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.

We do not support this recommendation. The mixed model described by the UK Endorsement Board is an amortisation model i.e. it treats goodwill as a wasting asset which is amortised over its useful life and it is subject to the impairment requirements of IAS 36 Impairment of Assets (similar to other finite assets).

We consider that IASB's original decision not to allow amortisation correctly reflected the balance of cost and benefit, and that its rationale remains valid as we do not think that new factors have emerged since then that should change its view.

We think that an annual amortisation charge is always likely to be arbitrary not reflect the underlying economics in terms of income generation - and indeed it would apply even if there is no reduction in value - and we therefore think that it is not decision-useful. Correspondingly, if there has been amortisation, an impairment charge will be lower by an arbitrary amount. This will not convey to investors the full impact of the impairment event, and so it obstructs the accountability of management to investors.

We understand the concern that goodwill may be shielded. But we think that the answer instead is enhanced focus on impairment indicators/testing by management and auditors alike.

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.

We do not support a mixed/amortisation model approach; however, we agree that impairment testing should be on an indicator-only basis if the mixed/amortisation model approach was introduced.

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.

We welcome the IASB's recognition of the high cost to preparers of impairment testing and its exploration of a way to reduce this cost. However, we note that impairment testing is used widely by management to monitor the performance of acquisitions and it supports management's accountability to investors. We are of the view that the costs of performing a robust annual impairment test are proportionate to the benefits,

Furthermore, the IASB's conclusion is that the impairment test cannot be improved and yet investors are concerned that impairments are not recognised swiftly enough. This suggests that there may be significant risk in moving to full reliance on impairment indicators.

To counter this risk, we suggest that any such move should be conditional on a successful test-case based evaluation of this approach, using also this an opportunity to see whether the indicator approach can be strengthened. And it would also need the clear support from investors whose concern is about timing.

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.

We do not support these recommendations. We do not agree with the IASB's Board's proposals to increase significantly the disclosures given in the notes to the accounts, nor do we agree with the UK Endorsement Board's alternative proposals.

In our view, in the notes to the accounts, management is responsible for giving information about the resources for which they are accountable. It is through the management commentary that management explains the use to which they put those resources, and it is thorough the IASB's current management commentary project that improvements in communications about such strategic matters should instead be sought.

We acknowledge investors' calls for better information about the subsequent performance of an acquisition, and we agree that more can often be provided. But disclosure on the subsequent performance of an acquisition in the note to the accounts puts it in the wrong context and therefore distorts the view given by financial statements as a whole. The notes overall add information about the entity's assets and liabilities cumulatively at the balance sheet date and about its financial performance in the period and the proceeding period. These reflect not just acquisitions in past periods but also other activities such as past significant acquisitions of tangible or intangible assets, or significant expenditure of an investing nature for benefits in future periods which is not capitalised. Yet, the disclosures for fixed assets and P&L expenditure do not serve as vehicles for accountability for subsequent performance and nor, quite rightly, is the Board proposing they should.

The Board's proposals do not help the investor understand better the carrying value of the goodwill in the balance sheet. Please see responses to Q18-21 where we note that we believe the existing IAS 36 requirements for disclosure of goodwill already provides sufficient information for the users of the accounts.

The management commentary is, by contrast, the place in which management explains, in the round, what use it has makes of the entity's resources and the benefits to accrue to investors. Where the subsequent performance of a past acquisition is of continuing significant interest to the investor, the management commentary can and should highlight relevant information - just as it should for other past major management decisions that are still relevant to management's accountability to investors.

We also highlight, from an insurer perspective, that life insurers especially don't necessarily use IFRS measures as objectives when they acquire a business. Concern is much more with Solvency II impacts and cash generation. Bringing in non-IFRS information into the notes to accounts and under the scope of the audit opinion would increase the costs of compliance. Further, it is debatable whether, given the long-term nature of life insurers' acquisitions, there is a lot of meaningful disclosure in the early years following the acquisition. By the time a lot of the synergies are realised, a life insurer's business model ordinarily suggests it would no longer monitor that business separately and attempting to do so under the new potential requirements would again increase costs.

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.

Please see our response to question 4 above.

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.

Please see our response to question 4 above.

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.

Please see our response to question 4 above.

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.

Please see our response to question 4 above.

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.

