

29 December 2020

Hans Hoogervorst  
Chair  
International Accounting Standards Board  
7 Westferry Circus  
Canary Wharf  
London, E14 4HD  
United Kingdom

Dear Mr Hoogervorst,

The Asian-Oceanian Standard-Setters Group (AOSSG) is pleased to provide comments on the International Accounting Standards Board's ('the IASB's') Discussion Paper ('the DP') *Business Combinations—Disclosures, Goodwill and Impairment* (DP/2020/1). In formulating these comments, the views of the constituents within each jurisdiction were sought and considered.

The AOSSG currently has 27 member standard-setters from the Asian-Oceanian region: Australia, Bangladesh, Brunei, Cambodia, China, Dubai, Hong Kong, India, Indonesia, Iraq, Japan, Kazakhstan, Korea, Macao, Malaysia, Mongolia, Nepal, New Zealand, Pakistan, Philippines, Saudi Arabia, Singapore, Sri Lanka, Syria, Thailand, Uzbekistan and Vietnam. To the extent feasible, this submission to the International Accounting Standards Board (IASB) reflects in broad terms the collective views of AOSSG members. Each member standard-setter may also choose to make separate submissions that are consistent or otherwise with aspects of this submission. Therefore, the views from AOSSG members described in Appendix of this submission may be observed in the separate submissions by each member. The intention of the AOSSG is to enhance the input to the IASB from the Asian-Oceanian region and not to prevent the IASB from receiving the variety of views that individual member standard-setters may hold. This submission has been circulated to all AOSSG members for their comment after having been initially developed through the AOSSG Business Groups and Assets Working Group.

The AOSSG appreciates the IASB's initiative in the DP to consider issues identified in a Post-implementation Review (PIR) of IFRS 3 *Business Combinations*. Views of the AOSSG members on major topics are as follows.

**Whether the objective of the goodwill and impairment research project is met**

Almost all AOSSG members did not consider that the package of preliminary views in the DP meet the project's objective to provide investors with more useful information about the acquisitions that companies make at a reasonable cost. One member noted that the high-priority issue identified through the PIR of IFRS 3 was the subsequent accounting for goodwill and disagreed with the DP's objective that did not focus on this issue. Another member stated that the DP tends to concentrate on a disclosure-based solution to the prevailing accounting issues, which that member considers may not fully address the issues surrounding the accounting for goodwill. This member thought that it may be beneficial to explore the fundamental accounting of goodwill more robustly. Another member noted that it was 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.

### **Disclosures on the subsequent performance of acquisitions**

Most AOSSG members disagreed with the IASB's proposal to add new disclosure requirements about the subsequent performance of an acquisition. Instead, some members suggested that the IASB consider whether this information could be more appropriately dealt with in the IASB's project to revise the Management Commentary Practice Statement. In addition, some other members recommended that this issue be discussed with the International Auditing and Assurance Standards Board (IAASB) to ensure the disclosure requirements are sufficiently specific, detailed and auditable. In contrast, one member believes that the proposed disclosures may, to some extent, facilitate investors' understanding and strengthen the basis for the pricing and determination of goodwill.

### **Subsequent accounting for goodwill**

All AOSSG members acknowledged that there was a concern that impairment losses may not be recognised in a timely manner, and most of those members noted the shielding effect as the main reason. Some members specifically stated that goodwill is not tested at the appropriate level of cash generating unit (CGU). AOSSG members held various views on whether to reintroduce amortisation or to retain the impairment-only approach to the subsequent accounting for goodwill. Some members advocated the reintroduction of amortisation. One of those members supported the use of management's reasonable estimate in determining the useful life of goodwill with a cap on it. Another member recommended that the IASB consider a hybrid approach based on the nature of the intangible assets in which an entity would be required to apply a hybrid of annual amortisation and trigger-based impairment test for intangible assets with finite useful lives (including goodwill), while an entity continues to be required to apply an annual quantitative impairment test for intangible assets with indefinite useful lives. This member was also of the view that the estimation of useful life of goodwill and its amortisation pattern should be subject to management's judgement. In addition, another

member that advocated the reintroduction of amortisation stated that amortisation of acquired goodwill was preferable because it better reflected the nature of acquired goodwill and helped ensure that the increasingly large goodwill balances as seen under the current impairment-only model would be allocated to expense on a timely basis. Yet, there was a member that questioned whether amortisation was a faithful representation of the entity's financial performance, stating that goodwill could be viewed as a mixture of different elements. Other members noted that there were mixed views within their jurisdictions, and one of those members expressed its support for retaining the impairment-only model for the time being, but suggested that the IASB reconsider whether to reintroduce amortisation after carrying out a holistic review of IAS 36 and the accounting for intangible assets in general with some urgency.

### **Presentation of total equity excluding goodwill**

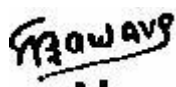
Most AOSSG members did not agree with the IASB's proposal to require companies to present on their balance sheets the amount of total equity excluding goodwill. One member sought further clarification as to whether there was a compelling need for goodwill to be separately identified and disclosed on the face of the statement of financial position. Some members expressed concerns that presenting the amount of equity excluding goodwill could imply that goodwill is not an asset and thus should not be recognised on the balance sheet.

### **Recognition of goodwill and identifiable intangible assets**

Almost all AOSSG members supported the IASB's proposal that it should not develop a proposal to allow some intangible assets to be included in goodwill.

In responding to the DP, AOSSG members have provided their responses to the questions in the DP as described in Appendix of this submission. If you have any questions regarding this submission, please contact either one of us.

Yours sincerely



D.R. S.B. Zaware

AOSSG Chair



Atsushi Kogasaka

AOSSG Business Groups and Assets Working Group

## Appendix

Comments from some jurisdictions in this paper are based on staff's view. Therefore, these comments may not necessarily reflect the views of the official entity in each jurisdiction.

### IASB DP Business Combinations—Disclosures, Goodwill and Impairment

#### Questions for respondents

##### Question 1

Paragraph 1.7 summarises the objective of the Board's research project. Paragraph IN9 summarises the Board's preliminary views. Paragraphs IN50–IN53 explain that these preliminary views are a package and those paragraphs identify some of the links between the individual preliminary views.

The Board has concluded that this package of preliminary views would, if implemented, meet the objective of the project. Companies would be required to provide investors with more useful information about the businesses those companies acquire. The aim is to help investors to assess performance and more effectively hold management to account for its decisions to acquire those businesses. The Board is of the view that the benefits of providing that information would exceed the costs of providing it.

- (a) Do you agree with the Board's conclusion? Why or why not? If not, what package of decisions would you propose and how would that package meet the project's objective?
- (b) Do any of your answers depend on answers to other questions? For example, does your answer on relief from a mandatory quantitative impairment test for goodwill depend on whether the Board reintroduces amortisation of goodwill? Which of your answers depend on other answers and why?

#### AOSSG members' comments on Questions 1

Almost all AOSSG members generally disagree that the IASB's proposal for the package of preliminary views in the DP meet the objectives. However, some members partly agree with the IASB's proposal. Specific comments from each member are described below.

#### [Australia]

Australia does not consider that implementing the package would meet the project's objective to provide investors with more useful information about the acquisitions that companies make at a reasonable cost.

In particular, Australia does not support the requirement 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, but recommend considering whether this information could be more appropriately dealt with in the IASB's project to revise the Management Commentary Practice Statement. Refer to Australia's response to question 2 for further discussion.

Australia has mixed views on whether to retain the impairment-only approach to accounting for goodwill. Some preparers and auditors prefer the amortisation of goodwill to reduce costs and remove some of the judgement associated with the impairment test. Users, on the other hand, generally favour the impairment-only approach as this provides better information about the success of an entity's acquisitions and avoids arbitrary amortisation charges. Refer to Australia's response to question 7 for further discussion.

Further, Australia does not support the IASB's proposal to remove the annual quantitative impairment test requirement, given users' concerns about the loss of information in financial statements and limited cost savings. Refer to Australia's response to question 7 for further discussion.

However, Australia does support the following proposals:

- retaining the existing pro-forma revenue and profit contribution disclosures, but not the introduction of new pro-forma cash-flow disclosures. Refer to Australia's response to question 5 for further discussion;
- removing the restriction on including uncommitted cash flows from future restructurings, improvements or asset enhancements in the value in use (ViU) test, subject to developing robust guidance about when it is appropriate for an entity to include those cash flows. Refer to Australia's response to question 10 for further discussion; and
- allowing the use of either pre- or post-tax cash flows and discount rates in estimating ViU subject to providing implementation guidance about the use of post-tax discount rates in ViU calculations. Refer to Australia's response to question 10 for further discussion.

## **[Japan]**

### **Question (a)**

- Japan disagrees with the conclusion that the package of preliminary views in the DP meet the objectives of the IASB's project if implemented, for the following reasons:

- (a) Japan disagrees with the objective of the project proposed in the DP. The DP states that the overall objective of the IASB's project is “to explore whether companies can, at a reasonable cost, provide investors with more useful information about the acquisitions those companies make” (paragraph 1.7 of the DP). The DP further states that better information “would help investors assess the performance of companies that have made acquisitions” and “would also be expected to help investors more effectively hold management to account for management’s decisions to acquire those businesses.” (ditto) In general, Japan does not object to setting such an objective considering that it is obvious that the IASB should consider the balance between costs and benefits in developing accounting standards. However, the IASB has identified issues to be addressed and their priorities through the PIR and the subsequent deliberations in this project, and the IASB has particularly focused on the issue of whether an entity is recognising expenses arising from goodwill in a sufficient and timely manner (hereinafter referred to as the “too little, too late” issue). Japan observes that the history of this project has not been reflected in the proposed objective and Japan is concerned that, under this objective, the project may proceed without solving the high-priority issue identified through the PIR.
- (b) In addition, regarding the proposed disclosures about the management’s objective and subsequent performance of an acquisition, there is a large disagreement between the views of users of financial statements and the views of preparers of financial statements, and Japan does not think that a feasible set of disclosure requirements is proposed in the DP in terms of the items and the location of disclosure. As Japan expects that a significant amount of effort is needed to consider this proposal, Japan suggests in its response to Question 2 that the IASB discuss this issue in constructive manner to find an acceptable level of disclosures among stakeholders concerned, apart from the efforts to solve the “too little, too late” issue so that the priority of this project is not obscured.
- (c) Furthermore, Japan disagrees with the following two related preliminary views:
- (i) Retaining the impairment-only approach to the subsequent accounting for goodwill
  - (ii) Providing relief from the mandatory annual quantitative impairment test

Japan disagrees with these preliminary views because providing relief from the mandatory annual quantitative impairment test while retaining the existing impairment-only approach to the subsequent accounting for goodwill is inconsistent with the IASB’s efforts in this project to improve the effectiveness of the impairment test. Japan thinks that the IASB should provide relief from the mandatory annual

quantitative impairment test only after the IASB reintroduces the amortisation of goodwill.

**Question (b)**

- Japan acknowledges that some of the preliminary views in the DP are interrelated and one of those examples is providing relief from the mandatory annual quantitative impairment test and the reintroduction of goodwill amortisation, as mentioned in the text of this question. Japan's view on these interrelated preliminary views is given in (c) of the preceding paragraph. Other examples are given in Japan's response to other specific questions.

**[Malaysia]**

Malaysia is supportive of the IASB's preliminary view that it should develop proposals to enhance the disclosure objectives and requirements in IFRS 3 to improve the information provided to investors about an acquisition and its subsequent performance, subject to careful consideration of Malaysia's concerns as set out in the responses to the respective Questions.

However, Malaysia disagrees with the IASB's conclusion in relation to goodwill and propose:

- (i) to reintroduce amortisation of goodwill and perform quantitative impairment test when there is an indication of impairment, as a hybrid solution to address practical issues relating to goodwill; and
- (ii) that the indicator approach for impairment test is preferable to the proposed requirement to perform an annual quantitative impairment test as this could reduce the cost of performing impairment test, provided that the amortisation of goodwill is reintroduced.

Further details on the above are set out in Malaysia's responses to Questions 6, 7 and 9 which are inter-linked.

**[New Zealand]**

- New Zealand acknowledges 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, New Zealand thinks 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 its response to Question 2, New Zealand is 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, New Zealand is concerned that the cost of preparing the proposed disclosures and having them audited would not be reasonable.

- If the IASB decides to proceed with the proposed disclosures New Zealand thinks 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.
- While the DP emphasises the importance of looking at the preliminary views in the DP as a package, New Zealand thinks 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. New Zealand understands that these wider considerations are outside the scope of this project, but New Zealand thinks 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).
- As to whether New Zealand’s answers to the questions in the DP are interlinked, New Zealand notes that a common theme in most of New Zealand’s answers is that New Zealand 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. New Zealand also notes the following interlinked answers:
  - (a) If the IASB introduces the proposed disclosures on the subsequent performance of acquisitions, New Zealand 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) New Zealand 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?

### Question 3

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

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

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

### Question 4

Paragraphs 2.62–2.68 and paragraphs 2.69–2.71 explain the Board’s preliminary view that it should develop proposals:

- to require a company to disclose:
  - a description of the synergies expected from combining the operations of the acquired business with the company’s business;
  - when the synergies are expected to be realised;
  - the estimated amount or range of amounts of the synergies; and
  - the expected cost or range of costs to achieve those synergies; and
- to specify that liabilities arising from financing activities and defined benefit pension liabilities are major classes of liabilities.

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

### Question 5

IFRS 3 Business Combinations requires companies to provide, in the year of acquisition, pro forma information that shows the revenue and profit or loss of the combined business for the current reporting period as though the acquisition date had been at the beginning of the annual reporting period.

Paragraphs 2.82–2.87 explain the Board’s preliminary view that it should retain the requirement for companies to prepare this pro forma information.

- (a) Do you agree with the Board’s preliminary view? Why or why not?
- (b) Should the Board develop guidance for companies on how to prepare the pro forma information? Why or why not? If not, should the Board require companies to disclose how they prepared the pro forma information? Why or why not?

IFRS 3 also requires companies to disclose the revenue and profit or loss of the acquired business after the acquisition date, for each acquisition that occurred during the reporting period.

Paragraphs 2.78–2.81 explain the Board’s preliminary view that it should develop proposals:

- to replace the term ‘profit or loss’ with the term ‘operating profit before acquisition-related transaction and integration costs’ for both the pro forma information and information about the acquired business after the acquisition date. Operating profit or loss would be defined as in the Exposure Draft *General Presentation and Disclosures*.
- to add a requirement that companies should disclose the cash flows from operating activities of the acquired business after the acquisition date, and of the combined business on a pro forma basis for the current reporting period.

- (c) Do you agree with the Board’s preliminary view? Why or why not?

### **AOSSG members’ comments on Question 2 to 5**

Most AOSSG members generally disagree with the IASB’s proposal for new disclosure requirements. However, some members partly agree with the IASB’s proposal. Specific comments from each member are described below.

#### **[Australia]**

##### **Question 2(a)**

Australia received mixed feedback on the usefulness of the proposed disclosures and therefore does not consider that the proposed disclosure requirements would resolve the issue identified in paragraph 2.4 of the Discussion Paper. Some users noted that they already receive sufficient information about the subsequent performance of acquisitions outside the financial statements, for example, in investor presentations and market announcements. Other users indicated concerns about management’s ability to manipulate which metrics are

disclosed in the financial statements and the ability to change the metrics from period-to-period to potentially mask poor performance.

For this reason, users indicated they would be sceptical about the reliability of the proposed disclosures.

### Question 2(b)

Australia does not support the requirement to disclose information about the subsequent performance of acquisitions, including the metrics used by the CODM to monitor these acquisitions in the financial statements. Australia notes that the objective of the financial statements as proposed in the IASB's Exposure Draft ED/2019/7 *General Presentation and Disclosures* is to help ensure that the financial statements provide "relevant information that faithfully represents an entity's assets, liabilities, equity, income and expenses". Australia questions whether the proposed subsequent performance disclosures are required to meet this objective, or whether this information is better addressed by the IASB's project to revise the Management Commentary Practice Statement, seeing that the aim of the management commentary is to provide primary users of financial reports with information that is useful in assessing the management's stewardship of the entity's economic resources.

Australia further notes that no similar information is required for internally developed intangible assets, even though users would have a similar interest in the success, or not, of such projects.

While Australia **does not** support the proposals, if the IASB proceeds with the disclosure proposals, Australia makes the following observations:

- While Australia agrees that the CODM approach is a pragmatic solution, stakeholders have raised concerns that this may result in financial reporting standards driving internal management reporting, as was the case when IFRS 8 *Operating Segments* was issued.
- There was further significant concern about management bias, including management's ability to change the metrics they disclose from period-to-period. While being required to disclose the reasons why the disclosed metrics were changed in the financial statements may mitigate this concern, Australia also suggests explaining in which situations it might be reasonable for the CODM to change the metrics used. Such situations could be, for example, when an entity has undergone a major restructure, or when a metric is related to earnings due to an earnout agreement, at the point the earnout target is either met or missed. This guidance would limit the potential for the CODM to change metrics to mask poor performance.

