

21 December 2020

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Submitted to: [www.ifrs.org](http://www.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). We acknowledge the importance and relevance of the topics discussed in the DP and appreciate the timeliness of the IASB's consultation on these topics. 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 on the specific matters discussed in the DP, we would strongly 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. We would recommend such a review for the reasons outlined in the AASB

Research Report, including the concern that goodwill impairment losses are being recognised too late under the current requirements.

- We also intend to recommend a holistic review of the accounting for goodwill and other intangible assets, including internally generated intangible items that are not recognised under current requirements in IFRS® Standards. In today's economy, intangible assets represent an important source of value for many entities. However, many internally generated intangible assets currently cannot be recognised on entities' balance sheets. We think that both investors and preparers would benefit from the IASB considering how to provide a more complete view of an entity's intangible resources in the financial statements. We would strongly support a holistic review of the accounting for intangible assets in general – and we think that changes in the accounting for goodwill should be considered in the wider context of such a review.

The main points that we have raised in this letter are summarised below.

- Subsequent accounting for goodwill
  - We think that without conducting a holistic review of IAS 36 and of the accounting for intangible assets in general, it is not feasible to make the impairment test significantly more effective at a reasonable cost.
  - To improve the goodwill impairment test, we recommend that the IASB develop additional guidance on the allocation of goodwill to cash-generating units (CGUs). We are aware that this is a challenging aspect of IAS 36 for preparers, and that there are concerns that goodwill is sometimes tested for impairment as part of excessively aggregated CGUs. Guidance on the allocation of goodwill to CGUs could be considered as part of a holistic review of IAS 36.
  - We have mixed views as to whether goodwill amortisation or the impairment-only model is generally more appropriate. However, at this stage, we recommend retaining the impairment-only model, and reconsidering this topic after carrying out a holistic review of IAS 36 and of the accounting requirements for intangible assets in general (including those that are currently not recognised on the balance sheet). We emphasise the urgency of this review.
  - We do not agree with moving to an indicator-based approach for goodwill impairment, unless amortisation is reintroduced. We think that an indicator-based approach would not be sufficiently robust to allow for the timely recognition of goodwill impairment losses and would exacerbate the concern that goodwill impairment losses are recognised 'too late'. Without having to perform a quantitative impairment test, it would be relatively easy to claim that the impairment indicators as currently described in IAS 36 do not apply, and therefore that goodwill is not impaired.
  - We agree with the proposal to allow the use of post-tax inputs in the value-in-use (VIU) calculation and note that this is consistent with current practice. However, we recommend not to remove the restriction on cash flows from future asset enhancements

and uncommitted restructures at this stage, but to reconsider this after a holistic review of IAS 36 – which could include considering what guidance would be needed to mitigate the risk of subjectivity and management over-optimism if the restriction is to be removed.

- Proposed disclosures on the subsequent performance of acquisitions and expected synergies:  
We do not agree that these disclosures should be included in the financial statements for the following reasons.
  - We are concerned that the subjective nature of the disclosures on the subsequent performance of acquisitions may lead to ineffective disclosures in the financial statements, and these disclosures may be challenging to audit. Furthermore, disclosures about synergies may be based on information that lacks accuracy and completeness.
  - We think that the cost of preparing the disclosures and having them audited would significantly increase costs for preparers of financial statements, and we are not convinced that these costs are outweighed by the possible benefits of the disclosures.
  - There is a risk that the proposed disclosures would be provided in such a generic way so as not to be useful to investors (for example, due to concerns about commercial sensitivity).
  - While the DP proposes relatively extensive disclosures in relation to business acquisitions, we note that no such disclosures are proposed in relation to organic growth, which may be equally as significant to the entity and of as much interest to investors as growth through business acquisitions. Arguably, it would be beneficial for investors to understand how successfully management is running the business as a whole and creating value for investors – be it through acquisitions or organic growth. This is linked to our comment above recommending that the IASB perform a holistic review of the accounting requirements for intangible assets, including those that are not recognised under the current requirements.
- Other topics:
  - Presentation of total equity excluding goodwill: We strongly disagree with this proposal, as such presentation would indicate that goodwill is not an asset. Furthermore, if investors are interested in the amount of equity excluding goodwill, it would be easy for them to obtain this amount themselves from readily available information in the financial statements.
  - Intangible assets: We agree that the IASB should retain the requirement to recognise identifiable intangible assets acquired in a business combination separately from goodwill. Subsuming such intangible assets within goodwill could result in entities providing investors with less information on what was acquired as part of the business combinations. As noted above, we recommend that the IASB conduct a holistic review on the accounting requirements for intangible assets (including those that are currently not recognised).