Please see our response to question 4 above. We believe that the annual impairment test should continue and hence consideration of targets would form part of that assessment.

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.

Please see our response to question 4 above; we believe that it could be interpreted as forward-looking information hence we do not think it is appropriate to include these disclosures in the financial statements.

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.

We agree. Please also see our response to question 4 above.

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).

We do not agree with the proposal to develop disclosures on synergies.

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).

We do not agree with the proposal to develop disclosures on synergies. *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).

We question whether such a new disclosure requirement is necessary, in addition to those already in IAS 19 and IAS 7. We do not object to the proposal to specify that liabilities arising from financing activities and defined benefit pension liabilities are major classes of liabilities (to be separately disclosed on the acquisition balance sheet), where these are material, though we consider that if these are material the disclosure requirement already exists within the current requirements of IFRS 3.

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).

Yes, we do.

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).

No, we believe that the current disclosures are sufficient.

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).

We do not agree with the IASB's proposal to introduce cash flow information into the disclosure requirements. We do not believe that this disclosure is useful for the users of the financial statements of an insurance company as it does not distinguish between policyholder/shareholder cashflows. It would introduce new complexity and cost without adding significant value.

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.

No, for goodwill IAS 36 already requires entities to disclose a description of management's approach to determining the value(s) assigned to each key assumption.

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.

No, because IAS 1 already requires entities to disclose sensitivities to methods, assumptions and estimates for assets and liabilities where there is a major source of estimation uncertainty. In addition, under IAS 36 if a reasonably possible change in a key assumption would cause the unit's carrying amount to exceed its recoverable amount, entities are required to disclose the amount by which the value assigned to the key assumption must change.

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.

No, we do not support additional disclosures because we believe that the existing IAS 36 disclosures for goodwill are appropriate.

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.

No, we believe that existing requirements in IAS 36 are sufficient and that the disclosure should only be required for CGUs where an impairment has been recognised or reversed.

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.

No, because in many cases a successful acquisition will result in complete integration into the existing business within a relatively short time scale, resulting in the cash flows relating to the acquired entity becoming indistinguishable from the acquiring entity (or an operating segment of the acquiring entity), and so at least an element of shielding is often inevitable and reflects normal business practice.

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.

We do not support this proposal because IAS 36 Impairment of Assets requires for the purposes of impairment testing, that goodwill is allocated to the CGU which "represent the lowest level within the entity at which the goodwill is monitored for internal management purposes." Therefore, we believe that including a new requirement within this DP would be duplication.

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.

We do not agree with the introduction of goodwill amortisation. Please see our answer to question 1 above.

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

We agree that the IASB should explore the potential for further disclosures in the notes to the accounts that relate more directly to the carrying value of goodwill in the balance sheet, such as acquisition dates and any previous impairment.

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).

We welcome the IASB's recognition that impairment testing can be costly and its exploration of ways to reduce that cost. However, we think that in practice impairment testing is used widely in any case by management to monitor the performance of acquisitions, in which case cost-savings would be limited. In addition, we are of the view that the costs of performing a robust annual impairment test are proportionate to the benefits,

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.

Please see our answer to question 3 above; we support retaining the annual impairment test for goodwill.

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.

We do not agree that the IASB should look to remove the restriction in IAS 36 that prohibits companies from including cash flows arising from a future uncommitted restructuring. We believe that this is too risky; it would facilitate management bias towards to more optimistic cash flows and could therefore contribute to the late recognition of impairment losses. Also, this approach is inconsistent with other proposals that aim to address concern about the shielding of goodwill assets. Further, the result would be inconsistency with IAS 37's recognition of liabilities for restructuring.

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.

Please see our answer to question 28 above.

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.

We agree.

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.

We agree. We think that allowing some identifiable intangible assets to be included in goodwill would result in less relevant information being given:

- *at acquisition, both about the intangible assets acquired and about the pure goodwill generated; and*
- *subsequently, both about the decline in economic value of the intangible assets though amortisation, and about the goodwill and its directly related impairment testing and recoverability.*

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.

We agree. We support IFRS/US GAAP convergence, but only to the extent that any related amendments to IFRS bring net benefits on a stand-alone basis.

33. Do you have any other comments?

We emphasise further the need for financial reporting to be balanced, clear, and concise.

Thank you for completing this Invitation to Comment