UK Endorsement Board Invitation to Comment:

IASB's DP 2020/1 Business Combinations: Disclosures, Goodwill and Impairment

RESPONSE FROM:

United Kingdom Shareholders' Association

25th January 2021

UKSA, 1 Bromley Lane, Chislehurst, BR7 6LH

Phone: 01689 856691

Email: officeatuksa@gmail.com

Web: www.uksa.org.uk

# Invitation to Comment: IASB's DP 2020/1 Business Combinations: Disclosures, Goodwill and Impairment

To: UK Endorsement Board

BCDGI@frc.org.uk

1. The UK Shareholders' Association have pleasure in submitting this response to the UK Endorsement Board's Invitation to Comment (ItC) which was published on 15 December 2020. We base our comments and answers to your questions on the joint response of UKSA and ShareSoc to the IASB's DP 2020/1 Business Combinations: Disclosures, Goodwill and Impairment as reproduced in Appendix 1.

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

**UKSA response to UK Endorsement Board**

# 1. Introduction

2. This introduction highlights our main points. Then the body of our response covers most of your 33 questions. We end with an appendix of our joint UKSA and ShareSoc response to the IASB.

**Our main points**

3. We support the Board's overall objective of enhancing disclosure on acquisitions and their subsequent performance. Current disclosure is extremely unsatisfactory. As a result we agree with the Board's preliminary views set out in paragraph IN9 of their Discussion Paper 2020/1 with the modifications and qualifications set out in our response reproduced in Appendix 1 and this response. We would also argue that there is a need to keep cumulative and separate goodwill and impairment disclosures for each acquisition.

4. We support your recommendations and conclusions except for those:

- Where you support the reintroduction of amortisation, as we see no point in this even if your mixed model is not introduced
- Based on protecting confidential or commercially sensitive information. We are sceptical of these being good reasons for non-disclosure of historic information of public stock market companies.

**About UKSA**

5. UKSA (UK Shareholders' Association) is the oldest shareholder campaigning organisation in the UK. We are a not-for-profit company that represents and supports shareholders who invest in the stock market.

6. There are many agents and intermediaries active in financial markets. Unlike them, we are an organisation solely representing people who are investing their own money.

7. UKSA was formed to provide private shareholders with a voice, influence and an opportunity to meet like-minded fellow investors. It is structured as a non-profit making company with annual subscriptions. An elected Chairman and Board of Directors (all volunteers and individuals with a wide range of backgrounds and experience) monitor a regional organisation. Each region benefits from oversight by an elected regional Chairman and Committee.

8. In addition to our own members, there are 5 million people who own shares and have investment accounts with platforms in the UK. The Office for National Statistics estimates that individual investors own 13.5% of the UK stock market by value. In addition to this there are many more individuals who have money invested in shares via funds, pensions and savings products such as employee share ownership schemes.

9. As a voice for individual shareholders, we develop relations with regulators, politicians and journalists to ensure that individual shareholders' voices are heard as law, regulation and financial markets develop.

## 3. Answers to your numbered questions

**Recommendation for a mixed model for accounting for goodwill**

**Q1: 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.**

10. Yes, we support your recommendation for a mixed model subject to disclosures keeping a track of goodwill creation and impairment separately for each material acquisition.

11. However, we disagree with the reintroduction of amortisation as we concur with the IASB's reasons for opposing it.

12. As goodwill arising on acquisitions is a balancing figure in the acquirer's financial statements, we question its meaningfulness to users. As a result, impairment testing and provisioning or amortisation become meaningless. In our view, the solution is to provide more meaningful disclosures on acquisitions and how these progress over time.

**Q2: 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.**

13. Yes, this would make sense.

14. However, please note our reservations expressed above in answer to Q1 and in our submission to the IASB in Appendix 1.

**Q3: 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.**

15. No we do not support this conclusion as we question the meaningfulness of the balance sheet goodwill figure to users and therefore any assessment of its impairment.

16. However, we find your research interesting that preparers find annual quantitative impairment testing less onerous than they think they will find impairment indication assessment. We can see how this leads towards your conclusion. It may indicate a preparer bias to keeping a meaningless or worthless number on their balance sheets and does not change our minds on not supporting any reintroduction of amortisation of goodwill and on

supporting an annual impairment indication test rather than the full blown one currently required by IFRS 3.