Our recommendations and responses to the specific questions for respondents are set out in the Appendix to this letter.

We would like to take this opportunity to thank IASB Vice Chair Sue Lloyd and IASB staff member Tim Craig for their assistance with an outreach event that we held on the DP with New Zealand constituents.

If you have any queries or require clarification of any matters in this letter, please contact Gali Slyuzberg ([gali.slyuzberg@xrb.govt.nz](mailto:gali.slyuzberg@xrb.govt.nz)) or me.

Yours sincerely

A handwritten signature in black ink, appearing to read "M. Bradbury". The signature is written in a cursive style with a large initial "M" and a stylized "B".

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?

**Response to Question 1:**

1. We acknowledge that acquisitions of businesses are often major transactions that have a significant impact on the acquiring entity, and that it is important for investors to receive enough information about these transactions and their impact on the entity's financial performance and financial position. However, we think that the package of preliminary views as discussed in the DP may not help investors assess the performance of acquisitions and hold management to account for their acquisition decisions. Specifically, as explained in our response to Question 2, we are concerned that the subjective nature of the proposed disclosures on the subsequent performance of acquisitions could result in ineffective disclosures – which would go against the intended purpose of the disclosures. Another risk is that the proposed disclosures may not be provided, or would be overly generic and therefore not useful to investors. Furthermore, while the DP aims to provide better information on acquisitions at a reasonable cost to preparers, we are concerned that the cost of preparing the proposed disclosures and having them audited would not be reasonable.
2. If the IASB decides to proceed with the proposed disclosures, we think it would be very important to consider:
  - (a) introducing safeguards to avoid ineffective disclosures or overly generic disclosures, and;
  - (b) analysing the costs of the proposed disclosures to ensure that the cost is justified by the expected benefits – field tests could be useful in this regard.

3. While the DP emphasises the importance of looking at the preliminary views in the DP as a package, we think it is also important to consider how these preliminary views fit within the larger package of IAS 36 as a whole and the accounting for intangible assets in general – including internally generated intangible items. We understand that these wider considerations are outside the scope of this project, but we think it is important to take these considerations into account before deciding whether to make significant changes to the disclosure requirements for acquisitions or to the accounting for goodwill (e.g. reintroducing amortisation).
4. As to whether our answers to the questions in the DP are interlinked, we note that a common theme in most of our answers is that we would recommend not to make significant changes to the accounting and disclosure requirements in relation to acquisitions without conducting a holistic review of IAS 36 and the accounting requirements for goodwill and other intangibles. We also note the following interlinked answers.
  - (a) If the IASB introduces the proposed disclosures on the subsequent performance of acquisitions, we would support retaining the existing requirements to disclose the ‘pro forma’ performance information currently required by IFRS 3 *Business Combinations* only for those acquisitions that are not monitored by the chief operating decision maker (CODM) – as the disclosures on the subsequent performance of acquisitions would not be provided for such acquisitions.
  - (b) We would not support an indicator-based approach for goodwill impairment testing if the impairment-only model is retained, but would support such an approach if goodwill is amortised.

## 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?

### **Response to Question 2**

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

5. We do not support requiring the disclosures listed in Question 2(b) in the financial statements. We acknowledge that, in principle, if the proposed disclosures are prepared in an unbiased and sufficiently detailed way, these disclosures could 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 how successful the acquisition has been. The proposed disclosures could also focus management’s attention on these matters. However, we are not sure to what extent these disclosures would affect investors’ decision making, and we are not convinced that the possible benefits of the disclosures are justified by the risks and costs explained below.

