?<br>(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?<br>(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?<br>(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.<br>(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.)<br>(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? |

*continued...*

*...continued*

| **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.

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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.

| **Question 10** |
|---|
| The Board's preliminary view is that it should develop proposals:<br>• 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<br>• 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).<br>The Board expects that these changes would reduce the cost and complexity of impairment tests and provide more useful and understandable information.<br>(a) Should the Board develop such proposals? Why or why not?<br>(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.<br>(a) Should the Board develop any of the simplifications summarised in paragraph 4.55? If so, which simplifications and why? If not, why not?<br>(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.<br>(a) Do you agree that the Board should not develop such a proposal? Why or why not?<br>(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?<br>(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).<br><br>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:<br>• its suggested disclosure requirements for acquisitions would provide useful information and are feasible; and<br>• 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:** | 31 December 2020 (comment deadline changed from 15 September 2020 because of the covid-19 pandemic). |

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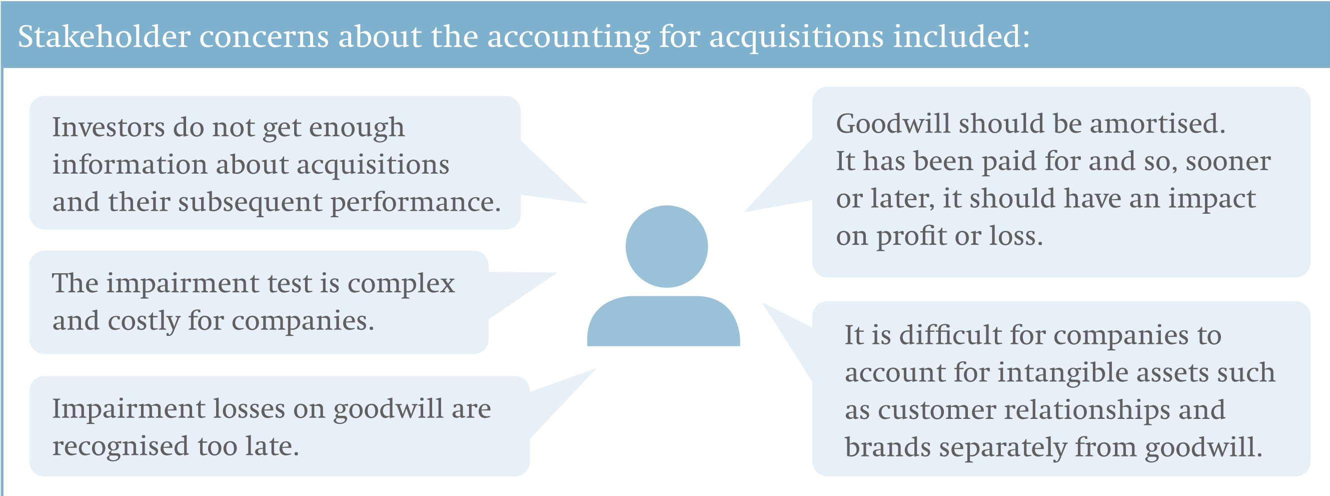
# Why is the Board undertaking this project?

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:<br>• management's objectives for the acquisition, disclosed in the year of acquisition; and<br>• how the acquisition has performed against those objectives in subsequent periods.<br>(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)

| | Question | Preliminary view |
|---|---|---|
| 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

