**Meeting with Business Combinations and Reporting Entity Advisory Panel**
(via videoconference)

Date: 13 July 2020, Monday
Time: 2:30 p.m. – 4:45 p.m.

**Members Present:** Anntice Lai
Catherine Yuen, Ernst & Young
Cynthia Leung, Financial Reporting Council
Elza Yuen, PwC
Fran Hung, Deloitte Touche Tohmatsu
Gary Stevenson, RSM
Gordon Lee, Deloitte Touche Tohmatsu
Jim Tang, KPMG
Simon Riley, BDO Limited
Steve Ong, HKEx
Susanna Lau, Securities and Futures Commission

**Staff in attendance:** Michelle Fisher, Deputy Director, Standard Setting, HKICPA
Tiernan Ketchum, Associate Director, Standard Setting, HKICPA
Norman Chan, Associate Director, Standard Setting, HKICPA
Joni Kan, Associate Director, Standard Setting, HKICPA

**Apologies:** Candy Fong, Foremost Advisors Limited
James Fawls
Michael Wong, Goldman Sachs
Shelley So, PwC

**IASB Discussion Paper DP/2020/1 *Business Combinations – Disclosures, Goodwill and Impairment***

**1. Improving disclosures about acquisitions**

*Proposed disclosures*

- Some panel members shared their concerns that the proposed new disclosure requirements would result in increased difficulty and complexity for auditors because they are qualitative and subjective in nature, and relevant information may not be available for some companies, particularly smaller private companies, because not all companies monitor or collect adequate data, or perform sufficiently detailed due diligence prior to acquisition. In addition, some Panel members noted that management may not use metrics to track the success of the acquired business, they may only monitor performance based on the profit or loss results of the acquired business without extensive analysis, thus there may be auditability issues with the metrics.
- One panel member agreed the proposed new disclosures would help users of financial statements to obtain more information. Although the member noted that the proposal may create burdens for auditors, the panel member considered that the majority of auditors should be able to overcome those difficulties.
- One panel member (a regulator[1]) supported the proposals but recommended the IASB consider requiring disclosure of the headroom related to goodwill (i.e., by how much the recoverable amount exceeds the carrying amount of the cash-generating unit)

[1] Comments by regulators have been marked. All other panel members are practitioners.

because this could provide more timely insight to users whether there would be potential goodwill impairment losses. Another member (a regulator) agreed with this sentiment, however suggested the IASB require all companies to disclose a sensitivity analysis of the assumptions used in impairment testing instead of the headroom because information about company's key assumptions and judgements used to determine recoverable amount would provide more useful information to users. The first panel member noted his support for disclosure of a sensitivity analysis as well as the headroom.

- Another panel member also considered that the disclosure of headroom may not be useful as goodwill may be nevertheless shielded by the value of the combined companies/cash-generating units. The panel member also shared feedback received from preparers that the IASB's proposed disclosures would increase the workload for preparers, and may compel them to develop further metrics to monitor the performance of the acquired business and measure whether the objectives for the acquisition are met. On the other hand, the proposed new disclosure requirements may encourage some companies to monitor the performance of the acquired business more robustly rather than only focusing on goodwill impairment.
- Some panel members commented that the IASB should consider whether the proposed new disclosures should be provided in the financial statements (e.g. in the segment reporting note to the financial statements) or outside the financial statements (e.g. in the management discussion and analysis) given their nature. One member recommended the IASB should further explain the reasons why the required disclosures should be disclosed in or outside of the financial statements[2]. A few panel members considered the proposed new disclosures are qualitative in nature and it is hence more appropriate to include them as part of the management commentary.
- Given the objective of the proposed disclosures is to provide useful information to investors, one panel member suggested the IASB should follow the objective of the IASB's Disclosure Initiatives project and set more principle based disclosure requirements that could be applied appropriately across different industries and by entities considering their specific circumstances, and not require disclosures of specific information for all companies (i.e. one size does not fit all). Required disclosures should be based on the users' needs and should not be excessive.
- One panel member noted that the Discussion Paper as written appears to focus primarily on a disclosure solution, and that this focus may not address the fundamental problems arising from the current accounting requirements. This member recommended the IASB better consider the root cause of the problems and reconsider whether additional disclosures would be the best way to address them. For example, if the problem is that the impairment-only approach is not working effectively, additional disclosures would not directly address this problem as that is a measurement issue.