#### Subjective nature of the disclosure requirements may lead to ineffective disclosures

6. We are concerned that the subjective nature of the disclosures and the level of judgement required in providing them could lead to ineffective disclosures about acquisitions. The proposed disclosures on the subsequent performance of acquisitions should be based on those metrics that are used by management (specifically, the CODM) to monitor the acquisition’s performance. Under this ‘management approach’, no requirements or guidance are proposed as to what metrics would be appropriate. There is a range of metrics that management could use to measure the subsequent performance of an acquisition. An acquisition may be successful based on one set of metrics but unsuccessful based on another set. For example, an acquisition may reach a revenue or sales volumes target, but fail with respect to profitability targets. Deciding which metrics should be used by the CODM to measure the success of an acquisition, and therefore which metrics should be disclosed, requires a high degree of judgement. Management would be able to select performance metrics or change these metrics in a way that portrays an unsuccessful acquisition as successful. This could happen inadvertently due to genuine perspective bias on management’s part, or it could happen due to a desire to hide poor acquisition decisions.
7. Furthermore, a high level of judgement would be required in determining the performance of the acquisition for a given metric. For example, if the CODM monitors the performance of the acquisition based on operating profit, it would be necessary to decide whether this operating profit should be measured for the acquired business on a standalone basis, or together with the acquirer’s existing business (or a division of that business) with which the acquired business is integrated. It would also be necessary to decide how to allocate revenue and costs to the acquired business (or to the acquired business and those parts of the existing business



with which it is integrated). In some cases, it would be challenging to determine whether a revenue or expense transaction is attributable to the acquisition and therefore should form part of the metric that measures the success of the acquisition, or whether that transaction is attributable to the existing business. Different decisions could lead to very different disclosures about the acquisition's performance. The subjective nature of these decisions and the high level of judgement involved means that the selected metrics and disclosures based on them may not provide a representationally faithful view of whether the acquisition is successful or not in meeting management's objectives for the acquisition.

8. If disclosures about the subsequent performance of acquisitions are ineffective for the reasons described above, this would negate the possible benefits of these disclosures.

#### Risk of entities providing overly generic or minimal disclosures

9. Furthermore, there is a risk that entities would change their internal reporting to the CODM in such a way that the CODM reviews overly generic information about acquisitions. This would justify the disclosure of overly generic information in the financial statements, which would not be helpful to investors. Overly generic disclosures could be driven by management concerns about commercial sensitivity and/or the risk of not achieving the expected objectives.
10. Commercial sensitivity was a common concern that constituents expressed during our outreach activities – particularly in the context of New Zealand's relatively small economy.
11. Concerns about commercial sensitivity could arise, particularly for privately held companies. Listed companies arguably already share information of a strategic nature with investors and provide some information about acquisitions beyond the current accounting requirements (for example, under the continuous disclosure requirements of the stock exchange). However, privately held companies may be less accustomed to sharing such information with the users of their financial statements.
12. We think commercial sensitivity would be a factor that entities would take into account when determining the nature of information and level of detail of the proposed disclosures. 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.

#### Cost of the disclosures: preparation, audit and regulation

13. We appreciate that the IASB has taken steps to ensure that costs to preparers would be reasonable (for example, 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). However, we think that the cost of the proposed disclosures (including audit costs) could be very high and may exceed the benefits (particularly given the above concerns about the risk of ineffective disclosure due to their subjective nature).

14. We think that the proposed disclosures could give rise to the following costs.
- (a) Preparation costs: We have heard concerns that the costs of providing the proposed disclosures may be high. Preparation 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.
  - (b) Assurance costs: The proposed disclosures are relatively extensive and would increase the scope of the audit. Furthermore, we have heard concerns that the proposed disclosures may be difficult to audit. This could lead to more expensive audits for entities that acquire other businesses.
  - (c) Regulatory costs: It is likely that the proposed disclosures would be a focus area for regulators (particularly due to the degree of subjectivity and level of judgement required). Compliance with regulators’ queries and reviews in relation to the proposed disclosures could indirectly lead to increased preparation costs and audit costs.
  - (d) Proprietary costs: Costs of providing information that an entity’s competitors can use to gain competitive advantage (and the costs incurred in trying to avoid providing this information).

