20 June 2024

Andreas Barckow
Chair
International Accounting Standards Board (IASB)

Exposure Draft: Business Combinations—Disclosures, Goodwill and Impairment

Dear Andreas,

We are responding to your invitation to comment on Exposure Draft *Business Combinations—Disclosures, Goodwill and Impairment* on behalf of the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity. This response summarises the views of member firms that contributed to our discussions during the comment period.

We support the overall objective of improving information entities provide about business combinations and therefore increasing the usefulness of the financial statements. We also support the IASB reducing the complexity of the impairment test and addressing concerns around impairment losses being recognised too late.

However, we have the following key concerns:

- **Expectation gap risk**: We believe that the proposed disclosures of the key objectives and targets (IFRS 3.B67A) and the quantitative information on expected synergies (IFRS 3.B64(ea)) create an expectation gap risk. Investors might place undue weight on the existence and achievability of such information as they are included in the audited financial statements, when the information might not be reliable or verifiable. We propose requiring the disclosure of an explicit statement that the disclosed key objectives, targets and expected synergies are solely based on information used and prepared by management

PricewaterhouseCoopers International Limited
1 Embankment Place
London WC2N 6RH
T: +44 (0) 20 7583 5000, F: +44 (0) 20 7822 4652

PricewaterhouseCoopers International Limited is registered in England number 3590073.
Registered Office: 1 Embankment Place, London WC2N 6RH.

based on their acquisition-date best estimates. See further details in our responses to questions 1 and 5.

- **Incremental costs to quantify synergies:** We believe that management will typically be required to incur substantial additional effort and costs to analyse and quantify expected synergies and their potential. We think that the costs of preparing the information proposed in IFRS 3.B64(ea) will outweigh the benefits. We suggest that a qualitative description should be required instead, to achieve an appropriate cost-benefit balance for material, but not strategic, acquisitions. See further details in our response to question 5.

- **Potential for diversity of application of the proposed exemption:** We support the use of judgement on the proposed exemption in IFRS 3.B67D, but we are concerned that without more application guidance, there is a risk of diversity in practice. We suggest that the IAS 37 wording of 'extremely rare' should be included in IFRS 3 to align the new exemption to current and well-understood practice under the IFRS® Accounting Standards. We also think that it would be helpful to include examples on when the exemption could be applied in addition to the current non-exhaustive list of examples of when it cannot be applied. See further details in our response to question 3.

- **Effect of proposals to reduce shielding:** We do not see that the proposals will result in a change in practice and reduce shielding, and we propose two alternative solutions to address the issue more effectively. See further details in our responses to questions 6 and 9. If no changes are made to the proposals, the IASB should explain whether the proposals clarify or amend the existing requirements. If they are clarifications of existing requirements, this will likely result in no change in current practice. If the IASB’s desire is to change practice, the Board should clarify that the changes are amendments to the current requirements and include appropriate transition relief.

- **Management over-optimism:** We do not agree that management over-optimism is one of the main causes of ineffective impairment tests and we believe that the existing requirements for impairment tests are typically applied appropriately. We think shielding from testing at too high a level is primarily responsible for ineffective impairment tests. We also disagree that disclosing the segment to which goodwill belongs will have a significant impact on the perceived management over-optimism. See further details in our response to question 6.

- **Reduction in costs and complexity of the VIU model:** We support the IASB’s proposals to allow the use of post-tax cash flows and post-tax discount rates. However, we believe that more guidance needs to be provided on how to treat any deferred tax balances in VIU calculations to avoid diversity. Further, since there will be fewer differences between the VIU and the FVLCD models, we believe that it is important for stakeholders to understand the remaining differences and we recommend that the IASB should explain the remaining differences. See further details in our response to question 7.

The appendix to this letter sets out our responses to the questions in the Exposure Draft.

Please contact Gary Berchowitz if you would like to discuss our responses.

Yours sincerely

PricewaterhouseCoopers

Eric Clarke

Partner, Incoming Global Chief Accountant and Head of Reporting

eric.clarke@pwc.com

Appendix

1—Disclosures: Performance of a business combination (B67A–B67G of IFRS 3)
The IASB is proposing changes to the disclosure requirements in IFRS 3 that, in its view, appropriately balance the benefits and costs of requiring an entity to disclose this information. It therefore expects that the proposed disclosure requirements would provide users with more useful information about the performance of a business combination at a reasonable cost. In particular, the IASB is proposing to require an entity to disclose information about the entity's acquisition-date key objectives and related targets for a business combination and whether these key objectives and related targets are being met (information about the performance of a business combination). The IASB has responded to preparers' concerns about disclosing that information by proposing: ● to require this information for only a subset of an entity's business combinations — strategic business combinations (see question 2); and ● to exempt entities from disclosing some items of this information in specific circumstances (see question 3).

