IAASB International Auditing and Assurance Standards Board

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December 31, 2020

Mr. Hans Hoogervorst
Chairman
International Accounting Standards Board (IASB)
Columbus Building, 7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Dear Hans,

**Re: Comments on IASB's Discussion Paper (DP), *Business Combinations—Disclosures, Goodwill and Impairment***

I am pleased to provide the attached comments on the IASB's DP, *Business Combinations–Disclosures, Goodwill and Impairment*.

The International Auditing and Assurance Standards Board (IAASB) broadly supports the IASB's work to explore whether companies can provide more useful information about the acquisitions those companies make. In particular, the IAASB supports the development of preliminary views for enhanced disclosures with regard to acquisitions (but taking into account the matters noted in the attached).

The comments in this letter have been developed by the IAASB's "IASB Liaison Working Group" (the Working Group), with a particular focus on auditability or verifiability arising from the matters set out in the DP. Consistent with our previous letters, the comments or matters for the IASB's consideration are set out in the attachment to this letter. The Working Group has also included some other specific matters for consideration with regard to the IASB's current thinking in relation to possible future changes (or in some cases where changes are not being considered).

I hope that you will find the comments helpful. If you need any clarification or would like to further discuss our written comments, please do not hesitate to contact me (tomseidenstein@iaasb.org), or the new Chair of the Working Group for 2021, Eric Turner (eturner@cpacanada.ca).

Yours sincerely,

**Tom Seidenstein**
IAASB Chair

**Working Group's Views on Specific Matters: *Business Combinations—Disclosures, Goodwill and Impairment***

The following sets out the Working Group's views in relation to specific aspects discussed in the IASB's DP, *Business Combinations—Disclosures, Goodwill and Impairment,* and are for consideration by the IASB. The Working Group has focused on those areas that impact auditability and verifiability, which is the remit of the Working Group, and did not comment on all aspects discussed in the DP. The Working Group has also included some specific comments about some of the changes that the IASB may want to also consider.

| No. | Specific Aspects in the DP that Impact Auditability and Verifiability | Working Group's Views |
|---|---|---|
| | **Section 2 – Improving Disclosures About Acquisition** | |
| *1.* | *Disclosures about the acquisition* | |
| | *Paragraph 2.45(a) sets out the IASB's preliminary view to disclose:*<br>*(i) The strategic rationale for undertaking an acquisition; and*<br>*(ii) Management's (CODM's) objectives for the acquisition.* | **Auditability / Verifiability Issue(s) Identified**<br>In 2015, the IAASB completed its project to revise the International Standards on Auditing (ISAs) to enhance the auditor's work with regard to disclosures in the financial statements. The changes made by the IAASB are premised on the relevance, understandability and quality of the disclosures, with robust requirements for these disclosures embedded in the financial reporting standards.<br>In undertaking the work to revise the ISAs, it was continually highlighted that one of the most challenging areas to audit with regard to disclosures relates to matters that are non-quantitative and the availability of evidence to support such disclosures. In line with this, in requiring disclosures for the '*strategic rationale*' for undertaking an acquisition, and '*management's objectives*' for the acquisition, this may result in auditability or verifiability issues for the auditors in relation to such disclosures.<br>**Matters for IASB Consideration**<br>In developing proposals, we encourage the IASB to consider developing robust requirements that guide the disclosures in relation to 'strategic |

