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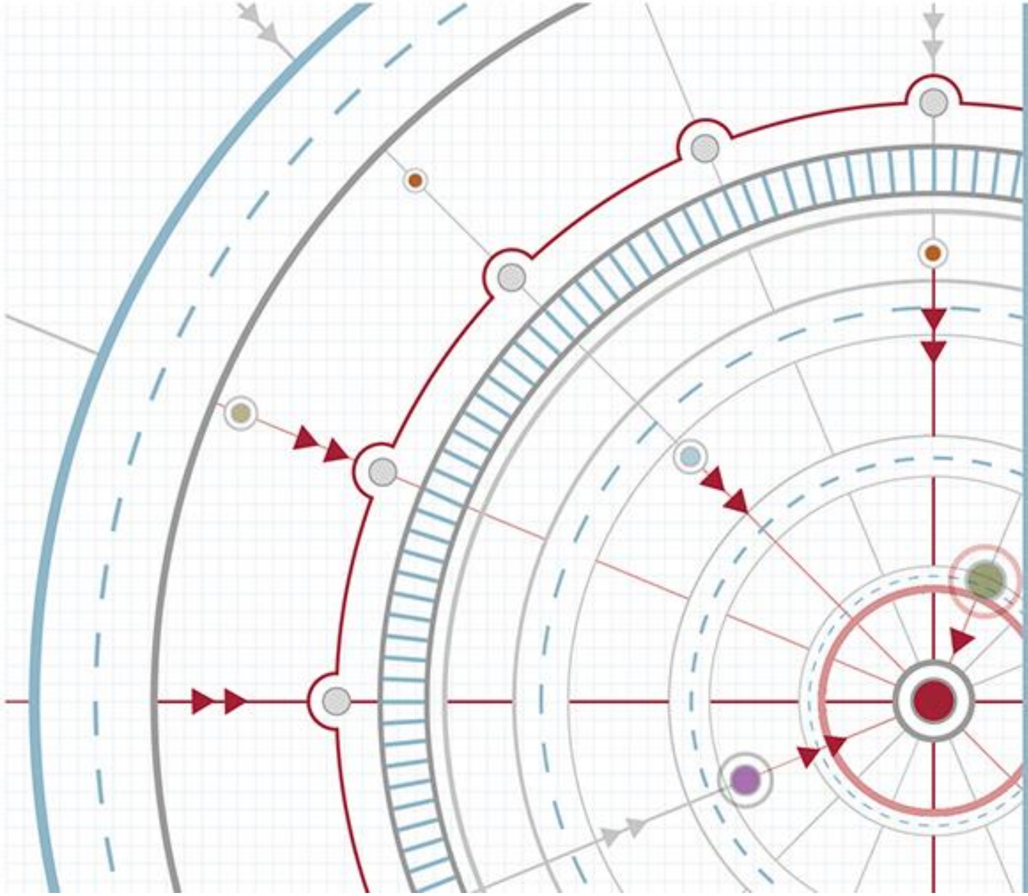

Agenda Paper 3

Discussion Paper
Business Combinations: Disclosures, Goodwill and Impairment

Tim Craig
Takaaki Otsu
Dehao Fang

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The views expressed in this presentation are those of the presenter, not necessarily those of the International Accounting Standards Board or IFRS Foundation.

Contents

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Purpose of meeting

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Discussion Paper

Present Board's preliminary view and provide clarification where needed.

- Expected publication: Mid March 2020; and
- Feedback session planned for joint meeting with CMAC in June.

Outreach & Fieldwork

The staff is seeking advice on:

- Area of focus for outreach activities;
- Explore how to encourage responses from preparers on DP; and
- How fieldwork on disclosures could be conducted.

Questions for discussion

Questions for GPF members

Do members have:

- Any suggestions on how to best encourage response from preparers on:
  - the usefulness and feasibility of the Board's preliminary view on disclosures; and
  - any new evidence on whether goodwill should be amortised or not.
- Any suggestions on the fieldwork approach?
- Any other comments?

Project background & overview

The Discussion Paper

Timeline

2004	2013–2014	2015–2020	March 2020
IFRS 3 issued*	PIR of IFRS 3	Goodwill and Impairment Project	Discussion Paper

Objective

To improve the information companies provide to investors, at a reasonable cost, about the businesses those companies buy.

Feedback

The Board is mainly seeking comments on:

- usefulness and feasibility of its new disclosure ideas; and
- any new evidence or arguments on whether or not goodwill should be amortised.