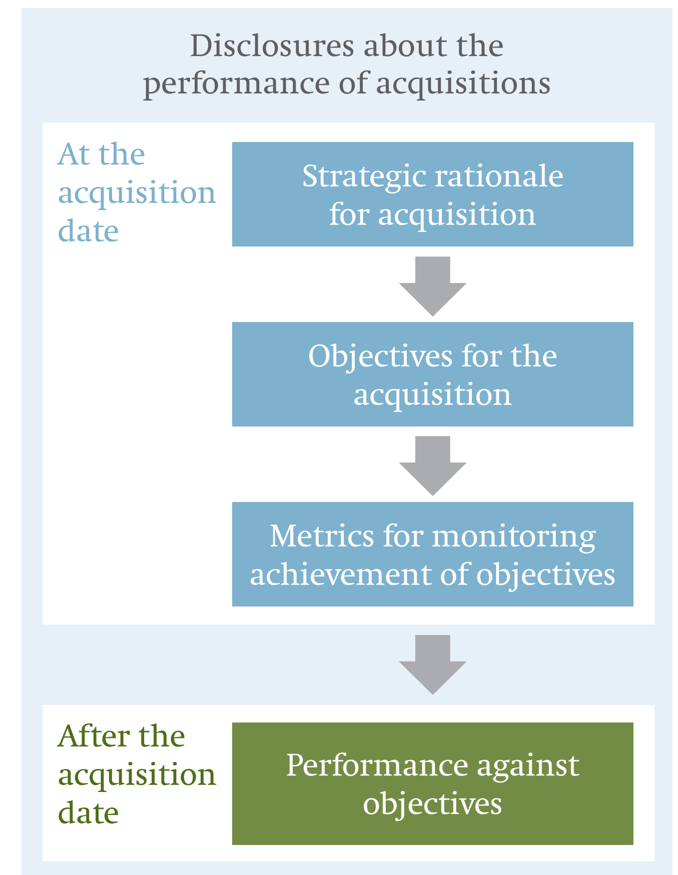
To provide investors with the information they need, companies should be required to disclose management's objectives for acquisitions and how acquisitions have performed against those objectives.

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.



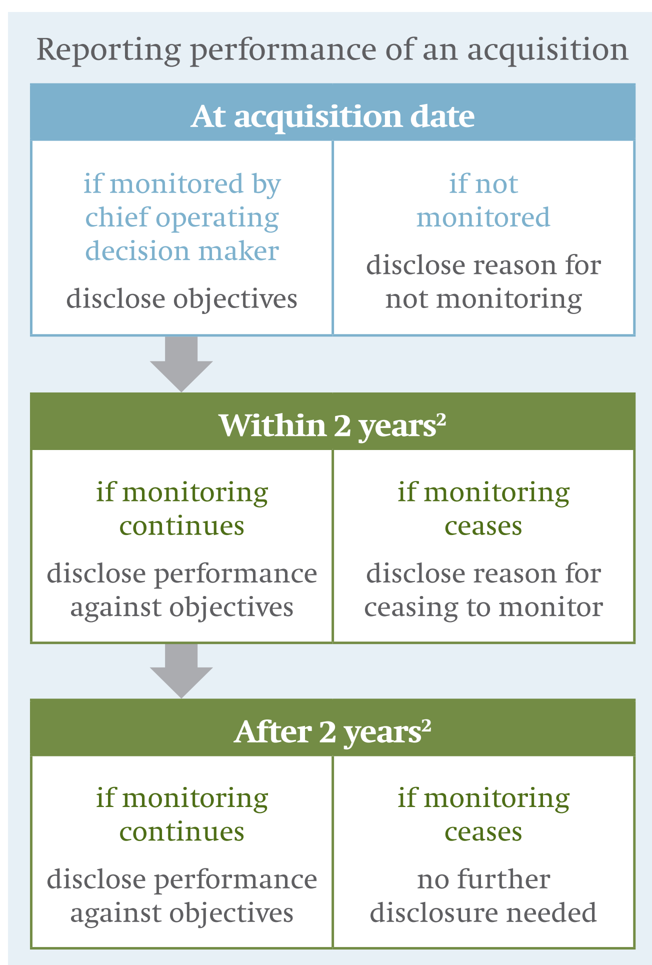
## For how long do investors need information about the performance of acquisitions?

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).