We agree with the IASB's proposal, but we have concerns that are set out below. We support limiting some of the disclosures to only strategic business combinations. We believe that the new disclosures might provide meaningful information about business combinations to users of the financial statements.

Reliability and verifiability risk arising from disclosures on objectives and targets

We understand that the intention of the IASB is not to require management to disclose forward-looking information and that, as auditors, we would not provide assurance over the existence and achievability of objectives and targets. IFRS 3.BC145 states that auditors and regulators will be able to verify whether an entity's disclosures are indeed those monitored and reviewed by key management personnel, whether there is sufficient and appropriate supporting evidence for the information, and whether the disclosures faithfully represent the actual information reviewed by key management personnel.

We agree with the IASB on the premise that the disclosures on objectives and targets present only information reviewed by management at a point in time, and that we as auditors of financial statements would not be able to obtain evidence that the objectives or targets can or will be achieved. Auditors can only obtain evidence that the disclosed information is consistent with information produced and reviewed by management, but not provide any further assurance over them. However, we are concerned that the proposal creates a significant expectation gap in this regard considering that the new disclosures would form part of the audited financial statements and associate the auditor with these numbers. This expectation gap risk is also applicable to the disclosures about expected synergies as discussed in our response to question 5 below.

We think it would be useful for investors if this expectation gap risk is mitigated by requiring additional disclosure. The inherent subjectivity in objectives and targets and the non-verifiable nature of their existence and achievability would result in the disclosure of information in the financial statements to investors that might not be sufficiently reliable. Auditors are also not able to provide reasonable assurance over the existence and achievability of the objectives and targets in a statutory audit at a manageable level of risk.

To mitigate this risk, we suggest that the IASB should require an explicit statement in the financial statements that the disclosed key objectives and targets:

a. are based solely on information used internally by management at the point of the acquisition and do not represent forward looking information; and

b. are based on management's best estimate when disclosures are provided and there is no expectation that the actual results will be consistent with the disclosure (that is, failing to achieve the targets does not mean that the estimate was not reasonable at that point in time).

We think that requiring this statement would be consistent with IFRS 18.122 which requires a company to disclose "*a statement that the management-defined performance measures provide management's view of an aspect of the financial performance of the entity as a whole and are not necessarily comparable with measures sharing similar labels or descriptions provided by other entities*".

In addition, we would suggest that the proposed IFRS 3 paragraph BC145 make it clear that it was not the Board's expectation that assurance providers would assess the reliability or achievability of the output related to the disclosures.

Non-financial key objectives and targets

We expect that entities increasingly pursue strategic acquisitions for non-financial reasons; ESG related for example. We have identified some implications for the IASB to consider.

Entities will be required to adapt their established financial reporting processes and controls to capture the required non-financial information of such targets or synergies in sufficient detail for disclosure. Different strategic business combinations might also have different unique targets, increasing complexity in monitoring these targets.

The reporting of non-financial data would result in a corresponding increase in audit efforts, because additional expertise will be required to assess the appropriateness of evidence to support the non-financial disclosures in addition to the need to assess potential errors at the same level of rigour as financial disclosures. Costs to preparers, auditors and regulators would increase as a result of providing these additional disclosures in the manner proposed and we believe that those costs will outweigh the benefits.

We note that entities currently already disclose such non-financial information through other channels outside the financial statements, such as in the management commentary. Investors already obtain this information from these other channels. We suggest that the IASB should reconsider requiring disclosure of non-financial key objectives and targets in the financial statements for strategic acquisitions.

Additional application guidance on disclosures of key objectives and targets

We suggest that the IASB should add an example of a disclosure required by IFRS 3.B67A(b) for subsequent reporting periods to provide preparers with helpful guidance, in addition to the example illustrating acquisition date key objectives and targets in IFRS 3.IE72A.