- Some stakeholders expressed concerns regarding the auditability of the proposed disclosures. Australia suggests that this is discussed with the International Auditing and Assurance Standards Board (IAASB) to ensure the disclosure requirements are sufficiently specific and detailed and auditable.
- While management may have good reasons to change metrics over time, users indicated that the loss of period-to-period consistency of information would be a concern. If this concern is also raised in other submissions, Australia suggests the IASB considers whether an approach similar to the approach in paragraphs 29 and 30 of IFRS 8 may be warranted. This would involve either restating comparative information or disclosing information on both the old and the new basis in the year in which the metrics have been changed.
- Another common concern of a broad range of stakeholders was that it might be difficult to track an acquiree's performance where the acquiree is integrated soon after acquisition. While Australia notes that the Discussion Paper proposes permitting entities to report the CODM metrics on an integrated basis where this occurs, this was not clear to stakeholders. Australia recommends emphasising this aspect of the proposals in any future consultations and outreach events.

### Question 2(c)

While Australia **does not** support the disclosure proposals, if the IASB proceeds, Australia agrees that the CODM approach is a pragmatic solution and that it should not be too onerous to make the disclosures as they are based on information management should already have.

### Question 4

Australia agrees with the IASB's preliminary view to require companies to disclose more comprehensive information about the synergies expected to be realised from an acquisition.

Some stakeholders did, however, express concern about the auditability of the proposed synergy disclosures. Concerns were also expressed that quantifying expected synergies may be difficult and very judgemental and that it may be difficult for auditors to assess whether management's expectations are reasonable.

Australia's understanding is that auditing these disclosures should be possible provided the framework against which the disclosures are to be audited is sufficiently specific and detailed. However, Australia suggests that the IASB discuss the auditability of the proposed disclosures with the IAASB to ensure that this is the case.

### **Question 5(a) and (b)**

Australia is supportive of the IASB's preliminary view to retain the current requirements for companies to prepare and disclose pro-forma information.

Users find the disclosure of pro-forma revenue particularly useful, but some noted that disclosure of pro-forma profit contribution may not always be useful as it can be arbitrary and judgemental. For example, estimating the expenses of the combined business for the period prior to acquisition could be judgemental if it involves estimating cost savings that may be realised through acquisition synergies.

On balance, however, while the pro-forma information currently required by IFRS 3 may be considered to be flawed and incomplete, Australia's view is that it provides a useful baseline for users to judge the future performance of an acquisition and it should therefore be retained.

Guidance about how to prepare the pro-forma information would help improve the quality and consistency of the disclosures and address stakeholders' concerns about possible manipulation. Requiring entities to disclose how the profit and revenue contribution disclosures were calculated may further increase transparency and decrease the scope for manipulation.

### **Question 5(c)**

Australia **does not** support the pro-forma cash flow disclosure proposals.

Feedback from users indicates the pro-forma cash flow information is not likely to be useful as it is quite arbitrary, judgemental and easily manipulated. For example, stakeholder feedback indicated that management may be able to use acquisition adjustments for working capital to reallocate cash flows between operating and investing cash flows when determining the acquiree's cash flow contribution for the period from the date of acquisition (e.g., acquiring a business with high receivables and low payables, which therefore increases cash flows from operations. However, this is paid for through investing cash flows as part of the acquisition deal). This information would, therefore, be considered with scepticism.

### **[Hong Kong]**

#### **Question 2(a) and (b)—Proposed disclosures**

#### **Questions 4 and 5—Other improvements to IFRS 3 disclosures**

##### ***Stakeholders' views***

- Most stakeholders supported the IASB's proposals on improved disclosures. Nonetheless, some practitioners from small and medium firms disagreed with the proposed additional

disclosures as they are seen to significantly increase audit difficulties and complexity. These practitioners considered that the existing disclosures under IFRS 3 *Business Combinations* and IFRS 8 *Operating Segments* provide sufficient information to users, and the disclosure requirements under IFRS 12 *Disclosure of Interests in Other Entities* do not require specific disclosures for material subsidiaries, hence these practitioners questioned why additional disclosures are required for acquisitions (i.e. acquisition of subsidiaries).

- Some stakeholders commented that certain proposed disclosures are quantitative in nature but may not be easily quantified, for example, non-monetary elements of synergies (i.e. management integration) and management or cultural metrics used for monitoring the achievement of acquisition objectives. These proposed disclosures may be practically difficult, particularly for smaller companies, as they often do not perform such a comprehensive analysis before or after acquisitions. A practitioner suggested that the IASB provide more guidance on how to quantify these disclosures, for example, the estimated amount or range of amounts of synergies.
- Some stakeholders commented that the proposed disclosure of the strategic rationale and objectives of an acquisition could be generic and boilerplate, and provide limited useful information to users.
- Practitioners generally expressed their concerns that the proposed new disclosure requirements would result in increased difficulty and complexity for audit because of their qualitative and subjective nature, particularly around the verification of the metrics used by management for monitoring purposes, and the expected synergies. Nonetheless, some of these practitioners considered that they should be able to overcome the majority of these difficulties because much of the information disclosed is likely to be broad and not difficult to reconcile to other supporting information, particularly for listed companies that already prepare circulars for major transactions with similar disclosures.
- Some users expressed concerns that given the proposed metrics disclosures have to be made in the first two years after the acquisition if the acquisition is monitored by the management, disclosing such short-term information may be detrimental to the long-term value of a company. Instead of focusing on narrowly detailed metrics, users often focus broadly on whether the transaction is ultimately successful (this would be reflected in the share price of the company), and whether there will be major issues/risks in that transaction. Hence the proposed metrics disclosures would provide limited useful information.
- Preparers commented that significant cost and effort would be involved for them to comply with the additional disclosures, and this may not justify the benefits of the resulting information. For example, the proposed metrics disclosures may require some preparers to develop further metrics to monitor the performance of the acquiree for disclosure purposes.



It was acknowledged however that this may beneficially encourage some preparers to monitor the performance of the acquiree more robustly, rather than only focusing on goodwill impairment.

- A group of banking industry preparers and a practitioner expressed concern about the proposed requirements to disclose the cash flows from operating activities of an acquired business after the acquisition date, and of the combined business on a pro forma basis for the current reporting period. They considered that there may be challenges to disclose information in the current reporting period on a pro forma basis since the businesses have already been combined and information about the acquired business before the acquisition may not be available. The separate cash flows of the acquired entity may need to be derived from assumptions and estimations and hence may not be sufficiently reliable or useful. There will also likely be significant challenges in auditing such pro forma information.
- This group of banking industry preparers also made the following suggestions to the IASB regarding the pro forma disclosures:
  - provide further guidance to address the difficulties and challenges faced by stakeholders in preparing the pro forma information required as described in paragraphs 2.74-2.75 of the DP in order to better align the practices among companies, in particular how to prepare the pro forma information when the companies are not able to obtain relevant financial information of the acquired business before acquisition;
  - replace the term “profit or loss” with the term “operating profit [or loss] before acquisition-related transaction and integration costs” for the pro forma information; and
  - define “integration costs” as mentioned in paragraph 2.80 of the DP to facilitate consistent application.
- Additionally, this group of banking industry preparers understood the need for the proposed disclosures, but suggested that the IASB allow sufficient flexibility for voluntary disclosures in the initial phase.
- A small group of practitioners from small and medium firms recommended that the IASB consider the related cost and practicability in applying these proposed disclosure requirements to all companies, and suggested that the IASB require such proposed disclosures only for listed companies or material transactions, perhaps through the application of criteria around the size of the transactions.
- Many practitioners, some preparers including a group of banking industry preparers and an academic commented that the IASB should consider whether the proposed disclosures

that may involve forward-looking assumptions (e.g. expected synergies) should be provided in or outside of the financial statements given their nature (i.e. qualitative, not based on historical information and not prepared in accordance with financial reporting framework). Some consider it more appropriate to include them as part of management commentary rather than in the financial statements.

- Example disclosures suggested by some stakeholders for the IASB's consideration include:
  - removing the proposed metrics disclosures and instead providing more flexibility to companies by, e.g. requiring an explanation of the key risks or subsequent events that affect the performance of the acquiree after the acquisition;
  - requiring an explanation of the potential decline in future prospects of the acquiree, and whether unexpected changes may happen in the future;
  - requiring a qualitative and quantitative explanation of the business model/strategic plan to achieve the expected synergies;
  - requiring explanations on how the disclosed information is being calculated, for example, how to calculate the expected synergies from an acquisition and how it is linked to the goodwill balance;
  - requiring disclosures of the basis for valuation of the acquiree (i.e. method and approach adopted, market research and analysis performed), to provide investors with a better understanding of what went into the acquisition price (which by extension can help users better understand the composition of goodwill);
  - requiring disclosures of earn-out and contingency information to facilitate the valuation; and
  - requiring disclosures of the sensitivity analysis of the assumptions used in impairment testing, the headroom related to goodwill (i.e. by how much the recoverable amount exceeds the carrying amount of the cash-generating unit (CGU)), and the profitability of the CGU(s), so as to provide more timely insight to users as to whether there would be potential goodwill impairment losses.

### ***Hong Kong's analysis and recommendation***

- Hong Kong appreciates and generally agrees with the IASB's proposal to have a primary objective to provide investors with better information about acquisitions. However, a majority of Hong Kong's stakeholders have raised concerns about the proposed disclosures, including that they are either too generic in nature (i.e. strategic rationale and objectives of acquisitions) which may lead to boilerplate disclosures and hence not be useful to users;

or are too specific (i.e. metrics used by management to monitor the performance of the acquiree and the amount of expected synergies), to the extent that such information may be considered commercially sensitive or that management may not be able to quantify them on a reasonable basis further giving rise to audit challenges.

- Hong Kong acknowledges the explanation as summarised in paragraphs 2.72-2.86 of the DP why the IASB's preliminary view is to retain the disclosure requirements for pro forma information. However, disclosures of pro forma information have raised significant challenges for preparers and auditors given information before the acquisition date may not be available to the latter. Furthermore, it is not clear whether pro forma information should take into account synergies as well as wider integration benefits and costs that would have been reaped or incurred had the acquisition taken place at the start of the reporting period, and whether preparers could make a reasonable quantification of such amounts and the ability of auditors to audit such amounts.
- Accordingly, Hong Kong recommends that the IASB consider whether the current requirement to disclose pro forma revenue and profit or loss of the combined entity is achieving the disclosure objectives of IFRS 3 as originally envisaged by the IASB, as well as what and how much value they are providing to users of the financial statements, before deciding on their retention and/or introducing additional disclosures on pro forma cash flows from operating activities of the combined entity. If the IASB consider pursuing the proposed pro forma disclosures, the IASB should provide specific guidance for companies about how to prepare such information, and consider the suggestions shared by Hong Kong's stakeholders in the eighth bullet point in *stakeholders' views* above.
- Hong Kong recommends that the IASB set up a working group comprising investors and preparers to enable direct communication between these two groups for them to understand each other's respective needs and the ability to provide information, before reconsidering the nature and extent of the proposed disclosure requirements. Hong Kong also recommends that the IASB consider the examples of additional disclosures as suggested by its stakeholders in *stakeholders' views* above.
- On replacing 'profit or loss' with 'operating profit [or loss] before... integration costs', the term 'operating profit' is not defined in IFRS. The IASB should refer to the project on primary financial statements to ensure consistency in definition or the description of the term. Furthermore, Hong Kong suggests that the IASB define the term 'integration costs' to ensure consistency in application.

## Question 2(c)—Proposed basis for disclosures

### *Stakeholders' views*

- Many stakeholders questioned the DP’s proposed basis for disclosures that makes analogy to the management approach used for segment reporting under IFRS 8.
- According to paragraph 80 of IAS 36 *Impairment of Assets*, goodwill is allocated to a CGU or groups of CGU(s) which represents the lowest level within the company at which the goodwill is monitored for internal management purposes (with that level not being larger than an operating segment). In light of this, some practitioners raised concerns that in situations where goodwill is managed internally at a lower level than the operating segment, such information may not be provided to the chief operating decision maker (CODM) and thus would not be presented in the financial statements.
- In addition, some practitioners commented that the CODM may be able to determine what information will be disclosed in the financial statements through selective reporting practices, and this could increase the challenges for auditing purposes. For example, it is difficult for auditors to assess whether the CODM is a reasonable person to make such a decision as not to monitor a significant acquisition, and thus not to disclose the related information. It is suggested that the IASB provide application guidance on how to perform such an assessment.
- It was observed that investors have generally not been satisfied with the “eyes of management” approach used for disclosures under IFRS 8. The overall quality of disclosures based on such a management approach is unsatisfactory in practice, and it allows significant opportunities for manipulation by management through the creation of internal information specifically to feed into disclosures for external reporting purposes. For example, management may prepare separate internal reporting to effectively hide certain information and avoid disclosure in the financial statements.
- Nonetheless, a few stakeholders who did support the IASB’s proposal considered that the proposed approach is easy for management and is entity/business specific. These stakeholders consider that going beyond the proposed level of disclosures may be costly to perform and lead to excessive disclosures.
- One practitioner from a small and medium firm considered that further information could be disclosed as a supplement, if necessary, if that additional information is relevant to an understanding of the financial statements that is not presented elsewhere as required by paragraph 112 of IAS 1 *Presentation of Financial Statements*.

### ***Hong Kong’s analysis and recommendation***

- Hong Kong acknowledges the IASB’s reasons for using a management approach as the basis for disclosures; nevertheless, Hong Kong shares similar views with its stakeholders

that the overall quality of disclosures based on such an approach is unsatisfactory in practice, and increases the opportunities for management manipulation of information disclosed in the financial statements, potentially leading to insufficient and not useful information. Hong Kong recommends that the IASB consider the pros and cons of using such a management approach before pursuing it.

#### **Question 2(d)—Commercial sensitivities**

#### **Question 2(e)—Constraints on proposed disclosures**

##### ***Stakeholders' views***

##### ***Commercial sensitivities***

- Many stakeholders, particularly preparers, expressed concerns about the sensitivity of the required disclosures, particularly the estimated amount or range of amounts of synergies expected from the acquisitions, and the metrics used by management for monitoring the acquiree's subsequent performance. Some stakeholders commented that useful information is often commercially sensitive, but that sensitivity should not be a valid reason for not making such disclosures. The extent of disclosures should be carefully considered to balance between generic and overly specific/sensitive disclosures.
- A practitioner from a small and medium firm commented that there could be diversity in the interpretation of "commercial sensitivity", and this flexibility could encourage companies to use sensitivity as an excuse not to make the required disclosures. This practitioner suggested that the IASB define "commercial sensitivity" and provide application guidance on how to consider whether information disclosed is commercially sensitive.

##### ***Constraints on proposed disclosures***

- A few practitioners from small and medium firms pointed out that detailed information related to the objectives of the acquisitions along with targets is necessarily forward-looking information, given forward-looking assumptions are used to estimate the future cash flows and quantify the expected synergies arising from the acquisitions. As such, they disagreed with the notion in paragraphs 2.29-2.32 of the DP that such information was not forward-looking.

##### ***Hong Kong's analysis and recommendation***

- Hong Kong understands the concerns shared by some of its stakeholders that the proposed

required disclosures are commercially sensitive and forward-looking in nature, for example, the amounts of expected synergies. Nevertheless, Hong Kong agrees that these are not sufficient constraints for not providing useful information to users. Hong Kong suggests that the IASB consider the extent of disclosures to balance between adequacy and necessity, the sensitivity of the information disclosed, and whether it is more appropriate to include certain of the proposed disclosures as part of management commentary rather than in the financial statements.

### **Question 3—Disclosure objectives**

#### ***Stakeholders' views***

- Stakeholders generally supported the IASB's proposal but considered that incorporating the disclosure objectives may not be sufficient or useful. The following comments were noted:
  - Information disclosed would still be subject to the judgement of the preparers regarding what is relevant information.
  - Although IFRS 15 *Revenue from Contracts with Customers* and IFRS 16 *Leases* have included disclosure objectives, it has been observed that preparers may not look at the objectives carefully and may only provide the disclosures specified in the Standards. Hence, such an approach may not be effective in practice.
- A few practitioners recommended that the IASB consider incorporating specific requirements on how to meet those objectives and to provide meaningful information to users. On the other hand, a practitioner from a large accounting firm suggested that the IASB follow the objective of its *Disclosure Initiative* project, and set disclosure requirements that are principle-based and could be applied appropriately across different industries, rather than requiring disclosures of specific information for all companies.

#### ***Hong Kong's analysis and recommendation***

- Hong Kong is generally supportive of the proposals in the DP and supports its stakeholders' suggestion on incorporating specified disclosures in the Standards. Hong Kong recommends that the IASB provide examples of specific disclosures that would be applicable to most of the companies to meet the disclosure objectives, similar to the requirements specified in paragraphs 52-60 of IFRS 16 on how to meet the disclosure objectives for lessees, so as to provide more meaningful information to users. Hong Kong considers that more specific disclosure objectives and requirements could facilitate

compliance by smaller companies and increase comparability across entities.