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| | | rationale' and 'management's objectives' so that the information provided in the financial statements can be appropriately verified by auditors. |
| *2.* | *Subsequent performance of acquisitions (disclosure of metrics used)* | |
| | **Paragraph 2.45(b)** of the DP sets out the IASB's preliminary view to develop proposals to add requirements for companies, in relation to an acquisition, to disclose:<br>(i) In the year in which an acquisition occurs, the metrics that management (CODM) will use to monitor whether the objectives of the acquisition are being met;<br>(ii) The extent to which management's (CODM's) objectives for the acquisition are being met using those metrics, for as long as management (CODM) monitors the acquisition against its objectives;<br>(iii) If management (CODM) does not monitor whether its objectives for the acquisition are being met, that fact and the reasons why it does not do so;<br>(iv) If management (CODM) stops monitoring whether its objectives for the acquisition are being met before the end of the second full year after the year of acquisition, that fact and the reasons why it has done so; and<br>(v) If management (CODM) changes the metrics it uses to monitor whether management's | **<u>Auditability / Verifiability Issue(s) Identified</u>**<br>Notwithstanding the IASB's recognition about whether some of the information in the new requirement would be verifiable (as noted in paragraph 2.17 of the DP), the Working Group is still of the view that it may be difficult for auditors to verify some of this information in the proposed new disclosure.<br>For example, as noted in paragraph 2.16(d), "a company's management is likely to pursue several objectives when acquiring a business and use several metrics for measuring progress towards those objectives. These metrics could be financial – for example, amount of synergies, profit measures, returns on capital – or non-financial – for example, market share, retention of staff, product launches – or both."<br>• A specific area of concern for the Working Group is understanding how the information has been prepared in particular relating to non-financial metrics or non-GAAP financial metrics (that may not likely complement amounts, totals or subtotals specified by IFRS standards), and which may be used by management to monitor whether the objectives of the acquisition are being met, and disclosed as such.<br>**<u>Matters for IASB Consideration</u>**<br>In light of the Working Group's concern, we suggest adding requirements and/or guidance that would assist preparers in how to integrate non-financial metrics as well as non-GAAP financial metrics into financial statement disclosures. By doing so, auditors would better be able to judge what the Board is looking for with regards to the balance of financial and |

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| | (CODM's) objectives for the acquisition are being met, the new metrics and the reasons for the change. | non-financial disclosures, with those disclosures normally found in the financial statements. Non-financial disclosures are typically found in the Management Commentary section of the Annual Report and not in the financial statements, and therefore further consideration about how to incorporate them is needed. |
| *3.* | *Other targeted improvements (disclosure of synergies as an objective of an acquisition)* | |
| | **Paragraph 2.91(a)** of the DP sets out the IASB's preliminary views to improve disclosure requirements of IFRS 3, *Business Combinations*, by amending paragraph B64(e) to require a company to disclose:<br>(i) A description of the synergies expected from combining the operations of the acquired business with the company's business;<br>(ii) When the synergies are expected to be realized;<br>(iii) The estimated amount or range of amounts of the synergies; and<br>(iv) The estimated cost or range of costs to achieve those synergies. | **<u>Auditability / Verifiability Issue(s) Identified</u>**<br>As noted in paragraph 2.66 of the DP, synergies are often difficult to quantify. In the Working Group's view, it would require significant judgment as to what these synergies (and related costs), and resulting disclosures, may be. Without clear guidance about what is meant by "synergies" this may result in verifiability issues for auditors.<br>**<u>Matters for the IASB's Consideration</u>**<br>With respect to the targeted improvements to the disclosure requirements in paragraph B64(e) of IFRS 3, it may be helpful for the IASB to consider:<br>(a) Defining or clearly describing the term 'synergies,' including clarifying whether the term, as contemplated by the IASB, covers both financial and non-financial information, or financial information only.<br>(b) Providing examples of synergies expected from combining the operations of an acquired business with the company's business.<br>Similar to the considerations noted in Item 2. above, it may also be helpful for the IASB to consider clarity about how such information is to be incorporated, which will assist auditors when auditing such disclosures. |

