HKAB's Comments on IASB Discussion Paper on Business Combinations — Disclosures, Goodwill and Impairment

No	IASB Question	HKAB Comments
1.	**<u>Question 1</u>** Paragraph 1.7 summarises the objective of the Board's research project. Paragraph IN9 summarises the Board's preliminary views. Paragraphs IN50–IN53 explain that these preliminary views are a package and those paragraphs identify some of the links between the individual preliminary views. The Board has concluded that this package of preliminary views would, if implemented, meet the objective of the project. Companies would be required to provide investors with more useful information about the businesses those companies acquire. The aim is to help investors to assess performance and more effectively hold management to account for its decisions to acquire those businesses. The Board is of the view that the benefits of providing that information would exceed the costs of providing it. (a) Do you agree with the Board's conclusion? Why or why not? If not, what package of decisions would you propose and how would that package meet the project's objective? (b) Do any of your answers depend on answers to other questions? For example, does your answer on relief from a mandatory quantitative impairment test for goodwill depend on whether the Board reintroduces amortisation of goodwill? Which of your answers depend on other answers and why?	We agree with the Board's conclusion, with our justifications and recommendations set out in the responses to individual questions below.

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2.	**<u>Question 2</u>** Paragraphs 2.4–2.44 discuss the Board's preliminary view that it should add new disclosure requirements about the subsequent performance of an acquisition. (a) Do you think those disclosure requirements would resolve the issue identified in paragraph 2.4—investors' need for better information on the subsequent performance of an acquisition? Why or why not? (b) Do you agree with the disclosure proposals set out in (i)–(vi) below? Why or why not? (i) A company should be required to disclose information about the strategic rationale and management's (the chief operating decision maker's (CODM's)) objectives for an acquisition as at the acquisition date (see paragraphs 2.8–2.12). Paragraph 7 of IFRS 8 Operating Segments discusses the term 'chief operating decision maker'. (ii) A company should be required to disclose information about whether it is meeting those objectives. That information should be based on how management (CODM) monitors and measures whether the acquisition is meeting its objectives (see paragraphs 2.13–2.40), rather than on metrics prescribed by the Board. (iii) If management (CODM) does not monitor an acquisition, the company should be required to disclose that fact and explain why it does not do so. The Board should not require a company to disclose any metrics in such cases (see paragraphs 2.19–2.20). (iv) A company should be required to disclose the information in (ii) for as long as its management (CODM) continues to monitor the	We understand the need for more insightful disclosure around material business combinations and disclosures that reflect those metrics shown to the CODM. Nonetheless, we would like to suggest the Board to make such disclosure requirements voluntary at the initial phase of implementation on material acquisitions to allow sufficient flexibility, given the following considerations: - There may be duplication with other existing disclosures, e.g. Segment Reporting which may have already included the performance of the combined business after acquisition; - It is perceived that the information monitored and reviewed by CODM varies among entities, and thus it may be difficult to come up with a consistent disclosure standard which allows comparability; and - The disclosure requirements are not specific to the financial impact of the acquisitions, subject to materiality and could be limited where management does not have objectives specific to an acquisition, but a balanced scorecard is in place. On the other hand, given the industry has mixed views on whether the new disclosure requirements about the subsequent performance of an acquisition could be commercially sensitive information, we would like to seek for the Board's further guidance on balancing the adequacy and necessity of the new disclosures made when the company considers certain information required to be disclosed are commercially sensitive.