## **[Japan]**

### **Question 2**

#### Question (a)

- Japan agrees that the preliminary views are intended to fulfil the information needs of users of financial statements. Paragraph 2.4 of the DP states “investors have said that companies typically do not provide enough information to help investors understand the subsequent performance of an acquisition.” Confirming this statement, users of financial statement in Japan have expressed positive responses to the preliminary views as follows, and Japan observes that they meet the needs of users of financial statements mentioned in paragraph 2.4 of the DP.
  - (a) Users of financial statements have been thinking that the proposed disclosures regarding material business combinations are necessary and the lack of such information has constrained their analyses.
  - (b) The disclosures would provide the basic information that helps users of financial statements assess the value of the entity and would enhance dialogue between users and preparers of financial statements. Such information would help users of financial statements understand the risks of the entity and forecast the entity’s future performance.
  - (c) Users of financial statements need more information about an acquisition for their assessments when compared to information about other investments, because an entity may make extremely large investments in acquisitions or in-depth analyses on goodwill that represents excess earning power may be needed as compared to other investments such as investments in plant and equipment.

#### Questions (b) (i) and (ii)

- Japan disagrees with the preliminary views as is currently described in the DP regarding the disclosure of information about the strategic rationale, management’s objectives for an acquisition as at the acquisition date and whether the acquisition is meeting its objectives. The reasons are as follows:
  - (a) There is a large disagreement among stakeholders and the DP has not proposed a set of disclosure requirements that is acceptable to such stakeholders.

In its outreach to stakeholders in Japan, users of financial statements strongly supported the proposal, as described in preceding paragraph. In contrast, preparers of financial statements are deeply concerned with the disclosure proposals in terms



of the items to be disclosed, the length of the period and the location of disclosure. Thus, Japan acknowledges that there is a large disagreement in the views on the disclosure proposals between users and preparers of financial statements. Moreover, auditors were concerned about the lack regarding the boundary of financial statements and the difficulty in auditing some of the information that would be included in the financial statements, although they acknowledged the information needs of the users of financial statements. Considering this situation, Japan thinks that the DP fails to propose a set of disclosure requirements that are feasible and persuasive to all of these stakeholders.

In this regard, paragraph 2.22 of the DP states following the three concerns regarding the proposed disclosures, which Japan commonly hears from stakeholders in Japan, and Japan's understanding is that (ii) and (iii) of these concerns have not been resolved:

- (i) impossible to provide because the acquired business is being integrated
- (ii) commercially sensitive
- (iii) forward-looking

Regarding (ii), paragraph 2.27 of the DP states that “some investors suggest the information they need to understand the management's objectives and to hold the management to account against those objectives may not need to be as detailed and precise as other stakeholders initially thought.” However, none of the preparers of financial statements were convinced with this statement, which did not specify the level of disclosure that would be required. Preparers of financial statements were particularly concerned that they may suffer from competitive disadvantages because other entities may take advantage of the disclosed information. This may prevent the effects of an acquisition from crystallising and may destroy the value of the entity. Preparers of financial statements were also concerned that users of financial statements may misunderstand that only the disclosed metrics are important. In addition, they indicated that information related to employment is very sensitive to handle because such information may affect employees' morale.

Regarding (iii), concerns with the information on the management's objectives for an acquisition along with detailed targets are related to the issue of the location of disclosure that will be discussed in (c) of this paragraph.

- (b) The focus on the subsequent accounting for goodwill may be obscured.

The DP proposes to adopt an approach that considers costs and benefits of a package of the preliminary views set out in paragraph IN9 of the DP as a whole. There is a

risk that the focus on the subsequent accounting for goodwill that is considered to be of high priority among the issues identified through the PIR may be obscured by giving priority to the proposal to expand disclosure.

- (c) Even if the proposed information were required to be disclosed, the information should not be disclosed in the notes to the financial statements.

Paragraph 2.29 of the DP states the concerns of some stakeholders that, information about the management's objectives for an acquisition along with detailed targets could, in some jurisdictions, be considered to be forward-looking information that could risk litigation and that the information should be provided outside the financial statements. In response to this concern, paragraph 2.30 of the DP states the IASB's view that the information about the strategic rationale, objectives and related targets for an acquisition reflects the management's target at the time of the acquisition and that it is not a forecast of the expected outcome at the time the entity prepares its financial statements. Paragraph 2.32 of the DP further states the IASB's view that entities should be required to disclose such information in the financial statements to ensure that all entities provide the information on the same terms. Japan is not aware of other rationales in the DP for the proposal to disclose the information in the financial statements.

In this regard, Japan does not think that, if an entity were required to disclose the information about the management's objectives for an acquisition along with detailed targets, the entity should disclose the information in the notes to financial statements for the following reasons:

- (i) Because the information relates to an entity's strategy or assessment of performance, the information may go beyond the supplement to the information provided on the face of financial statements.

Paragraph 3.3 (c) of the *Conceptual Framework for Financial Reporting* (hereinafter referred to as the "Conceptual Framework") and paragraph 7 of IAS 1 *Presentation of Financial Statements* explain the items of information that would be disclosed in the notes to the financial statements. Such items include the disaggregations of items presented on the face of financial statements (primary financial statements), information about the nature and risks related to recognised and unrecognised items, information about estimates of the amount presented or disclosed (the methods, assumptions and judgements used, etc.). In addition, paragraph 3.6 of the Conceptual Framework states that "Financial statements do not typically provide other types of forward-looking information, for example, explanatory material about management's expectations and

strategies for the reporting entity.” Accordingly, Japan does not think that the information about an entity’s strategy and assessment of performance directly corresponds to the abovementioned items.

In particular, Japan thinks that the information about the management’s objectives for an acquisition and the detailed targets are of forward-looking nature because the information provides the management’s prospects after the end of the reporting period and it is likely that such prospects include the effects of the events that is beyond the reach of management’s discretion. Although Japan does not necessarily disagree that financial statements may include forward-looking information, such information usually relates to recognised or unrecognised items at the end of the reporting period as mentioned above. Other information related to events after the end of the reporting period is very limited, such as the information about non-adjusting events after the reporting period.

For this reason, Japan thinks that the proposals should have a robust rationale for including the information in the notes to the financial statements. However Japan is not convinced that such clear rationales in terms of the Conceptual Framework and accounting standards are provided in the DP.

- (ii) Items similar to those proposed in the DP are noted in IFRS Practice Statement No. 1 *Management Commentary, A framework for Presentation* for the entire entity. It would be more consistent to disclose the information outside the financial statements if the objective of the disclosure is similar.
- (iii) Paragraph 2.32 of the DP proposes to disclose the information in the notes to financial statements to ensure that all entities provide information on the same terms. Taking into account that there could be useful information to assess the value of the entity inside the financial statements as well as outside the financial statements, the DP has not discussed how to strike a balance between the necessity and the risk of including the information in the notes to the financial statements (such as financial statements could be less understandable, or explanation could be less flexible).
- While Japan acknowledges that improvements to the existing disclosures was one of the issues identified through the PIR, Japan’s understanding is that there are many stakeholders who cannot accept the disclosures as is currently proposed in the DP. As Japan expects that a significant amount of effort is needed to consider this proposal, Japan suggests that the IASB discuss this issue in a constructive manner to find an acceptable level of disclosures among stakeholders concerned, apart from the efforts to solve the “too little, too late” issue so that the priority of this project is not obscured.

- On the other hand, if the information were required to be disclosed, Japan would agree that the information should be based on how management monitors and measures whether the acquisition is meeting its objectives. This is because there are various reasons for entering into acquisitions and various forms of acquisitions, and Japan does not think that specified disclosure items would meet the information needs of users of financial statements.

#### Questions (b) (iii)

- Japan disagrees with the preliminary view. If an acquisition is material to the entity, management would monitor the acquisition to a greater or lesser extent. Japan does not think that the proposed disclosure requirement is necessary if the IASB expects this proposal would deter an entity from not disclosing the information. Paragraph 2.19 of the DP distinguishes between the management's monitoring against the target set at the acquisition date of the acquisition and the management's monitoring against the target as part of the business planning cycle, the latter of which the DP does not consider to be the management's monitoring of the acquisition. However, Japan's understanding is that entities usually change how to monitor their businesses depending on their situation and based on this understanding, Japan thinks that there are many cases where the two ways of monitoring in the DP cannot be clearly distinguished.

#### Questions (b) (iv)

- Japan disagrees with the preliminary view. It is expected that entities continue to monitor their acquired business, although the way they monitor the business may change depending on the situation. Japan is concerned that the disclosures may continue to be provided indefinitely because it is difficult to determine whether management continues or stops monitoring, although the extent to which management focuses on the acquired business may vary over time.

#### Questions (b) (v)

- Japan disagrees with preliminary view. If the disclosures were to be required, setting a specific timeline such as two years may lead to misunderstandings about the relationship between (iv) and (v), that is, it may be perceived that entities could stop the disclosure at the end of second full year after the year of acquisition.

#### Questions (b) (vi)

- Japan disagrees with the preliminary view. Japan's understanding is that management usually changes its metric to assess whether it is meeting its objectives depending on the surrounding environment. Requiring disclosures that implicitly assumes consistency

over time, such as that required for accounting policies, is inconsistent with this understanding of how the business is internally managed.

#### Question (c)

- Japan disagrees with the preliminary view. Although Japan agrees that an entity should identify an acquisition that is material to the entity worth disclosing if the disclosures were to be required, Japan thinks that whether the notion of CODM is helpful to identify such an acquisition would depend largely on the internal management mechanism within the entity. Accordingly, Japan is of the view that each entity should determine whether an acquisition in question is material to the entity worth disclosing.

#### Question (d)

- Japan agrees that concerns about commercial sensitivity may inhibit entities from disclosing the proposed information. Based on Japan's outreach to the stakeholders, they indicated that they may suffer from competitive disadvantages if other competitors take advantage of the disclosed information about financial and non-financial quantitative targets or timelines. Those respondents were concerned that the value of an entity may be destroyed as a result. Other stakeholders are concerned that users of financial statements may misunderstand that only the disclosed metrics are important. Yet other stakeholders indicated that information related to employment, such as the potential reduction in the workforce, is very sensitive because such information may affect employees' morale and the progress of integration.

#### Question (e)

- Japan is not aware of any constraints in its jurisdiction that could directly affect an entity's ability to disclose the proposed information.

### **Question 3**

- Japan's understanding is that the proposed disclosure objectives are primarily related to improving the disclosure of the management's objective for an acquisition and its subsequent performance and the extended disclosure of expected synergies proposed in the DP and that the proposed disclosure objectives are developed to explain the main reasons why users of financial statements need the information that would be required to be disclosed, as mentioned in paragraph 2.56 of the DP. Japan is concerned that the relationship between the objective and the requirements is opposite to what the relationship should be. In other words, the IASB should, in principle, start from the disclosure objectives and then develop accounting requirements that would meet the disclosure objectives or require entities to consider disclosing the information that would

meet the disclosure objectives if there are no specific requirements. However, in this case, the DP proposes disclosure objectives apart from the proposed disclosure requirements.

#### **Question 4**

##### Proposal for extended disclosures regarding synergies

- Japan disagrees with the extended disclosures of expected synergies as currently proposed in the DP. This proposal is closely related to the disclosure of the management's objective for an acquisition and its subsequent performance discussed in Question 2, because achieving synergies is often an important objective of an acquisition. In this regard, users of financial statements support for providing information regarding when the synergies are expected to be realised and the estimated amount of the synergies by extending the existing disclosure requirements, while preparers of financial statements disagree with proposed disclosures stating their concerns that the information is of forward-looking nature and is likely to be commercially sensitive. Accordingly, for the reasons similar to why Japan disagrees with the proposed disclosures of the management's objectives for an acquisition and its subsequent performance, Japan disagrees with the extended disclosures of expected synergies as is currently proposed in the DP.

##### Liability from financing activities and defined benefit pension liabilities

- Japan disagrees with the preliminary view. This is because it is not necessary to always specify that these liabilities would always be major classes of liabilities, and it is sufficient to rely on entity's ability to specify which items are major classes depending on the situation of individual acquisitions.

#### **Question 5**

##### Question (a)

- Japan agrees with the preliminary view. Although Japan acknowledges the view that such pro forma information should not be disclosed in the financial statements, Japan thinks that it is not necessary to remove the existing requirement to disclose such information because stakeholders recognise the usefulness of information and the requirement is currently applied in practice, which Japan thinks proves to be practicable.

##### Question (b)

- Japan disagrees with the preliminary view. Pro forma information is hypothetical information, and whether adjustment is necessary and to what extent the adjustment should be made should depend on the reasonable judgment of the entity.

#### Question (c)

(Proposal to replace profit or loss with a measure based on operating profit or loss)

- Japan disagrees with the preliminary view because Japan does not support the definition of operating profit or loss proposed in the IASB's Exposure Draft *General Presentation and Disclosure* (hereinafter referred to as the "ED").
- Japan acknowledges that there may be some benefits of replacing profit or loss with a measure based on operating profit or loss as noted in paragraph 2.78 of the DP. However, Japan thinks that whether stakeholders can enjoy such benefits would depend on the definition of operating profit or loss. In this regard, the ED proposed to define operating profit or loss as a residual category, but Japan suggested in its comment letter to the ED that operating profit or loss be defined directly as "income and expenses recognised in profit or loss related to activities that an entity identifies as its main operating activities." Japan does not support replacing profit or loss with a measure based on operating profit or loss without characterising operating profit or loss directly in the abovementioned manner.
- As an additional note, paragraph B64 (q) (i) of IFRS 3 requires the disclosure of the amount of profit or loss of the acquiree, and paragraph B64 (q) (ii) of IFRS 3 requires disclosure of the amount of profit or loss of the combined entity. Regarding the adjustment of acquisition-related costs and integration costs when replacing profit or loss with a measure based on operating profit or loss, Japan thinks that the IASB should clarify that it is not necessary to adjust acquisition-related costs in disclosing the information required by paragraph B64(q) (i) of the IFRS 3 because the acquiree would not incur the acquisition-related costs.

(Proposal to disclose cash flow from operating activities)

- Japan disagrees with the preliminary view. Japan does not agree with expanding disclosure of pro forma information from existing requirements, because Japan acknowledges that some hold the view that pro forma information should not be disclosed within the financial statements.

#### **[Korea]**

#### **Disclosure of the subsequent performance**



**(a) Reliability of information vs preparation cost**

Subsequent performance disclosure is highly subjective because estimation and judgment by management are inevitable. For instance, if management selects and targets specific metrics (e.g., target sales growth rate or target operating profit growth rate), it means a significant ‘judgment’ has been involved. Also, after choosing a metric to measure the achievement of the objective, management has to set a target number for the target metric (e.g., CU 100 sales) based on the ‘estimation’ of the future forecast. Moreover, auditors or regulators could challenge the company that the target metric is too high or too low. In the year-end, if management decides to disclose whether the company is likely to meet the objective in the next year, management must make a ‘judgment’ on it yet again.

Korea believes that maintaining the reliability of information is the key to information usefulness, especially for subjective disclosures like this. This could be achieved through high-quality reviews by auditors or regulators. If auditors or regulators do not perform high quality reviews, users might not rely on the information, and consequently, there might not be a benefit in providing such information. On the other hand, however, if reviews are performed in a very strict manner, the cost to respond to the challenges raised by auditors and regulators could be burdensome to companies.

Overall, Korea is not convinced that the benefit of providing subsequent performance disclosure would outweigh the preparation cost.

**(b) CODM approach**

According to the DP’s proposal, even though the subsequent performance information could be material from the perspective of users, the company is not forced to disclose it when the company can’t produce such information because the CODM does not monitor an acquisition. Korea believes that the Board’s intention of this approach is to make a reasonable balance between meeting the needs of users and maintaining appropriate preparation costs for companies.

Instead, the DP proposes that if the CODM does not monitor an acquisition, the company should disclose that fact and explain why it does not do so. Korea disagrees with this disclosure.

Korea believes that the board intended to use this disclosure to fill the gap between the materiality threshold and the CODM approach. However, this could rather cause tensions between the two thresholds. Such disclosure could imply that the internal control is weak. Also, it could unintentionally raise doubts about whether the financial statements are in full compliance with IFRS.

If the CODM approach was chosen considering the balance between meeting the needs of users and maintaining an appropriate level of preparation costs for entities, Korea believes that the CODM's monitoring system should be respected. There is no reasonable ground to require companies to disclose the fact and reason why the CODM does not monitor an acquisition if the board decided to take the CODM's monitoring system. For example, IFRS 8 does not require companies to disclose the fact and explain why when the CODM does not disclose the segment information.

## **[Malaysia]**

### **Response to Question 2(a)–(c)**

Malaysia is of the view that the proposed new disclosure requirements may, to some extent, assist to address investors' need for better information on the subsequent performance of an acquisition. However, Malaysia wishes to highlight the following concerns:

#### **(i) Purpose of the proposed disclosures**

Malaysia notes the objective of the Goodwill and Impairment research project, as set out in paragraph 1.6–1.7 of the Discussion Paper, which focuses on exploring whether companies can, at a reasonable cost, provide investors with more useful information about the acquisitions those companies make.