*Proposed basis for disclosures and commercial sensitivities*

- Some panel members (including a regulator) supported the IASB's approach for the proposed disclosures, which is akin to a "management approach" used for segment reporting, as this approach is easier for management, is entity/business specific and based on how management actually monitors the goodwill and assesses the performance of the acquisition. However, one panel member considered such a management approach would negatively affect comparability among companies and industries.
- One panel member supported the IASB's proposal, however raised concerns that according to paragraph 80 of IAS 36 *Impairment of Assets*, goodwill is allocated to a cash-generating unit or groups of cash-generating units 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). The member

[2] Paragraph 2.32 of the DP explains that the IASB takes the view that all companies should provide the information on the same terms. Not all companies produce a management commentary and not all management commentaries may be available to investors on the same terms as the financial statements. The IASB's preliminary view is that companies should be required to disclose information about strategic rationale, objectives and related targets in the financial statements.

suggested there may be situations where goodwill is managed internally at a lower level than the operating segment, and hence information provided to the chief operating decision maker (CODM) would be different from those reviewed by the management that monitors the goodwill. The panel member questioned whether the proposed disclosure requirements based on information reviewed by the CODM would be sufficient, and recommended the IASB to consider the pros and cons of using such a management approach.
- Two panel members commented that useful and relevant information is usually commercially sensitive. They both agreed that commercial sensitivity is not a valid reason for companies not to disclose the management's (CODM's) objectives for an acquisition and metrics used to monitor whether those objectives are being met.

*Constraints on proposed disclosures*
- One panel member shared his observations that there could be constraints for smaller companies to disclose the objectives of the acquisition and the metrics used to monitor the progress in meeting those objectives. This is because certain smaller or less sophisticated companies may not have concrete process for evaluating targets prior to acquisition (e.g. there may be no formal valuation to support the consideration and the transaction price is negotiated between the acquirer and the seller)[3].

*Disclosure objectives*
- One panel member commented that incorporating specific disclosure objectives may not result in useful information for investors, because the information disclosed would be subject to the judgement of the preparers regarding what is relevant information.
- One member reiterated that the IASB's preliminary view overly emphasises disclosures at the expense of addressing underlying accounting issues. This member suggested the IASB should consider what problems need to be addressed, and reconsider whether additional disclosures are the right way to accomplish this.

*Other improvements to IFRS 3 disclosures*
- One panel member considered the proposed disclosures, particularly on areas such as expected synergies, are highly subjective and may involve forward-looking assumptions. The panel member questioned whether such disclosures should be made in the financial statements[4].
- One panel member questioned the usefulness and relevance of the pro forma information of cash flows from operating activities of the combined business for the reporting period because information about the acquired business before the acquisition may not be obtainable from the seller, and hence such cash flows would need to be estimated based on the corresponding cash flows after the acquisition.

## 2. Goodwill impairment and amortisation

*Effectiveness of impairment test*
- One member considered that the current impairment-only model is generally still an effective model. This member noted that the impairment test already considers the effect of synergies and future performance, and that the functioning of the model depends heavily on management estimation and judgement. This member noted that it may be the case that management optimism could result in the model being less effective, but that this would vary on a case by case basis, and that if entities perform quality estimates and assessments that the concerns (e.g. 'too little, too late' impairment recognition) noted in the Discussion Paper may be addressed.

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[3] Paragraphs 2.20-2.21 of the DP explain that the IASB's preliminary view is to require entity to disclose the acquisition objectives and the metrics to monitor the acquisition if the CODM reviews these metrics. If CODM does not monitor the acquisition, this fact has to be disclosed.