In our experience, management might have multiple targets used to measure success of an acquisition, with some being internally communicated aspirational goals. We believe that those key objectives and related targets that are closely linked to management's strategic rationale for the acquisition, and that typically support the purchase price, provide the greatest value to investors. Accordingly, to ensure that the most relevant objectives and targets are disclosed, the IASB should consider providing indicators or examples to help entities in making their judgement when determining which key objectives and targets are disclosed for strategic business combinations.

We have significant concerns over the application of the exemption (see our response to question 3 below).

In addition, we note a need to consider the interaction of the proposed disclosure requirements in IFRS 3.B67A(b) and interim financial statements prepared in accordance with IAS 34. IAS 34.16A(i) requires relevant IFRS 3 disclosures in interim financial statements. We note that the proposals would require an entity to disclose the actual performance of a strategic business combination and whether acquisition-date key objectives and related targets are being met in the interim financial statements. Furthermore, key objectives and targets of strategic business combinations are typically longer term in nature, and the impacts of such acquisitions might not materialise in the short term. Disclosing updates on actual performance in the interim financial statements might provide users with a misleading view of the acquisition's performance. We believe that these items should only be disclosed in the annual financial statements, reducing the costs to preparers while retaining the benefit of providing useful information on an annual basis, thus achieving a better cost-benefit balance.

2—Disclosures: Strategic business combinations (B67C of IFRS 3)
The IASB is proposing to require an entity to disclose information about the performance of a business combination (that is, information about the entity's acquisition-date key objectives and related targets for the business combination and whether these key objectives and related targets are being met) for only strategic business combinations—a subset of material business combinations. A strategic business combination would be one for which failure to meet any one of an entity's acquisition-date key objectives would put the entity at serious risk of failing to achieve its overall business strategy. The IASB is proposing that entities identify a strategic business combination using a set of thresholds in IFRS 3—a business combination that met any one of these thresholds would be considered a strategic business combination (threshold approach) (see paragraphs BC56–BC73).

The IASB based its proposed thresholds on other requirements in IFRS Accounting Standards and the thresholds regulators use to identify particularly important transactions for which an entity is required to take additional steps such as providing more information or holding a shareholder vote. The proposed thresholds are both quantitative (see paragraphs BC63–BC67) and qualitative (see paragraphs BC68–BC70).

We agree with the proposal to use a threshold approach. As stated above, we are supportive of limiting the most detailed disclosure requirements to only strategic business combinations.

However, we have the following concerns over certain details of the threshold approach:

- **10% quantitative threshold**

  We note that the 10% threshold is an arbitrary one, and we acknowledge the value in having a threshold similar to that applied in IFRS 8 for identification of reportable operating segments. We also note that the thresholds are, in principle, meant to identify business combinations "*for which failure to meet any one of an entity's acquisition-date key objectives would put the entity at serious risk of failing to achieve its overall business strategy*".

  We recommend that the IASB should perform further outreach to stakeholders on the threshold. We understand that existing requirements for capital market disclosures on significant acquisitions are typically based on thresholds higher than 10%. For example, regulators in the US, the UK, Europe and Australia apply broadly similar thresholds of between 20% and 25%. We believe that applying a higher threshold, aligned with many regulatory requirements, would still identify those acquisitions for which, if key objectives were not met, would seriously risk the achievement of the entity's overall business strategy. We believe that the 10% threshold would capture possibly too many acquisitions, including those for which failure to meet the acquisition-date key objectives and targets would not put the entity at serious risk of failing their overall strategy.

  Therefore we suggest that the IASB should either:

  a. consider increasing the quantitative threshold of 10% to something more in line with capital market regulations for significant acquisitions; or
  b. explain, perhaps in the Basis for Conclusions, why the 10% threshold would be more appropriate than higher thresholds that are already successfully used in many prominent capital markets around the world.

- **Unintended outcomes when applying the quantitative threshold tests**

  We appreciate that the quantitative threshold provides a clear criterion for the identification of strategic business combinations. However, we think that there will be cases where this quantitative threshold would result in acquisitions that are not 'strategic', in the eyes of management, being classified as strategic business combinations. This is especially because the asset test in IFRS 3.B67C(b) compares "*the amount recognised as of the acquisition date for all assets acquired (including* *goodwill)*" (that is, the fair value of the acquiree's net identifiable assets plus goodwill) against the acquirer's total assets which are typically measured at historical cost.