* IFRS 3 introduced the impairment-only approach and replaced IAS 22 (which required amortisation).

Stakeholders' feedback

What we have heard

- Investors do not get enough information to understand how acquisitions are performing
- The impairment test is complex and costly
- Impairment losses on goodwill are recognised too late
- Goodwill should be amortised
- It is difficult to recognise intangible assets, such as customer relationships and brands, separately from goodwill

The Board's preliminary views

❶ Improving disclosures about acquisitions	Require companies to disclose: • in the year of acquisition, managements' objectives for acquisitions; • in subsequent periods, how acquisitions have performed against those objectives; and • other targeted improvements.
❷ Improving accounting for goodwill	A Can impairment test be made more effective? — No, not at a reasonable cost. B Should goodwill be amortised? — No, retain the impairment-only model. C Can impairment test be simplified? — Yes, provide relief from the annual impairment test and simplify how value in use is estimated.
❸ Other topics	• Present on balance sheet the amount of total equity excluding goodwill. • Do not change the range of intangible assets recognised in a business combination.

➊ Improving disclosures about acquisitions

❶ Improving disclosures about acquisitions

What we have heard

Investors do not get enough information to understand how acquisitions are performing.

The Board is seeking feedback

- Do you think investors would find the information useful?
- Is the Board's approach feasible?

Preliminary views on disclosures

At the acquisition date

Strategic rationale for acquisition

Objectives for the acquisition

Metrics for monitoring achievement of objectives

After the acquisition date

Progress towards meeting acquisition objectives

❶ Improving disclosures about acquisitions

Principle

Companies would disclose the information management uses internally to monitor acquisitions. Companies would not need to create information solely for external reporting purposes.

Why is information needed?

- To assess performance of companies making acquisitions
- To hold management to account (stewardship)

What metrics should be disclosed?

- No single metric suitable
  - Diversity of business combinations
- Management approach
  - Less costly to produce
  - Insights into how management manage
- Operational or financial metrics

❶ Improving disclosures about acquisitions

Should all material acquisitions be disclosed?

- Disclosure depends on what ‘management’ monitors
- Could be onerous disclosure for serial acquirers
- ‘Management’ defined as ‘chief operating decision maker’ (CODM) (IFRS 8 *Operating Segments*)
- Are these the acquisitions that investors would like to know more about?

How long should information be provided for?

- Disclosure required for as long as it is monitored by management
- Expect management to know how acquisition is performing in first 3 years

Reporting performance of an acquisition

At acquisition date

monitored by chief operating decision maker disclose objective	not monitored disclose reason for not monitoring

Within 3 years

monitoring continues disclose progress	monitoring ceases disclose reason for ceasing to monitor

After 3 years

monitoring continues disclose progress	monitoring ceases no further action needed

❶ Improving disclosures about acquisitions

Principle

Companies would disclose the information management, the CODM, uses internally to monitor acquisitions. Companies would not need to create information solely for external reporting purposes.

What happens if	Companies should disclose
acquired business is integrated with existing business?	the metrics that the CODM uses for monitoring; this may be about the combined business.
the metric used for monitoring changed?	reason for change, and performance based on the revised metric.
the information is commercially sensitive?	not sufficient reason if investors need this information.
CODM does not monitor the acquisition?	that fact and reason why. No further action needed.

❶ Improving disclosures about acquisitions

	Message from stakeholders	Preliminary view of the Board
Disclosure of expected synergies	• Synergies are often an important part of an acquisition. • Help investors better understand the factors that contributed to the acquisition price.	• To require companies to disclose the amount, or range, of synergies expected from the acquisition.
Defined benefit pension liabilities & debt	• Some investors consider these liabilities to form part of the capital employed for acquisitions. • Needed to assess return on capital employed.	• Require companies to disclose the amount of defined benefit pension liabilities and debt of the acquiree.
Pro-forma information	• Existing disclosure requirements lack guidance, resulting in diversity in practice. • Preparers question the usefulness of the information, while investors think that the information is important.	• Require companies to disclose both actual and pro-forma revenue, operating profit and cash flow from operating activities.

