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Mr Hans Hoogervorst
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UNITED KINGDOM

XX November 2020.

Dear Hans,

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

The Australian Accounting Standards Board (AASB) is pleased to have the opportunity to provide comments on DP/2020/1 *Business Combinations – Disclosures, Goodwill and Impairment* issued in March 2020 (DP/2020/1).

In formulating these comments, the views of our Australian stakeholders were sought and considered. This included:

- consultation with the AASB's User Advisory Committee, comprising a range of primary users of financial statements;
- two webinars seeking feedback on the proposals, with participation from over 110 stakeholders. We would like to express particular thanks to IASB Board Member Ann Tarca and IASB Technical Staff Tim Craig for their participation in the webinars, which we consider was of significant mutual benefit to both the AASB and the IASB;
- consultation with the AASB's Business Combinations/Equity Method Project Advisory Panel, which comprises subject matter experts across a range of stakeholder groups;
- two formal comment letters; and
- other targeted consultation with key stakeholders, such as professional bodies, auditors and preparers in Australia.

The AASB acknowledges the efforts of the IASB and broadly agrees with the proposals in DP/2020/1.

However, as detailed in Appendix A, the AASB does have concerns with some of the proposals, including:

- The AASB does not support requiring entities to disclose information about the subsequent performance of acquisitions, including the metrics used by the chief operating decision maker (CODM) to monitor those acquisitions in the financial statements. While noting that the disclosures are responding to a need for further information expressed by investors, the AASB questions whether this type of information would be required to meet the objective of financial statements as proposed in the IASB's Exposure Draft *General Presentation and Disclosures* or whether this would be more appropriately dealt with in the IASB's project to

Commented [MR1]: Note to Board: As noted in the staff paper, this is only a working draft of the proposed submission.

Staff are not seeking views on drafting at this time, as individual responses are yet to be properly formulated and will be refined subsequent to the November Board meeting, reflecting the decisions made at that meeting.

Staff are providing this working draft so Board Members can see the broad outline and proposed content of the submission and provide general direction to staff about any additional issues they would like incorporated in the submission.

revise the Management Commentary Practice Statement. The AASB also noted that no similar information is required for internally developed intangible assets.

- While the AASB is supportive of retaining the impairment only model and not reintroducing amortisation, the AASB considers further improvements to the impairment model are required. In particular, the AASB notes that goodwill is not always allocated to the lowest level at which it is being monitored and therefore not tested for impairment at the appropriate level, often due to difficulties in understanding and applying the requirements of IAS 36 *Impairment of Assets*.
- The AASB is generally supportive of the proposed simplifications to the annual impairment test. However, the AASB is concerned that not performing an annual impairment test may reduce the robustness of the impairment model and result in a loss of information to users and would need appropriate safeguards put in place to address this. The AASB has also not received strong evidence that removing the annual impairment test requirement will result in significant cost savings to preparers.
- The AASB does not support the proposed requirement to present total equity excluding goodwill on the statement of financial position.

The AASB notes that it has only responded to those questions in the discussion paper where Board members have concerns about the proposals or have recommendations for improvements.

If you have any questions regarding this letter, please contact myself or Meina Rose, Technical Principal (mrose@aasb.gov.au).

Yours sincerely,

[signature]

Dr. Keith Kendall

AASB Chair

APPENDIX A – Responses to questions raised in DP/2020/1

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?