For example, an entity might pay a premium to acquire a technology startup, despite having low revenues and profits in its most recent annual reporting period. The amount recognised by the acquirer for all assets acquired (including goodwill) might be 21% of the acquirer's total assets, while the acquiree's revenue and operating profits only represent 1% of the acquirer's revenue and operating profits respectively. In our experience, management might not consider such an acquisition to be key to its overall business strategy, which would, however, be defined as a strategic business combination under the proposals.

In view of this, and our comments on the qualitative threshold test below, we suggest a different threshold approach as follows:

a. If the operating profit or loss, asset or qualitative thresholds are met, there would be a rebuttable presumption that the acquisition is a strategic business combination. If management rebuts this presumption, this fact and the reason(s) should be disclosed in the financial statements.
b. If the revenue threshold is met, the acquisition is always a strategic business combination.

We believe that this approach to applying the thresholds would provide a better alignment in identifying strategic business combinations that management actually views as 'strategic', without unintentionally bringing into scope those acquisitions that are not. This fulfils the IASB's objective to balance costs and benefits.

- **Basis of financial information used in the quantitative threshold tests**

We note that IFRS 3.BC67C does not specify whether the acquiree's financial information used in the quantitative threshold test needs to comply with IFRS Accounting Standards. In our experience, there might be complications in obtaining audited IFRS Accounting Standards-compliant financial information of the acquired business in order to apply the threshold. This could happen where: the acquired business is a portion of a legal entity; the financial statements of the acquiree might not be audited; or the financial statements might be prepared in accordance with another accounting framework. These situations are not uncommon and could result in application issues and increased costs for preparers.

We do not think that the financial information used in the quantitative threshold test needs to be fully compliant with IFRS Accounting Standards. Even if the financial information was not compliant with IFRS Accounting Standards, it would likely provide a sufficient basis for the test, because such information would have typically been used by management as part of the decision-making process. Accordingly, we suggest that the IASB should clarify in paragraph B67C that the information to be used for the quantitative threshold test should be based on the information available to management without undue cost or effort, but that reasonable effort should be undertaken by management to ensure a like-for-like comparison.

- **Allow judgement to be applied in the qualitative threshold test**

  We note that the qualitative threshold of a new 'major line of business' is consistent with IFRS 5.32. We have noted diversity in the application of the 'major' qualitative threshold due to a lack of clear guidance in IFRS 5. For the purposes of the IFRS 3 test, it would be helpful for the IASB to provide additional application guidance or indicators for a 'major' line of business.

  The qualitative threshold of a new 'geographical area of operations' might not be difficult to apply in practice but it might produce counterintuitive outcomes. For example, situations where entities venture into new geographical areas through less material acquisitions in order to test if it would be feasible to further invest in said territory might be captured under the qualitative threshold and as such be reported as strategic business combinations. We do not think that this is the IASB's intention.

  Therefore, to allow room for appropriate management judgement, we believe that the qualitative assessment in IFRS 3.B67C(c) of a strategic business combination should include further clarifications. Management would then disclose the judgements that they have made in the process of applying the entity's accounting policies under IAS 1.122.

3—Disclosures: Exemption from disclosing information (B67D–B67G of IFRS 3)
The IASB is proposing to exempt an entity from disclosing some of the information that would be required applying the proposals in this Exposure Draft in specific circumstances. The exemption is designed to respond to preparers' concerns about commercial sensitivity and litigation risk but is also designed to be enforceable and auditable so that it is applied only in the appropriate circumstances (see paragraphs BC74–BC107). The IASB proposes that, as a principle, an entity be exempt from disclosing some information if doing so can be expected to prejudice seriously the achievement of any of the entity's acquisition-date key objectives for the business combination (see paragraphs BC79–BC89). The IASB has also proposed application guidance (see paragraphs BC90–BC107) to help entities, auditors and regulators identify the circumstances in which an entity can apply the exemption.

We understand the principle underpinning the exemption proposed by the IASB, and we appreciate the benefits that it would bring to preparers. However, we have significant reservations about the potential for diversity in the application of the exemption to avoid disclosure of information relevant to investors, and the proposed exemption's interaction with IAS 37. We think that additional guidance needs to be provided in this area.

- **Potential for diversity of application**

  As auditors, we are concerned about globally consistent application and auditability of management's use of the disclosure exemption.

  A reading of the proposed amendments could imply that the exemption is presumed to be available. Based on the proposal, an entity could consider the effect of not disclosing the information, the public availability of information and the possibility of aggregating the information in determining whether the exemption can be applied. While the proposal states that these factors are non-exhaustive, the examples in IFRS 3.B67D illustrate scenarios where an entity would not be able to apply the exemption. We think that this would lead to potential diversity of application of the exemption, because it would be difficult and judgemental to challenge this presumption.