**Disclosures on strategic rationale, objectives and metrics**

**Q4: 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.**

17. Yes, as we see improvements to disclosures as being the main solution to our concerns about acquisition accounting.

**Q5: 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.**

18. Yes, we support your recommendation as we would expect all material acquisitions to be tracked over their existence within the acquiring entity. We cannot see why the performance of any material acquisition would not be reviewed by the CODM.

**Q6: 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.**

19. No, we do not support your recommendation as it based on not disclosing so called confidential or commercially sensitive information.

20. In our experience, it is very rare for public stock market companies to have material confidential or commercially sensitive information that remains confidential in respect of financial statements reporting historically; or which they need to disclose because it has become material price sensitive information. Commercial sensitivity is in our view never a good excuse for not providing information especially for publicly listed companies who should be transparent to the market.

21. If your recommendation is progressed, we suggest it is tempered by requiring companies to inform shareholders that they have withheld information on the grounds of confidentiality or commercial sensitivity with a broad explanation of the reasons.

**Q7: 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.**

22. No, we do not support your recommendation as it based on not disclosing so called confidential or commercially sensitive information. See our comments to Q6.

**Q8: 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.**

23. Yes, we support your recommendation as we see improvements to disclosures as being the main solution to our issues with acquisition accounting.

**Q9: 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.**

24. Yes we support your recommendation. However, we suggest that if for good reason it is not treated as an indication of impairment that the company should be required to explain this.

**Q10: 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.**

25. Yes, we agree. This is information that should be available to shareholders in acquisition prospectuses or similar and then reported on in retrospect. We agree that it is not forward looking information.

**Disclosures on synergies**

**Q11: 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.**

26. No, we do not agree with your conclusion as we remain sceptical that confidentiality and commercial sensitivity are valid reasons for non-

disclosure, especially of price sensitive information. See our comments to Q6.

27. We agree with IASB's position that commercial sensitivity is not a valid reason for lack of disclosure.

28. We do not agree with your belief that confidentiality and commercial sensitivity are valid reasons for non-disclosure. Disclosure contributes to confidence in transactions and markets. We see your proposals as conveying an establishment view that prevents providers of equity risk capital from understanding what is going on.

**Q12: Do you support our recommendation that if the proposals on synergies are developed, synergies should be defined? (Draft comment letter, appendix 2, paragraph A13i).**

29. Yes, we support your recommendation as it seems sensible. However, we would expect any disclosures on synergies to be clear on what the synergies mean to the acquirer.

**Q13: 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).**

30. Yes, for the same reason as given in Q4.

**Disclosure of debt and defined pension liabilities acquired**

**Q14: 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).**

31. Yes, for the same reason as given in Q4.

**Pro-forma information**

**Q15: Do you support our recommendation that 'related transaction and integration cost,' is defined? (Draft comment letter, appendix 2, paragraph A17 i).**

32. Yes, for the same reason as given in Q4.

**Q16: 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).**

33. Yes, for the same reason as given in Q4.

**Q17: 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).**

34. Yes, for the same reason as given in Q4.

**Improving the impairment test**

**Q18: 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.**

35. Yes, for the same reason as given in Q4.

**Q19: 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.**

36. Yes, for the same reason as given in Q4.

**Q20: 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.**

37. Yes, for the same reason as given in Q4.

**Q21: 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.**

38. Yes, for the same reason as given in Q4.

**Q22: 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.**

39. Yes, for the same reason as given in Q4.

**Q23: 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.**

40. Yes, for the same reason as given in Q4.

**Amortisation methods and disclosures**

**Q24: 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.**

41. No, as we do not support the reintroduction of amortisation.

**Q25: Do you support our proposed disclosures on goodwill balances? (Draft comment letter, appendix 2, paragraph A32). Please explain why or why not.**

42. Yes, for the same reason given in Q4.

**Indicator-only impairment test**

**Q26: 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).**

43. We have insufficient experience on which to base any response to this question.

**Q27: 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.**

44. Yes, as we have no experience or knowledge to counter this conclusion. We are assuming that, if a mixed model is adopted as you suggest and goodwill

is not amortised but assessed for impairment indications, this conclusion does not apply to goodwill arising on acquisitions.

**Including cash flows from uncommitted restructurings and asset improvements**

**Q28: 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.**

45. Yes, we support your recommendation as it will provide some prudence in the inclusion of cash flows in the value in use calculation and mitigate, as you conclude, against any bias towards optimism.