- The AASB do not agree with the IASB's conclusion that implementation of the package would meet the objective of the project to provide investors with more useful information about the acquisitions companies make at a reasonable cost.
- In particular, the AASB do not support the inclusion of the subsequent performance information in the financial statements and recommend considering whether this information could be more appropriately dealt with in the management commentary project.
- Feedback suggests users are already getting sufficient information and would view subsequent performance information for example with scepticism.
- However, the AASB support the following proposals in the package:
  - retaining the impairment-only model, subject to the impairment test being improved (see response to question 7 for detail);
  - removing the restriction on including cash flows from future restructuring, improvements or asset enhancements, subject to developing robust guidance about when it is appropriate for an entity to include those cash flow (see response to question 10 for detail); and
  - allowing the use of either pre- or post-tax cash flows and discount rates in estimating value in use (ViU) with additional implementation guidance provided in relation to the use of post-tax discount rates and the inclusion of other items such as lease liabilities and asset retirement obligations (see response to question 10 for detail).
  - removing the annual impairment test requirement, but only if the indicator approach can be made more robust and supplemented with additional disclosures (see response to question 9 for detail).

Commented [KC2]: Note to Board:

As feedback on this proposal was mixed, staff have presented two alternative views in Agenda Paper 6.1 on how to respond to this issue and is seeking the Board's views on which to adopt.

If Board Members decide not to support removing the annual impairment test requirement (View 1), the submission would be revised as necessary to reflect this.

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).

(v) 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?

In response to question 2(a):

- There was mixed feedback on the usefulness of the disclosures. Some users indicated that they already get sufficient information about the subsequent performance of acquisitions outside the financial statements. Others were concerned about management's ability to manipulate the metrics and would therefore view the 'reliability' of the disclosures with scepticism.

In response to question 2(b):

- The AASB do not agree with the disclosure proposals set out in (i)-(vi).
- The AASB question if this type of information is required to meet the objectives of financial statements as proposed in the IASB's Exposure Draft *General Presentation and Disclosures* and suggest it may be more appropriately included as in management commentary.
- No similar information is required for internally developed intangible assets.
- Requiring this type of information may result in financial reporting driving internal reporting (similar to when IFRS 8 was implemented).

However, if the IASB proceed with the disclosure proposals, the AASB make the following observations:

In response to 2(b)

- The CODM approach is a pragmatic solution however there is concern about management bias (including management's ability to change the metrics they disclose).
- Disclosing the reasons why the metrics were changed may mitigate this risk.
- The AASB also recommend additional guidance on situations where it is reasonable to change the metrics to limit the potential to change metrics to mask poor performance.
- The AASB heard that consistency of information may be a concern. If this is also raised in other submissions, we recommend the IASB considers whether the IFRS 8 approach regarding presentation of comparative information where metrics have been changed may be warranted to provide consistency in the disclosures.
- It was not clear to stakeholders that they were permitted to report the metrics on an integrated basis where an acquiree is integrated soon after acquisition. Suggest making clear in future consultation documents.
- Some stakeholders have raised concerns about the auditability of the subsequent performance disclosures. The AASB suggest discussing the auditability with the International Auditing and Assurance Standards Board (IAASB).

In response to question 2(c):

- The CODM approach should not be too onerous as it is information management already have.

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?

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- The AASB support requiring the synergy disclosures.

- However, stakeholders are concerned about the auditability of synergy information as quantifying expected synergies may be difficult and extremely judgemental.
- The AASB understands that auditing should be possible provided the 'framework' against which the disclosures are audited is sufficiently specific and detailed, however suggest discussing the auditability with the International Auditing and Assurance Standards Board (IAASB).

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?

In response to question 5(a):

- The AASB are broadly supportive of the IASB's preliminary view to retain the current requirements for companies to prepare and disclosure the pro-forma information.
- Feedback from our stakeholders is that disclosure of pro-forma revenue is particularly useful.
- However, stakeholders are concerned about ability to manipulate in particular the pro-forma profit and cash flow disclosures.

In response to question 5(b):

- Providing guidance about how to prepare the pro-forma information would help with the quality and consistency of the disclosure and could address stakeholders' concerns about possible manipulation of the disclosures.

In response to question 5(c):

- The AASB do not support the introduction of new pro-forma cash flow disclosures as stakeholder feedback indicates the information would not be useful.

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?