While this objective may be achieved through the introduction of the proposed disclosures, Malaysia is of the view that the proposed disclosures may be too narrow and inadequate for the purpose of assessing and measuring impairment. As such, users of the financial statements may be unable to arrive at a conclusion as to whether a particular acquisition was successful.

#### **(ii) Interpretation and application of the Chief Operating Decision Maker (CODM)**

Following the IASB's Post-implementation Review of IFRS 8 *Operating Segments* in 2012, the IASB had identified the concept of an identifiable CODM as an area needing improvement. In March 2017, the IASB issued Exposure Draft ED/2017/2 *Improvements to IFRS 8 Operating Segments* which proposed amendments to address, among others, concerns relating to the application of CODM. However, this project was subsequently discontinued by IASB In February 2019.

Taking the above into consideration, Malaysia notes that the concerns raised in its 16 November 2012 response to the IASB Request for Information *Post-implementation Review: IFRS 8 Operating Segments* remain valid. In particular, Malaysia's constituents had expressed difficulties in identifying the CODM.

Given that this Discussion Paper similarly applies the concept of CODM, Malaysia reiterates its recommendations for the IASB to further clarify the definition of CODM to avoid unnecessary confusion and inconsistent application, as well as to require the disclosure of the identity of the CODM in the financial statements.

(iii) Relationship between strategic rationale and objective with subsequent impairment tests

The strategic rationale and objective identified at the time of an acquisition may not necessarily have a linear relationship with the results of the subsequent impairment tests carried out. Hence, while Malaysia appreciates that the disclosure proposals need to be principle-based in nature, they may lead to greater diversity in practice, in particular in relation to the level of detail disclosed.

**Response to Question 2(d)–(e)**

Malaysia agrees that commercial sensitivity is not a valid justification for non-disclosure of information about management's (CODM's) objectives for an acquisition and the metrics used to monitor whether those objectives are being met. In addition, Malaysia believes that the proposed disclosures would be useful to investors as they would facilitate investors' understanding as well as strengthen the basis for the pricing and determination of goodwill.

However, Malaysia is of the view that:

(i) more clarity is needed on the extent of disclosures to be made.

While Malaysia supports the development of proposed disclosure requirements applying the principle-based approach, Malaysia cautions that these may also inadvertently encourage the use of generic (boilerplate) disclosures which may be of limited or no value to investors.

(ii) the example of a qualitative statement being information disclosed which does not constitute forward-looking information, as provided in paragraph 2.31 of the Discussion Paper, is too generic.

Malaysia proposes instead for the IASB to provide specific examples to guide and assist preparers in differentiating disclosures on targets from forward-looking information as these two categories are not significantly different.

(iii) the disclosure of information setting out management's (CODM's) objectives for the acquisition and the metrics used to monitor progress in meeting those objectives at the time of the acquisition in the financial statements would provide minimal strategic advantage and hence would be less likely to be commercially sensitive.

Having considered the above, Malaysia recommends that the IASB carefully considers whether the proposed disclosures would be most appropriately placed within the financial statements or outside of the financial statements.

In the event if the IASB still maintains its preliminary view that such proposed disclosures should be part of the financial statements despite the concerns expressed by some stakeholders could risk litigation as elaborated in paragraph 2.29 of the Discussion Paper, Malaysia suggests that more clarity and explanation be provided, including sufficient guidance on areas of quantitative and qualitative disclosures, quantification approach and extent of disclosures.

In addition, in Malaysia, shareholders and analysts alike would have had access to information about an acquisition prior to it being carried out. In particular, it is common for Malaysian public listed companies to conduct briefing sessions for selected shareholders and analysts where such information would be shared ahead of the acquisition.

Specifically, relevant local jurisdictional requirements include:

- (i) section 223(2) of the *Companies Act 2016*, which requires approval to be procured from a company's shareholders before proceeding with the acquisition of an undertaking or property of a substantial value. Where the company intending to carry out the acquisition is an unlisted subsidiary of a listed holding company, approval must also be procured from the listed holding company's shareholders.
- (ii) paragraph 9.08(2) of the Bursa Malaysia Main Market Listing Requirements<sup>1</sup>, which states that a listed issuer must ensure that no disclosure of material information is made on an individual or selective basis to analysts, shareholders, journalists or other persons unless such information has previously been fully disclosed and disseminated to the public. If material information is inadvertently disclosed at any meetings with analysts, shareholders, journalists or others, it must be publicly disseminated as promptly as possible.
- (iii) chapter 10 of the Bursa Malaysia Main Market Listing Requirements, which sets out the requirement for a listed issuer to include additional specific information in relation to very substantial transactions in its announcement of the transaction to Bursa Malaysia and the circular issued to its shareholders. Such information includes, among others, the financial effects before and after the completion of the transaction (e.g. acquisition).

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<sup>1</sup> Public listed companies in Malaysia have a choice of three markets for listing – Main Market, ACE Market and LEAP Market – and are required to comply with the respective sets of listing requirements. For the purpose of this response, reference is made to the Bursa Malaysia Main Market Listing Requirements. Further information on these is available at <https://www.bursamalaysia.com>.

The above disclosures would be subject to paragraph 9.12(1) of the Bursa Malaysia Main Market Listing Requirements which requires a listed issuer to refrain from any form of promotional disclosure activity which may mislead investors or cause unwarranted price movement and activity in a listed issuer's securities.

### **Response to Question 3**

Subject to the concerns highlighted in Malaysia's response to Question 2 in relation to the concept of CODM, Malaysia agrees with the IASB's preliminary view that it should develop, in addition to proposed new disclosure requirements, proposals to add disclosure objectives.

Paragraph 2.58 of the Discussion Paper has indicated that these disclosures are intended to allow investors to assess performance and more effectively hold management to account for its decision to acquire the business, including whether management has paid a reasonable price for the acquired business.

However, Malaysia is mindful that situations could arise where the acquired business itself is not performing well, but the acquisition has contributed towards the rest of the group's business, e.g. where the acquisition of a loss-making competitor results in an increase in market share. Such situations may not have been in line with the original objectives of the acquisition, and could be challenging to quantify.

### **Response to Question 4**

Malaysia generally agrees with the IASB's preliminary view set out in paragraphs 2.62–2.71 of the Discussion Paper, subject to careful consideration of the following:

- (i) whether the IASB could provide more clarity in relation to disclosure on synergies, as opposed to forward-looking information.

Paragraph 2.67 of the Discussion Paper acknowledges that information on expected synergies could also be considered to be forward-looking in some jurisdictions. This appears to contradict paragraphs 2.29–2.32 of the Discussion Paper whereby the IASB considers that information reflecting management's targets at the time of acquisition would not be forward-looking information.

- (ii) how synergies could be reliably quantified for disclosure, particularly in view that many acquisitions do not achieve the synergies expected, often due to human factors, etc.

- (iii) potential litigative and/or regulatory implications on the company and its auditors should the company fail to meet the targets/synergies specified at the time of the acquisition, notwithstanding that other ‘updated’ targets/synergies had been identified.

#### **Response to Question 5(a)–(b)**

Malaysia agrees with the IASB’s preliminary view to retain the requirement for companies to prepare, 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.

In addition, Malaysia is of the view that the following examples of disclosures as set out in paragraph 2.83 of the Discussion Paper, while not sufficient on their own to help investors assess the potential full-year contribution of the acquired business, may be helpful to supplement disclosures insofar as they provide relevant and useful information to investors:

- (i) information about how seasonality affects the financial performance and cash flows of the acquired business;
- (ii) the unadjusted revenue, operating profit and cash flows from operating activities from the most recent annual financial statements of the acquired business; or
- (iii) the amounts of the material one-off items.

The above is in line with Malaysian local jurisdictional requirements whereby the public listed company would have to issue a public announcement to disclose the full effect of a significant acquisition on it (paragraph 11 of Appendix 10A to the Bursa Malaysia Main Market Listing Requirements).

#### **Response to Question 5(c)**

Malaysia agrees with the IASB’s preliminary view to replace the term ‘profit or loss’, subject to:

- (i) alignment with the term used in the final Standard upon finalisation of Exposure Draft ED/2019/7 *General Presentation and Disclosures*, currently identified as ‘operating profit’, and
- (ii) clear definition of the term ‘integration costs’ which the IASB has acknowledged in paragraph 2.80 of the Discussion Paper as yet to be discussed.

Malaysia is also agreeable to the proposal on disclosure of 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 insofar that the disclosures are not tantamount to providing a statement of cash flows.

With regard to the two options being considered by the IASB in paragraph 2.87 of the Discussion Paper, Malaysia believes that requiring companies to disclose how they have prepared the pro forma information would be more in line with the principle-based nature of the IFRS Standards.

## **[New Zealand]**

### ***Response to Question 2:***

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

- New Zealand does not support requiring the disclosures listed in Question 2(b) in the financial statements. New Zealand acknowledges 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, New Zealand is not sure to what extent these disclosures would affect investors' decision making, and New Zealand is 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

- New Zealand is 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.

- 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.
- 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

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

- New Zealand thinks 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

- New Zealand appreciates 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, New Zealand thinks 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).
- New Zealand thinks that the proposed disclosures could give rise to the following costs.
  - (a) Preparation costs: New Zealand has 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, New Zealand has 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

- 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.
- 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 New Zealand’s comment about recommending that the IASB perform a holistic review of the accounting requirements for intangible assets, including those that are not currently recognised<sup>2</sup>
- 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 New Zealand understands 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.

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<sup>2</sup> Refer to New Zealand’s response to Question 14.

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

- If the IASB is inclined to proceed with proposing the disclosures included in the DP, New Zealand thinks 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.
- If, after considering the above, the IASB decides to propose requiring the disclosures in the DP, New Zealand thinks 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 New Zealand 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.
- As New Zealand does not support requiring the proposed disclosures on the subsequent performance of acquisitions in the financial statements, New Zealand has not answered Question 2(c)–(f) of the DP.

### ***Response to Question 3:***

- New Zealand supports the IASB’s proposal to update the disclosure objectives in IFRS 3 to specifically refer to providing information on benefits expected from an acquisition. New Zealand notes 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.
- Regarding the proposed specific disclosure objective to provide information on the extent to which acquisitions are meeting management’s objectives: As noted in New Zealand’s response to Question 2 above, New Zealand does not support requiring the proposed disclosures on the subsequent performance of acquisitions in the financial statements.

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

#### ***Proposed disclosures about synergies***

- New Zealand does not agree with the IASB’s proposal to require the specific disclosures on expected synergies from acquisitions as proposed in the DP.
- New Zealand acknowledges 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, New Zealand is not convinced that the benefits of providing these disclosures would exceed the costs and risks explained below.

- (a) Accuracy and completeness: New Zealand thinks there could be issues around the accuracy and completeness of the underlying information that will be used to prepare the proposed disclosures on synergies. New Zealand is 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: New Zealand 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. New Zealand is 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: New Zealand is 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.
- If the IASB proceeds with proposing the disclosures on synergies as described in the DP, New Zealand thinks 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*

- New Zealand notes 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.
- 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.
- For these reasons, New Zealand does 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.
- New Zealand also notes 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.

***Response to Question 5:***

- In the context of its disagreement with including the proposed disclosures on the subsequent performance of acquisitions in the financial statements (see Question 2 above), New Zealand agrees 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. New Zealand also agrees that the IASB should develop guidance on how to calculate the abovementioned pro-forma



information, as New Zealand is aware that it is often difficult for preparers to provide this information. However, New Zealand would prefer not to require the proposed additional disclosures on operating cash flows.

- If the IASB introduces the proposed disclosures on the subsequent performance of acquisitions that are monitored by the CODM, then New Zealand recommends retaining the existing disclosures on the acquiree's pro-forma and actual contribution to the group 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.
- Regarding the proposal to use term 'operating profit before acquisition-related transaction and integration costs' instead of 'profit or loss': New Zealand notes 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.

#### [Saudi Arabia]

Saudi Arabia supported in general the additional disclosure and would like to extend it to the fully integrated acquisitions. Such additional disclosure requirements may be made in the note or by cross reference to other documents such as management commentary.

#### 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.

- 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?
- 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?
- Paragraph 3.20 discusses two reasons for the concerns that impairment losses on goodwill are not recognised on a timely basis: estimates that are too optimistic; and

shielding. In your view, are these the main reasons for those concerns? Are there other main reasons for those concerns?

- (d) Should the Board consider any other aspects of IAS 36 in this project as a result of concerns raised in the Post-implementation Review (PIR) of IFRS 3?

### Question 7

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

- (a) Do you agree that the Board should not reintroduce amortisation of goodwill? Why or why not? (If the Board were to reintroduce amortisation, companies would still need to test whether goodwill is impaired.)
- (b) Has your view on amortisation of goodwill changed since 2004? What new evidence or arguments have emerged since 2004 to make you change your view, or to confirm the view you already had?
- (c) Would reintroducing amortisation resolve the main reasons for the concerns that companies do not recognise impairment losses on goodwill on a timely basis (see Question 6(c))? Why or why not?
- (d) Do you view acquired goodwill as distinct from goodwill subsequently generated internally in the same cash-generating units? Why or why not?
- (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?

### AOSSG members’ comments on Question 6 to 7

All AOSSG members acknowledge that there is a concern that impairment losses may not be recognised in a timely manner, and most of those members note the shielding effect as the main reason. Some members specifically state that goodwill is not tested at the appropriate level of cash generating unit (CGU). AOSSG members hold various views on whether to reintroduce amortisation or to retain the impairment-only approach to the subsequent accounting for goodwill. Some members advocates the reintroduction of amortisation. One of those members supports the use of management’s reasonable estimate in determining the useful life of goodwill with a cap on it. Another member recommends that the IASB consider

a hybrid approach based on the nature of the intangible assets in which an entity will be required to apply a hybrid of annual amortisation and trigger-based impairment test for intangible assets with finite useful lives (including goodwill), while an entity continues to be required to apply an annual quantitative impairment test for intangible assets with indefinite useful lives. This member is also of the view that the estimation of useful life of goodwill and its amortisation pattern should be subject to management's judgement. In addition, another member that advocates the reintroduction of amortisation states that amortisation of acquired goodwill is preferable because it better reflects the nature of acquired goodwill and helps ensure that the increasingly large goodwill balances as seen under the current impairment-only model will be allocated to expense on a timely basis. Yet, there is a member that questions whether amortisation is a faithful representation of the entity's financial performance, stating that goodwill could be viewed as a mixture of different elements. Other members note that there are mixed views within their jurisdictions, and one of those members expresses its support for retaining the impairment-only model for the time being, but suggests that the IASB reconsider whether to reintroduce amortisation after carrying out a holistic review of IAS 36 and the accounting for intangible assets in general with some urgency.

#### **[Australia]**

##### **Question 6(c)**

Feedback obtained from outreach activities echoed the PIR feedback that the market typically recognises impairment losses before they are recognised in financial statements. However, this is because financial statements are only lodged periodically whereas market announcements are made more frequently and would alert users to potential impairments before the financial statements are issued.

Australia's main concern with the current impairment model is that goodwill is not always tested at the appropriate level which increases the shielding effect. This is because goodwill is potentially allocated to larger CGUs/groups of CGUs than would be required if the principles in IAS 36 were appropriately applied.

Australia recommends the IASB considers explaining what is meant by the reference to 'the lowest level within the entity at which goodwill is monitored for internal management purposes' and in particular confirming that this does not refer to monitoring by the CODM, but could be at a lower level.

As this does not involve changes to the application of the impairment test as such, Australia considers that this could be addressed as part of this project, or via a separate short-term improvements project.

**Question 6(d)**

In addition to the concern about the allocation of goodwill to CGUs identified in Australia's response to question 6(c), Australia also noted difficulties in understanding and applying the ViU model in IAS 36, including determining when to in-or exclude cash flows and the related assets and liabilities for items such as lease liabilities and asset retirement obligations.

To address this, Australia suggests the IASB develop a template or illustrative examples to assist entities in understanding and applying the principles of the ViU model in IAS 36.

**Question 7(a)**

Australia has mixed views on whether to retain the impairment-only approach to accounting for goodwill. Feedback from stakeholders was also mixed.

While no new arguments were put forward, Australia noted that, some preparers and auditors prefer the amortisation of goodwill to reduce costs and remove some of the judgement associated with the impairment test. Some stakeholders were of the view that the economic benefits of an acquisition are usually expected to be finite, i.e. that goodwill is a wasting asset. Amortisation would provide users with additional information about the timeframe of the expected realisation of the benefits of the acquisition and reduce the effect of shielding.

Feedback from preparers also noted that it can be costly and practically challenging to verify impairment assumptions for goodwill that has been acquired many years ago, in particular if the business model/strategy has changed during this period.