#### Asymmetry between reporting on business acquisitions vs reporting on organic growth

15. The proposals in the DP would introduce relatively extensive disclosure requirements about the subsequent performance of business acquisitions. However, no such disclosures are required for the organic growth of an entity – which could involve just as much capital outlay and have just as significant an impact on the entity’s performance and position as growth through acquisitions, and could be of as much interest to investors.
16. There is already a difference in the extent of accounting requirements for growth through acquisitions as compared to organic growth. For example, goodwill and certain intangible assets can be recognised in a business combination, but not when they are generated internally. However, introducing significant disclosure requirements in relation to acquisitions would increase this ‘imbalance’ in information provided in the financial statements about the two different types of investment in the entity’s growth. Arguably, it would be beneficial for investors to understand how successfully management is running the business as a whole and creating value for investors – be it through acquisitions or organic growth. This is linked to our comment in the cover letter about recommending that the IASB perform a holistic review of the accounting requirements for intangible assets, including those that are not currently recognised.
17. The IASB’s Practice Statement *Management Commentary* notes that two of the key elements of management commentary are “management’s objectives and its strategy for meeting these objectives” and “critical performance measures and indicators that management uses to evaluate the entity’s performance against stated objectives”. The nature of the proposed disclosures on the subsequent performance of acquisitions appears to be similar in nature to these elements of management commentary. Therefore, the proposed disclosures seem to fit better in management commentary than in the financial statements. If the proposed disclosures on the objectives and subsequent performance of acquisitions are included in an

entity's management commentary – together with information about the strategy and performance of the existing business (which we understand is already disclosed in management commentary by some entities) – then by reading the management commentary an investor would receive a holistic picture of the entity's performance and value creation.

Proposed considerations should the IASB be inclined to proceed with the proposed disclosures:

18. If the IASB is inclined to proceed with proposing the disclosures included in the DP, we think it would be very important for the IASB to consider the following before requiring these disclosures.
  - (a) Considering whether and to what extent it is possible to introduce safeguards to avoid the risk of disclosures being ineffective due to their subjective nature. For example, the IASB could consider providing principles-based guidance on the type of disclosures on objectives and metrics that would be expected or appropriate, or a certain minimum level of disclosures. While this may mean that some entities would need to collect certain information that they did not previously collect as part of their internal monitoring processes, it could help remove some of the subjectivity and bias around the proposed disclosures and ensure that investors are receiving a certain minimum level of useful information about acquisitions.
  - (b) Analysing the costs of providing the proposed disclosures. A careful consideration of the costs of the disclosures in practice – for example, by running field tests – could help the IASB confirm whether the benefits of the disclosures could outweigh the costs to preparers, and what changes to the proposed disclosures would be necessary for the benefits to exceed the costs.
  - (c) Carrying out a holistic review of the accounting and disclosure requirements for intangible assets, including those that are currently not recognised, before deciding whether to introduce the disclosures proposed in the DP.
  - (d) Working with the International Auditing and Assurance Standards Board (IAASB) with a view to ensuring that any proposed disclosures are verifiable for audit purposes, and to clarify what auditors' responsibilities would be in relation to the proposed disclosures.
19. If, after considering the above, the IASB decides to propose requiring the disclosures in the DP, we think that there are certain matters that would need to be clarified for constituents. For example, it would be important to clarify:
  - (a) whether comparative information must be restated when there is a change in the metrics used to assess the performance of the acquisition (given that changes in metrics can result in lack of year-on-year comparability);
  - (b) whether it is permitted to provide the proposed disclosures in aggregate for a number of similar acquisitions, particularly if the CODM monitors these acquisitions in aggregate (for highly acquisitive entities, this could reduce the cost and volume of the disclosures);
  - (c) that if the acquired business is integrated into the acquirer's existing business soon after the acquisition, information on performance metrics can be provided for the integrated business, if that is how the CODM monitors the success of the acquisition.