In response to question 6(c):

- In the AASB's view, the main issues with the current impairment model is that goodwill is not always tested at the right level.
- The concept of shielding may be increased by the potentially inappropriate allocation of goodwill to larger CGUs than may otherwise have been intended.
- This supports the need for guidance about how to apply IAS 36, however this may be better addressed through a holistic review of the IAS 36 requirements rather than through this project (links also to question 6(d)).

In response to question 6(d):

- The impairment model needs further improvements - goodwill is not always allocated to the lowest level at which it is being monitored and therefore not tested for impairment at the appropriate level, often due to difficulties in understanding and applying the requirements of IAS 36 *Impairment of Assets*.

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?

In response to question 7(a):

- The AASB support retaining the impairment-only approach, subject to the impairment model being improved.
- Even if impairment losses are 'only' confirmatory, their reporting provides useful information, particularly in the first few periods after an acquisition when the outcomes of an acquisition (i.e. its success or failure) are most interesting to users.
- If amortisation is reintroduced, useful information may be hidden, with impairment losses not being recognised due to 'routine' amortisation charges being recognised instead.
- Other useful information (e.g. model inputs and sensitivities) may also be lost from the financial statements if the amortisation model is reintroduced and this information is not otherwise required to be disclosed.
- Difficulties in reliably estimating the useful life of goodwill and how it is 'consumed' may mean that the amortisation approach results in arbitrary amortisation charges over arbitrary periods of time.
- The impairment-only model may be considered equally as judgemental as the amortisation model as the inputs in determining, for example, whether an indicator for impairment present can be just as subjective.
- The amortisation model may increase costs to preparers as they would be required to estimate the useful life of goodwill, calculate amortisation and make associated disclosures, as well as assessing for impairment indicators and test for impairment, if impairment indicators are present.
- Goodwill is not a wasting asset as the common components of goodwill are not diminishing over time and this is also consistent with how businesses are valued and priced for transactions.

In response to question 7(e)

- Feedback from users suggest that they would add back amortisation in the same way as they add back impairment losses, as both are non-cash items. This is likely to affect how management is treating those items when reporting 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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In response to question 8(a):

- The AASB do not support a presenting total equity excluding goodwill on the balance sheet.
- This approach appears to be inconsistent with the IASB conclusion in IFRS 3 that goodwill is an asset that will generate future economic benefits to the entity.
- Goodwill is presented separately on the face of balance sheet, therefore calculating total equity excluding goodwill should be straight forward for financial statement users, if they need this information.

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?

- The AASB's comments are limited to the removal of the annual impairment test requirement as it relates to goodwill. We did not receive any feedback about the proposal also applying to other intangible assets.
- Users have stated that they are primarily interested in the key assumptions made when testing goodwill for impairment and that they would be concerned if this information was lost if an annual impairment test was no longer required.
- Feedback from stakeholders on expected cost savings was mixed, with many not expecting the cost savings to be significant.

***View 1:** Do not support the removal of the annual impairment test*

- The AASB does not support removal of the annual impairment test, because there is not enough evidence of significant cost savings and there is significant concern from users about the loss of information from the financial statements

- However, if the IASB disagrees and proceeds, we suggest that the indicator approach needs to be made more robust and supplemented with additional disclosures.
- In particular, entities should be required to disclose if they have not performed an impairment test (as there were no impairment indicators) and explain the reasons why no test was required, including the indicators considered in the assessment.
- The IASB should also reconsider the list of impairment indicators and provide a non-exhaustive list of additional, more specific indicators which have a stronger focus on internal factors that are particularly relevant to goodwill and intangible assets with an indefinite life. Examples could be a loss of a major customer or group of customers, loss of market share, loss of key employees that were critical for the brand development or development of technological platforms, or the failure to meet internal metrics determined at the time of the acquisition, including expected synergies to arise from the acquisition.

