



Business Combinations—Disclosures, Goodwill and Impairment (DP)

—*Preliminary Feedback from Chinese Stakeholders*

China Accounting Standards Committee

1st December, 2020

This presentation is prepared for discussing “Business Combinations—Disclosures, Goodwill and Impairment (DP)” issues and does not necessarily reflect the views of the CASC.

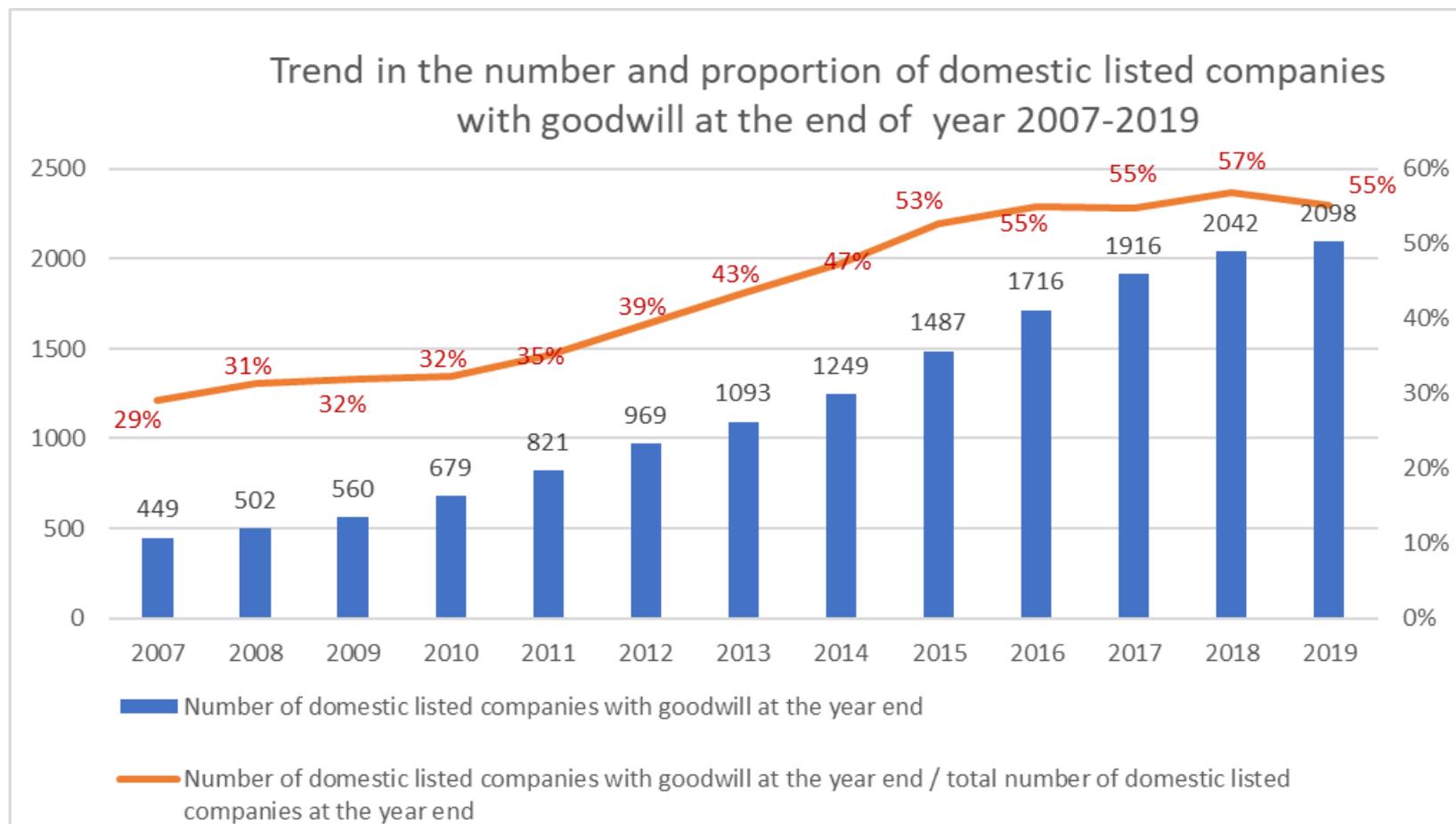


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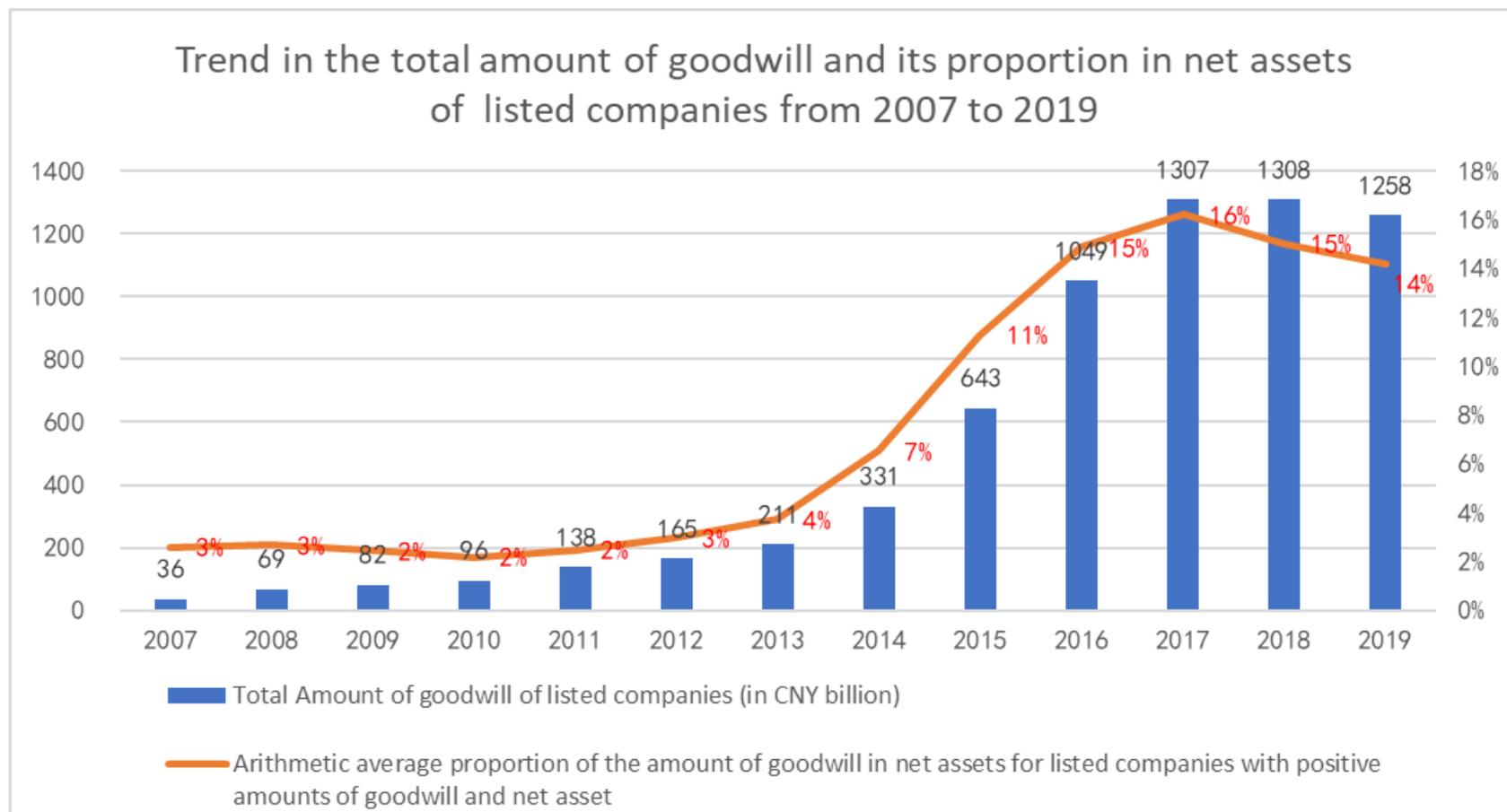