Users, on the other hand, generally favoured the impairment-only approach as this provides better information about the success of an entity's acquisitions. In their view, even if impairment losses are only confirmatory because the market has already recognised the loss before it is reported in the periodic financial statements, impairments still provide useful information, particularly in the first few periods after an acquisition when the outcomes of the acquisition (i.e., its success or failure) are most interesting to users.

Proponents of the impairment-only model disagreed that goodwill is a wasting asset and noted the difficulties in reliably estimating the useful life of goodwill and how it is consumed, which will result in arbitrary amortisation charges over arbitrary periods of time. This is unlikely to provide useful information to users.

However, as an impairment test would be required under both the impairment-only and amortisation approaches to accounting for goodwill, Australia recommends that the IASB considers the improvements proposed in Australia's response to questions 6(c) and 6(d)

regardless of whether the IASB reintroduces amortisation or retains the impairment-only model.

### **Question 7(e)**

Feedback from users suggests that they would add back amortisation in the same way as they add back impairment losses, as both are non-cash items. Australia would therefore expect management to do the same when reporting to investors.

### **[Hong Kong]**

#### **Question 6—Effectiveness of impairment test**

##### ***Stakeholders' views***

- Some stakeholders suggested that the current impairment-only model is generally effective. Those who took this view generally considered that in cases where the model has failed to perform well, improvements would likely come through more robust application and control.
- A stakeholder commented that the IASB should consider further what the impairment test is fundamentally testing, given that the model does not test goodwill directly. This stakeholder suggested that if the impairment model only ever tests a CGU(s), the underlying issues about impairment of goodwill may not be resolved.

##### ***Hong Kong's analysis and recommendation***

- Hong Kong supports an amortisation plus impairment approach, which it expands on in its comments to the DP's Question 7.
- The DP notes the IASB identified two broad reasons for the concerns that impairment losses are not recognised on a timely basis, including management over-optimism and the impairment shield. Hong Kong agrees that these two reasons are relevant; in particular, Hong Kong thinks the impairment shield issue is significant.
- Hong Kong would however posit that in addition to management over-optimism, an issue more broadly is the combination of the ability for management to exercise significant judgement over the model and the incentives that exist to avoid impairment. As discussed in Hong Kong's RP, Hong Kong consider that the impairment-only regime may contribute to various incentives for delaying impairment (e.g. to maximize financial reporting metrics).

- An example of the judgement referred to above would be the ability for management to allocate goodwill to a sufficiently large CGU such that a decline in value is shielded by the broader CGU. If the IASB elects to retain an impairment-only model, Hong Kong would suggest that areas such as this be scrutinized for potential improvements. A key potential improvement would be with regard to determining whether the requirements around allocating goodwill to CGUs can be refined to prevent cases of management shielding operations within overly large CGUs, which Hong Kong considers a relevant issue of the existing requirements.

## **Question 7—Amortisation of goodwill**

### ***Stakeholders' views***

- Overall, Hong Kong's stakeholders' views on the accounting for goodwill have been mixed, with a small majority favouring amortisation.
- Among stakeholders more supportive of amortisation, key messages include:
  - The DP is heavily focused on a disclosure-based solution, and appears to relegate the accounting of goodwill to be a secondary issue. The IASB should firstly consider the fundamental nature of goodwill and address the conceptual accounting issues. Additionally, some considered that the DP attempts to preemptively discard a variety of historical arguments about goodwill. However, quality of argument should matter over novelty, and some of the “well-known” arguments are worth considering in more detail.
  - Goodwill does become less representative of the underlying entity over time. This is because goodwill is “static” and it only represents a snapshot of acquired/external goodwill as of a historical acquisition date. Overtime, what goodwill is ostensibly supposed to represent is commingled with (non-recognised) internally generated goodwill. Amortisation better reflects this fact.
  - Acquired goodwill is wasting because it is static. There will inevitably be churn. Furthermore, the argument that goodwill is not wasting on the basis that the value or going-concern element of an entity is valued and projected into perpetuity is inappropriate because that argument is not looking at acquired goodwill, but rather is looking at overall economic goodwill.
  - There is a significant bias in financial reporting between acquisitive and organic growth. Current goodwill accounting exacerbates this issue and contributes to

skewing management incentives.

- Amortisation of goodwill can better reflect the consumption of an acquisition. When an entity is acquired, the goodwill amount in part reflects expectations for future cash flows. When those cash flows are realised, it is logical to recognise a corresponding expense through goodwill amortisation to reflect the consumption. This also addresses the double counting issue that arises if this expense is not taken (double counting cash flows first as acquired goodwill, then as income if expectations are realised and the value of an acquisition is monetised).
- Many of the issues that arise with goodwill accounting do so as a result of the recognition of acquired (external) goodwill and non-recognition of internally generated goodwill. Theoretically, there are three possible ways to resolve these issues:
  - Do not recognise external goodwill as an asset.
  - Recognise external goodwill as an asset and apply amortisation.
  - Move to a full revaluation model including external and internal goodwill.
- It is operationally and practically easier to amortise goodwill. Hence in the absence of rationale otherwise, it is better to amortise than to have impairment-only. A significant amount of time and resources are devoted to the goodwill impairment process, the amount of which may be disproportionate to the value that it provides to users of financial statements.
- The impairment test is highly subjective and allows management ample opportunity to delay impairment.
- Among stakeholders more supportive of impairment, key messages include:
  - The impairment model may not be perfect for investors, but it does at least provide confirmatory information in the form of impairment expense, and allows users to monitor the goodwill balance over time. Amortisation does not provide useful information, and results in the goodwill balance disappearing over time.
  - Some members of the valuation community argue generally that goodwill is a non-wasting asset on the basis that valuations are done on a terminal value basis that assumes perpetual cash flows.
    - However, this argument was disputed by some of Hong Kong's stakeholders on the basis that it is assessing the wrong type of goodwill. The argument assesses total or economic goodwill, whereas what is recognised under IFRS 3 is external goodwill, the latter being a static accounting concept.



- The impairment model can be and is still effective when implemented properly, and most entities in Hong Kong do robustly implement the test. Instances of “too little too late” are an implementation issue. Additionally, it may not necessarily be a problem that goodwill balances are increasing globally, as this may simply reflect increased acquisition activity.
- An amortisation charge would be inappropriate in the event that an acquisition has not failed or otherwise destroyed value.
- Amortisation could hide impairment and fail to hold management to account for acquisitions, because as the carrying amount of goodwill is amortised the amount which would be compared against the recoverable value shrinks.

### ***Hong Kong’s analysis and recommendation***

- In March 2020, Hong Kong, with Japan, published a joint Research Paper (RP) *Improvements to Subsequent Accounting and an Update of the Quantitative Study*. The RP presents the joint view of the staff involved that goodwill should be amortised, and that the CGU(s) to which goodwill is attributed should be tested for impairment when there is an indication of impairment (an amortisation plus impairment approach). Hong Kong recommends that the IASB refer to the RP in full as an integral part of Hong Kong’s comments on the DP.<sup>3</sup>
- Hong Kong observes that the DP in general concentrates on disclosures and improvements to the existing framework. Ideally, Hong Kong would suggest the IASB to consider a more fundamental review of the accounting for goodwill, including the initial recognition of acquired goodwill, the status of goodwill as an asset, and the relationship between acquired goodwill and internally generated goodwill. Hong Kong echoes a comment noted from one of its stakeholders above that many of the issues with goodwill arise from the recognition of acquired goodwill and non-recognition of internally generated goodwill.
- Hong Kong nevertheless appreciates that this would be a broad undertaking and potentially beyond the project’s scope. As such, and as Hong Kong does in the RP, Hong Kong focuses its comments on the accounting for acquired goodwill under the existing recognition framework.

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<sup>3</sup> [https://www.hkicpa.org.hk/-/media/HKICPA-Website/New-HKICPA/Standards-and-regulation/SSD/07\\_Major-projects/goodwill/rp\\_goodwill20.pdf](https://www.hkicpa.org.hk/-/media/HKICPA-Website/New-HKICPA/Standards-and-regulation/SSD/07_Major-projects/goodwill/rp_goodwill20.pdf)

*Question 7(a)(b)(c) – reintroducing amortisation*

- Hong Kong takes the view that amortisation plus impairment is preferable to an impairment-only approach.
- In Part 3B of the RP, Hong Kong analyses the nature of goodwill and compare acquired goodwill with economic goodwill. Hong Kong then argues how amortisation is a preferable approach to subsequent measurement as it better reflects the nature of goodwill and addresses the issue of increasingly large goodwill balances as seen under the current impairment-only model.
- The RP defines the concept of “economic goodwill” as the difference between the fair value of an entity and its identifiable net assets recognised under prevailing accounting standards. As such, Hong Kong notes that goodwill is only an amount that is used to represent the divergence between what can be recognised and measured for financial reporting purposes and what cannot.
- The relationship between economic goodwill and acquired goodwill is that the latter is a point-in-time snapshot of an acquiree’s economic goodwill as of the acquisition date. As a snapshot, acquired goodwill is a distinct and static concept. This is in contrast to economic goodwill, which is dynamic, as its amount would vary as the fair value or recognised identifiable net assets of an entity changes from time to time.
- Key points as to why amortisation of acquired goodwill is preferable include:
  - Amortisation better reflects the nature of acquired goodwill, in particular:
    - It better reflects the fact that acquired goodwill becomes increasingly less representative of the acquiree and of the overall consolidated entity.
    - It provides a better opportunity to show how an acquisition is utilised.
    - It improves comparability between entities that grow organically and through acquisitions.
  - Amortisation helps ensure that the increasingly large goodwill balances as seen under the current impairment-only model will be allocated to expense on a timely basis.
- Details of these points are presented in Part 3B of Hong Kong’s RP. Rather than reproduce them here, Hong Kong recommend that the IASB review the RP in full.

*Question 7(d) – acquired goodwill as distinct from internally generated goodwill*

- The DP asks whether respondents view acquired goodwill as distinct from subsequent

internally generated goodwill. As noted in Part 3B of the RP, Hong Kong thinks that acquired goodwill is a distinct unit of account and independent from other forms of goodwill. This is because only acquired goodwill is permitted to be recognised as an asset, and the distinction is a key reason why many issues with goodwill accounting arise (e.g. the impairment shield, lack of comparability between types of growth, and a static acquired goodwill figure). Although acquired goodwill can be shielded by subsequent internally generated goodwill, it cannot be remeasured from its original amount.

- Hong Kong observes that this question may be relevant to arguments which posit that goodwill is a non-wasting asset because valuations are done on a basis that reflects a perpetual growth assumption of cash flows. Hong Kong agrees with its stakeholder feedback noted above that this argument is inappropriate because it is not looking at acquired goodwill, but rather at overall economic goodwill.
- Acquired goodwill is always a residual amount. It cannot be directly measured or directly valued because it is only a difference between an entity's fair value and identifiable net assets recognised under accounting standards at a point in time. In this sense, acquired goodwill is not an item subject to valuation, unlike the entity as a whole. Goodwill is simply a residual amount due to the inability of accounting standards to fully identify, recognise and measure every component that makes up the fair value of an entity. It can be further said that goodwill is only a part of an asset (that asset being the entity as a whole) rather than a stand-alone asset itself.
- An argument that acquired goodwill is not wasting because an entity is valued under a perpetual growth assumption, in Hong Kong's view, inappropriately conflates acquired goodwill and economic goodwill, and hence ignores that what is recognised in the financial statements (acquired goodwill) is a static amount representing a historical snapshot of economic goodwill.

*Question 7(e) – adjustment of performance measures under amortisation or impairment*

- With regard to this question, Hong Kong believes it is important to keep in mind that acquired goodwill is not an effective item for assessing an acquisition's performance or the success of an acquisition. The DP notes this in a number of instances. When assessing the subsequent accounting of goodwill, Hong Kong would recommend that the IASB focus on the nature of acquired goodwill and its position within the accounting framework.

*Question 7(f) – amortisation period and pattern*

- Hong Kong discusses its views on the amortisation period and method in Part 4B of the RP. The HKICPA considers that the amortisation period can be determined in terms of the expected utilisation of an acquisition. This could be informed by factors such as management's expected integration and monetisation of the acquisition (e.g. acquisition plan and timeframe of expected financial results).
- Much of the information that the DP proposes as disclosures can be used to inform the determination of an amortisation period. For example, the metrics that management uses to monitor the objectives of an acquisition, combined with information about the extent to which those metrics are being met, can be key inputs for determining the expected utilisation/monetisation period of an acquisition. Hong Kong considers this strengthens the case for amortisation approach, as (1) information that the DP proposes as useful will be represented through the amortisation mechanism (e.g. information about objectives for an acquisition and the timeframe in which those are met), and (2) management will be able to access the requisite information at little additional cost.
- Hong Kong does not think that there should be a mandatory floor or ceiling for the amortisation period, as that may fail to reflect an entity's particular situation, industry and economic environment. Hong Kong nevertheless would support a rebuttable presumption that the amortisation period should not exceed a specified number of years.
- With regard to the amortisation pattern, Hong Kong similarly thinks that entities should be required to apply judgement to determine what pattern is expected to best reflect the expected utilisation of an acquisition. Hong Kong thinks that entities should leverage on the information used to determine the amortisation period when determining the amortisation method. Consistent assumptions and judgements should be applied for both the amortisation period and method. Hong Kong thinks that the residual value of goodwill should be zero for amortisation purposes.
- Hong Kong does not believe that determining an amortisation approach for goodwill is overly difficult, judgemental or arbitrary. Hong Kong's RP suggests a principle-based approach to amortisation can be used to determine both the amortisation period and method using reasonably available information. Hong Kong thinks that some arguments that amortisation can only be arbitrary go back to a fundamentally different understanding of what acquired goodwill represents as compared to economic goodwill. As noted above, Hong Kong thinks that acquired goodwill needs to be considered distinctly from other forms of goodwill.

**[Japan]**

## Question 6

### Question (a)

- Japan agrees that it is not feasible to design an impairment test that is significantly more effective in terms of timely recognition of impairment losses on goodwill at a reasonable cost. Japan agrees that it is difficult to improve the impairment test considering the history of the discussion in the project explained in paragraphs 3.31 to 3.52 of the DP. That is, the DP discusses the approach which incorporates the estimate of headroom into the design of the impairment test ('headroom approach'), but this approach has a significant application problem, which seems difficult to be solved. Accordingly, Japan thinks that it is difficult to improve an impairment test so that the test would be operational at a reasonable cost and would result in timely recognition of expense arising from goodwill.

### Question (b)

- Not applicable.

### Question (c)

- Japan thinks that the shielding effect is the main reason for the late recognition of impairment losses of goodwill. This is because the increase in the balance of goodwill in the statement of financial position has been observed steadily increasing from a historical perspective, and accordingly, the accounting mechanism that creates the shielding effect seems to be the largest contributor to this phenomenon. Other potential contributors, such as estimation uncertainties in the measurement of value in use or fair value less costs of disposal or the possibility that the cash generating unit to which goodwill is attributed at acquisition is larger than necessary, may contribute to some extent but Japan does not think they are the main contributors.

### Question (d)

- No comment.

## Question 7

### Question (a)

- Japan disagrees with the preliminary view the amortisation of goodwill should not be reintroduced. While Japan will explain its reasons with "new evidence" later in Japan's response to Question 7(b), the particular reason related to Japan's response to Question 6 is that, if the existing impairment-only approach is retained, the shielding effect would not be addressed under this approach. The shielding effect results in expenses arising

from goodwill being recognised too little as well as too late. As noted in Japan's response to Question 6(a) of this Appendix of the comment letter, the IASB has attempted to improve the effectiveness of impairment tests but it turned out to be difficult to achieve the improvement at a reasonable cost. Accordingly, Japan thinks that the only way to solve the "too little, too late" issue is to reintroduce the amortisation of goodwill.

#### Question (b)

- Japan's view has not changed since before 2004, and Japan believes that goodwill should be amortised and be tested for impairment.

(Rationale before 2004, with some evidence after 2004)

- The main rationale for Japan's view in the preceding paragraph before 2004 is described in paragraph 3.57(c) of the DP. That is, goodwill is acquired in an acquisition in the exchange for payments, and Japan considers goodwill to be an asset that primarily represents excess earning power and to be a wasting asset with a finite useful life. Amortisation reflects the consumption of goodwill and, by appropriately recognising income earned subsequent to the acquisition and the corresponding amortisation expense of this paid cost in net income in each period, useful information about the performance subsequent to the acquisition would be provided to users of financial statements.
- Some stakeholders who support retaining an impairment-only approach have criticised that amortisation would not provide useful information for the following reasons:
  - (a) It is questionable whether goodwill is always a wasting asset with a finite useful life. (paragraph 3.81 of the DP)
  - (b) The useful life and amortisation pattern of goodwill are generally cannot be predicted and that straight-line amortisation of goodwill over an arbitrary period fails to provide useful information. (paragraph BC131E of IAS 36, paragraphs 3.70 and 3.72 of the DP)
  - (c) Users of financial statements would add back the amortisation expense would not help them assess performance (paragraph 3.74 of the DP)
- Japan has the following arguments against the criticisms in the preceding paragraph, and in particular, in Japan's view the argument against the criticism (c) presents "new evidence" which Japan confirmed through its survey after 2004.
  - (a) Regarding the criticism that it is questionable whether goodwill is always a wasting asset with a finite useful life

Paragraph BC313 of IFRS 3 presented the analysis of goodwill components and stated that goodwill is mainly composed of the going concern element that represents

reputation or know-how of the acquiree and the synergies element that would be expected to arise from combining acquirer's and acquiree's businesses.