❷ Improving accounting for goodwill

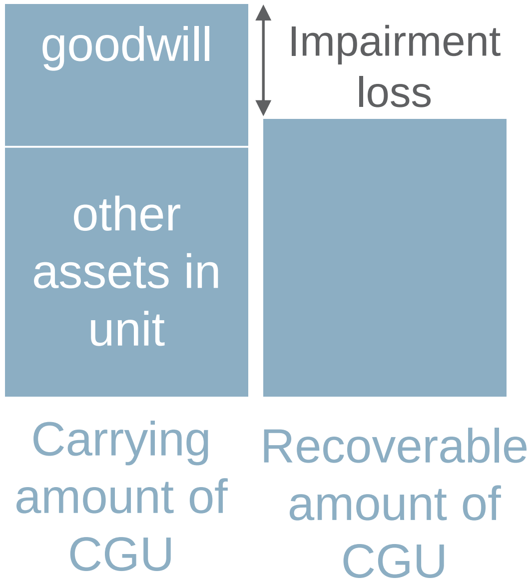
❷ Improving accounting for goodwill

How is goodwill tested for impairment?

- Goodwill does not generate its own cash flows

- Goodwill is tested for impairment as part of a CGU/ group of CGUs

- Any reduction in recoverable amount of CGU(s) is first charged against goodwill



What are the issues?

Stakeholders have said that:

- impairment losses on goodwill are often recognised too late; and
- the impairment test can be costly and complex to perform.

In view of these issues, the Board considered whether:

A. the impairment test could be made more effective (slides18–19);

B. goodwill should be amortised (slides 20–21); and

C. the impairment test could be simplified (slides 22–24).

❷🅐 Can the impairment test be made more effective?

What is the issue?

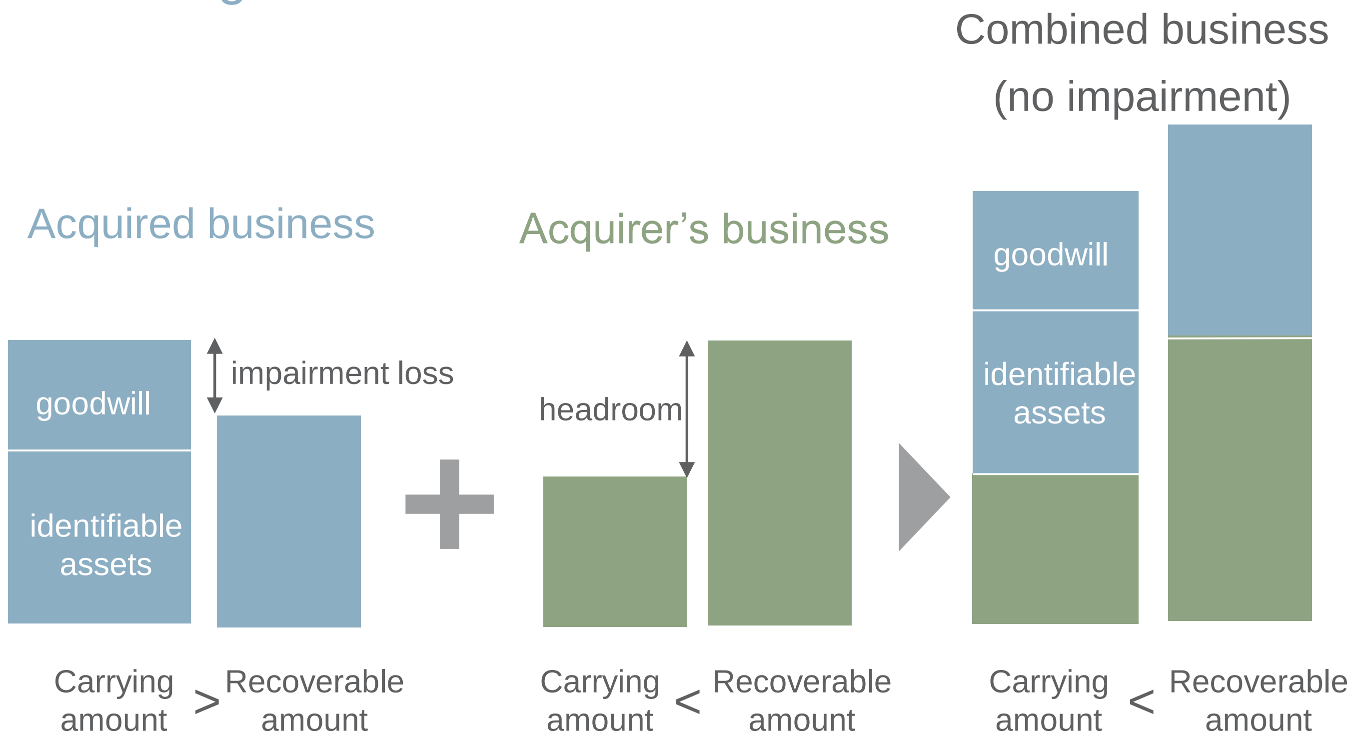
Delay in recognising impairment losses on goodwill could be due to:

- overly optimistic cash flow estimates; and
- ‘shielding’ of impairment by ‘headroom’.