**Q29: 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.**

46. Yes, we support your recommendation. However, there may be a practical problem in determining whether any preparer of financial statements has omitted any uncommitted restructurings or asset improvements unless they have been up front in planning and disclosing these.

**Q30: 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.**

47. Yes, as we have no knowledge or experience to counter the proposal.

**Q31: 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.**

48. Yes, as we support the IASB's view as articulated in our response to them (see Appendix 1).

**Q32: 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.**

49. Yes, we support your conclusion as our preference is for a levelling up rather than a levelling down in the quality of accounting standards between different jurisdictions.

**Q33: Do you have any other comments?**

50. No, we have no further comments.

# 4. Appendix 1: Joint UKSA and ShareSoc response to IASB's DP 2020/1 Business Combinations: Disclosures, Goodwill and Impairment

**UK Shareholders' Association**
UKSA, 1 Bromley Lane, Chislehurst, BR7 6LH
Phone: 01689 856691
Email: officeatuksa@gmail.com
Web: www.uksa.org.uk

**ShareSoc**
**UK Individual Shareholders**
Suite 34, 5 Liberty Square, Kings Hill, West Malling, ME19 4AU
Phone: 0333-200-1595 Email: info@sharesoc.org
Web: www.sharesoc.org

31st December 2020

IFRS Foundation
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD

Via email: commentletters@ifrs.org

Dear Sir/Madam

**Re: The IASB's Discussion Paper on Business Combinations – Disclosures, Goodwill and Impairment (DP/2020/1)**

## 1. Our key messages

1.1. We support the Board's overall objective of enhancing disclosure on acquisitions and their subsequent performance. Current disclosure is extremely unsatisfactory. As a result we agree with the Board's preliminary views set out in paragraph IN9 with the modifications and qualifications set out in this letter. We would also argue that there is a need to keep cumulative and separate goodwill and impairment disclosures for each acquisition.

1.2. We do not regard testing goodwill for impairment as either robust or desirable.

1.3. We concur with the Board's opposition to the reintroduction of goodwill amortisation.

1.4. We do not see any need to require companies to report total equity excluding goodwill as this number is easy to derive if required.

1.5. We regard separate classifications of all intangibles as useful and, as a minimum, we would like to see separate disclosure of internally generated intangible assets and those created during the acquisition consolidation process.

## 2. Introduction

2.1. Our comments on the discussion are set out in our key messages above and in the general discussion and answers to your questions section below.

2.2. UKSA and ShareSoc represent the interests of individual shareholders. In addition to our own members, there are 5 million people who own shares and have investment accounts with platforms in the UK. The Office for National Statistics estimates that individual investors own 13.5% of the UK stock market by value[1]. In addition to this there are many more individuals who have money invested in shares via funds, pensions and savings products such as employee share ownership schemes.

2.3. Our comments are based on our members' use of annual reports and financial statements. Our experience is not necessarily one of technical expertise but more of an interested well informed user of financial statements. We believe individual shareholders obtain a lot of their information from audited financial statements and therefore will be supportive of your proposals on business combinations.

## 3. General discussion and answers to your questions

3.1. We are supportive of the Board's research project on goodwill and impairment following its post implementation review ("PIR") of IFRS 3 "Business Combinations"; and of the project's objective to explore whether companies can, at a reasonable cost, provide investors with more useful information about the acquisitions those companies make. We agree that better information would help investors assess the performance of companies that have made acquisitions. Better information would also be expected to help investors more effectively hold a company's management to account for management's decisions to acquire those businesses.

3.2. We believe that audited financial statements are one of the best sources of reliable and reasonably accurate company or group financial performance information. This information needs to be relevant, material, concise, consistent, clear and understandable and comparable between years and comparable with other organisations. However, in the area of business combinations, we are not being given such information.

3.3. While we recognise that IFRS 3 goes some way to providing disclosures about acquisitions, like your PIR we also think these disclosures are not sufficient and therefore welcome the Board's efforts to improve this situation.

3.4. Our comments and answers to your specific questions are provided in the context of our concerns about how business combinations are currently reflected in financial statements. Our main concerns are summarised as follows.

1 Ownership of UK quoted shares - Office for National Statistics (ons.gov.uk)

3.4.1. The financial statements do not always provide in one place clear information about each acquisition, which should include:

3.4.1.1. how the acquiree has been valued

3.4.1.2. what the total consideration was

3.4.1.3. how the consideration was paid

3.4.1.4. what assets and liabilities at their carrying amount, as assessed in accordance with relevant accounting standards, were acquired.

