Hong Kong Institute of
Certified Public Accountants
香港會計師公會

Meeting with Financial Reporting Valuation Advisory Panel
(via videoconference)

Date: 29 September 2020, Tuesday
Time: 10:00 a.m. – 12:00 noon

Members Present: Brett Shadbolt, Censere Group
Fran Hung, Deloitte Touche Tohmatsu
Gordon Lee, Deloitte Touche Tohmatsu
Kenneth Ma, Moore
Martin Friedhoff, KPMG
Mateusz Lasik, Deloitte Touche Tohmatsu
Mimosa Chan, Ernst & Young
Ricky Lee, Duff & Phelps
Shelley So, PwC
Wee Kang Keng, GW Financial Advisory Services
Wiley Pun, Savillis

Staff in attendance: Tiernan Ketchum, Associate Director, Standard Setting, HKICPA
Norman Chan, Associate Director, Standard Setting, HKICPA
Joni Kan, Associate Director, Standard Setting, HKICPA

Apologies: Bernard Poon, Ernst & Young
Bow Kotanut, Blackrock
Candy Fong, Foremost Advisors
Janet Cheung, KPMG
Kevin Chan, Jones Lang LaSalle
Lee Yin Toa, Ernst & Young
Michael Wong, Goldman Sachs
Simon Chan, Jones Lang LaSalle
Spencer Tse, PwC
Steve Ong, HKEx
Tony Pang, KPMG
Vincent Pang, Avista Group
Zhang Guochang, The University of Hong Kong

IASB Discussion Paper DP/2020/1 *Business Combinations – Disclosures, Goodwill and Impairment*

1. Improving disclosures about acquisitions

Panel members generally supported the IASB's proposal to add new disclosures about the acquisitions, but there were also a number of concerns and suggestions. The following comments were noted from members:

- One member shared his view that the proposed new disclosures are similar to those required by the Hong Kong Stock Exchange Limited to be made in the circulars for substantial acquisitions and major acquisitions. This member considered such disclosed information is useful to investors to have a better understanding of the transaction. This was echoed by another member. However, this latter member suggested the IASB should consider the extent of disclosures carefully to balance

between generic and overly specific disclosures. For example, the improved disclosures related to the amount, or range of amounts, of expected synergies may be seen as being too specific and sensitive to some companies.

- One member commented that the current disclosures under IFRS 3 *Business Communications* are insufficient for valuers to perform their analysis; for example, valuers may struggle to obtain sufficient appropriate information to carry out their analysis on comparable transactions. This member considered the proposed new disclosures would be helpful to valuers and suggested the IASB to also consider requiring the disclosures of earn-out and contingency information.
- One member agreed with the proposed disclosures but considered the proposal may not be welcomed by preparers due to business reasons such as sensitivity. This member commented that adding the disclosure objectives may not be sufficient. The member shared the observations that although IFRS 15 *Revenue from Contracts with Customers* and IFRS 16 *Leases* have disclosure objectives, many Hong Kong companies do not look at the objectives carefully and only provide minimum disclosures. She recommended the IASB considers, apart from adding the disclosure objectives, incorporating minimum required disclosures to provide meaningful information to investors. In addition, this member thought that if the IASB uses the management approach to determine the information to be disclosed, the IASB should require companies to provide explanations on how the disclosed information is being calculated, for example, how to calculate the expected synergies from an acquisition and how it is linked to the goodwill balance.
- Another member agreed with the previous member's recommendation to specify the minimum disclosure requirements for an acquisition. This member commented that some of the proposed new disclosures are quantitative in nature and it may be practically difficult for smaller companies to comply, as they normally do not perform such comprehensive analysis before and after the transaction. This member suggested the IASB should provide more guidance on how to quantify those numbers, for example, expected synergies.
- One member agreed with the IASB's proposed new disclosures and shared his view that although the information related to the expected synergies is important, valuation of the entity is more important, particularly investors would like to know how well the money they invest in for an acquisition. This member recommended the IASB should consider requiring a company to perform a valuation for an acquisition and to disclose the basis for valuation in the financial statements, for example, the valuation method and approach adopted, market research, and analysis performed for the valuation.
- One member generally welcomed the additional disclosures proposed, however, was not convinced that the proposals would achieve their objectives unless there is better enforcement by the regulators and better corporate governance.
- One member did not agree with the management approach proposed by the IASB because investors have been generally not satisfied with the approach used for disclosures under IFRS 8 Operating Segments and IFRS 7 Financial Instruments: Disclosures. This member shared the observations that the overall quality of disclosures from the eyes of management is unsatisfactory in practice, and such an approach allows significant opportunities for manipulation such as through the creation of internal information specifically to feed into disclosures for external reporting purposes. For example, management can prepare separate internal information to hide sensitive information and not to disclose in the financial statements.
- Two of the members suggested IASB should consider what goodwill represents before developing the proposed new disclosures as the measurement and recognition of goodwill are more important than its disclosures.

2. Goodwill impairment and amortisation

Panel members shared mixed views on the impairment and/or amortisation of goodwill, with some members in favour of an impairment-only approach, and some in favour of amortisation. Two members representing Big 4 accounting firms noted their firms were split with mixed views. One Big 4 representative noted the firm tended to pro-impairment.