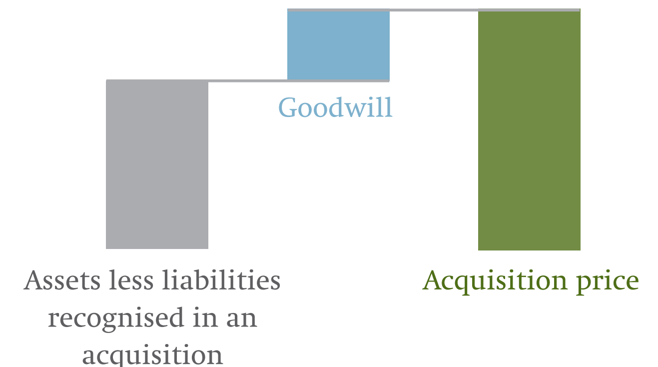
## What is goodwill and how do companies account for it?

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.

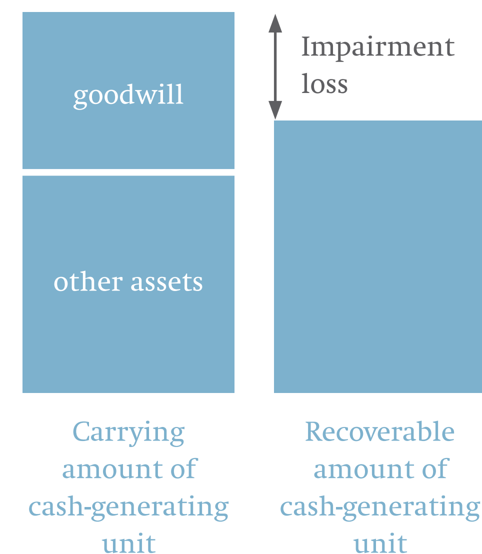
## How is goodwill tested for impairment?

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.

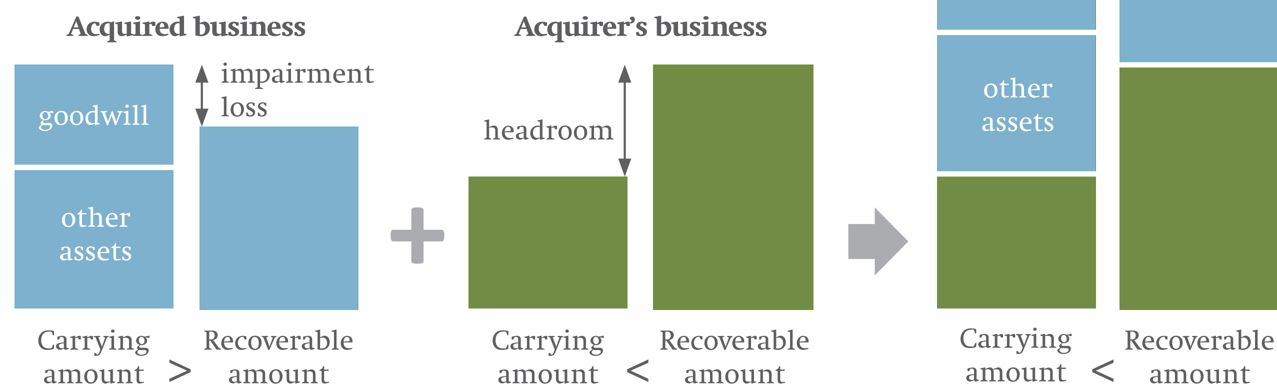
Headroom largely arises because not all of the value of a business is recognised on a company's balance sheet. For example, a company's balance sheet does not include some intangible assets that the company generates internally.

### 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.

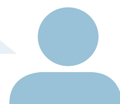
# 2 C Simplifying the impairment test

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.

# 3 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.

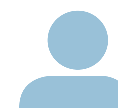
## Recognising acquired intangible assets separately from goodwill

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.

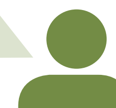
Considering whether to align the accounting treatments for acquired and internally generated intangible assets is beyond the scope of this project.



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 31 December 2020

The deadline has changed to 31 December 2020 because of the covid-19 pandemic; previously it was 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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