  We believe that providing additional examples to those included in IFRS 3.B67D would allow management and auditors to better assess when the exemption can be applied. For example, it would be useful to illustrate a situation in which a competitor could use the information to gain an advantage over the entity in commercial negotiations with the entity's customers or suppliers, thus making the exemption applicable to the entity. Another example could state that the exemption would only be applicable if the information (or any related information) has not been made publicly available by the entity through any other communication channel. Since this list of factors is non-exhaustive, management would still be able to apply its judgement and apply the exemption if appropriate circumstances arise, while the additional guidance would help restrict the use of the exemption and mitigate diversity.

- **Interaction with IAS 37**

  Inherently, the 'seriously prejudicial' threshold for applying the exemption in practice implies a rare occurrence. Therefore, we recommend stating this in the standard, similar to IAS 37.92 that states "*[i]n extremely rare cases, disclosure of some or all of the information required by paragraphs 84–89 can be expected to prejudice seriously the position of the entity*". This would also reduce potential diversity and restrict abuse.

  We note in the proposed IFRS 3.BC92 that the IASB decided against stating that application of the exemption would be extremely rare, even though there is a similar notion (that of 'seriously prejudicial') in IAS 37.92. The reason for this is not explained, despite the proposed exemption in IFRS 3 being very similar to the exemption allowed in IAS 37 (this is acknowledged in IFRS 3.BC93).

  We observe that practice around applying the exemption in IAS 37 has already developed. The IASB also received feedback that the exemption in IAS 37 works well in practice (IFRS 3.BC80). We believe that aligning the wording of the proposed exemption in IFRS 3 to the existing exemption in IAS 37 would increase clarity for preparers and auditors through aligning the expectation and threshold to be applied. Without alignment, questions would arise about whether the constraints on the application of the exemptions would be the same for IFRS 3 and IAS 37, particularly since the words 'seriously prejudicial' are used in both.

4—Disclosures: Identifying information to be disclosed (B67A–B67B of IFRS 3)
The IASB is proposing to require an entity to disclose information about the performance of the entity's strategic business combinations (that is, information about its acquisition-date key objectives and related targets for a strategic business combination and whether these key objectives and related targets are being met) that is reviewed by its key management personnel (see paragraphs BC110–BC114). The IASB's proposals would require an entity to disclose this information for as long as the entity's key management personnel review the performance of the business combination (see paragraphs BC115–BC120). The IASB is also proposing (see paragraphs BC121–BC130) that if an entity's key management personnel: ● do not start reviewing, and do not plan to review, whether an acquisition-date key objective and the related targets for a business combination are met, the entity would be required to disclose that fact and the reasons for not doing so; ● stop reviewing whether an acquisition-date key objective and the related targets for a business combination are met before the end of the second annual reporting period after the year of acquisition, the entity would be required to disclose that fact and the reasons it stopped doing so; and ● have stopped reviewing whether an acquisition-date key objective and the related targets for a business combination are met but still receive information about the metric that was originally used to measure the achievement of that key objective and the related targets, the entity would be required to disclose information about the metric during the period up to the end of the second annual reporting period after the year of acquisition.

We agree with the IASB's proposals. We think that requiring disclosure of information about strategic business combinations that are reviewed by the entity's key management personnel represents the appropriate level for disclosure purposes. This meets the objective of the project to provide investors with relevant information – the same information that is used by management – to assess how efficiently and effectively management has used the entity's economic resources. We also agree with the duration over which disclosure is required because it aligns with what management considers to be the relevant period for monitoring. The two-year cut-off, albeit arbitrary, appears reasonable, because typically entities aim to integrate the acquired businesses within a relatively short time-frame. We acknowledge though that synergies and other benefits may take longer than two years to come into effect, but if management has stopped reviewing then there should be a cut off for disclosures as well.

5—Disclosures: Other proposals

The IASB is proposing other amendments to the disclosure requirements in IFRS 3. These proposals relate to:

New disclosure objectives (proposed paragraph 62A of IFRS 3)

The IASB proposes to add new disclosure objectives in proposed paragraph 62A of IFRS 3 (see paragraphs BC23–BC28).