The following comments were noted from members who were more supportive of amortisation:

- The DP seems to overly focus on a disclosure solution, but it would be more rationale to begin by looking at goodwill at a fundamental level.
- Goodwill is a “catchall” amount that contains a variety of elements, some of which may theoretically persist over time and others that should theoretically be written off immediately or in short order. It is worthwhile to highlight the value of goodwill upon an acquisition in order to provide analysts with that information for reference, however over time the entity changes and continuing to test goodwill against the changing entity becomes inappropriate (additionally, there is a distinction between acquired and internally generated goodwill). Hence, the amount of goodwill should be highlighted, for example, for a couple of years, but thereafter should be amortised.
- There is a bias between organic and acquisitive growth under existing IFRSs. This results in certain incentives as it pushes management to go for M&A growth. Hence, having external/acquired goodwill recognised as an asset itself creates a distortion. Goodwill is not a traditional asset and does not qualify without a recognition exception. Goodwill is impacted by various accounting driven aspects such as any IFRS 3 exceptions where fair value isn’t required to be used (e.g. deferred taxes). Such aspects are rolled into and hidden into goodwill, which is problematic and emphasizes concerns with goodwill as an asset. Goodwill is asymmetric in that it cannot show value creation. As such, it incentivizes management to avoid impairment.
- Goodwill as recognised under IFRS 3 is necessarily wasting because it is a “snapshot” and is static. Overtime, it does not hold and there inevitably will be churn. Those who argue that goodwill is not wasting are looking at “economic” goodwill, not external goodwill as recognised under IFRS 3. There are three preferred ways forward:
    - Do not recognise external goodwill as an asset.
    - Recognise external goodwill as an asset and apply amortisation.
    - Move to a full revaluation model including external and internal goodwill.
- The form of accounting (e.g. merger accounting or acquisition accounting) drives the resulting situation. For acquisition accounting, it may not be appropriate to recognise excess profit if PPA is done appropriately (unless extra synergies are realised).
- An amortisation period requirement would not be more challenging to implement than the impairment test.
- The IASB’s request for and focus on only “new arguments” is unhelpful. The IASB should consider and welcome quality and strength of argument over novelty, and consider what alternatives exist. It is not helpful or welcoming to pre-emptively refuse arguments based on this premise.
- Conceptually goodwill is more a wasting asset. Additionally, there is a pragmatic element about impairment being more challenging to implement, hence more in favour of amortisation.
- If the IASB discards an impairment approach, it should consider whether it can implement derecognition requirements for goodwill that are not impairment.

The following comments were noted from members who were more supportive of impairment-only approach:

- The current impairment testing regime is generally effective in most cases. There may be a minority of cases where there was a failure of stringent testing, but this would be an enforcement issue. In Hong Kong, most entities and auditors perform robust impairment testing.
- It may not be appropriate to say that “management optimism” has caused a “too little too late” problem. Management generally acts to serve the best interests of shareholders, and failure to achieve expectations may be due to many different reasons.
- Amortisation may not be able to solve the “too little too late” issue. The proposed disclosures will address “too little too late” more directly.

- It is challenging to determine the useful life for amortisation, and this may be highly dependent on type of entity.
- Entities should focus on ensuring the PPA allocation is done properly on acquisition date, in particular with regard to intangible assets.
- Goodwill is in majority going concern value. Hence, from a valuation perspective, it would be considered to have an indefinite life, and hence amortisation may be inconsistent with this valuation concept.
- Amortisation of goodwill is more of a "cost accounting" concept. However, goodwill is in between cost accounting (whereby it cannot be revalued up) and fair value/equity instrument accounting (whereby it must be tested for impairment).
- There may be disagreement with whether "too little too late" exists with regard to impairment, and it may be the case that the recognised goodwill still has value. Goodwill also can serve as a benchmark of performance, and amortisation could result in expensing value that should not be expensed. Furthermore, amortisation may not be able to help show management performance. Even if the underlying entity changes, recognised goodwill can show that the entity has still maintained value rather than destroyed it.

3. Other topics

Panel members shared a number of targeted comments regarding other topics presented in the DP. The following comments were noted among members:

- One member disagreed with the proposed relief of the annual impairment test of goodwill, because it appears to contradict with the project objective to address the issue of "too little, too late". This member also mentioned that indicators of impairment are subject to management's judgment, so over-optimistic estimates made by management may conceal the impairment of goodwill. Another member suggested that allowing goodwill and intangible assets with indefinite lives to be subject to the impairment test only if there is an impairment indicator would make the accounting treatment more consistent with other intangible assets.
- One member suggested allowing the use of post-tax cash flows and discount rates would not be very helpful since the process of determining post-tax cash flows and discount rates is highly complex in terms of the required adjustments. Hence, this would not necessarily be a "simplification". However, another member supported the change to allow the use of post-tax cash flows and discount rates because they are commonly used in practice.
- One member agreed with the preliminary view not to change the intangible asset recognition criteria because it is complex and difficult to distinguish certain intangible assets (e.g. customer list) from goodwill, and to disentangle intangible assets excluding goodwill from amongst themselves, and the recognition criteria should be kept consistent. Allowing some intangible assets to be included in goodwill would only make the existing accounting messier.
- A couple members disagreed with presenting total equity excluding goodwill, because the figure is very easy to compute and such a presentation format may call into question what goodwill represents and whether it is an asset. However, one member stated that although it is easy to compute, such presentation could emphasize the issues that do exist with goodwill and fact it is different from other assets, and hence would be supportive. Another member mentioned that such presentation could resolve the comparability issue concerning organic versus acquisitive growth entities.