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].

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.

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

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.

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.

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.

Answers to questions 1 to 3

I do not agree with your recommendation for a mixed model.

I consider goodwill to be a predominantly non-wasting asset. I have read the work of the International Valuations Standards Council (IVSC) on this matter, as set out in their Perspectives Paper, "Is Goodwill a Wasting Asset?" (https://www.ivsc.org/files/file/view/id/1599). Their functional assessment of goodwill concludes that goodwill can be understood to comprise a number of components. These are 'reputation', 'future intangible value', 'workforce', 'synergies', and 'assemblage value'. They conclude that all of these are non-wasting in nature, with the exception of one part of the workforce. They observe that the workforce component of goodwill comprises the 'knowledge base' of the workforce, which is non-wasting, and the 'employees' of the workforce, which they identify as wasting. Consequently, I disagree with the premise on which you have recommended a mixed model.

The IVSC paper also goes on to consider an analysis of the assumptions underlying deal models and the implicit assumptions regarding goodwill. In that analysis, they observe that 'if one were to assume the synergistic portion of goodwill was a wasting asset realised only over the discrete period, it would imply that either 1) market participants systematically overpay for businesses, or 2) that the capital asset pricing model systematically overestimates the cost of equity and resulting WACC'.

Furthermore, an annual amortisation charge provides little, if any decision-useful information to users of financial statements. In contrast, an impairment charge provides information about the entity's performance and management's expectations about the entity's future performance. The introduction of an amortisation charge would reduce the likelihood and magnitude of a subsequent impairment charge because the impairment charge compares recoverable amount with carrying amount of goodwill and its associated group of cash generating units. Consequently, an annual impairment charge would likely deprive users of decision-useful information.

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.

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.

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.

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.

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.

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.

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.

Answers to questions 4 to 10

I agree with your recommendation for illustrative examples and field testing. In principle the information proposed would provide useful information for users, but I think that the practical challenges for companies producing such information needs to be carefully assessed.

I also agree that disclosures should be required for all material acquisitions. The way in which an entity chooses to organise its internal monitoring of the outcome of an acquisition should not be the basis for determining what disclosures are given.

I am concerned about your recommendation that the post-acquisition performance disclosures should be of the metrics chosen rather than the targets in place. This sounds like it would result in predominantly qualitative disclosures. I question whether this would enable users to adequately assess the extent to which the acquisition is achieving the objectives that management set when it decided to make the acquisition for the price that it paid.

I agree with your recommendation that management discloses when monitoring of material acquisitions stops, together with an explanation of why it has stopped, regardless of when this happens.

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.

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).

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).

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).

Pro-forma information

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

16. 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).

17. 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).

Improving the impairment test

18. 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.

19. 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.

20. 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.

21. 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.

22. 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.

23. 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.

Answers to questions 18 to 23
I disagree with your conclusion that it is not feasible to make the impairment test for CGUs containing goodwill significantly more effective at recognising impairment losses than the existing IAS 36 requirements. I think that the shielding effect of unrecognised goodwill in the current model is the principal problem with the current requirements, and should be addressed through changes to the impairment test. I think that the old UK GAAP (pre-2005) impairment test under FRS 11 *Impairment of Fixed Assets and Goodwill* was a better model that was capable of addressing the shielding effect, and that a solution based on that should be looked at again by the IASB.

However, I do agree with your recommendations to improve the disclosures around impairment testing. I also agree with your recommendation that the IASB explores the testing of goodwill at a more disaggregated level so that the testing is more targeted. This could compensate to some extent the problems with the shielding effect.

Amortisation methods and disclosures

24. 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.

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

Indicator-only impairment test

26. 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).

27. 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.

Including cash flows from uncommitted restructurings and asset improvements

28. 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.

29. 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.

30. 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.

31. 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.

32. 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.

33. Do you have any other comments?

Thank you for completing this Invitation to Comment