1. Overview of China's domestic listed companies - scale of goodwill



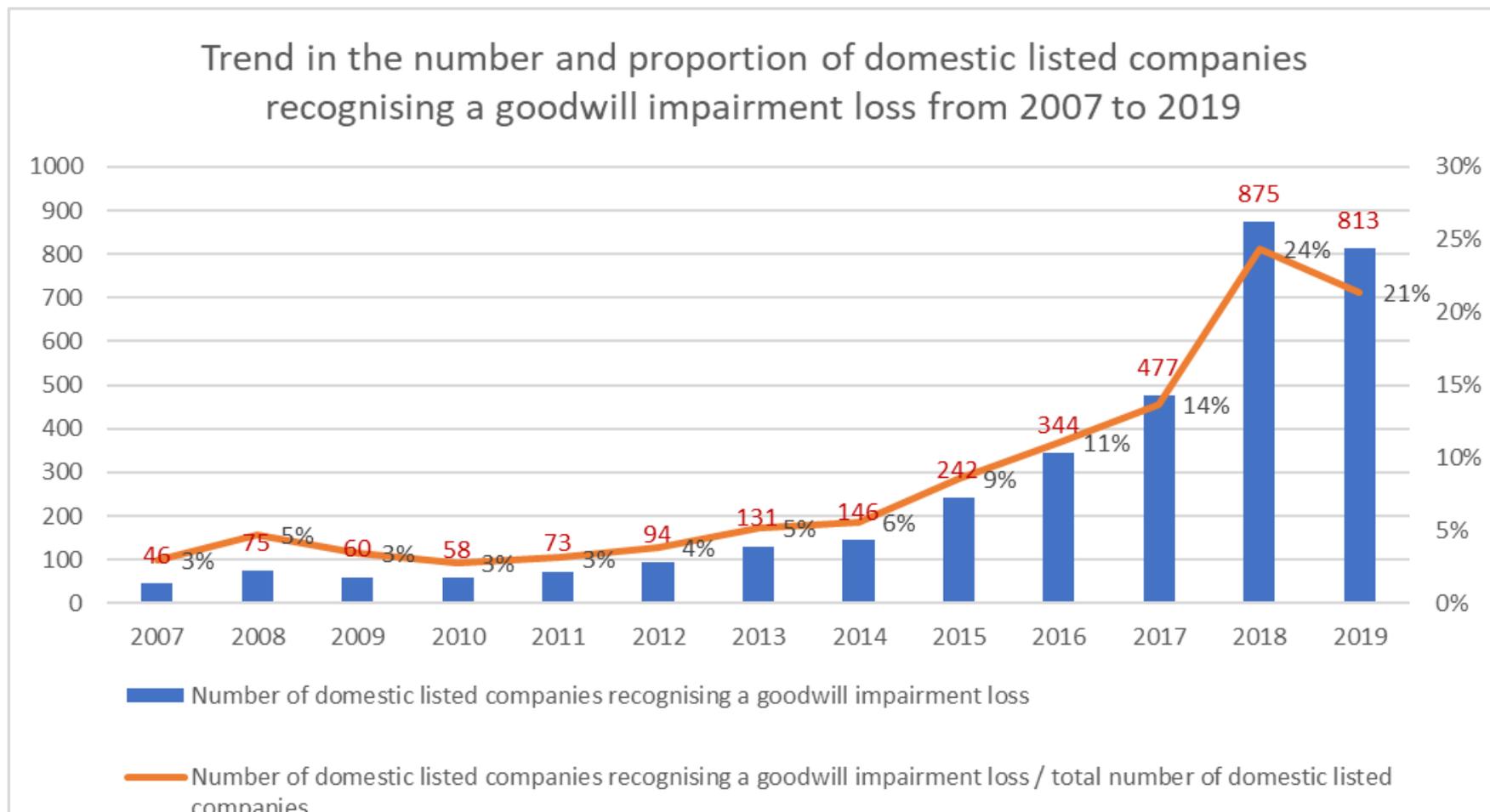


1. Overview of China's domestic listed companies - scale of goodwill (continued)





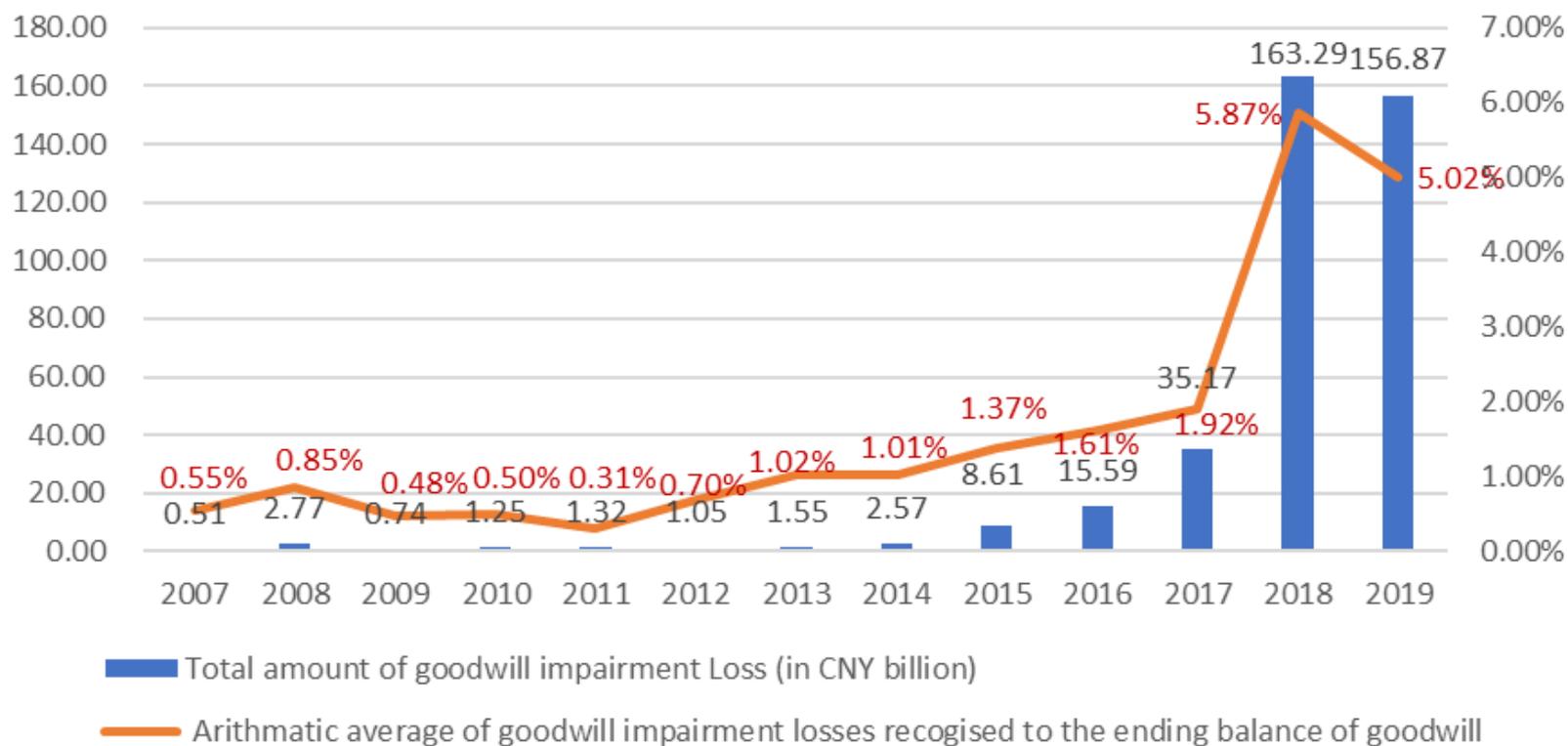
1. Overview of China's domestic listed companies - scale of goodwill impairment loss