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	acquisition to see whether it is meeting its objectives (see paragraphs 2.41–2.44). (v) If management (CODM) stops monitoring whether those objectives are being met before the end of the second full year after the year of acquisition, the company should be required to disclose that fact and the reasons why it has done so (see paragraphs 2.41–2.44). (vi) If management (CODM) changes the metrics it uses to monitor whether the objectives of the acquisition are being met, the company should be required to disclose the new metrics and the reasons for the change (see paragraph 2.21). (c) Do you agree that the information provided should be based on the information and the acquisitions a company's CODM reviews (see paragraphs 2.33–2.40)? Why or why not? Are you concerned that companies may not provide material information about acquisitions to investors if their disclosures are based on what the CODM reviews? Are you concerned that the volume of disclosures would be onerous if companies' disclosures are not based on the acquisitions the CODM reviews? (d) Could concerns about commercial sensitivity (see paragraphs 2.27–2.28) inhibit companies from disclosing information about management's (CODM's) objectives for an acquisition and about the metrics used to monitor whether those objectives are being met? Why or why not? Could commercial sensitivity be a valid reason for companies not to disclose some of that information when investors need it? Why or why not? (e) Paragraphs 2.29–2.32 explain the Board's view that the information setting out management's (CODM's) objectives for the acquisition and the metrics used to monitor progress in meeting those objectives is not forward-looking information. Instead, the Board considers the information would	

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	reflect management's (CODM's) targets at the time of the acquisition. Are there any constraints in your jurisdiction that could affect a company's ability to disclose this information? What are those constraints and what effect could they have?	
3.	**<u>Question 3</u>** Paragraphs 2.53–2.60 explain the Board's preliminary view that it should develop, in addition to proposed new disclosure requirements, proposals to add disclosure objectives to provide information to help investors to understand: • the benefits that a company's management expected from an acquisition when agreeing the price to acquire a business; and • the extent to which an acquisition is meeting management's (CODM's) objectives for the acquisition. Do you agree with the Board's preliminary view? Why or why not?	We agree with the Board's preliminary view. This enables investors to keep track of the performance of the acquisitions and it is not expected to significantly increase preparers' costs. Nonetheless, we would like to express our concern whether such disclosures should be included in the financial statement, given the fact that the relevant financial figures and information disclosed, to the extent that they help with investors' understanding may not be prepared in accordance with the same accounting and financial reporting framework as other information in the financial statement (especially the recognition and measurement methods).

4.	**<u>Question 4</u>**
	
	Paragraphs 2.62–2.68 and paragraphs 2.69–2.71 explain the Board's preliminary view that it should develop proposals:
	
	• to require a company to disclose:
	
	    o a description of the synergies expected from combining the operations of the acquired business with the company's business;
	
	    o when the synergies are expected to be realised;
		We agreed with the proposed requirements, except for the quantitative disclosure requirements regarding the estimated range of amounts of the synergies and the expected cost or range of costs to achieve those synergies, considering below factors:
		
		- The complication of deriving the estimation of such quantitative range;
		
		- Practical difficulties to align the estimation basis among entities for comparability;
		
		- Potential effort needed and risk of disclosing sensitive information to disclose detailed assumptions and inputs in estimating such quantitative

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	○ the estimated amount or range of amounts of the synergies; and ○ the expected cost or range of costs to achieve those synergies; and • to specify that liabilities arising from financing activities and defined benefit pension liabilities are major classes of liabilities. Do you agree with the Board's preliminary view? Why or why not?	range, in order to make it understandable and useful for financial statement users; - Practical difficulties to quantify non-monetary elements of synergies; - Such range may not be regularly updated if the synergies are not included in the metrics disclosed as management objectives and for monitoring purposes. In addition, we would like to seek clarification from the Board whether there is a threshold of materiality regarding the requirement to disclose liabilities arising from financing activities and defined benefit pension liabilities as major classes of liabilities.
5.	**Question 5** IFRS 3 *Business Combinations* requires companies to provide, in the year of acquisition, pro forma information that shows the revenue and profit or loss of the combined business for the current reporting period as though the acquisition date had been at the beginning of the annual reporting period. Paragraphs 2.82–2.87 explain the Board's preliminary view that it should retain the requirement for companies to prepare this pro forma information. (a) Do you agree with the Board's preliminary view? Why or why not? (b) Should the Board develop guidance for companies on how to prepare the pro forma information? Why or why not? If not, should the Board require companies to disclose how they prepared the pro forma information? Why or why not?	We agree with the Board's preliminary views. We would like to suggest that the Board consider below suggestions: - Provide further guidance for preparing the pro forma information required to better align the practices among companies, in particular when the entities 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; - As mentioned in Paragraph 2.80, a definition of "integration costs" is needed; On the other hand, we would like to suggest the Board to re-consider the requirement to disclose cash flows from operating activities as stated in Paragraph 2.77(b) and 2.81. There may be challenges to disclose cash flows from operating activities of the combined business on a pro forma basis for the