The going concern element represents something that the acquirer is willing to pay to earn a return higher than the return the market expects to earn from the acquiree's individual assets. This excess return will decrease over time assuming that there is healthy competition. In addition, some stakeholders claim that the going concern element may include the entity's reputation with customers, technology and know-how that support the business and assembled workforce, and if it were possible to consider these individual factors of goodwill, the effects of the entity's reputation with customers, and the effects of technology and know-how would decrease as the surrounding environment changes and the workforce is replaced. Accordingly, improvements or adjustments would be needed to ensure that these factors continue to be effective. Thus, the goodwill originally acquired in an acquisition would decrease and would be replaced by updated reputation with customers and updated technology and know-how.

Similarly, for the synergies element, if the element is expected to generate excess returns, similar behaviours aiming to achieve such excess returns would be enhanced in the industry, and such excess returns would decrease over time assuming there is healthy competition.

It should be noted that some stakeholders criticise that, if goodwill is of a wasting nature, there would be a large portion of cash flows that are unexplained after the entity's finite-lived resources with finite useful lives are consumed. However, Japan thinks that the cash flows generated from the resources with finite useful lives originally acquired in an acquisition and cash flows generated as a result of reinvestment of those cash flows to new resources should be considered to be separate cash flows. This cycle of reinvestment continues while the entity continues as a going concern, and accordingly the understanding that goodwill has a finite useful life is not inconsistent with the fact that the entity continuously produces cash flows from goodwill beyond such a finite useful life.

- (b) Regarding the criticism that the useful life and amortisation pattern of goodwill generally cannot be predicted and that straight-line amortisation of goodwill over an arbitrary period fails to provide useful information

Considering that an entity is required to estimate the period and the pattern in which the benefits of property, plant and equipment (PPE) and intangible assets with a finite useful lives are expected to be consumed, Japan expects that the same would apply to goodwill. More information may be available in estimating the wasting



period and pattern for PPE or intangible assets with finite useful lives because those assets are exposed to physical wear and tear or may have legal limits on the use of those assets. However, their useful lives are defined in terms of the assets' expected utility to the entity and technical or commercial obsolescence are considered. In this regard, goodwill is essentially no different from PPE or intangible assets.

Accordingly, there is little justification that goodwill should be treated otherwise.

Although Japan acknowledges that some may argue that the period or the pattern in which goodwill diminishes cannot be predicted reasonably, Japan thinks that it would be more reasonable to amortise goodwill on a systematic basis over a certain period rather than adopting an approach that may not recognise the decrease in the value of goodwill at all in certain periods.

In addition, because the price of an acquisition is usually high and the acquisition is usually expected to have a significant impact on the business of the acquirer, the acquirer usually makes the decision to acquire the business of the acquiree only after conducting diligent analyses. Those analyses may include identifying the advantages and disadvantages of the business of the acquiree and, the types and the scale of expected synergies after being integrated into the business of the acquirer. The acquirer should generally be able to estimate a useful life of goodwill based on such analyses, together with other information. Japan acknowledges that some may be concerned that such estimate would include a certain level of uncertainty. However, users of financial statements who support amortisation think that information based on management's estimate was useful and therefore, the benefit of providing the management's estimate outweighs the concerns related to estimation uncertainty

- (c) Regarding the criticism that users of financial statements would add back the amortisation expense because the amortisation expense would not help them assess performance

Japan conducted a survey with analysts in Japan in 2017 on how they used financial information of acquisitions in their analyses<sup>4</sup>. The objective of this survey was to obtain in-depth understanding of the views of analysts regarding goodwill and impairment considering that arguments were often heard such as “analysts believe that goodwill amortisation would not provide relevant information” or “all analysts ignore goodwill amortisation and adjust profit or loss in order to eliminate the effect of goodwill amortisation.”

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<sup>4</sup> Research Paper No.3, *Analyst Views on Financial Information Regarding Goodwill*, June 2017  
[https://www.asb.or.jp/jp/wp-content/uploads/20170612\\_e.pdf](https://www.asb.or.jp/jp/wp-content/uploads/20170612_e.pdf)

As a result of the survey, the way analysts used financial information in their analyses varied. In addition, whether the analysts conducted their analyses based on cash flow information or accounting information (profit or loss that includes amortisation of goodwill) depended on the objective of their analyses. Analysts could be classified broadly into two groups: (i) those who placed more significant importance on analyses based on cash flow information and (ii) those who placed significant importance on analyses based on accounting information (profit or loss that includes amortisation of goodwill) as much as on analyses based on cash flow information. The views regarding the amortisation of goodwill varied, but those who were indifferent between amortisation and non-amortisation of goodwill were generally those classified in the former group of analysts and those who supported amortisation were generally those classified in the latter group of analysts.

Based on this survey, while users of financial statements may oftentimes add back amortisation in practice, the main objective of doing so is to obtain information that approximates cash flows, and for this objective, users of financial statements would also add back impairment losses, regardless of whether goodwill is amortised. Accordingly, the practice of adding back amortisation in itself does not demonstrate that information about amortisation is less useful.

In light of the above, to broadly summarise the analysts' views, Japan thinks that there are largely two views among analysts: one view is that goodwill should be amortised and the other view is that there is no difference between amortisation and non-amortisation. In this regard, because analysts usually would not incur significant costs in adding back amortisation, amortisation would improve the relevance of financial information to the analysts who hold the former view and would not affect the relevance of financial information to the analysts who hold the latter view. Accordingly, the reintroduction of amortisation would result in improving the relevance of financial information for more analysts.

(Rationale after 2004)

- A reason in addition to the reasons stated in the second paragraph of Japan's response to Question 7(b) of this Appendix of the comment letter, the reason for Japan's view in the first paragraph of Japan's response to Question 7(b) of this Appendix of the comment letter (the support for the reintroduction of amortisation) is that the impairment test is not working as the IASB intended and expense that should arise from goodwill is not recognised in a timely manner as suggested through the PIR conducted in 2013 as mentioned in paragraph 3.57(a) of the DP.

- Regarding the statement in the preceding paragraph, Japan conducted quantitative studies regarding goodwill in 2016 and 2020<sup>5</sup>. From these studies, Japan finds that the amount of goodwill generally increased steadily and globally over time after the impairment-only approach became effective, even though there were changes in the economic environment. In addition, the average implied time to fully expense goodwill far exceeded 20 years which was the maximum amortisation period before IFRS was revised in 2004.
- This increasing trend may be partly due to the increase in the number of acquisitions, but Japan believes that the main cause of this trend is the accounting mechanism that creates the shielding effect, as mentioned in its response to Question 6(c) of this Appendix. Japan acknowledges that the IASB was aware of the shielding effect when the IASB initially developed the impairment test of IFRS 3 in 2004 as mentioned in paragraph 3.75 of the DP, and the impairment test is working as intended, but Japan does not think that the IASB was aware at that time that the shielding effect would prove to be so problematic that the balance of goodwill could be large in the statement of financial position and its expense could be recognised too late. Stakeholders have become aware of this effect after many years of application, which was and this is after 2004. The IASB's efforts to solve this problem have not been successful and this was confirmed after 2004.

#### Question (c)

- Japan thinks that the reintroduction of amortisation will solve the main reason for the “too little, too late” issue. This is because amortisation would not be affected by the shielding effect. If the estimate of the useful life can be reasonably estimated, amortisation would result in recognising a sufficient amount of expense arising from goodwill in a timely manner

#### Question (d)

- Japan thinks that acquired goodwill is separate from goodwill that is subsequently generated internally. In order to provide information about financial performance of regarding how an entity generated returns on its economic resources, it is basically necessary to distinguish between the investment and what it generates from the investment and these two should be considered to be separate.

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<sup>5</sup>Research Paper No.2, *Quantitative Study on Goodwill and Impairment*, September 2016

[https://www.asb.or.jp/wp-content/uploads/20161003\\_01\\_e.pdf](https://www.asb.or.jp/wp-content/uploads/20161003_01_e.pdf)

Research Paper, *Goodwill: Improvements to Subsequent Accounting and an Update of the Quantitative Study*, by the Staff of Accounting Standards Board of Japan and the Staff of Hong Kong Institute of Certified Public Accountants, March 2020

[https://www.asb.or.jp/wp-content/uploads/20200324\\_e.pdf](https://www.asb.or.jp/wp-content/uploads/20200324_e.pdf)

Question (e)

- If amortisation is reintroduced, management may add back amortisation to present a management performance measures, but Japan thinks that the main objective of this measure is to show a measure that approximates cash flows. For this objective, impairment losses would also be added back. Accordingly, adding back amortisation to present a management performance measure does not indicate that the information about amortisation is less useful.

Question (f)

- Japan supports the use of management's reasonable estimate in the determining the useful life with a cap on it. In this regard, Japan thinks that the management's estimate should be based on "the period for which future net cash inflows are expected to increase as a result of the business combination," with a maximum period of 10 years. Japan's reasons are summarised as follows:
  - (a) According to interviews Japan conducted with analysts in Japan, those who supported the amortisation with impairment approach supported the use of management's reasonable estimates, stating that "the period for which the future net cash inflows are expected to increase as a result of the business combination" would provide useful information. Even though management's reasonable estimate may result in different outcomes as a result of management judgement, Japan thinks that such estimates provide relevant information to users of financial statements.
  - (b) On the other hand, Japan thinks that it is appropriate to set a maximum on the amortisation period considering that (i) it is necessary to address the "too little, too late" issue and (ii) goodwill is calculated as a residual and its components cannot necessarily be disaggregated in monetary terms. Setting a maximum on the amortisation period will ensure that the carrying amount of goodwill will be reduced within this maximum period.
- Although it is not easy to logically set an appropriate maximum amortisation period, Japan proposes 10 years as the maximum period because it seems to be acceptable to most stakeholders. Japan's proposal is based on (i) the understanding that there are views in the international community that it is unlikely to expect the effects of acquisitions to continue more than 10 years, (ii) the fact that the amortisation requirement under International Financial Reporting Standards for Small and Medium Sized Entities (IFRS for SMEs) and the amortisation option provided for private companies under U.S. GAAP set 10 years as the maximum on the amortization period

and that such amortisation period are applied in practice, and (iii) the results of academic studies<sup>6</sup>.

- As shown in the preceding paragraph, Japan's preference is to determine the amortisation period based on management's estimates and to set 10 years as the maximum period. However, based on the international discussions that have been held in the past, Japan acknowledges that there are diverse views. Accordingly, if it would lead to reaching global consensus, Japan is willing to accept, as the second best alternative, that goodwill shall be amortised over 10 years, or less than 10 years if the entity demonstrates that another useful life is more appropriate. Japan believes that this approach eliminates the subjectivity in estimating the amortisation period and, at the same time, ensures a certain degree of reasonableness by leaving room for judgement regarding the use of an amortisation period that is shorter than 10 years.
- In addition, Japan thinks that the amortisation pattern should reflect the pattern in which the future economic benefits of goodwill are expected to be consumed by the entity, and if that pattern cannot be determined reliably, the straight-line method should be used. This is because goodwill should be treated in the same way as other intangible assets with finite useful lives.

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<sup>6</sup> Japan reviewed academic papers including the following:

Dickinson, V. and G. A. Sommers (2012). Which competitive efforts lead to future abnormal economic rents? Using accounting ratios to assess competitive advantage. *Journal of Business Finance and Accounting*, 39(3) & (4), 360-398.

Healy, P., Serafeim, G., Srinivasan, S. and Yu, G. (2011). Market competition, government efficiency, and profitability around the world. Working paper, Harvard Business School. Available at SSRN 1865878.

Muramiya, K. (2010) Characteristic analysis of financial ratios that constitute residual income model. In Sakurai, H. ed., *Empirical analysis of enterprise valuation*, Section 9, 230-269, Chuokeizai-sha, Inc. (the titles of the paper and the book are not official ones but tentative translation by the ASBJ staff.)

Nissim, D. and Penman, S. H. (2001). Ratio analysis and equity valuation. *Review of Accounting Studies*, 6, 109– 154.

Obinata, T. (2013). Sustainability and mean reversion of profitability. Chuokeizai-sha, Inc. (In Japanese. The title of the book is tentative translation by the ASBJ staff.)

Palepu, K. G. and Healy, P. M. (2012). *Business analysis and valuation* 5th edition - International edition, Cengage learning.

Sakurai, T. (2010) Sustainability of residual income and enterprise valuation. In Sakurai, H. ed., *Empirical analysis of enterprise valuation*, Section 10, 270-315, Chuokeizai-sha, Inc. (the titles of the paper and the book are translations by the ASBJ staff.)

Palepu and Healy showed the empirical research results that excess operating returns on equity diminished within 5 to 10 years. Nissim and Penman explored the period of the mean reversion for decile portfolios formed on excess operating profit and found that excess operating profit for the highest decile remained over 10 years.

**[Korea]**

**Accounting for goodwill**

**(a) Goodwill amortization**

Korea believes that goodwill does not have a clear characteristic of an asset in the first place. IFRS 3 ‘mechanically’ defines goodwill as an excess of transferred consideration over the net fair value of identifiable assets and liabilities. Moreover, the definition and recognition criteria of goodwill do not appear to be sufficiently robust when compared to PP&E or intangible assets. For instance, while PP&E or intangible assets have a recognition criterion such as a probability of generating future economic benefits, goodwill does not have a specific recognition criterion.

Given it is not obvious whether goodwill is an asset, Korea does not think there is a solid ground on which goodwill can be viewed as a wasting asset. Rather, goodwill could be viewed as a mixture of different elements: some elements whose value diminishes over time and other elements whose value does not necessarily diminish over time. If that is the case, Korea can hardly consider the entire goodwill as a wasting asset.

If goodwill is amortized, it only mechanically reduces the carrying amount of goodwill without providing useful information to users. For example, there could be a situation where the company's performance is reversed from net profit to net loss after recognizing a large amount of goodwill amortization expense. When the financial performance is overwhelmed by arbitrary amortization of goodwill as it is in this example, it is questionable whether this is a faithful representation of the company's financial performance.

**(b) Simplification of impairment test for goodwill**

The benefit of performing impairment test only when there is a sign of impairment (the indicator approach) without a mandatory annual impairment test for goodwill might not be immense. The indicator approach still requires a high level of judgment and estimation because the indicators in IAS 36 tend to be vague and difficult to apply. Also, auditors and regulators could challenge the companies more often if there is no mandatory annual impairment test, and it might be costly for companies to defend themselves. Therefore, Korea recommends the IASB to consider extending the period of regular mandatory impairment tests for goodwill (e.g., to every two years) instead of removing the requirement for mandatory annual impairment test for goodwill.

Korea agrees with the proposal for simplifying the calculation of the value in use.

## **[Malaysia]**

### **Response to Question 6**

Malaysia is of the view that the impairment test serves to hold management to their promises in relation to a particular acquisition. However, Malaysia concurs with the view set out in the paragraph 3.2 of the Discussion Paper that impairment losses on goodwill are sometimes recognised too late and should be recognised on a timelier basis. In addition, the concept of ‘shielding’ is not easily understood.

Malaysia thus recommends that the IASB considers the following hybrid approach:

- (i) for intangible assets with finite useful life, to apply a hybrid of annual amortisation and trigger-based impairment test (as described in the proposed relief).
- (ii) for intangible assets with indefinite useful life, to continue to require an annual quantitative impairment test.

For avoidance of doubt, Malaysia is of the view that goodwill falls under category (i) and should be subject to the combination of annual amortisation and trigger-based impairment test. Please refer to Malaysia’s response in Question 7 for further details.

Malaysia also recommends that the IASB reconsider its preliminary view, set out in paragraphs 4.55–4.56 of the Discussion Paper, against developing simplifications and guidance for the impairment test. Please refer to Malaysia’s response in Question 11 for further details.

### **Response to Question 7(a)–(d)**

Malaysia disagrees with the IASB’s preliminary view of not reintroducing the amortisation and instead retaining the impairment-only model for the subsequent accounting for goodwill.

Malaysia’s view on amortisation of goodwill remains largely consistent since 2004. In Malaysia’s 28 March 2003 response to IASB ED 3 Business Combinations, Malaysia was of the view that the issues raised by the alternative views of the two IASB members, as set out in the Basis for Conclusions to ED 3, should be given due consideration.

There is shortcoming in the impairment approach to goodwill, in particular, due to the inability to eliminate internally generated goodwill accruing after a business combination from the measure of goodwill’s implied value. This shortcoming would provide a ‘cushion’ against the recognition of impairment losses of purchase goodwill by the ‘indirect’ recognition of



internally generated goodwill. In this case, it will be inconsistent with IAS 38 *Intangible Assets* that prohibits recognition of internally generated goodwill.