Headroom = excess of recoverable amount over carrying amount arising from:

- Pre-existing business with which the acquired business is combined; or
- Goodwill internally generated after acquisition.

Shielding—illustration



Headroom could shield goodwill from impairment loss that would have otherwise occurred.

❷Ⓐ Can the impairment test be made more effective?

✓ An impairment test seeks to assess:

- whether a company's assets are worth less than their carrying amounts.
- for assets that are part of a cash-generating unit, whether the unit (or group of units) as a whole is worth less than the carrying amount of its assets.

✗ An impairment test cannot:

- test goodwill directly.
- be designed to signal whether an acquisition is succeeding or failing.
- be performed without relying on management's estimates of uncertain future cash flows. These estimates will always be subjective.

Board's preliminary view:

- Significantly improving the effectiveness of the test at a reasonable cost is not feasible.
- Shielding cannot be eliminated because goodwill has to be tested for impairment with other assets.
- The test cannot always signal how an acquisition is performing, but that does not mean that the test has failed.
- When performed well, the test achieves the objective of ensuring that the carrying amount of the CGU as a whole is not higher than its combined recoverable amount.
- The disclosure ideas (discussed in slides 11–14) could help provide investors with the information about the performance of acquisition they need.

❷❸ Impairment-only vs amortisation

A lookback in time

IASC		IASB		
1983	1993	2004	2013–2014	2015–Present
IAS 22 issued Amortisation or direct write-off	IAS 22 amended Required amortisation	IFRS 3 issued Introduced the impairment-only approach	Post-implementation Review of IFRS 3	Goodwill and Impairment research project

❷Ⓑ Impairment-only vs amortisation

Having concluded that the impairment test cannot be significantly improved at a reasonable cost, the Board considered whether to reintroduce amortisation of goodwill (an impairment test would still be required).

Arguments for amortising goodwill

Some say:

- feedback from PIR of IFRS 3 suggests that impairment test is not working as the Board intended
- carrying amounts of goodwill are overstated and, as a result, a company's management is not held to account
- amortisation provides a simple mechanism that targets acquired goodwill directly, which the impairment-only model cannot
- goodwill is a wasting asset, reducing as the benefits are consumed—amortisation shows consumption of goodwill
- amortisation would eventually make impairment testing easier and less costly because amortisation would reduce carrying amount of goodwill, making a large impairment less likely

Arguments for impairment-only approach

Some say:

- the impairment-only model provides more useful information than amortisation which is arbitrary—many investors would ignore it and many companies would adjust it from their results
- if applied well, the impairment test achieves its purpose of ensuring the combined carrying amount of the cash-generating unit (or group of units) to which goodwill has been allocated is not higher than the combined recoverable amount
- benefits of goodwill are maintained for an indefinite period of time, so goodwill is not a wasting asset with a finite life
- amortising goodwill would not significantly reduce the cost of impairment testing, especially in the first few years

The Board's preliminary view is that it should retain the impairment-only approach because there is no compelling evidence that amortisation would significantly improve financial reporting.

Stakeholders are invited to provide convincing new arguments or reasons why prior arguments are more relevant today, to help the Board decide on the direction moving forward.

❷ⓒ Simplifying the impairment test

Having to perform goodwill impairment test when there is no indicator of impairment adds unnecessary cost.

Relief from an annual impairment test

Existing requirements	Board's preliminary view
Companies must perform annual impairment test, even when there is no indicator.	• Remove requirement to test CGU containing goodwill for impairment at least annually • Companies must still assess if there is any indicator of impairment, and perform the test if there is • Helps companies to reduce cost • Reduction in robustness of the test marginal because it is unlikely that material impairment losses occur with no indicator • Benefit of performing the test when there is no indicator is marginal

❷ⓒ Simplifying the impairment test

It's costly to decide which cash flows to exclude from value in use estimates.

Simplifying value in use estimates
- Remove restriction of uncommitted restructuring and asset enhancement cash flows in value in use estimates

Existing requirements	Board's preliminary view
Companies must exclude cash flows from future uncommitted restructuring or asset enhancements from their forecasts.	• These cash flow forecasts would still need to be reasonable and supportable • Would reduce the cost and complexity of performing impairment tests • Less prone to error

❷ⓒ Simplifying the impairment test

Pre-tax discount rates are not observable. In practice, valuation is usually performed on a post-tax basis.