3.4.2. They often provide little meaningful information about the strategies and business objectives of acquisitions, how these will be monitored and assessed and over what time period. This can make it impossible for investors to hold managers in the acquiring company to account.

3.4.3. They do not provide clear time series information (eg for at least five years or ten years), as required for other fixed assets, such as total goodwill acquired and split between individual acquisitions, annual movements in goodwill arising on acquisitions or their disposals, total impairments made to goodwill and annual movements in impairments.

3.4.4. They do not always provide clear information in the period of acquisition of the acquiree's income, expenditure, cash flows, assets and liabilities included in the consolidated primary statements.

3.5. You list in Table 1.1 the feedback you received from the PIR. We agree with the feedback that it is difficult to assess the performance of an acquisition. We are surprised that many preparers find it difficult to provide information that is helpful to assess performance as a lot of this will be available in acquisition prospectuses or, if not, should have been prepared during management's assessment of the acquiree. We have mixed views on the usefulness of impairment adjustments and/or amortisation as it is generally accepted that goodwill is difficult to measure and its creation is simply the difference or balance between consideration and the measurable net assets received on consolidation. Therefore we agree that it is helpful to separate out from goodwill and recognise other intangible assets.

3.6. To answer your question 1, we support the Board's decision to address the topic and we agree that business combination disclosure is unsatisfactory and needs to improve.

3.7. In answer to your questions 2 to 5, we agree that the board should add and develop disclosures and disclosure objectives to improve the information available to investors and address some of the problems we have outlined in 3.4 above. We are particularly interested in improvements to performance reporting as this should increase our ability to hold companies and their management to account. We believe that the improvements to standards of performance reporting should help to ensure that companies and their management will be more cautious in bidding to take over other organisations. Commercial sensitivity is in our view never a good excuse for not providing information especially for publicly listed companies who should be transparent to the market.

3.8. In response to your questions 6, 9 and 10 we agree it is not feasible to design an impairment test that is significantly more effective at the timely recognition of impairment losses on goodwill at a reasonable cost. This is mainly because we cannot see any impairment test being effective. Goodwill is a balancing figure with little practical meaning and, as seems agreed in your DP, it is inherently difficult to value. However we would support any move to reduce the time spent on assessing goodwill impairment, especially if the disclosures to improve the reporting of business combinations, their performance over time and holding management to account are introduced to compensate.

3.9. In reply to your question 7, we concur with the Board's opposition to the reintroduction of goodwill amortisation for similar reasons set out in our response above to question 6.

3.10. To answer your question 8, there is no reason to provide equity less goodwill on the balance sheet as this is something readers of financial statements are able to calculate for themselves from balance sheet information.

3.11. Following on from 3.8 above and in response to your question 11, we can see benefits in simplifying the process of impairment assessment if goodwill was left on the balance sheet for as long as it is felt the acquirees are part of the combined business. It will also compensate if disclosures to improve the reporting of business combinations, their performance over time and holding management to account are introduced.

3.12. To answer your question 12, we support the Board's proposal not to allow some intangible assets to be included in goodwill mainly because we wish to see differentiation between identifiable non goodwill intangibles and the balancing figure of goodwill itself.

3.13. In response to question 13, we support convergence between IFRS and US GAAP developed by FASB but only if the convergence is upward towards the higher quality standard. We do not support IFRS converging with US GAAP if this results in any dilution of their quality.

3.14. In response to question 14, we would like to see separate disclosure of internally generated intangible assets and those created or marked up to fair value during an acquisition. Where each class of intangible asset is material, these should also be separately disclosed.

4. If you have any questions or require clarification of our comments, please contact Charles Henderson at charles.henderson@uksa.org.uk and Cliff Weight at cliff.weight@sharesoc.org. We would be happy to have a follow up meeting if required.

5. We understand our comments will be on the public record and posted on your website. We specifically do not request confidentiality and wish as many people as possible to read our comments.

Yours faithfully

Charles Henderson, Director, UK Shareholders' Association
Direct phone: 07709 465772; Email: charles.henderson@uksa.org.uk

Cliff Weight, Director, ShareSoc
Direct phone: 07712 793114; Email: cliff.weight@sharesoc.org