1. Overview of China's domestic listed companies - scale of goodwill impairment loss (continued)

Trend in the amount and proportion of goodwill impairment losses recognised from 2007 to 2019





2. Relevant activities in China

- *Business Combinations— Disclosures, Goodwill and Impairment DP* published in March 2020
 - Summarize the main contents and propagate the *Update Information*
 - Translate the DP into Chinese and seek comments in China
 - Seminars with the CASC Advisory Committee members and other stakeholders
 - Other outreach with the CASC Advisory Committee members



Preliminary Feedback



3. Feedback on improving disclosures about acquisitions

Overall Perspectives

- Disclosing the information based on how management monitors and measures whether the acquisition is meeting its objectives is relevant and useful, however, there are a lot of concerns on practical application of such disclosures, and more specific guidance is highly needed
- Non-financial information is recommended moving to management commentary or other parts of financial reports
- The end of the second full year is considered too early when requiring management to disclose the facts and reasons if it stopped performance monitoring before it
- Disclosing synergies has great difficulty in practice
- Commercial sensitivity will inhibit management from disclosing information adequately and completely
- There are mixed views about providing further guidance on the pro-forma information



Disclose relevant information based on how management (CODM) monitors and measures whether the acquisition is meeting its objectives

- **Stakeholders generally support the above proposal**
- **A few stakeholders consider the practical application of such disclosure is feasible:**
 - The existence of feasibility study on the acquisitions can support relevant disclosures
- **A majority of stakeholders consider the practical application of such disclosures is difficult:**
 - Some preparers consider the objectives of a complicated acquisition may be hard to depict
 - Some auditors state there are many non-financial and/or non-GAAP information included in the disclosure requirement, and the lack of unified standards or specific guidance may result in uncertainties as to whether such disclosures will meet its intended objectives
- **Recommendations:** some stakeholders state the current disclosure requirement in the DP is too principal-based which may lead to large diversity in practical application, and suggest the IASB to provide more specific guidance on the manner, content and degree of relevant disclosures.



Disclose the facts and reasons if management stopped performance monitoring before the end of second full year

- **Most stakeholders don't support setting the end of second full year as the benchmark to require management's disclosures on facts and reasons:**
 - Management may stop effective performance monitoring activities too early in some instances
 - Most acquisitions of Chinese entities require evaluation on operating results against its objectives for at least 5 years, and the second year seems not long enough to reflect the characteristics of operational objectives
 - Most listed companies set performance betting period more than 3 years, which should be consistent with the performance monitoring period
- **Recommendations:** Most stakeholders suggest to extend the benchmark year to require management to disclose the facts and reasons if management stops performance monitoring before it.



Disclose synergies

- **Some stakeholders consider it has great difficulty disclosing synergies in practice:**
 - Preparers and auditors state the concept of synergy is not clear within the current IFRSs, and its realization is a progressive process, it is difficult to estimate and quantify its impact on the transaction price
 - Valuers state providing quantified disclosure on synergy is very difficult because there may not have sufficient technical support or resource. Normally, the valuation on the underlying will not include synergies unless specifically required
- **Some stakeholders object the disclosure of synergies:**
 - In theory, the relationship between synergies and goodwill is unclear, and it lacks evidence if synergy will be representative of the substance of goodwill, for example, the acquisition across different industries may not create synergy effect



Commercial sensitivity will inhibit companies from disclosing information about management's objectives

- **Most stakeholders agree the above view:**
 - ▣ In some instance, commercial sensitive information is directly linked to the merge objective which may reveal company's merge strategy and considered not appropriate to be disclosed
- **Recommendations:** some stakeholders suggest the IASB to provide specific guidance on the identification, content, extent and degree of commercial sensitive information and its relevant disclosures to avoid leaving too much discretion to preparers in order to improve the quality of such disclosures.