Simplifying value in use estimates
- Allowing post-tax discount rate and post-tax cash flows

Existing requirements	Board's preliminary view
Companies must estimate value in use based on pre-tax cash flows and pre-tax discount rate.	• Discount rate and cash flows need to be internally consistent • Would reduce the cost and complexity of performing impairment tests • More understandable and better aligned with industry practice

❸ Other topics

❸ Other topics

Presenting total equity excluding goodwill

Goodwill is different from other assets because it:

- can only be measured indirectly; and
- cannot be sold separately.

Presenting total equity excluding goodwill on the balance sheet helps to:

- draw attention to companies whose goodwill constitute a significant portion of their equity; and
- make this amount more prominent.

XYZ Group – Statement of financial position as at 31 December 20X0

Property, plant and equipment	1,000
Goodwill	2,000
Total non-current assets	3,000
Inventories	1,000
Trade receivables	2,000
Cash and cash equivalents	3,000
Total current assets	6,000
Total assets	9,000

Long-term borrowings	1,000
Deferred tax	2,000
Total non-current liabilities	3,000
Trade and other payables	3,000
Total current liabilities	3,000
Total liabilities	6,000
Share capital	1,000
Retained earnings	2,000
Total equity	3,000
Total equity and liabilities	9,000
Total equity excluding goodwill	1,000

Recognise acquired intangible assets separately from goodwill

Separate recognition helps to explain what companies have acquired. It also ensures that intangible assets that are different in nature to goodwill are presented separately.

Separate recognition does not provide useful information, because:

- similar intangible assets are not recognised if generated internally; and
- some intangible assets are hard to value.

Existing requirements

All identifiable intangible assets acquired in an business combination need to be separately recognised.

Board's preliminary view

- No compelling evidence that requirements in IAS 38 should be amended.
- Considering whether to align the accounting treatments for acquired and internally generated intangible assets is beyond the scope of this project.

Overall package of preliminary views

Overall package of preliminary views

In the Board's view, its package of preliminary views achieves a balance between the following objectives:

- providing more useful information, allowing investors to hold management to account; and
- reducing costs for companies.

The table summarises whether each of the changes suggested:

- is in line with the objective (✓);
- is in conflict with the objective (✗);
- is not expected to harm the objective (…); or
- has effects that are not yet clear (?).

Preliminary view – changes to existing requirements

	More useful information	Reduce cost
Improving disclosures about acquisitions	✓	✗
Relief from mandatory annual impairment test	?	✓
Amend how value in use is estimated	✓	✓
Present total equity excluding goodwill	✓	…

The Board has also considered, and decided against, the suggestion to reintroduce amortisation of goodwill. Furthermore, the Board decided that all identifiable intangible assets acquired in an business combination should continue to be separately recognised from goodwill. This is because:

- there is no compelling evidence that the Board should make these changes; and
- both changes would likely reduce the usefulness of information provided to investors.

Outreach and fieldwork

Outreach and fieldwork

March 2020 — DP issued

June 2020 — Joint CMAC-GPF meeting

September 2020 — End of comment period

October 2020 ~ — Comment letter analysis and redeliberation

Stakeholders outreach

- roundtables in various jurisdictions for all stakeholders
- focused investor outreach

Project fieldwork – preparers

Planning → Feedback

Fieldwork

Tentative plan	
Scope	Board's preliminary views on disclosures about subsequent performance of acquisitions
Purpose	Help the Board to understand: • feasibility of preliminary view • usefulness of information • how management monitors acquisitions (or not) • specific issues encountered during preparation
Participants	Looking at around 15 to 20 participants, with diverse geographic and industry background

Fieldwork

Tentative plan	

Format	• Kick-off meeting to explain and clarify Board's preliminary view
	• Volunteers prepare mock disclosures based on actual acquisition
	• Follow-up via VC or face-to-face meeting to discuss mock disclosure—follow-up questions could include:
	    • How readily available was the information?
	    • Why was the CODM monitoring this acquisition?
	    • How did the CODM receive the information?
	    • Has there been any changes in the information used?
	    • Are any of the metrics used based on combined business?
	    • Was any supplementary information needed?
	    • Is any of the information commercially sensitive?

Fieldwork

Addressing concerns on commercial sensitivity

- Need not be a recent acquisition—preferably a well-reported past acquisition
- Focus on how management monitor acquisitions and what the disclosures might look like, not factual accuracy of information
- Response will only be shared within the team; reports back to the Board will be on no-name basis

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