In addition, the Working Group also provided input on the following specific matters within the proposals, that may be helpful for the IASB to consider:

| No. | Other Matters for the IASB's Consideration | Working Group's Views |
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| | **Section 2–Improving Disclosures About Acquisitions** | |
| *1.* | *Other targeted improvements (integration costs)* | |
| | **Paragraph 2.91(c) of the DP** sets out the IASB's preliminary view to develop proposals to make targeted improvements to the disclosure requirements of IFRS 3 to replace the term 'profit or loss' in paragraph B64(q) of IFRS 3, with the term 'operating profit before deducting acquisition-related transaction and integration costs.' Operating profit or loss would be defined as in the Exposure Draft, *General Presentation and Disclosures*. | **Issue Identified**<br>As noted in paragraph 2.80, acquisition-related costs are defined in paragraph 53 of IFRS 3. However, "integration costs" is not defined and may lead to inconsistent interpretation of what is included.<br>**Matter for IASB Consideration**<br>It would be helpful to auditors if a robust definition, including examples of what should, and what should not, be included in "integration costs" was provided. |
| | **Section 3–Goodwill Impairment and Amortization** | |
| *2.* | *Whether the amortization of goodwill should be reintroduced* | |
| | **Paragraphs 3.90-3.91** of the DP, notes the IASB accepts that both accounting models for goodwill—an impairment only model and an amortization model—have limitations. No impairment test has been identified that can test goodwill directly, and for amortization it is difficult to estimate the useful life of goodwill and the pattern in which it diminishes.<br>The IASB reached a preliminary view that it should retain an impairment only approach, but this was by a small majority and so the IASB would particularly like stakeholders' views on this topic. | **Matters for IASB Consideration**<br>While the Working Group acknowledges that there may be challenges for auditors under either accounting model, on balance the Working Group supports the IASB's preliminary view to retain an impairment only approach to the carrying value of goodwill. Determining a useful life of a tangible asset is often difficult, but becomes substantially more judgmental and difficult for intangible assets, in particular goodwill. The Working Group therefore cautions against reintroducing a requirement to amortize goodwill because of the auditability issues related to determining the amortization period. |

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| *3* | *Making the impairment test more effective* | |
| | **Paragraphs 3.20-3.21** of the DP sets out the IASB's considerations about the concerns about the possible delay in recognizing impairment losses on goodwill and whether goodwill should be tested directly.<br>**Paragraphs 3.22-3.30** set out matters for consideration with regard to management's over-optimism, including in **paragraph 3.29** where the DP notes that the risk of over-optimism is best addressed by auditors and regulators. | **Matters for IASB Consideration**<br>While the Working Group notes that the Board is not considering changes to the impairment test at this time, the Working Group cautions about future changes, and if any are contemplated, to consider the subjectivity related to future cash flows, and how these future cash flows can be verified. If there is insufficient clarity as to how the future cash flows are to be calculated, this will likely result in auditability issues.<br>The Working Group agrees that there is a risk of over-optimism in management's estimates of its future cash flows. However, the Working Group believes that the statement in paragraph 3.29 that it is up to auditors and regulators to address this, not by changing IFRS standards, should be reconsidered.<br>The auditor is required to evaluate whether judgments and decisions made by management in making accounting estimates in the financial statements are indicators of possible management bias. However, auditors do not have the same level of knowledge of the company as do management and those charged with governance. Accordingly, it is important that IFRS standards contain sufficient requirements and guidance for preparers to address concerns about over optimism and for auditors to have an appropriate basis for evaluating management's judgments. This might be achieved by making the impairment test less subjective, with a focus on leading versus lagging indicators. |

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| | **Section 4-Simplifying the impairment test** | |
| *4* | *Relief from the annual impairment test* | |
| | **Paragraph 4.32** sets out the IASB's preliminary view to propose removing the requirement for a company to perform an annual impairment test for cash-generating units containing goodwill if there is no indication that the cash-generating units may be impaired. As explained in **paragraph 4.31**, that proposal would also apply to intangible assets with indefinite useful lives and intangible assets not yet available for use. A company would still need to assess at the end of each reporting period whether there is any indication that there may be an impairment. | **<u>Matters for Consideration</u>**<br>If the IASB moves forward with removing the requirement for an annual impairment test for cash-generating units containing goodwill, intangible assets with indefinite useful lives and intangible assets not yet available for use, more attention and scrutiny will be placed on management and auditors to focus on the indicators of when there may be an impairment. Accordingly, the public interest would be best served with a robust list of such indicators, and therefore the list of indicators in paragraph 12 of IAS 36 may need further consideration. |