[4] Paragraphs 2.29-2.32 of the DP explain that the IASB's preliminary view is that the required disclosures are not forward-looking information and companies should be required to disclose such information in the financial statements.

  - Another member agreed with these comments and suggested that many of the concerns raised by the Discussion Paper may be a result of how the model is being applied rather than a result of the model itself.
- One member noted that the current impairment model does not test goodwill directly, but rather tests a cash generating unit(s). This member suggested that the IASB should consider not just how the impairment model is being applied, but consider more fundamentally what the model is testing. The member commented that if the impairment model only ever tests a cash generating unit(s), the underlying issues about impairment of goodwill may not be resolved.
- One member (a regulator) reiterated comments that headroom associated with goodwill and a sensitivity analysis of the impairment test should be disclosed, as this would help users identify potential impairment earlier. This member would additionally support reconsidering amortisation plus impairment. This member also suggested that the IASB should consider related requirements under US GAAP and the importance of convergence.

*Amortisation of goodwill*

- One member suggested that a starting point should be to consider whether there are any particular concerns with goodwill being "overstated" for a given entity. If such concerns cannot be identified, then this member would not see a need for amortisation. This member also took the view that goodwill is not an asset which is consumed.
  - Another member agreed with this position. This latter member also suggested that amortisation could result in hiding potential impairment losses (as the carrying value of goodwill is reduced through amortisation), and questioned how amortisation could then address the "too little, too late" concern about impairment losses.
- One member stated that the impairment model is costly, and amortisation would help to reduce this cost. This member further commented that whether investors prefer an impairment-only or impairment with amortisation model may depend on how they view goodwill and assess the value of goodwill as an asset. This member suggested that the SSD staff reach out to user groups to better understand their information needs and valuation perspectives.
- One member (a regulator) suggested that arguments for amortisation have some merits, but that amortisation is based more on the concept of "prudence", whereas recent developments in IFRS Standards are based more on the principle of "neutrality". Therefore, this member considered it could be difficult to change back to an amortisation approach.

## 3. Other topics

*Removal of annual impairment test*

- One panel member commented that there would be pros and cons of removing the requirement to perform an annual impairment test. The member added that more effort and analysis would be required to conclude that there were no impairment indicators.
- One member (a regulator) was supportive of the proposals in the DP, but on the condition that the removal of the annual impairment test is supported by disclosures around the sufficiency of headroom and the profitability of CGU(s). In situations where headroom is not sufficient, or where a CGU is making losses, this member thinks the impairment test should be performed on an annual basis as impairment may be imminent and in order to avoid a "too little, too late" scenario. This member noted these comments on disclosures were consistent with recommendations to listed issuers set out in paragraphs 119-152 of the HKEX Annual Report Review Disclosure Report dated 31 January 2020[5].

[5] https://www.hkex.com.hk/-/media/HKEX-Market/Listing/Rules-and-Guidance/Other-Resources/Exchanges-Review-of-Issuers-Annual-Disclosure/rdiar_2019.pdf

*Simplification of value in use*

- One panel member considered that the IASB should include more specific requirements if it allows the inclusion of cash flows related to future uncommitted restructuring or improving the asset's performance, as blanket withdrawals of such restrictions without specific requirements/guidance may result in unintended consequences (eg companies including inappropriate cash flows.  This panel member also welcomed allowing the use of post-tax cash flows and the post-tax discount rate in estimating value in use, since they are commonly used in valuations.

*Presentation of total equity excluding goodwill*

- Two panel members welcomed the IASB's proposal to present total equity excluding goodwill on the balance sheet. However, they also commented this change in presentation would not be a significant improvement since the figure for total equity excluding goodwill can already be easily computed from the financial statements. A panel member also suggested that such a change may create confusion for users, and may beg the question of what is being implied by separate presentation of a subtotal which can otherwise be easily determined.
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*Separate recognition of Intangibles*

- Two panel members supported the IASB's preliminary view not to develop a proposal to allow some intangibles to be included in goodwill. A panel member commented that commingling some identifiable intangibles (e.g. non-contractual customer relationships/brand names) with goodwill would result in loss of information.