(This is noted in the DP, but the inability to provide the proposed disclosures due to integration was a common concern that we heard, so it would be important to make this point very clear); and

- (d) if the CODM monitors the performance of the acquisition against targets established shortly after the acquisition, rather than the estimated targets that existed at the acquisition date, whether the updated targets can be used as the basis for disclosing ‘the metrics that management (CODM) will use to monitor whether the objectives of the acquisition are being met’ in the year of the acquisition.

20. As we do not support requiring the proposed disclosures on the subsequent performance of acquisitions in the financial statements, we have not answered Question 2(c)–(f) of the DP.

**Question 3**

Paragraphs 2.53–2.60 explain the Board’s preliminary view that it should develop, in addition to proposed new disclosure requirements, proposals to add disclosure objectives to provide information to help investors to understand:

- the benefits that a company’s management expected from an acquisition when agreeing the price to acquire a business; and
- the extent to which an acquisition is meeting management’s (CODM’s) objectives for the acquisition.

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

***Response to Question 3:***

21. 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. We note that IFRS 3 already requires entities to disclose the reason for the business combination, and the proposed specific disclosure objective could help enhance this disclosure.
22. Regarding the proposed specific disclosure objective to provide information on the extent to which acquisitions are meeting management’s objectives: As noted in our response to Question 2 above, we do not support requiring the proposed disclosures on the subsequent performance of acquisitions in the financial statements.

#### **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?

#### ***Response to Question 4:***

##### *Proposed disclosures about synergies*

23. We do not agree with the IASB’s proposal to require the specific disclosures on expected synergies from acquisitions as proposed in the DP.
24. We acknowledge that, in principle, the proposed specific disclosures on synergies could 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). However, we are not convinced that the benefits of providing these disclosures would exceed the costs and risks explained below.
  - (a) Accuracy and completeness: We think there could be issues around the accuracy and completeness of the underlying information that will be used to prepare the proposed disclosures on synergies. We are aware that some acquirers have well-documented and detailed synergy calculations, whereas others do not. It is possible that the proposed specific disclosure requirements on synergies could encourage entities to consider and document expected synergies more carefully, which would be beneficial. However, some entities may continue to undertake acquisitions without detailed analysis and documentation of synergies – in which case the proposed disclosures would be prepared based on incomplete and potentially inaccurate information. Furthermore, it could be argued that despite an acquirer’s efforts around the performance of due diligence, business acquisitions are always based on incomplete information. Therefore, there would be a certain degree of risk around the completeness and accuracy of the information underlying the proposed disclosures on synergies, even for entities that have robust processes around the analysis of synergies.
  - (b) Verifiability and cost of audit: We also have concerns about the auditability of the proposed disclosures on synergies. As noted above, depending on the robustness of an entity’s analysis and documentation of synergies, the disclosures may be prepared

based on incomplete and potentially inaccurate information. This would make such disclosures challenging to audit. We are also aware of concerns that auditors may be expected to opine on the reasonableness of management's expectations around synergies – which would effectively require the auditor to perform a due diligence exercise in relation to the acquisition. The process of determining the acquisition price, including the determination of expected synergies, is often complex. If auditors have to review this process to determine whether the disclosures on synergies are faithfully representative, this would significantly increase the scope and therefore the cost of the audit.

- (c) Concerns about commercial sensitivity: 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.

- 25. If the IASB proceeds with proposing the disclosures on synergies as described in the DP, we think it would be important to clarify certain matters to constituents. These include the acceptable level of disclosures on synergies (this may help mitigate concerns about commercial sensitivity to a certain extent), that synergies may not necessarily equal or be readily reconcilable to the transaction price itself, and what disclosures are required when no synergies are expected from an acquisition (for example, because the purchased business is unrelated to the existing business, or in case of a 'protective' acquisition). Furthermore, it would be important to clarify, through discussions with the IAASB, the auditor's role regarding assurance over the disclosures about synergies.

