Invitation to Comment:
Draft Comment Letter – IASB's DP 2020/1 *Business Combinations: Disclosures, Goodwill and Impairment*

Deadline for completion of this Invitation to Comment: Close of business 25 January 2021 Please submit to: BCGDI@frc.org.uk

Introduction

The objective of this Invitation to Comment is to obtain input from stakeholders on the draft comment letter on the IASB's DP 2020/1 *Business Combinations: Disclosures, Goodwill and Impairment*.

Who should respond to this Invitation to Comment?

Stakeholders with an interest in the quality of accounts that apply IFRS.

How to respond to this Invitation to Comment

Please download this document, answer any questions on which you would like to provide views, and return to BCDGI@frc.org.uk by close of business on 25 January 2021.

Brief responses providing views on individual questions are welcome, as well as comprehensive responses to all questions.

The UK Endorsement Board

The UK leaves the EU at the end of the Transition Period on 31 December 2020.

Until the end of the Transition Period, the European Commission will continue to endorse IFRS for use in the UK.

At the end of the Transition Period, UK-adopted international accounting standards will consist of all international accounting standards already adopted in the EU. New and amended standards, not already adopted in the EU, will be considered for endorsement and adoption in the UK. The Secretary of State for the Department for Business, Energy and Industrial Strategy will undertake this function from the end of the Transition Period until the endorsement and adoption functions are delegated to the UK Endorsement Board (UKEB). This delegation is currently expected to occur during 2021.

The requirements for UK endorsement and adoption are set out in the Statutory Instrument 2019/685[1].

1 The International Accounting Standards and European Public Limited-Liability Company (Amendment etc.) (EU Exit) Regulations 2019: https://www.legislation.gov.uk/uksi/2019/685/made

The UKEB is currently being established and will be responsible for endorsing and adopting IFRS for use in the UK once these functions have been delegated to it by the Secretary of State. The UKEB will also be responsible for influencing the development of IFRS.[2]

During the establishment of the Endorsement Board, the staff are undertaking influencing activities with the support of Financial Reporting Council (FRC) infrastructure and resource.[3]

This Invitation to Comment forms part of these influencing activities.

Privacy and other policies

The data collected through submitting this Invitation to Comment will be stored and processed by the FRC/EB. By submitting this Invitation to Comment, you consent to the FRC/EB processing your data for the purposes of influencing the development of and endorsing IFRS for use in the UK. For further information, please see our Privacy Statements and Notices[4] and other Policies (e.g. Consultation Responses Policy, Data Protection Policy and Freedom of Information Policy)[5].

The FRC's policy is to publish on its website all responses to formal consultations issued by the FRC unless the respondent explicitly requests otherwise. A standard confidentiality statement in an e-mail message will not be regarded as a request for non-disclosure. The FRC does not edit personal information (such as telephone numbers or postal or e-mail addresses) from submissions; therefore, only information that you wish to be published should be submitted.

2 For more information on the UK Endorsement Board, please see https://www.gov.uk/government/groups/uk-endorsement-board-ukeb#contents

3 For more information on the Endorsement Board's interaction with the FRC, please see https://www.frc.org.uk/endorsement-of-ias

4 These can be accessed here: https://www.frc.org.uk/about-the-frc/procedures-and-policies/privacy-the-frc

5 These policies can be accessed here: https://www.frc.org.uk/about-the-frc/frc-operational-policies

Part B: Questions

Recommendation for a mixed model for accounting for goodwill

1. Do you support our recommendation for a mixed model, where impairment testing is supported by an annual amortisation charge? (Draft comment letter, appendix 2, paragraph A1). Please explain why or why not.

   a) I do not support this recommendation. I do not believe that Goodwill is a wasting asset nor do I believe that it meets the definition of an asset. It is simply a balance to reflect payment in excess of identifiable net assets to acquire a business. This number should be held into perpetuity to reflect the capital deployed by the management.

   b) If I were coming up with an alternative, to address your concerns, then I would propose a 5 year period where the balance is not adjusted at all except for impairments and then a one-off charge to OCI. In this way management are held to account for 5 years to determine if they have clearly over-paid within the limitations of shielding effects. After 5 years then the information content of the goodwill balance is largely lost although a note in the accounts should show all goodwill incurred through the history of the business.

2. Do you support our conclusion that if a mixed model is introduced, impairment testing should be on an indicator-only basis. (Draft comment letter, appendix 2, paragraph A2). Please explain why or why not.

   a) Whilst I do not support your proposal, I do think an indicator approach makes sense, as the goodwill balance is reducing and so should be supportable. BUT it fails the test of robustly holding management to account which my proposal would have addressed.

3. Do you support our conclusion that if a mixed model is not introduced, an annual quantitative impairment test should be retained? (Draft comment letter, appendix 2, paragraph A2). Please explain why or why not.

   a) Yes as indicated by my earlier responses.