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	IFRS 3 also requires companies to disclose the revenue and profit or loss of the acquired business after the acquisition date, for each acquisition that occurred during the reporting period. Paragraphs 2.78–2.81 explain the Board's preliminary view that it should develop proposals: • to replace the term 'profit or loss' with the term 'operating profit before acquisition-related transaction and integration costs' for both the pro forma information and information about the acquired business after the acquisition date. Operating profit or loss would be defined as in the Exposure Draft *General Presentation and Disclosures*. • to add a requirement that companies should disclose the cash flows from operating activities of the acquired business after the acquisition date, and of the combined business on a pro forma basis for the current reporting period. (c) Do you agree with the Board's preliminary view? Why or why not?	current reporting period, since the businesses have already been combined and actual cash flows should be considered for the combined business as a whole. The cash flows of the acquired business separated from the combined one may be derived on assumptions which may hinder the reliability and usefulness of such information. In addition, we would like to seek further guidance and possible concrete solutions from the Board to address the difficulties and challenges faced by stakeholders as described in Paragraph 2.74 and 2.75.
6.	**<u>Question 6</u>** As discussed in paragraphs 3.2–3.52, the Board investigated whether it is feasible to make the impairment test for cash-generating units containing goodwill significantly more effective at recognising impairment losses on goodwill on a timely basis than the impairment test set out in IAS 36 Impairment of Assets. The Board's preliminary view is that this is not feasible. (a) Do you agree that 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? Why or why not?	We agree with the Board's preliminary view that it is not feasible to design a different impairment test for goodwill that is significantly more effective than the current one. Determining "unrecognized headroom" in adopting the "headroom approach" as well as the pro-rate allocation of reduction in total goodwill between acquired goodwill and the unrecognized headroom as stated in Paragraph 3.40 requires additional costs. As goodwill cannot generate any cashflows by itself, it would be more reasonable to test for impairment together with other assets as a CGU per IAS 36.

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	(b) If you do not agree, how should the Board change the impairment test? How would those changes make the test significantly more effective? What cost would be required to implement those changes? (c) Paragraph 3.20 discusses two reasons for the concerns that impairment losses on goodwill are not recognised on a timely basis: estimates that are too optimistic; and shielding. In your view, are these the main reasons for those concerns? Are there other main reasons for those concerns? (d) Should the Board consider any other aspects of IAS 36 in this project as a result of concerns raised in the Post-implementation Review (PIR) of IFRS 3?	We also agree with the two reasons for the concerns that impairment losses on goodwill are not recognised on a timely basis stated in Paragraph 3.20.
7.	**<u>Question 7</u>** Paragraphs 3.86–3.94 summarise the reasons for the Board's preliminary view that it should not reintroduce amortisation of goodwill and instead should retain the impairment-only model for the subsequent accounting for goodwill. (a) Do you agree that the Board should not reintroduce amortisation of goodwill? Why or why not? (If the Board were to reintroduce amortisation, companies would still need to test whether goodwill is impaired.) (b) Has your view on amortisation of goodwill changed since 2004? What new evidence or arguments have emerged since 2004 to make you change your view, or to confirm the view you already had? (c) Would reintroducing amortisation resolve the main reasons for the concerns that companies do not recognise impairment losses on goodwill on a timely basis (see Question 6(c))? Why or why not?	There is a mixed view among the industry on the Board's decision on not reintroducing the amortisation of goodwill. Certain industry players support the Board's preliminary view and agree that this would not remove the need for an impairment test, and determining a reasonably estimated useful life of goodwill (and thus amortization period) tends to be arbitrary. Therefore, additional effort may be introduced if it is required to apply amortisation without improving the accuracy of goodwill significantly. In the meanwhile, stakeholders who support the reintroduction of the amortization of goodwill take the view that periodic amortization is a simple way to reflect the diminishing value of goodwill. This would be a simpler outcome than a series of forward-looking disclosures for justifying the success of an acquisition. Entities may disclose the basis on which they determine the useful life of goodwill. Challenges on impairment test that the recognition of goodwill impairment may be delayed could be partially resolved as well. We understand that according to Paragraph 3.86 and 3.87, the Board will propose changing IFRS requirements only if it has enough information to conclude that a change to the Standard is necessary. As such, we look forward

