Hong Kong Institute of
Certified Public Accountants
香港會計師公會

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23 December 2020

Mr Hans Hoogervorst
International Accounting Standards Board
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Dear Hans,

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

The Hong Kong Institute of Certified Public Accountants (HKICPA) is the only body authorised by law to set and promulgate standards relating to financial reporting, auditing and ethics for professional accountants in Hong Kong. We are grateful for the opportunity to provide our views and the views of our stakeholders on this Discussion Paper (DP).

The HKICPA appreciates the IASB's initiative and efforts to explore ways to provide investors with more useful information about the acquisitions made by companies and improve the accounting of goodwill. The HKICPA has been actively engaged with this topic, and in March 2020 the staff of the HKICPA, with the staff of the Accounting Standards Board of Japan, published a joint Research Paper *Goodwill: Improvements to Subsequent Accounting and an Update of the Quantitative Study* (RP). The RP, in order to contribute relevant and timely analyses to the global project, shares findings on a quantitative study and explores views on the subsequent accounting for goodwill. The HKICPA recommends that the IASB refer to the RP in full as an integral part of our comments on the DP.

The HKICPA has carefully reviewed the DP and performed outreach with local stakeholders to broaden awareness of the proposals and seek feedback. We provide detailed comments in the Appendix, with primary points including:

- The DP tends to concentrate on a disclosure-based solution to the prevailing accounting issues, which we consider may not fully address the issues surrounding the accounting for goodwill. We think that it may be beneficial to explore the fundamental accounting of goodwill more robustly.

- The HKICPA supports an amortisation plus indicator-based impairment approach as we outlined in our RP, which is supported by a slight majority of our stakeholders. We have noted a variety of arguments for both the amortisation plus impairment model and the current impairment-only model from practical, cost-benefit, usefulness, and conceptual perspectives. This is detailed in the Appendix.

- The HKICPA generally supports the IASB's intention to enhance the disclosure objectives and requirements in IFRS 3, and thereby improve the information provided to users about an acquisition and its subsequent performance. Nevertheless, we noted diverse views from different types of stakeholders. Many of our stakeholders voiced concerns that some of the proposed new disclosure requirements are subjective and would likely lead to boilerplate disclosures, while some of the proposed new disclosures may be considered commercially sensitive and may raise quantification difficulties and give rise to audit challenges. Additionally, the proposed pro forma information disclosures may raise significant challenges for preparers and auditors. The HKICPA recommends that the IASB perform sufficient further consultation and outreach on this aspect including hosting a consultation group comprising both investors and preparers to enable direct communication and to obtain further clarity over the respective needs and concerns. We also recommend the IASB carefully consider the extent of the disclosures, together with the example disclosures and suggestions shared by our stakeholders as summarised in paragraphs 8 and 12 of the Appendix.

- Specifically, among the disclosure proposals, the HKICPA disagrees with the proposal for disclosures that analogises to the management approach and shares similar views with our stakeholders that the resulting disclosures would be of insufficient quality. We recommend that the IASB carefully reconsider the costs and benefits of this proposal.

- The HKICPA and the majority of our stakeholders do not think the IASB's proposal of presenting total equity excluding goodwill would improve financial reporting.

- We found the proposed removal of the restriction on including cash flows relating to uncommitted future restructurings and asset enhancements in estimating value in use lacking conceptual basis, and that the proposal would increase the risk of overly optimistic inputs, aggravating the 'too little, too late' problem. These concerns are shared by some of our stakeholders and we recommend that if the IASB were to pursue this proposal, it should provide a conceptual basis for such a change and include more specific criteria on when such cash flows could be included. On the other hand, we and a majority of our stakeholders support the IASB's proposal to allow companies to use post-tax cash flows and post-tax discount rates in estimating value in use.

Our detailed responses to the questions raised in this DP are in the Appendix.

If you have any questions regarding the matters raised in this letter, please contact me (ceciliakwei@hkicpa.org.hk) or Tiernan Ketchum (tiernanketchum@hkicpa.org.hk), Deputy Director of the Standard Setting Department.