Since 2004, Malaysia observed that:

- (i) the retention of the impairment-only model for goodwill encourages companies to defer impairment, and increases the risk of addressing ‘too little, too late’.

Every business has its cycle of ‘good years’ alternating with ‘bad years’. During ‘good years’, it is unlikely that goodwill will be impaired, and this is reflected indefinitely in the financial statements. However, during the ‘bad years’, subject to the presence of indicators of impairment, goodwill may be written off, never to be reinstated even if ‘good years’ are experienced at a later date.

- (ii) it is in rare circumstances that a particular business can successfully sustain a particular brand name over an extended period of time, e.g. over a century.

In such cases, it is highly likely that any goodwill arising from the initial acquisition would have been replaced by internally generated goodwill.

It is thus Malaysia’s view that although amortisation of goodwill may not be a perfect method, it remains a more effective method of reflecting the consumption of goodwill over time against revenue earned from the acquisition. Coupled with trigger-based impairment tests, Malaysia believes this can effectively address concerns on ‘shielding’ as this will prevent acquired goodwill from being gradually and implicitly ‘replaced’ by internally generated goodwill (i.e. indirect recognition of internally generated goodwill). The use of trigger-based impairment testing is also likely to be less costly compared to annual quantitative impairment testing.

#### **Response to Question 7(e)**

No, Malaysia is of the view that companies would not adjust or create new management performance measures to add back the amortisation expense, for the reasons as set out above.

#### **Response to Question 7(f)**

Malaysia is of the view that the estimation of useful life of goodwill and its amortisation pattern should be subject to management’s judgement, and that the reintroduction of goodwill amortisation would result in financial statements which are more faithfully representative of the business in the longer run. In making such estimations, the management could consider its own historical experience, or alternatively, assumptions used by market participants consistent with the highest and best use of the asset as adjusted for entity-specific factors.

In this respect, the IASB could consider providing guidance on when an entity is required to provide disclosures about such estimates, including consideration of whether the effect of the useful life or change in useful life or expected likelihood of renewal or extension of goodwill would be material to the financial statements, either individually or in aggregate by major intangible asset class.

## **[New Zealand]**

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

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

- New Zealand thinks 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.
- 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, New Zealand agrees that goodwill will inevitably be shielded by unrecognised headroom within the CGU, be it headroom generated before or after the acquisition.
- New Zealand also agrees 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*

- New Zealand agrees 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. New Zealand’s specific comments on these two concerns are included below.

#### Management over-optimism

- There are already some requirements in IAS 36 that attempt to mitigate the risk of management over-optimism, and New Zealand agrees that in general, any additional

safeguards to mitigate against this risk should come from the work of auditors and regulators.

- However, it may be worth considering whether there are opportunities to enhance the existing safeguards in IAS 36. For example, New Zealand 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

- As noted above, New Zealand agrees 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.
- However, New Zealand notes 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.
- 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, New Zealand is 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.

- To the extent that this issue arises from incorrect application of IAS 36, New Zealand thinks this issue 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.
- Therefore, New Zealand recommends considering whether 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*

- As noted above, New Zealand recommends 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.

### ***Response to Question 7:***

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

- New Zealand has heard mixed views from constituents regarding the subsequent accounting for goodwill, and like the IASB, New Zealand is aware that both the impairment-only model and the amortisation model have advantages and disadvantages. New Zealand's views on this topic are also mixed.
- New Zealand is 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.
- On the other hand, New Zealand is 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) New Zealand 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.
- On balance, New Zealand thinks 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, New Zealand thinks it would be important to carry out this holistic review with some urgency.
- 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), New Zealand thinks 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?*

- At an outreach event, New Zealand constituents were asked 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.

- New Zealand is 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, New Zealand 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?*

- 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.
- 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?*

- New Zealand thinks 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.
- 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?*

- New Zealand thinks 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?*

- As noted above, on balance New Zealand does not recommend the reintroduction of amortisation of goodwill at this time.
- However, if the IASB reintroduces amortisation, New Zealand would recommend that the IASB introduce a rebuttable cap on the amortisation period. New Zealand believes 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.

**[Saudi Arabia]**

Saudi Arabia is advocating reintroduction of amortization of goodwill. However, Saudi Arabia suggests that the Board should set specific requirements suitable for amortizing goodwill taking into consideration the specific nature of every cash-generating unit to which goodwill is assigned.

### 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?

### AOSSG members’ comments on Question 8

Most AOSSG members do not agree with the IASB’ proposal to require companies to present on their balance sheets the amount of total equity excluding goodwill. One member observes that in applying the existing requirements of IAS 38, goodwill is clearly disclosed in the notes to the financial statements and thus concurs with paragraph 3.110 of the Discussion Paper that it is simple for investors to calculate this amount. Hence, this member would like to seek further clarification as to whether there is a compelling need for goodwill to be separately identified and disclosed on the face of the statement of financial position. Specific comments from each member are described below.

#### [Australia]

##### Question 8(a)

Australia does not support the proposal to require entities to present total equity excluding goodwill on the balance sheet.

Australia acknowledges that this proposal was intended to provide greater transparency about goodwill, in particular in situations where goodwill makes up a significant proportion of an entity's equity balance. However, in Australia’s view, presenting total equity excluding goodwill on the balance sheet would be inconsistent with the IASB’s conclusion in IFRS 3 that goodwill is an asset that will generate future economic benefits to the entity.

As goodwill must be separately disclosed, calculating total equity excluding goodwill should be straightforward for financial statement users.

**[Hong Kong]**

**Question 8—Presentation of total equity excluding goodwill**

***Stakeholders' views***

- Stakeholders generally disagreed with the IASB's proposal of presenting total equity excluding goodwill on the balance sheet. These stakeholders noted that the proposed figure can already be easily computed, thus separate presentation would not provide significant improvements to financial reporting. Stakeholders also commented that the proposal may raise the question of why goodwill is being highlighted as such, and what this may imply (e.g. whether goodwill is an asset).
- A smaller selection of stakeholders stated that although the figure is trivial to compute, such presentation may be beneficial in that it could highlight the fact that goodwill is different from other assets, and help reduce the comparability issue concerning organic versus acquisitive growth entities.

***Hong Kong's analysis and recommendation***

- Hong Kong agrees with its stakeholders who consider that the IASB's proposal would not significantly improve financial reporting given the ease with which the figure can be computed, and overall Hong Kong notes that the fundamental issues with goodwill accounting cannot be resolved through changes in presentation. Hong Kong also notes that the existence of this proposal is indicative of the fact that goodwill has a rather unique nature as an asset. As noted elsewhere in Hong Kong's comments, Hong Kong recommends the IASB consider the fundamental accounting of goodwill.

**[Japan]**

**Question (a)**

- Japan disagrees with the preliminary view. If an entity is required to present in the statement of financial position the amount of total equity excluding goodwill, this would imply that goodwill is not an asset or that goodwill is negative equity, and Japan thinks neither is inappropriate. Paragraph IN41 of the DP states that this presentation "would be expected to enhance investors' understanding of a company's financial position." However, for this purpose, Japan thinks that the accounting for goodwill should be improved and the reintroduction of amortisation is Japan's response to such improvement as mentioned in its response to Question 7(a) of the Appendix of the comment letter. Paragraph IN41 of the DP also explains the reason for limiting the item that would be

excluded from total equity to goodwill but Japan questions whether this limitation is consistent with the abovementioned purpose of this disclosure.

Question (b)

- No comment.

**[Korea]**

**Presentation of total equity before goodwill**

Korea agrees with the proposal.

**[Malaysia]**

Malaysia has no major objection to the IASB's preliminary view to develop a proposal to require companies to present on their balance sheets the amount of total equity excluding goodwill.

Malaysia notes from paragraphs 3.108 – 3.110 of the Discussion Paper that the IASB has opted to focus on goodwill given its unique nature and that this proposal is intended to provide further transparency about the effect of goodwill and so contribute further to investors' understanding of a company's financial position, as it can help to highlight those companies for which goodwill is a significant portion of their total equity. At the same time, Malaysia notes from paragraph 3.112 of the Discussion Paper that the IASB does not intend to pursue this change as changing the structure of the financial statements to allow the presentation of this subtotal could be too disruptive.

Based on Malaysia's observations, in applying the existing requirements of IAS 38, goodwill is clearly disclosed in the notes to the financial statements. Malaysia thus concurs with paragraph 3.110 of the Discussion Paper that it is simple for investors to calculate this amount. Hence, Malaysia would like to seek further clarification as to whether there is a compelling need for goodwill to be separately identified and disclosed on the face of the statement of financial position.

**[New Zealand]**

- New Zealand strongly disagrees with the IASB's proposal to require entities to disclose the amount of equity excluding goodwill on the balance sheet.
- New Zealand appreciates 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, New Zealand disagrees with the IASB's proposal for the following reasons.

- (a) New Zealand acknowledges 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.

#### [Saudi Arabia]

Saudi Arabia recommends that the exclusion should be made from both total assets and total equity and liability. This will enhance comparability between entities and ease the financial analysis

#### 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?

## **AOSSG members' comments on Question 9**

Almost all AOSSG members disagree with the IASB's proposal to remove the requirement to perform a quantitative impairment test every year. One member disagrees with this proposal unless amortisation is reintroduced along with indicator-based impairment. Specific comments from each member are described below.

### **[Australia]**

Australia's comments are limited to removing the annual impairment test requirements for goodwill. Australia did not receive any specific feedback on the proposals as they may apply to intangible assets with indefinite useful lives and intangible assets not yet available for use.

Australia **does not** support the removal of the annual impairment test. There does not appear to be any evidence of significant cost savings and there is significant concern from users about the loss of information from the financial statements, as noted below.

Large preparers have indicated that they would continue to perform an annual impairment test regardless of a requirement to do so, as they have well designed systems and processes in place to perform the annual testing. Entities in the SME space would be more likely to take advantage of this relief as annual impairment testing is costly and time consuming. However, auditors have noted that they would likely need additional audit evidence to confirm that the goodwill is not materially misstated, which could offset the cost savings from the removal of the annual test.

Further, under an indicator approach, entities would still need to spend time assessing and documenting whether impairment indicators are present and would need to spend time regaining skills and expertise should an impairment test be required in a subsequent period. For this reason, stakeholders thought that any potential cost savings may not be as great as expected. An indicator approach may also result in indicators being missed and impairment losses not being recognised when they should be. Finally, users expressed concerns about the loss of the disclosures of the key assumptions made in performing the annual impairment test.

However, if the IASB disagrees and proceeds with removing the annual quantitative impairment test requirement, Australia suggests that the indicator approach 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 needed. This should include disclosing the indicators considered in the assessment.

Australia further suggests the IASB reconsiders the list of impairment indicators and provides a non- exhaustive list of additional, more specific indicators that have a stronger focus on



internal factors that are particularly relevant to goodwill and intangible assets with an indefinite life. Examples of such indicators could be the 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.

## **[Hong Kong]**

### ***Stakeholders' views***

- Most of Hong Kong's stakeholders considered that removing the mandatory annual impairment test for goodwill, while retaining an impairment-only model, may increase the chance that impairment losses could be concealed or otherwise not recognised in a timely manner.
- On the other hand, a few stakeholders welcomed the proposal because the provision of such relief would make the accounting treatment of goodwill more consistent with other assets that are not assessed annually for impairment.

### ***Hong Kong's analysis and recommendation***

- Hong Kong, in line with its RP, supports an amortisation approach for goodwill including testing for impairment when there is an indication of impairment. However, if the IASB retains an impairment-only approach, Hong Kong believes that the annual impairment should be retained as an indicator-based approach would make the impairment assessment less robust. Were the IASB to decide to pursue the removal of the annual impairment test and retain an impairment-only model, Hong Kong would recommend that the IASB revisit the indicators for impairment to ensure those indicators are sufficiently clear and precise.

## **[Japan]**

### **Question (a)**

- Japan disagrees with the preliminary view to remove the requirement to perform a quantitative impairment test every year unless amortisation is reintroduced. As described in paragraphs 3.31 to 3.52 of the DP, this project has been making efforts to improve the effectiveness of the impairment test for goodwill and Japan thinks that providing relief from the mandatory annual quantitative impairment test while retaining the existing impairment-only approach to the subsequent accounting for goodwill is inconsistent with those efforts in this project.

- As explained in paragraph 4.9 of the DP, the annual quantitative impairment test was introduced when the IASB decided to eliminate the requirement to amortise goodwill and was intended to make the impairment test robust. In this regard, paragraph 4.23 of the DP notes the following views that imply that the removal of the annual quantitative impairment test affects little robustness of the impairment test:
  - (a) there may be little difference in the outcome of recognising impairment losses depending on whether a quantitative impairment test is required annually because an entity would still need to assess at the end of each reporting period whether there is any indication that there may be an impairment;
  - (b) performing an annual impairment test cannot remove the shielding effect resulting from unrecognised headroom.

However, based on Japan's understanding that the "too little, too late" issue exists, Japan does not think that it is desirable to make an amendment that may exacerbate the issue.

#### Question (b)

- Japan is of the view that the effects of cost savings from removing the annual quantitative impairment tests would vary significantly among entities because such cost savings would depend on the volumes of businesses that have been acquired by an entity and on the extent to which information that is used to assess the businesses for internal management purposes can also be used for the impairment test.
- In addition, paragraph 4.34 of the DP states that the IASB plans to assess whether it needs to update the list of indicators in paragraph 12 of IAS 36 because moving to an indicator-based approach would place more reliance on identifying the indicators of impairment. If the list of indicators is extended and, as a result, indicators are identified more frequently, Japan questions whether the expected effects of cost savings can be achieved.

#### Question (c)

- Japan has learned that entities regularly monitor the conditions of their businesses for internal management purposes, and Japan is not aware of any views that the removal of the annual quantitative impairment test would significantly reduce the robustness of the impairment test. However, based on Japan's understanding that the "too little, too late" issue exists, Japan thinks that this amendment may exacerbate the issue. Japan also notes that there was a view expressed in a recent international forum that the removal of the annual quantitative impairment test may affect the robustness of the impairment test because there are cases where it is difficult to identify individual indicators of impairment.

#### **[Malaysia]**

#### **Response to Question 9(a)–(b)**

With reference to Malaysia's response in Questions 6 and 7, Malaysia disagrees for the IASB to develop proposal to remove the requirement to perform a quantitative impairment test every year unless amortisation is reintroduced along with the indicator-based impairment.

Malaysia is of the view that sole dependence on the trigger-based impairment test approach is unlikely to address concerns relating to the delayed recognition of impairment losses arising from the current annual quantitative impairment test approach. Malaysia is also doubtful that applying a trigger-based impairment test approach alone would significantly reduce costs, as the indicators of impairment would be present.

With respect to intangible assets not yet available for use, Malaysia believes that the trigger-based impairment test would be sufficient.

### **Response to Question 9(c)**

Malaysia is of the view that the robustness of the impairment test depends on the assumptions that the test is based on as well as the statistical method used for the test inputs. Accordingly, Malaysia believes that the removal of the annual quantitative impairment test approach would not affect the robustness of the impairment test.

### **[New Zealand]**

- If the IASB retains the impairment-only model for goodwill, then New Zealand does not agree with the IASB's proposal to move to an indicator-based approach to goodwill impairment testing. New Zealand recommends retaining the current requirement to test goodwill for impairment every year.
- 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.
- 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.

- 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.
- 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).
- 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.
- If the IASB implements an indicator-based approach for goodwill impairment testing, New Zealand thinks 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.

### **AOSSG members' comments on Question 10**

Some AOSSG members disagree with the IASB's proposal 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. However, one member generally agrees with the IASB's proposal while another member has no major objections with certain concerns raised. Specific comments from each member are described below

#### **[Australia]**

##### ***Removing restrictions for some cash flows***

While there were some mixed views, Australia generally agrees with the IASB's proposal to remove the restriction in IAS 36 that prohibits companies from including cash flows arising from a future uncommitted restructuring or from improving or enhancing the asset's performance in estimating ViU.

However, the Board was concerned that this could further delay recognising impairment losses due to overly optimistic cash flow forecasts. For example, entities may include cash flows from restructuring activities that may never occur or may be continuously delayed in ViU calculations.

Assessing whether cash flows from future restructurings or asset enhancements are reasonable and supportable could be difficult and judgemental. It may not be possible, for example, to compare those expected future cash flows to past cash flow projections the same way it is done for other types of cash flows in ViU calculations and required by paragraph 34 of IAS 36.

To ensure the impairment test remains robust, Australia suggests that the IASB develops guidance which clarifies when it would be reasonable and supportable to include cash flows from uncommitted future restructuring and asset enhancements. For example, the guidance could specify that the entity needs to be able to demonstrate both its intent and financial ability to implement the restructuring and has developed a reasonably detailed plan.

#### ***Pre- or post-tax discount rates***

Australia supports the use of either pre- or post-tax discount rates, however, Australia recommends providing guidance to explain how this will affect the ViU model. 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 provide the same result, in practice, this will only be the case if there are no temporary differences.