Disclosures on strategic rationale, objectives and metrics

4. Do you support our recommendation for illustrative examples and field-testing of the proposed disclosures on acquisitions? (Draft comment letter, appendix 2, paragraph A3). Please explain why or why not.

   a) Yes

5. Do you support our recommendation that disclosures should be required for all material acquisitions, rather than only those whose performance is reviewed by the CODM? (Draft comment letter, appendix 2, paragraph A5 ii). Please explain why or why not.

   a) Yes and think this should arguably be based on the level of the individual with P&L responsibility for the segment rather than for the overall company.

6. Do you support our recommendation that the requirement is to disclose the metrics chosen to monitor subsequent performance of the acquisition rather than to disclose targets in place to monitor subsequent performance of the acquisition against those

metrics? (Draft comment letter, appendix 2, paragraph A5 iii). Please explain why or why not.

a) I prefer targets in place to measure subsequent performance against. I do not accept the argument of commercial sensitivity.

7. Do you support our recommendation that the requirement is for qualitative disclosure of performance against chosen metrics, rather than disclosure of the quantitative targets in place to track progress and actual performance against those targets? (Draft comment letter, appendix 2, paragraph A5 iv). Please explain why or why not.

a) I prefer quantitative disclosures. I do not accept the argument of commercial sensitivity.

8. Do you support our recommendation that disclosure is required when monitoring of material acquisitions stops, together with an explanation of why it has stopped? (Draft comment letter, appendix 2, paragraph A5 v). Please explain why or why not.

a) I want to understand why management has stopped monitoring. It may simply be enough to state that integration was done within a few months and they have stopped monitoring. Users will accept that and there is almost zero cost to provide the disclosure.

9. Do you support our recommendation that failure to meet an objective or target identified at acquisition is treated as an indication of an impairment of goodwill in the cash-generating unit to which it has been allocated? (Draft comment letter, appendix 2, paragraph A6). Please explain why or why not.

a) I agree

10. Do you agree that the proposed disclosure of CODM's objectives for the acquisition and the metrics used to monitor progress in meeting those objectives is not forward-looking information? (Draft comment letter, appendix 2, paragraph A7). Please explain why or why not.

a) Yes I agree as it reflects the views at a point in time when the acquisition was made.

Disclosures on synergies

11. Do you agree with our conclusion not to recommend the proposed disclosures on synergies? (Draft comment letter, appendix 2, paragraph A12). Please explain why or why not.

a) No - disclosures are often a highly material part of the consideration paid in an acquisition and shareholders should be given full disclosure about it.

12. Do you support our recommendation that if the proposals on synergies are developed, synergies should be defined? (Draft comment letter, appendix 2, paragraph A13i).

a) Yes - synergies need to be defined clearly, accepting that there needs to be disaggregation between differing types - revenue vs cost vs market access etc.

13. Do you support our recommendation that if the proposals on synergies are developed, illustrative examples and field-testing are required? (Draft comment letter, appendix 2, paragraph A13ii).

    a) Yes

Disclosure of debt and defined pension liabilities acquired

14. Do you agree with our support of the proposal to disclose separately defined pension liabilities and debt as major classes of liability? (Draft comment letter, appendix 2, paragraph A15).

15. Yes

Pro-forma information

16. Do you support our recommendation that '*related transaction and integration cost*,' is defined? (Draft comment letter, appendix 2, paragraph A17 i).

    a) Yes

17. Do you support our recommendation that disclosure requirements for the basis on which pro-forma information is prepared are developed, to support understandability and comparability? (Draft comment letter, appendix 2, paragraph A17 ii).

    a) Yes

18. Do you support our recommendation to field test the proposals to ascertain expected practicalities and costs of providing pro-forma cash flow information? (Draft comment letter, appendix 2, paragraph A17 iii).

    a) I am not sure there is much benefit for providing pro-forma cash flow information at all as users will focus more on profits and some changes in working capital can be very arbitrary.

Improving the impairment test

19. Do you support our recommendation to disclose how discount rates have been derived, differentiating between CGUs with different risk profiles (in addition to the current disclosure of the discount rate applied to the cash flow projections)? (Draft comment letter, appendix 2, paragraph A21i). Please explain why or why not.

    a) Yes

20. Do you support our recommendation to disclose possible changes to key assumptions in the recoverable amount calculation and the impact of those changes on recoverable amount (replacing the current disclosure of key assumptions and the amount by which the key assumption would need to change if a reasonably possible change to it would cause carrying amount to exceed recoverable amount)? (Draft comment letter, appendix 2, paragraph A21ii). Please explain why or why not.

    a) I do not have a strong view on this as I can see an argument for either.