To retain the requirement of preparing pro-forma information and whether the IASB should develop guidance for companies on how to prepare it

- **Most stakeholders support retaining the above requirement and suggest to provide guidance:**
 - The key objective is to provide relevant and comparable financial information, as such, the preparation of the pro-forma information is considered necessary. Currently, there is diversity in practice, so stakeholders suggest the IASB to provide specific guidance on the basis for preparation and to unify disclosure requirements to enhance the comparability and reliability of pro-forma information
- **A few stakeholders consider the pro-forma information has limited usefulness and suggest not to provide guidance:**
 - The pro-forma information is less comparable with the actual financial information of the acquired company, and the guidance on how to prepare it is not considered necessary



4. Feedback on improving the accounting for goodwill

Overall Perspectives

- The majority of stakeholders support the retaining of the impairment-only model and a minority of them favor the reintroduction of the amortisation model
- An overwhelming majority of stakeholders expressed objections or reservations to the proposal to eliminate the annual impairment test
- There was general support for allowing the use of post-tax cash flows and discount rates in estimating VIU, but mixed views on whether to allow companies to include cash flows from uncommitted future restructurings, improvements or enhancements in their cash flow estimates



Impairment-only model Vs. Amortisation model

- **Most stakeholders support impairment-only model for the following reasons:**
 - The useful life of goodwill cannot be determined accurately, and the future income generated from it also has a high degree of uncertainty. Also its amortisation life and method selection lack theoretical basis
 - There are a lot of uncertainties in the timing and ways of the consumption of economic benefits generated by goodwill. In the absence of compelling evidence, the existing impairment-only model should be retained
 - Prudently consider the effect of reintroducing the amortisation model on the global capital markets and macro economies.



Impairment-only model Vs. Amortisation model (continued)

- **Supporters of the amortisation model hold the views as below:**
 - It is believed that goodwill, as an asset, also has a consumption cycle. Amortising goodwill over a period of time and matching it with the economic benefits it brings is a reasonable subsequent accounting method
 - Goodwill amortisation helps to urge the management of enterprises to treat M&A prudently, effectively carry out post-merger integration, and realize subsequent merger effects
 - Goodwill amortisation is beneficial to protect investors and restrain aggressive M&A pricing
 - Goodwill amortisation could alleviate the "too little, too late" problem under the impairment-only model



Relief from the annual impairment test

- **Respondents generally object to the relief from annual impairment test:**
 - It is difficult to identify the indicators of goodwill impairment in practice, and the judgment could be too subjective. Hence, exempting enterprises from the annual goodwill impairment test will exacerbate the "too little, too late" problem existing in the current practice
 - If the annual impairment test is required, the enterprise should disclose the main parameters and methods adopted in testing at least annually, and then can provide additional useful information for users to supervise the realization of the post-merger synergies
- **A few respondents support the relief from annual impairment test:**
 - This simplification would be cost-saving considering the implementation cost of annual impairment test
 - The disclosure requirements of relevant information should be strengthened if to apply the exemption of annual impairment test



Simplify VIU calculation

■ Include restructuring cash flows

- Supporters concern that there is operational difficulty in identifying cash flows expected to arise from a future uncommitted restructuring or expected to arise from improving or enhancing the asset's performance
- Opponents believe incorporating cash flows related to future restructurings or future asset improvements that have not yet been committed into the VIU calculation will lead to
 - ✓ more confusing VIU forecasts
 - ✓ management optimism
 - ✓ confusion about the difference between VIU and FVLCD

■ Allow post-tax calculations

- All stakeholders agree on this simplification



5. Other concerns and suggestions

- **Apart from the subsequent goodwill accounting problems, respondents have concerns on the initial measurement of goodwill and purchase price allocation considering the following practical problems:**
 - a long interval between the acquisition date and the evaluation date
 - potential underestimation of intangible assets from business combination
 - difficulty in obtaining the market value of some related assets and liabilities
- **Further survey should be conducted on relevant disclosure practices about acquisitions and more granular guidance should be provided on the content, manner and degree of disclosure**



Thank you!