Sincerely,

Cecilia Kwei
Director, Standard Setting Department

Work undertaken by HKICPA in forming its views

The Hong Kong Institute of Certified Public Accountants:

(i) issued an Invitation to Comment on DP/2020/1 on 23 March 2020 to its members and other stakeholders;

(ii) met with representatives from Hong Kong's financial reporting, securities and listing regulatory bodies;

(iii) sought input from its Business Combinations and Reporting Entity Advisory Panel, Financial Reporting Valuation Advisory Panel, and Small and Medium Practitioners Technical Issues Working Group, which are mainly comprised of technical and industry experts from large as well as small and medium accounting firms (collectively, Practitioners);

(iv) held a public roundtable discussion on 6 October 2020, comprising investors, analysts, preparers, academics and practitioners, with IASB Board member and staff participation; and

(v) developed its views through its Financial Reporting Standards Committee, having reflected on its stakeholder views. The Committee comprises academics, preparer representatives from various industry sectors, regulators, as well as technical and industry experts from small, medium and large accounting firms.

This submission outlines the HKICPA's views and summarises our stakeholders' comments on the DP/2020/1. You may access our stakeholder responses to the DP/2020/1 here:
https://www.hkicpa.org.hk/en/Standards-and-regulation/Standards/Our-views/pcd/financial-reporting-submissions/2020

Detailed comments on IASB DP/2020/1

Improving disclosures about acquisitions

Question 2(a) and (b)—Proposed disclosures
Questions 4 and 5—Other improvements to IFRS 3 disclosures

Stakeholders' views

1. 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).

2. 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.

3. 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.

4. 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.

5. 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.

6. 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 focus on goodwill impairment.

7. 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.

8. 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.

9. 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.

10. 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.

11. 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.

12. 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.

HKICPA analysis and recommendation

13. The HKICPA 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 our 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.

14. The HKICPA 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.

15. Accordingly, the HKICPA 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 considers 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 our stakeholders in paragraph 8 above.

16. The HKICPA 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. We also recommend that the IASB consider the examples of additional disclosures as suggested by our stakeholders in paragraph 12 above.

17. 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, we suggest that the IASB define the term 'integration costs' to ensure consistency in application.

Question 2(c)—Proposed basis for disclosures

Stakeholders' views

18. Many stakeholders questioned the DP's proposed basis for disclosures that makes analogy to the management approach used for segment reporting under IFRS 8.

19. 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.

20. 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.

21. 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.

22. 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.

23. 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*.

HKICPA analysis and recommendation

24. The HKICPA acknowledges the IASB's reasons for using a management approach as the basis for disclosures; nevertheless, we share similar views with our 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. We recommend 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

25. 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.

26. 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

27. 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.

HKICPA analysis and recommendation

28. The HKICPA understands the concerns shared by some of our stakeholders that the proposed required disclosures are commercially sensitive and forward-looking in nature, for example, the amounts of expected synergies. Nevertheless, we agree that these are not sufficient constraints for not providing useful information to users. We suggest 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

29. 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.

30. 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.

HKICPA analysis and recommendation

31. The HKICPA is generally supportive of the proposals in the DP and supports our stakeholders' suggestion on incorporating specified disclosures in the Standards. We recommend 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. The HKICPA considers that more specific disclosure objectives and requirements could facilitate compliance by smaller companies and increase comparability across entities.

Goodwill impairment and amortisation

Question 6—Effectiveness of impairment test

Stakeholders' views

32. 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.

33. 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.

HKICPA analysis and recommendation

34. The HKICPA supports an amortisation plus impairment approach, which we expand on in our comments to the DP's Question 7.

35. 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. We agree that these two reasons are relevant; in particular, we think the impairment shield issue is significant.

36. We 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 our RP, we consider that the impairment-only regime may contribute to various incentives for delaying impairment (e.g. to maximize financial reporting metrics).

37. 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, we 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 we consider a relevant issue of the existing requirements.

Question 7—Amortisation of goodwill

Stakeholders' views

38. Overall, our stakeholders' views on the accounting for goodwill have been mixed, with a small majority favouring amortisation.

39. 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.

40. 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 our 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.