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

- 26. 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 liabilities.
- 27. Furthermore, paragraph 31 of IAS 1 *Presentation of Financial Statements* notes that if a certain disclosure is required by an IFRS Standard but it is not material, then the disclosure need not be provided – whereas additional disclosures that are not specifically required by IFRS Standards should be considered to enable users to understand a transaction. Therefore, if information about the acquiree's liabilities from financing activities and/or defined benefit pension plan liabilities are material, then separate disclosure of these liabilities would need to be considered under paragraph 31 of IAS 1 – even if the IASB does not specifically require the disclosure of these liabilities. Conversely, if these liabilities are not material, then application of paragraph 31 of IAS 1 would mean that these liabilities would not be disclosed, even if the IASB specifically requires the proposed disclosures.
- 28. For these reasons, we do not think it is necessary to introduce the proposed specific requirement to disclose the acquiree's liabilities from financing activities and defined benefit pension liabilities.

29. We also 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.



### 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?

### **Response to Question 5:**

- 30. In the context of our disagreement with including the proposed disclosures on the subsequent performance of acquisitions in the financial statements (see Question 2 above), we agree with the IASB’s proposal to retain 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. We also agree that the IASB should develop guidance on how to calculate the abovementioned pro-forma information, as we are aware that it is often difficult for preparers to provide this information. However, our preference is not to require the proposed additional disclosures on operating cash flows.
- 31. If the IASB introduces the proposed disclosures on the subsequent performance of acquisitions that are monitored by the CODM, then we recommend retaining the existing disclosures on the acquiree’s pro-forma and actual contribution to the group, but only for those acquisitions that are not monitored by the CODM. For acquisitions that are monitored by the CODM, the new disclosures on subsequent performance of acquisitions would mean that the existing disclosures on the acquiree’s pro-forma and actual contribution to the group are unlikely to be needed by investors.

32. 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, using the term 'operating profit before acquisition-related transaction and integration costs' will add a layer of subjectivity to these disclosures.

## 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?

### **Response to Question 6:**

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

- 33. We think that without conducting a holistic review of IAS 36 and of the accounting requirements for intangible assets, 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.
- 34. 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 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 consider that goodwill will inevitably be shielded by unrecognised headroom within the CGU, be it headroom generated before or after the acquisition.
- 35. We also agree that the IASB should not implement the alternative impairment method described as the ‘headroom approach’ in Section 3 of the DP. This method would not eliminate the shielding of goodwill and there would be issues around allocating the impairment amount between acquired goodwill and unrecognised ‘headroom’ items. Furthermore (as the DP notes) it will be costly for preparers to implement this model.

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

36. 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

37. 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.
38. 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’. Currently, IAS 36 requires cash flows in the value in use (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. For example, 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

39. 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.
40. 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 aggregated CGUs can exacerbate the impact of shielding.
41. 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 acquisitions) 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.

42. To the extent that this issue arises from incorrect application of IAS 36, we think it is 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.
43. Therefore, we recommend that additional guidance on allocating goodwill to CGUs or groups of CGUs should be provided.

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

44. 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?

### Response to Question 7:

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

- 45. 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. Our views on this topic are also mixed.
- 46. We are aware of the following arguments in favour of retaining the impairment-only model.
  - (a) There is an argument that core elements of goodwill as described in BC313–BC 318 of IFRS 3, i.e. synergies and the ‘going concern’ element, generate economic benefits over an indefinite time period. On this basis, the impairment-only model is appropriate for goodwill and the amortisation model is not (like other intangible assets with an indefinite life).
  - (b) Even if it is argued that the value of goodwill is consumed over a finite period, it could be 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. 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.