Requirements to disclose quantitative information about expected synergies in the year of acquisition (proposed paragraph B64(ea) of IFRS 3)

The IASB proposes:

- to require an entity to describe expected synergies by category (for example, revenue synergies, cost synergies and each other type of synergy);
- to require an entity to disclose for each category of synergies:
  - the estimated amounts or range of amounts of the expected synergies;
  - the estimated costs or range of costs to achieve these synergies; and
  - the time from which the benefits expected from the synergies are expected to start and how long they will last; and
- to exempt an entity from disclosing that information in specific circumstances.

See paragraphs BC148–BC163.

The strategic rationale for a business combination (paragraph B64(d) of IFRS 3)

The IASB proposes to replace the requirement in paragraph B64(d) of IFRS 3 to disclose the primary reasons for a business combination with a requirement to disclose the strategic rationale for the business combination (see paragraphs BC164–BC165).

Contribution of the acquired business (paragraph B64(q) of IFRS 3)

The IASB proposes to amend paragraph B64(q) of IFRS 3 to improve the information users receive about the contribution of the acquired business (see paragraphs BC166–BC177). In particular, the IASB proposes:

- to specify that the amount of profit or loss referred to in that paragraph is the amount of operating profit or loss (operating profit or loss will be defined as part of the IASB's Primary Financial Statements project);
- to explain the purpose of the requirement but add no specific application guidance; and
- to specify that the basis for preparing this information is an accounting policy.

Classes of assets acquired and liabilities assumed (paragraph B64(i) of IFRS 3)

The IASB proposes to improve the information entities disclose about the pension and financing liabilities assumed in a business combination by deleting the word ‘major’ from paragraph B64(i) of IFRS 3 and adding pension and financing liabilities to the illustrative example in paragraph IE72 of the Illustrative Examples accompanying IFRS 3 (see paragraphs BC178–BC181).

Deleting disclosure requirements (paragraphs B64(h), B67(d)(iii) and B67(e) of IFRS 3)

The IASB proposes to delete some disclosure requirements from IFRS 3 (see paragraphs BC182–BC183).

We agree with most of the proposals, subject to our comments below.

Synergy disclosures

We note that entities typically describe expected synergies to their investors in management commentaries or other communications outside the financial statements. Requiring entities to provide quantitative synergy disclosures, which are forward-looking in nature, within the financial statements, without clarifying that they are solely information used by management, would subject such information to audit procedures, because the auditor would be associated with this information (see our comment on the expectation gap risk in our response to question 1 above). Whilst audit work over the quantitative disclosures could be done (for example in compilation reports that some territories require to provide limited assurance in connection with certain takeover transactions), this is separate from a statutory audit, undertaken solely for the purpose of a capital market transaction, and it comes at significant additional costs to the entity.

Similarly to key objectives and targets in question 1, we suggest that the IASB should reconsider requiring disclosure of quantitative synergies in the financial statements for material but not strategic acquisitions, given that there is no requirement to disclose the achievement of, or performance against, the synergies in subsequent periods. We do not believe that providing information at the time of the acquisition without ongoing assessment or follow-up disclosure provides substantial benefits to stakeholders. Rather, the IASB might consider improved qualitative disclosures. In the event that the IASB continues to require quantitative synergy disclosures in the financial statements, we comment additionally as follows:

- **Expectation gap risk**

  We have elaborated on the expectation gap risk and our suggested solution in our response to question 1 above. We believe that the same applies to the proposed quantitative disclosures on expected synergies. There is a real risk of investors placing undue reliance on the perceived assurance from the auditor over the existence and achievability of the synergies.

- **Auditor association with the quantitative disclosures of expected synergies**

  We agree with the IASB’s view that quantitative disclosures of expected synergies might be useful to investors for strategic acquisitions. We believe that there would also be benefits to preparers, since the disclosures would require the business plan and any supporting computations to be prepared with rigour, thus increasing management accountability.

However, the IASB should clarify (for the reasons outlined in our response to question 1 above) that the quantitative information on expected synergies is solely based on information used by management and that there is no assurance to the existence and achievability of such measures.

- **Synergies versus targets**

  We think that the linkage between a synergy and a target is not clear and can be improved. We observe that an expected synergy would most likely form a target for the acquisition. A synergy could even be considered both a key objective and a related target for the acquisition, if the synergy is significant enough and monitored by key management personnel. We believe that it would be useful to clarify in the Basis for Conclusions to IFRS 3 the linkage and interaction between a synergy and a target, and even their relevance to the strategic rationale of the business combination.