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	(d) Do you view acquired goodwill as distinct from goodwill subsequently generated internally in the same cash-generating units? Why or why not? (e) If amortisation were to be reintroduced, do you think companies would adjust or create new management performance measures to add back the amortization expense? (Management performance measures are defined in the Exposure Draft General Presentation and Disclosures.) Why or why not? Under the impairment-only model, are companies adding back impairment losses in their management performance measures? Why or why not? (f) If you favour reintroducing amortisation of goodwill, how should the useful life of goodwill and its amortisation pattern be determined? In your view how would this contribute to making the information more useful to investors?	to insights from other stakeholders to be shared in this Discussion Paper and any subsequent development.
8.	**<u>Question 8</u>** Paragraphs 3.107–3.114 explain the Board's preliminary view that it should develop a proposal to require companies to present on their balance sheets the amount of total equity excluding goodwill. The Board would be likely to require companies to present this amount as a free-standing item, not as a subtotal within the structure of the balance sheet (see the Appendix to this Discussion Paper). (a) Should the Board develop such a proposal? Why or why not? (b) Do you have any comments on how a company should present such an amount?	We agree with the Board's preliminary view to develop a proposal to present total equity excluding goodwill as a free-standing item.

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<tr><th>No</th><th>IASB Question</th><th>HKAB Comments</th></tr>
<tr><td>9.</td><td><u>Question 9</u>

Paragraphs 4.32–4.34 summarise the Board’s preliminary view that it should develop proposals to remove the requirement to perform a quantitative impairment test every year. A quantitative impairment test would not be required unless there is an indication of impairment. The same proposal would also be developed for intangible assets with indefinite useful lives and intangible assets not yet available for use.

(a) Should the Board develop such proposals? Why or why not?

(b) Would such proposals reduce costs significantly (see paragraphs 4.14–4.21)? If so, please provide examples of the nature and extent of any cost reduction. If the proposals would not reduce costs significantly, please explain why not.

(c) In your view, would the proposals make the impairment test significantly less robust (see paragraphs 4.22–4.23)? Why or why not?</td><td>We agree with the Board to develop such proposals. However, we would like to suggest the Board provide further recommendations in addressing below concerns:

- Further guidance should be provided on (1) whether there is any mandatory requirement on the impairment indicator identification, and (2) the practical assessment steps to conclude if there is any indication of impairment to trigger the goodwill impairment test;

- The indicator-based approach may possibly delay entities’ setup of the impairment testing approach and logistics, as well as impairment recognition.

In addition, whether such proposals reduce costs significantly depends on the level of work required at the outset and on an on-going basis for entities to consider the impairment testing parameter inputs and their movement that would impact the assessment.</td></tr>
<tr><td>10.</td><td><u>Question 10</u>

The Board’s preliminary view is that it should develop proposals:

• to remove the restriction in IAS 36 that prohibits companies from including some cash flows in estimating value in use—cash flows arising from a future uncommitted restructuring, or from improving or enhancing the asset’s performance (see paragraphs 4.35–4.42); and

• to allow companies to use post-tax cash flows and post-tax discount rates in estimating value in use (see paragraphs 4.46–4.52).</td><td>We agree with the Board to develop such proposals. In particular, allowing companies to use post-tax cash flows and post-tax discount rates in estimating value in use would reduce cost and complexity. As noted in the Discussion Paper, in practice, valuations of assets are generally performed on a post-tax basis. The proposal would therefore better align value in use estimation with common valuation practice.