- (c) While amortisation reduces the goodwill balance every year, it also increases headroom within the CGU every year, which could reduce the likelihood of an *impairment loss* being recognised when an acquisition is not performing as well as expected. 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.
  - (d) 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 profit or loss in the same year: once from expenditure incurred to enhance goodwill, and again from amortisation.
  - (e) 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.
  - (f) The reintroduction of amortisation would be a major change in accounting practice. 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.
  - (g) 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, the reintroduction of amortisation should be considered as part of a more comprehensive project on this subject – rather than as part of this project.
47. On the other hand, we are also aware of the following arguments in favour of the reintroduction of amortisation.
- (a) As the IASB noted, there are concerns that under the current impairment-only model, the recognition of goodwill impairment is ‘too little and too late’. 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 – 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. (Conversely, under the current impairment-only model there is also sometimes a tendency to fully impair the goodwill balance as soon as impairment is identified, even if some of the goodwill balance could be supported by future cash flows. Amortisation of goodwill could possibly address the risk of understated goodwill balances).

- (b) There is an argument 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 (which is different to acquired goodwill). This consumption would be best reflected by amortisation.
- (c) Under the impairment-only model, goodwill remains on the balance sheet long after it has stopped being relevant or meaningful. An entity can be restructured several times and change significantly after an acquisition that gives rise to goodwill. Without regular amortisation, goodwill stays on the balance sheet throughout these changes and restructures (as long as the recoverable amounts of relevant CGUs exceed their carrying amounts) – even when the entity bears very little resemblance to either the acquired business or the original business as it existed at the time of the acquisition.
- (d) We have heard concerns that the goodwill impairment test is costly, particularly for medium-sized companies, which do not have the same level of 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 the amortisation model, amortisation coupled with the IASB’s proposed indicators-based approach to goodwill impairment testing would mean that goodwill will need to be tested for impairment less often than it is currently, which could reduce costs for preparers.
- (e) The Basis for Conclusions on IFRS 3 explains 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.
- (f) 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 an overly optimistic estimation of useful life. Such caps could be based on academic research, the IFRS for SMEs Standard, or another current standard or standards used prior to the adoption of IFRS that allow amortisation with a cap on useful life.



48. On balance, we think that the IASB should retain the impairment-only model *at this time*, but reconsider whether to reintroduce amortisation after carrying out a holistic review of IAS 36 (including considering guidance on the determination of CGUs and the allocation of goodwill to CGUs), and of the accounting for intangible assets in general (including those intangible items that are not recognised under the current requirements). Having said this, we think it would be important to carry out this holistic review with some urgency.
49. To help the IASB decide on whether to retain the impairment-only model or to reintroduce goodwill amortisation (after carrying out the abovementioned holistic reviews), we think it may be useful for the IASB to conduct further research on the following.
- (a) Whether goodwill is generally a wasting asset with a finite life or a non-wasting asset with an indefinite life – including investors’ perception on this matter.
  - (b) Whether the hybrid approach discussed in the DP (i.e. applying the impairment-only model for the first few years after an acquisition and then applying amortisation) would result in useful information for investors.

*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 significant new conceptual arguments in favour of amortisation that the IASB is not already aware of. However, the practical issues that have been arising from applying IAS 36 since the impairment-only model for goodwill was introduced could possibly constitute a reason for reintroducing amortisation. Such practical issues include the length of time that goodwill has stayed on entities’ financial statements, 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. Having said this, we would recommend a review of IAS 36 as a whole, as well as the accounting requirements for intangible assets in general, before considering the reintroduction of goodwill amortisation.

*Question 7(c): Would reintroducing amortisation resolve the main reasons for the concerns that companies do not recognise impairment losses on goodwill on a timely basis (see Question 6(c))? Why or why not?*

52. In terms of shielding, 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 amount 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.
55. However, if it is accepted that acquired goodwill has a finite useful life, then it is likely that it is 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?*

56. 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?*

57. As noted above, on balance we do not recommend the reintroduction of amortisation of goodwill at this time.
58. However, if the IASB reintroduces amortisation, we would recommend that the IASB introduce a rebuttable cap on the amortisation period. We believe that this cap should be based on research, such as academic research on the lifespan of acquisitions' additive value. Introducing such a cap would mitigate the risk of over-optimistic estimations of the amortisation period and would simplify the amortisation requirements for preparers.