21. Do you support our recommendation that additional disclosures should also be required for each CGU or group of CGUs with allocated goodwill with a significant carrying amount

when compared to the entity's total net assets excluding goodwill? (Draft comment letter, appendix 2, paragraph A21 iii). Please explain why or why not.

a) Yes

22. Do you support our recommendation to disclose how CGUs have been identified and whether that has changed from the prior period? (These disclosures are currently only required for CGUs for which an impairment has been recognised or reversed during the period). (Draft comment letter, appendix 2, paragraph A23i). Please explain why or why not.

a) Yes although it is worth noting that many users believe that most goodwill should be tested at the segment level rather than a CGU which the users typically get little disclosure about so it is hard to robustly challenge assumptions. Whilst this increases shielding, we are less concerned about the value of goodwill as an asset but about the capital employed. Where excessive amounts have been paid for acquisitions and this imperils the business then segment level analysis should be enough anyway. Having said that anything that makes the impairment test tougher does do a better job at holding management to account soon after acquisition - I would therefore support this were my proposal on the subsequent treatment of goodwill adopted.

23. Do you support our recommendation to disclose where goodwill is more likely to be shielded, for example when goodwill has been allocated to a CGU where the acquisition has been integrated with an existing business? (Draft comment letter, appendix 2, paragraph A23 ii). Please explain why or why not.

a) Not particularly as I am more concerned about excess goodwill at a segment level. Having said that any disclosure that measures the degree of shielding is helpful additional information and would be better in the example I gave previously relating to subsequent accounting for goodwill.

24. Do you support our recommendation to explore options for testing goodwill for impairment at a more disaggregated level, so that testing is more targeted? One option to explore would be to require allocation of goodwill to CGUs which represent the lowest level within the entity at which the results of the acquired business are monitored for internal management purposes. (Draft comment letter, appendix 2, paragraph A23 iii). Please explain why or why not.

a) As noted above I am not sure how much use this is for users unless my new approach to goodwill accounting be adopted. I do accept that it provides a more rigorous test for management stewardship at a more granular level which may well justify this approach in itself.

Amortisation methods and disclosures

25. Do you support our recommendations for areas to be explored for developing a model for amortising goodwill? (Draft comment letter, appendix 2, paragraph A28). Please explain why or why not.

a) I do not support amortisation of goodwill as I do not believe it is an asset but rather a balancing number to generate the right level of “Invested Capital” to ensure ROICs are more accurate.

26. Do you support our proposed disclosures on goodwill balances? (Draft comment letter, appendix 2, paragraph A32). Please explain why or why not.

    a) Yes - but I would expand this to include keeping disclosure of gross amounts into perpetuity even if amortised or written off.

Indicator-only impairment test

27. Please provide your views on anticipated cost savings from the IASB's proposal to move to an indicator-only impairment test (Draft comment letter, appendix 2, paragraph A35).

    a) I cannot have a view as I am not a preparer

28. Do you support our conclusion that the quantitative impairment test should be retained for intangibles which are not amortised? (Draft comment letter, appendix 2, paragraph A36). Please explain why or why not.

    a) Yes although I am sceptical about many of these "assets" which I would often tend to subsume into goodwill.

Including cash flows from uncommitted restructurings and asset improvements

29. Do you support our recommendation that, if cash flows from uncommitted restructurings and asset improvements are included in the value in use calculation, expected values are used to incorporate risk into the cash flows? (Draft comment letter, appendix 2, paragraph A38i). Please explain why or why not.

    a) Yes

30. Do you support our recommendation that, if cash flows from uncommitted restructurings and asset improvements are included in the value in use calculation, the proposal is redrafted so that entities are *required* to include cash flows from uncommitted restructuring or asset improvements? (Draft comment letter, appendix 2, paragraph A38ii). Please explain why or why not.

    a) Yes

31. Do you agree with our support of the proposal to allow either a pre-tax discount rate or a post-tax discount rate to be used in the value in use calculation, provided that the rate chosen is consistent with the cash flows? (Draft comment letter, appendix 2, paragraph A39). Please explain why or why not.

    a) Yes

32. Do you agree with our support for the IASB's preliminary view not to develop proposals to change the recognition criteria for intangible assets acquired in a business combination as part of the current project? (Draft comment letter, appendix 2, paragraph A42). Please explain why or why not.

    a) Yes given the need to improve the disclosure around goodwill but I would welcome a project on this as well. I do not believe we should see capitalisation of internally generated intangibles - that is an argument for another day.

33. Do you agree with our conclusion that our answers to the IASB's consultation should take into account a full range of relevant considerations for UK stakeholders and should not be

solely dependent on consistency with current or future US GAAP? (Draft comment letter, appendix 2, paragraph A45). Please explain why or why not.

a) Yes

34. Do you have any other comments?

a) The views in your DCL are in direct conflict with the views expressed by the User - Peter Reilly, in your panel event. I tend to agree with his views. I had assumed that the UK EB would consider that user needs should have primacy given the importance of efficient allocation of capital and the needs to evaluate stewardship. Your DCL seems to be more aligned with my perceived preference of the preparer community.

Thank you for completing this Invitation to Comment