View 2: *Support the removal of the annual impairment test*

- The AASB supports removal of the annual impairment test only if the indicator approach can be made more robust and supplemented with additional disclosures.
- In particular, entities should be required to disclose if they have not performed an impairment test (as there were no impairment indicators) and explain the reasons why no test was required, including the indicators considered in the assessment.
- The IASB should also reconsider the list of impairment indicators and provide a non-exhaustive list of additional, more specific indicators which have a stronger focus on internal factors that are particularly relevant to goodwill and intangible assets with an indefinite life. Examples could be a loss of a major customer or group of customers, loss of market share, loss of key employees that were critical for the brand development or development of technological platforms, or the failure to meet internal metrics determined at the time of the acquisition, including expected synergies to arise from the acquisition.

Commented [KC3]: Note to Board:

As feedback on this proposal was mixed, staff have presented two alternative views in Agenda Paper 6.1 on how to respond to this issue and is seeking the Board's views on which to adopt.

Subject to decisions at the November meeting, only View 1 or View 2 will be included in the final submission.

Roll-forward of impairment tests from prior years

- While the AASB has only received limited feedback regarding how, if at all, the ability to roll-forward prior year impairment tests may reduce compliance costs for preparers in practice, this could be a preferred solution to removing the annual impairment test altogether. We therefore recommend the IASB conduct further research on this matter.

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.

Removing restrictions for some cash flows

- The AASB agree with the proposal.
- However, there is concern that allowing entities to include cash flows from future uncommitted restructurings or other asset enhancements may further delay the recognition of impairment losses due to overly optimistic cash flow forecasts. This could further delay in the recognition of impairment losses.
- Assessing whether cash flows from future restructurings or asset enhancements are reasonable and supportable could also be difficult and judgemental. For example, it may not be possible, to compare those expected future cash flows to the past cash flow projections the same way it is done for other type of cash flows in ViU calculations as required by paragraph 34 of IAS 36.
- Guidance about when it is reasonable and supportable to include cash flows from uncommitted future restructuring and asset enhancements is needed.
    - Consider some elements of the “highly probable” guidance in IFRS 5 and have an expected time frame to complete the restructure.
    - Essentially management need to be able to demonstrate their intent, commitment and financial ability.

Pre- or post-tax discount rates

- The AASB support the use of either pre- or post-tax discount rates, however guidance is required.
- While conceptually, discounting post-tax cash flows at a post-tax discount rate and discounting pre-tax cash flows at a pre-tax discount rate should give the same result, in practice, this will only be the case if there are no temporary differences.
- If the entity is using a post-tax discount rate and post-tax cash flows, it will need to consider the reversal of temporary differences (and the timing thereof). The guidance should explain that:
    - If an entity intends to use post-tax discount rates, it will need to ensure the relevant cash flows are also determined on a post-tax basis and reflect the actual post-tax cash flows expected to be received from the assets;
    - Estimating the post-tax cash flows may require detailed scheduling of the reversal of existing temporary differences; and
    - If an entity uses a post-tax discount rate and post-tax cash flows in calculating VIU, the resulting recoverable amount must be compared to the CGU, including any relevant deferred tax balances to assess whether there is an impairment.

Other guidance on application of ViU model

- Guidance is needed on the treatment of other items such as lease liabilities and asset retirement obligations in the ViU model. For example, when to in- or exclude the cash flows and the carrying value of the related assets and liabilities.

Is there a need for two models?

- While noting that the majority of stakeholders either did not comment or supported retaining two different models, moving to one model would remove some of the judgement and could also address the concerns about too much optimism used in performing ViU calculations. The AASB therefore recommend the IASB undertake further research in this regard.

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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?

Allowing reversal of goodwill impairment

- The AASB asked stakeholders in additional outreach for feedback on whether reversal of goodwill impairments could encourage entities to recognise impairments earlier. Limited feedback received indicates that is unlikely to be the case. However, as this was not a matter contemplated in the DP, we recommend the IASB undertake further research in this regard.