## 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?

### **Response to Question 8:**

- 59. We strongly disagree with the IASB’s proposal to require entities to disclose the amount of equity excluding goodwill on the balance sheet.
- 60. 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. Furthermore, if there are users who do not know how to calculate the amount of equity excluding goodwill themselves, for such users the presentation of two equity balances could be even more confusing.

### 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?

### **Response to Question 9:**

- 61. If the IASB retains the impairment-only model for goodwill, then 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.
- 62. 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 due to management over-optimism, or due to incorrect assumptions as to when goodwill impairment can occur (as explained further below). This would result in not recognising impairment losses on time. This would exacerbate the concern over late recognition of impairment losses.
- 63. By contrast, if goodwill must be tested for impairment every year, there is less risk that an impairment loss will be missed. For example, if the entity’s competitor launches a new product, under an indicator-based approach it would be relatively easy to argue that this does not constitute “significant changes with an adverse effect on the entity [...] in the technological, market, economic or legal environment in which the entity operates” (IAS 36, paragraph 12), and does not indicate that goodwill is impaired. However, if the annual impairment test requirement was retained, management would need to quantify the impact of the competitor’s new product launch on the future cash flows or fair value of the relevant CGU, which could result in the recognition of an impairment loss that may have otherwise been missed. Furthermore, some may assume that a CGU must be making a loss for an impairment of goodwill to occur. This could lead to an assumption that as long as the operations relating to the CGU are profitable, there are no indicators of goodwill impairment. Again, this could lead to goodwill impairment not being recognised, as goodwill can be impaired even if the related business is profitable (albeit not profitable enough to support the carrying amount of the assets within the CGU). There is good discipline in performing the goodwill impairment test every year.
- 64. 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.

65. Cost savings 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 (including regaining expertise in performing the impairment test).
66. Having said this, moving to an indicator-based approach could be appropriate if the IASB reintroduces goodwill amortisation. If goodwill is amortised, then there is less risk that missing an impairment indicator would result in an overstated goodwill balance.
67. If the IASB implements an indicator-based approach for goodwill impairment testing, we think it would be important to enhance 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.

**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.

**Response to Question 10:***Allowing the use of post-tax inputs*

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

*Removing the restriction on the inclusion of cash flows from future asset enhancements and uncommitted restructures*

70. In our view, the proposal to allow the use of post-tax inputs in the VIU calculation reflects current practice and has clear advantages. By contrast, the proposal to remove the restriction on the inclusion of cash flows from future asset enhancements and uncommitted restructures in the VIU calculation would represent a significant change to the VIU model, and would be associated with a greater risk of non-recognition of impairment losses, due to the increased subjectivity involved in the estimation of cash flows from future enhancements to assets.
71. At this time, we disagree with removing the restriction on the inclusion of cash flows from future asset enhancements and uncommitted restructures in the VIU calculation. However, we recommend that the IASB reconsiders this matter after conducting a holistic review of IAS 36.
72. 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. This could be mitigated by developing guidance to explain more clearly when it is appropriate to include the abovementioned cash flows in the VIU calculation – which could be done as part of a holistic review of IAS 36. It would be important to include such guidance in IAS 36 if, after conducting a holistic review of that standard, the IASB decides to remove the abovementioned restrictions.

73. Furthermore, removing the abovementioned restrictions 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. If, after conducting a holistic review of IAS 36 and considering the additional guidance mentioned in the previous paragraph, the IASB decides to remove the abovementioned restrictions from the VIU method, we think that the IASB would need to consider whether both methods for calculating the recoverable amount of a CGU should be retained, or whether a single method should be mandated.

**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 pursued 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?

**Response to Question 11:**

74. As noted above, we recommend that the IASB considers 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.

- (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?

**Response to Question 12:**

- 75. 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 provides users of financial statements with a better understanding 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.
- 76. As noted elsewhere in this letter, we recommend that the IASB undertakes a holistic review of the accounting for intangible assets.

**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?

**Response to Question 13:**

77. 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?

**Response to Question 14:**

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