HKICPA analysis and recommendation

41. In March 2020, the staff of the HKICPA, with the staff of the Accounting Standards Board of 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). The HKICPA recommends that the IASB refer to the RP in full as an integral part of our comments on the DP.[1]

42. The HKICPA observes that the DP in general concentrates on disclosures and improvements to the existing framework. Ideally, we 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. We echo a comment noted from one of our stakeholders above that many of the issues with goodwill arise from the recognition of acquired goodwill and non-recognition of internally generated goodwill.

43. We nevertheless appreciate that this would be a broad undertaking and potentially beyond the project's scope. As such, and as we do in the RP, we focus our comments on the accounting for acquired goodwill under the existing recognition framework.

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

44. The HKICPA takes the view that amortisation plus impairment is preferable to an impairment-only approach.

45. In Part 3B of the RP, we analyse the nature of goodwill and compare acquired goodwill with economic goodwill. We then argue 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.

46. 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, we note 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.

47. 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

[1] https://www.hkicpa.org.hk/-/media/HKICPA-Website/New-HKICPA/Standards-and-regulation/SSD/07_Major-projects/goodwill/rp_goodwill20.pdf

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.

48. 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.

49. Details of these points are presented in Part 3B of our RP. Rather than reproduce them here, we recommend that the IASB review the RP in full.

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

50. The DP asks whether respondents view acquired goodwill as distinct from subsequent internally generated goodwill. As noted in Part 3B of the RP, we think 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.

51. We observe 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. We agree with our stakeholder feedback noted above that this argument is inappropriate because it is not looking at acquired goodwill, but rather at overall economic goodwill.

52. 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.

53. An argument that acquired goodwill is not wasting because an entity is valued under a perpetual growth assumption, in our 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

54. With regard to this question, we believe 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, we 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

55. The HKICPA 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).

56. 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. We consider 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.

57. We do 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. We nevertheless would support a rebuttable presumption that the amortisation period should not exceed a specified number of years.

58. With regard to the amortisation pattern, we similarly think that entities should be required to apply judgement to determine what pattern is expected to best reflect the expected utilisation of an acquisition. We think 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. We think that the residual value of goodwill should be zero for amortisation purposes.

59. We do not believe that determining an amortisation approach for goodwill is overly difficult, judgemental or arbitrary. Our RP suggests a principle-based approach to amortisation can be used to determine both the amortisation period and method using reasonably available information. We think 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, we think that acquired goodwill needs to be considered distinctly from other forms of goodwill.

Other topics

Question 8—Presentation of total equity excluding goodwill

Stakeholders' views

60. 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).

61. 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.

HKICPA analysis and recommendation

62. The HKICPA agrees with our 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 we note that the fundamental issues with goodwill accounting cannot be resolved through changes in presentation. We also note 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 this comment letter, we recommend the IASB consider the fundamental accounting of goodwill.

Question 9—Relief from an annual impairment test

Stakeholders' views

63. Most of our 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.

64. 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.

HKICPA analysis and recommendation

65. The HKICPA, in line with our 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, we believe 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, we would recommend that the IASB revisit the indicators for impairment to ensure those indicators are sufficiently clear and precise.

Question 10—Simplifying value in use estimates

Stakeholders' views

66. A majority of our 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.

67. 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.

HKICPA analysis and recommendation

68. The HKICPA is generally supportive of the proposals in the DP and supports our 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.

69. 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, we do 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. We question 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.

70. If the IASB decides to pursue this route, we recommend 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).

Question 11— Simplification of impairment test

Stakeholders' views

71. 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.

HKICPA analysis and recommendation

72. The HKICPA acknowledges that the impairment test may not be simplified further in general without challenges. However, we 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 paragraph 37 of this comment letter, we consider that management shielding operations within overly large CGUs is a relevant issue of the existing requirements.

Question 12—Recognising acquired intangible assets separately from goodwill

Stakeholders' views

73. 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.

HKICPA analysis and recommendation

74. The HKICPA 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.

Question 13—Convergence with US GAAP

Stakeholders’ views

75. 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.

HKICPA analysis and recommendation

76. The HKICPA believes that convergence is good but it should not come at the expense of IFRS stakeholders. We 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.

~ End ~