We would like to seek clarification from the Board whether the proposals will be a mandatory requirement. If yes, further guidance should be provided for determining and justifying cash flows arising from a future uncommitted restructuring, or from improving or enhancing the asset’s performance, and the post-tax cash flows and post-tax discount rates in estimating value in use.</td></tr>
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	The Board expects that these changes would reduce the cost and complexity of impairment tests and provide more useful and understandable information. (a) Should the Board develop such proposals? Why or why not? (b) Should the Board propose requiring discipline, in addition to the discipline already required by IAS 36, in estimating the cash flows that are the subject of this question? Why or why not? If so, please describe how this should be done and state whether this should apply to all cash flows included in estimates of value in use, and why.	We also agree with the Board to propose additional discipline in estimating the cash flows that are the subject of this question, since the assumptions applied by the management on forecast preparation and budgeting may be over-optimistic, and the future cash flow estimation would need to be backed by reasonable and supportable assumptions based on the most recent financial budgets or forecasts approved by management.
11.	**<u>Question 11</u>** Paragraph 4.56 summarises the Board's preliminary view that it should not further simplify the impairment test. (a) Should the Board develop any of the simplifications summarised in paragraph 4.55? If so, which simplifications and why? If not, why not? (b) Can you suggest other ways of reducing the cost and complexity of performing the impairment test for goodwill, without making the information provided less useful to investors?	We agree with the Board's preliminary view not to further simplify the impairment test, since it would be challenging to simplify the impairment test and lower the cost of performing the test substantially without scarifying the quality of the test. Current requirement per IAS 36 together with the proposed decision from this discussion paper is considered to be sufficient.
12.	**<u>Question 12</u>** Paragraphs 5.4–5.27 explain the Board's preliminary view that it should not develop a proposal to allow some intangible assets to be included in goodwill. (a) Do you agree that the Board should not develop such a proposal? Why or why not?	We agree with the Board's preliminary view that it should not develop a proposal to allow some intangible assets to be included in goodwill. Recognizing identifiable intangible assets acquired in a business combination separately would provide more useful information on what the company has paid for in addition to the tangible assets, and to identify possible future cash flows than being absorbed in a larger goodwill balance. The inclusion will lead to a loss of information about those assets from investors' perspective.

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	(b) If you do not agree, which of the approaches discussed in paragraph 5.18 should the Board pursue, and why? Would such a change mean that investors would no longer receive useful information? Why or why not? How would this reduce complexity and reduce costs? Which costs would be reduced? (c) Would your view change if amortisation of goodwill were to be reintroduced? Why or why not?	In addition, even if the amortisation of goodwill were re-introduced, our view is still the same since the estimated useful life of the goodwill and relevant intangible assets may not be aligned, and the intangible assets may be transferrable. These make it not feasible for the goodwill and relevant intangible assets to be combined for amortisation calculation.
13.	**<u>Question 13</u>** IFRS 3 is converged in many respects with US generally accepted accounting principles (US GAAP). For example, in accordance with both IFRS 3 and US GAAP for public companies, companies do not amortise goodwill. Paragraphs 6.2–6.13 summarise an Invitation to Comment issued by the US Financial Accounting Standards Board (FASB). Do your answers to any of the questions in this Discussion Paper depend on whether the outcome is consistent with US GAAP as it exists today, or as it may be after the FASB's current work? If so, which answers would change and why?	None of the answers above depend on the consistency of outcome with US GAAP. However, we would welcome if alignment with US GAAP could be achieved where possible.
14.	**<u>Question 14</u>** Do you have any other comments on the Board's preliminary views presented in this Discussion Paper? Should the Board consider any other topics in response to the PIR of IFRS 3?	We have no other comments.