If the entity uses a post-tax discount rate and post-tax cash flows, it will need to consider the reversal of temporary differences and the timing thereof. Australia suggests 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.

#### ***Is there a need for two models?***

Feedback from stakeholders generally supported retaining two different models for the reasons set out in paragraphs 4.55(b) and 4.56(b) of the Discussion Paper (e.g., if an entity can generate greater cash flows by using an asset, determining the recoverable amount based on fair value less costs of disposal (FVLCD) would be misleading and vice versa). Having two models can also be useful in situations such as the current COVID-19 pandemic where FVLCD can be volatile but may in certain circumstances be higher than ViU and therefore avoid the recognition of an impairment loss even if a sale is not intended.

However, some stakeholders noted that simplifying the ViU calculation will blur the distinction between the ViU and FVLCD model and questioned whether there could be merit in moving to one model. These stakeholders noted that having only one model may remove some of the judgement involved in impairment testing and address concerns about over-

optimism in ViU calculations, by having a stronger and clearer focus on external evidence in setting assumptions.

Australia therefore suggests the IASB undertake further research and discusses with valuation professionals whether the recommendation in AASB Research Report No 9 *Perspectives on IAS 36: A case for Standard-Setting* to develop a modified single model approach and reserve the use of a FVLCD type model for assets expected to be disposed of may have merits.

However, Australia acknowledges that this may be better addressed through a holistic review of the IAS 36 requirements rather than through this project.

If the two separate models are retained, Australia recommends the IASB clearly explains the differences between the two models, acknowledging an increasing focus by regulators on the use of market- based evidence in setting the assumptions for the ViU model.

## **[Hong Kong]**

### ***Stakeholders' views***

- A majority of Hong Kong's stakeholders welcomed allowing the use of post-tax cash flows and the post-tax discount rates in estimating value in use (VIU), on the basis that they are commonly used in practice. One stakeholder however commented that allowing the use of post-tax cash flows and discount rates would not be very helpful and may introduce complexity, as the process of determining post-tax cash flows and discount rates can require complex adjustments.
- Some stakeholders expressed concern on allowing the inclusion of cash flows related to future uncommitted restructurings, or improving or enhancing the asset's performance. Including cash flows from a future uncommitted restructuring may not be conceptually sound, as this would use forward-looking information. It may also increase the risk that management's inputs are too optimistic or aggressive, and contribute to challenges for auditors.

### ***Hong Kong's analysis and recommendation***

- Hong Kong is generally supportive of the proposals in the DP and supports its majority stakeholders' view to permit the use of post-tax cash flows and the post-tax discount rates in estimating VIU, since they are commonly used in practice by preparers.
- With regard to the proposal to remove the restriction on including cash flows from a future uncommitted restructuring or from improving or enhancing an asset's performance, Hong Kong does not believe that this is consistent with the concept of VIU that requires an assessment of cash flows from an asset's current condition. The DP at 4.38(c) describes



the proposal as being consistent with how fair value is determined. Hong Kong questions whether this alignment of VIU and fair value less costs of disposal is appropriate and if pursued, whether there is a need to retain these two ‘separate’ concepts.

- If the IASB decides to pursue this route, Hong Kong recommends that the IASB establish a conceptual basis for the proposal and that it includes more specific criteria on when such cash flows could be included in the VIU calculation. For example, at what stage of a planned but uncommitted restructuring should these cash flows be included, what kind of qualitative indicators should be considered and disclosed, as well as other guidance to promote consistency and to reduce unintended consequences (e.g. reporting entities including inappropriate cash flows in their calculation resulting in a delayed recognition of impairment).

## **[Japan]**

### Question (a)

(Removal of the restriction in IAS 36 that prohibits entities from including certain cash flows in estimating the value in use)

- Japan disagrees with the preliminary view. Japan thinks that there is no need reconsider this part of the standard because Japan thinks that the impairment framework under IAS 36 is not broken.
- The issue discussed in paragraphs 4.40 to 4.42 of the DP is whether sufficient discipline would work against the over-optimism that could occur if the proposal was implemented. In this regard, the proposal would change the concept of value in use, that is “value in use for the asset in its current condition” (paragraph BC72(a) of IAS 36), and Japan thinks that whether to make this conceptual change is a more significant issue. Japan does not think that such a conceptual change should be made as part of a simplification initiative.

(Allowing the use of after-tax cash flows and after-tax discount rates when estimating the value in use)

- Japan agrees with the preliminary view. This is because Japan does not think that it is necessary to restrict cash flows and discount rates to those of either pre-tax or post-tax basis if both provide the same outcome.

### Question (b)

- Not applicable.

**[Malaysia]**

Malaysia agrees that companies should be allowed to use post-tax cash flows and post-tax discount rates in estimating value in use.

While Malaysia has no major objections to the IASB's preliminary view and proposal 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, Malaysia wishes to highlight the following concerns:

- (i) Having considered the guidance in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* on determining when a company is committed, Malaysia notes that an entity could arbitrarily change its mind and take a different course of action at any point prior to there being a binding sale agreement.

Thus, Malaysia finds that the inclusion of cash flows arising from a future uncommitted restructuring may inadvertently increase the complexity of impairment testing, which in turn may negate the benefits expected to be derived from the removal of the IAS 36 restriction.

- (ii) The proposed removal of the IAS 36 restriction may render the cash flows open to greater misuse.

Notwithstanding that companies would be required to use reasonable and supportable assumptions based on the most recent financial budgets or forecasts approved by management, Malaysia is concerned that the inclusion of such cash flows may instead introduce greater uncertainty and compromise the reliability of disclosures.

- (iii) Malaysia notes the IASB's view that over-optimistic cash flow estimates could be more effectively addressed by auditors or regulators rather than through a probability threshold or additional qualitative disclosures (paragraph 4.42 of the Discussion Paper). In this respect, the IASB may wish to consider whether the inherent uncertainty in the assumptions about an entity's decision and final course of action may render such assumptions difficult to regulate or challenge. This may result in financial statements which are misleading.

At this juncture, Malaysia also wishes to re-emphasise that the responsibility for the faithful representation and reliability of financial statements rests with the preparers, and not the auditors and regulators.

In light of the above, in the event that the IASB proceeds with the proposed removal of the IAS 36 restriction, Malaysia recommends for more guidance be provided to facilitate the thought

process involved in assessing the level of commitment of ‘future uncommitted restructuring’ and the extent to which the cash flows estimates from these should be included.

## **[New Zealand]**

### *Allowing the use of post-tax inputs*

- New Zealand agrees that the IASB should allow the use of post-tax inputs in the VIU calculation. New Zealand notes that this is how VIU tends to be calculated in practice, with the pre-tax discount rate being calculated for disclosure purposes.
- However, if this proposal is implemented, New Zealand recommends 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*

- In New Zealand’s 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.
- At this time, New Zealand disagrees with removing the restriction on the inclusion of cash flows from future asset enhancements and uncommitted restructures in the VIU calculation. However, New Zealand recommends that the IASB reconsiders this matter after conducting a holistic review of IAS 36.
- New Zealand thinks 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.

- 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, New Zealand thinks 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.

- Should the Board develop any of the simplifications summarised in paragraph 4.55? If so, which simplifications and why? If not, why not?
- 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?

### AOSSG members’ comments on Question 11

One AOSSG member agrees with the IASB’s proposal not to further simplify the impairment test, while one member recommends that the IASB consider developing additional guidance on the identification of CGUs and the allocation of goodwill to CGUs.

One member recommends that the IASB reconsiders its preliminary view against developing principle-based simplifications and guidance for the impairment test.

Specific comments from each member are described below.

### [Hong Kong]

#### *Stakeholders’ views*

- Stakeholders generally agreed with the IASB’s preliminary view not to simplify the impairment test further, as it would be challenging to do so without sacrificing its quality.

#### *Hong Kong’s analysis and recommendation*

- Hong Kong acknowledges that the impairment test may not be simplified further in general without challenges. However, Hong Kong would recommend that the IASB

consider adding guidance on identifying CGUs and on allocating goodwill to CGUs. This is an issue that is frequently encountered in practice, and as noted in the last bullet point in Hong Kong's analysis and recommendation for question 6 of this comment letter, Hong Kong considers that management shielding operations within overly large CGUs is a relevant issue of the existing requirements.

**[Japan]**

Question (a)

Japan agrees with the preliminary view. Japan thinks there is no need to reconsider this part of the standard because Japan thinks that the impairment framework under IAS 36 is not broken.

Question (b)

Japan does not have any suggestions.

**[Malaysia]**

Malaysia noted the IASB's rationale and preliminary view that certain simplifications and guidance for the impairment test should not be developed.

However, Malaysia has also received feedback from preparers who expressed that they face challenges in applying the impairment test, in particular to those scenarios listed in paragraph 4.55 of the Discussion Paper, and that these challenges faced are indicative that guidance is not sufficient, contrary to the explanation by the IASB in paragraph 4.56(a) of the Discussion Paper.

Hence, Malaysia recommends that the IASB reconsider its preliminary view against developing principle-based simplifications and guidance for the impairment test. For example, rather than developing a specific list of examples of triggering events, the IASB could develop a principle-based thought process to guide allocation of goodwill which could be complemented by an internal assessment control mechanism to strengthen and provide a more reliable basis for estimating impairment test outcome while mitigating the shielding effect and delays in disclosure. This would help to reduce allocation inappropriateness while also enhancing management's integrity and transparency in discharging their stewardship responsibilities.

However, in the event that the IASB maintains its preliminary view, the IASB may instead wish to consider providing further clarification on the reasons why the simplifications and

guidance for the impairment test should not be developed, in particular for those scenarios listed in paragraph 4.55 of the Discussion Paper.

#### [New Zealand]

- As noted above, New Zealand recommends that the IASB consider developing additional guidance on the identification of CGUs and the allocation of goodwill to CGUs.

#### Question 12

Paragraphs 5.4–5.27 explain the Board’s preliminary view that it should not develop a proposal to allow some intangible assets to be included in goodwill.

- Do you agree that the Board should not develop such a proposal? Why or why not?
- 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?
- Would your view change if amortisation of goodwill were to be reintroduced? Why or why not?

#### AOSSG members’ comments on Question 12

Almost all AOSSG members agree with the IASB’s proposal not to develop a proposal to allow some intangible assets to be included in goodwill. Specific comments from each member are described below.

#### [Hong Kong]

##### *Stakeholders’ views*

- Stakeholders generally supported the IASB’s preliminary view not to change the current recognition criteria for intangible assets because it is complex and difficult to distinguish certain intangible assets (e.g. customer lists) from goodwill. Some stakeholders also noted that certain intangible assets are often nebulous to value and can be difficult to distinguish from the rest of the company. Commingling some identifiable intangibles with goodwill could result in a loss of useful information. Furthermore, broadening the scope of what is allowed into goodwill would only make the goodwill impairment process more challenging and exacerbate the ‘too little, too late’ issue.

***Hong Kong's analysis and recommendation***

- Hong Kong is supportive of the IASB's preliminary view to retain the current recognition requirements in IFRS 3 and IAS 38, and not develop a proposal to allow certain intangible assets to be included in goodwill. This is the case regardless of whether goodwill is amortised.

**[Japan]****Question (a)**

- Japan agrees with the preliminary view. This is because Japan has heard both positive and sceptical views on this preliminary view from Japanese stakeholders and Japan has not obtained solid basis that would support changing the existing requirements to provide more useful information. Examples of positive views include the view that separating identifiable intangible assets from goodwill would enhance transparency, and the view that items that should be amortised would be identified in many cases. Examples of sceptical views include the view that there are many cases where intangibles lack sufficient reasons to be recognised or lack sufficient support for the amount to be recognised, and the view that estimates of the fair values estimate of intangible assets are highly uncertain and such items would not provide very useful information when they are recognised as individual items.

**Question (b)**

- Not applicable.

**Question (c)**

- When reintroducing the amortisation of goodwill, Japan thinks it may be worth considering whether to include some intangible assets in goodwill. If goodwill is to be amortised, certain intangible assets that are currently amortised may be included in goodwill from a cost-benefit perspective.

**[Korea]****Recognition of goodwill and identifiable intangible assets**

Korea agrees with the IASB's proposal unless comprehensive amendments to existing IAS 38 *Intangible assets* are contemplated. Identifiable intangible assets for business combination should be recognized separately from goodwill under current requirements and Korea believes the standard should be maintained. As Korea expects the valuation to become a necessary process in the accounting for intangible assets in the near future,



identifiable intangible assets should be separately recognized and measured to help establish the valuation practice, despite the complexity and subjectivity issues.

On the other hand, existing IAS 38 should be generally reviewed to reflect the demand for information on the increasing value of intangibles. Korea is planning to suggest it during the 2020 Agenda Consultation.

## **[Malaysia]**

### **Response to Question 12(a)–(b)**

Malaysia agrees with the IASB's preliminary view that it should not develop a proposal to allow some intangible assets to be included in goodwill, in view that combining these would result in the commingling of identifiable and unidentifiable intangible assets.

With regard to the approaches discussed in paragraph 5.18 of the Discussion Paper, Malaysia is of the view that none would reduce complexity and costs since IFRS 3 continues to require identifiable assets acquired to be recognised separately from goodwill.

### **Response to Question 12(c)**

Any change to Malaysia's views above is subject to further clarity being provided on the amortisation of goodwill.

## **[New Zealand]**

- New Zealand agrees with the IASB that it should not change the current requirement to recognise identifiable intangible assets acquired in a business combination separately from goodwill. New Zealand's 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.

- As noted elsewhere in this letter, New Zealand recommends that the IASB undertakes a holistic review of the accounting for intangible assets.

### **[Saudi Arabia]**

Saudi Arabia considers that recognition of more assets separately from goodwill provides more transparency and more representation of what has been acquired in a business combination.

#### **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?

#### **AOSSG members' comments on Question 13**

### **[Hong Kong]**

#### ***Stakeholders' views***

- A stakeholder noted the importance of convergence with US GAAP especially for dual-listed companies with listings in Hong Kong and in the US. The stakeholder noted that a divergence in goodwill accounting between IFRS and US GAAP could result in materially different balance sheets for the same company listed on different stock exchanges.

#### ***Hong Kong's analysis and recommendation***

- Hong Kong believes that convergence is good but it should not come at the expense of IFRS stakeholders. Hong Kong would recommend that the IASB monitor the US Financial Accounting Standards Board's progress on their equivalent project and provide its constituents with the reasons and an effects analysis of any potential GAAP differences if there were to be a divergence in views.

### **[Japan]**

- Japan expects that the IASB and the FASB work closely together with the FASB in developing their respective accounting standards so that their resulting accounting standards become comparable. Japan's expectations to both boards are explained in the response to each question in this comment letter, and do not depend on whether the outcome is consistent with U.S. GAAP as it exists today or consistent with U.S GAAP as it may be after the FASB's current work.

#### [Malaysia]

No, Malaysia confirms that its answers to the questions in this Discussion Paper do not depend on whether the outcome is consistent with US GAAP.

However, Malaysia believes that convergence or, at minimum, having a consistent outcome would be beneficial for those companies who need to prepare financial statements in compliance with both financial reporting frameworks.

#### [New Zealand]

- New Zealand does 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.

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| <b>Question 14</b>   |
| 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? |

#### **AOSSG members' comments on Question 14**

#### [Australia]

##### ***Allowing reversal of goodwill impairment***

Australia notes that the IASB staff have been seeking feedback on whether allowing companies to reverse previously recognised impairment losses could encourage entities to recognise impairment losses earlier and thereby address concerns that impairment losses are recognised 'too little too late'.

Australia **does not** support this proposition.

While there may be a view that entities are recognising impairment losses too late because they cannot reverse them in a subsequent period if circumstances improve, limited feedback obtained from stakeholders does not support this view. Users did not believe that the ability to reverse impairment losses would result in more timely recognition. Similarly, preparers indicated that the ability to reverse a previously recognised impairment loss would not affect when they recognise impairment losses.

While Australia acknowledges that prohibiting the reversal of goodwill impairment losses is inconsistent with other assets, Australia expects it would be difficult to determine the extent to which the reversal is attributable to the recovery of the acquired goodwill rather than the recognition of internally generated goodwill as noted in paragraph BC 189 of the Basis for Conclusions to IAS 36.

#### **[Malaysia]**

Paragraph 5.24 of the Discussion Paper states that it is outside the scope of this research project to consider the concerns of investors who want to compare companies that grow by acquisitions more easily with those that grow organically. Notwithstanding that the investors' concerns may be largely related to governance and accountability, Malaysia believes that a broader project on intangible assets to compare those acquired in a business combination and those generated internally would be beneficial and useful for investors and other users of financial statements.

#### **[New Zealand]**

New Zealand's 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 New Zealand has focused New Zealand's responses to the specific matters discussed in the DP, New Zealand would strongly support a holistic review of IAS 36

and intend to make a recommendation to that effect when New Zealand comments on the IASB's forthcoming agenda consultation.

- New Zealand also intends 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.