- **Other clarifications or suggestions**

  - We note that IFRS 3.B64(ea)(iii) and IFRS 3.BC158 acknowledge the IASB's view that synergies might be present for a finite or indefinite duration. This is in contrast with the conclusion that goodwill is an asset with an indefinite useful life. We think that it would be helpful for the Basis for Conclusions to IFRS 3 to explain this interaction – for example, by explaining that (i) goodwill is made up of many different components, some of which are finite, some indefinite, and (ii) cash flow forecasts used for impairment testing should reflect the same judgements on the period of time over which synergies are expected to benefit the entity.
  - It is unclear how the proposed requirements to disclose information about synergies in IFRS 3.B64(ea) for individually immaterial business combinations would be disclosed in aggregate in accordance with IFRS 3.B65. We believe that it would be impracticable for entities to provide such a disclosure, and it would also not provide useful information to the users. We recommend that the IASB should exclude the disclosures in IFRS 3.B64(ea) from the requirements of IFRS 3.B65.

Other disclosures

Separately, we have concerns with using the term 'accounting policy' in relation to the proposal on pro forma information in IFRS 3.B64(q)(ii). We believe that pro forma disclosure is different from an 'accounting policy'. Pro forma information by nature is illustrative and prepared on an 'as if' basis and not on actual transactions or events. We understand that the IASB's intention was to describe the compilation of this information as a policy to ensure that the related disclosures on accounting policies in IAS 8 are provided. If that is the Board's intention, we suggest that the IASB should explicitly require preparers to disclose how the pro forma information was prepared within the note itself, instead of referring to it as an accounting policy.

6—Changes to the impairment test (paragraphs 80–81, 83, 85 and 134(a) of IAS 36)
Proposals to reduce shielding The IASB considered developing a different impairment test that would be significantly more effective at a reasonable cost but concluded that doing so would not be feasible (see paragraphs BC190–BC191). Instead, the IASB is proposing changes to the impairment test (see paragraphs 80–81, 83 and 85 of IAS 36) to reduce shielding by clarifying how to allocate goodwill to cash- generating units (see paragraphs BC194–BC201). *Proposal to reduce management over-optimism* The IASB's view is that management over-optimism is, in part, better dealt with by enforcers and auditors than by amending IAS 36. Nonetheless, the IASB is proposing to amend IAS 36 to require an entity to disclose in which reportable segment a cash- generating unit or group of cash-generating units containing goodwill is included (see paragraph 134(a) of IAS 36). The IASB expects this information to provide users with better information about the assumptions used in the impairment test and therefore allow users to better assess whether an entity's assumptions are over-optimistic (see paragraph BC202).

Question 6(a) – Shielding

We see limited improvements resulting from the proposals. We are unclear how the IASB expects the effects of shielding to be reduced and whether the proposals will result in practical changes in impairment tests. If the proposals are meant to reduce shielding, transition impacts due to changes in the application of the guidance on the allocation of goodwill should be considered.

- **Nature of the amendments – clarifications or substantive change**

  We understand that the proposed insertion of IAS 36.80A and IAS 36.80B aim to clarify existing requirements for allocating goodwill to cash-generating units (CGUs). This is also noted in IAS 36.BC199(b). If the proposed insertions are merely clarifications and not substantive changes to the existing requirements of IAS 36, we would expect that there will not be changes to the goodwill allocation unless entities had previously applied the requirements erroneously.

  Accordingly, we do not think that the proposals introduce any new requirement to force an entity to allocate goodwill to the lowest possible level. Accordingly, prima facie we are unsure whether the proposals will substantially reduce shielding when applied in practice.

  If the IASB believes that the proposed amendments to address shielding are substantive changes that would lead to practical changes in the level to which goodwill is allocated for impairment testing purposes, the effects of transition should be considered; if they are not prospectively dealt with, the would need to include how to deal with any potential prior periods. This is elaborated in our response to question 9 below.

We believe that a more substantive amendment would be required to effectively address shielding. Two possible solutions are as follows:

- *Removal of the operating segment cap*

  This solution involves deleting the guidance in IAS 36.80(b) that the CGU to which goodwill is allocated should “*not be larger than an operating segment*”. The IASB had previously identified that entities often defaulted to the operating segment as the level at which goodwill is allocated and tested for impairment. Without this cap in place and with the shift to require a test at the level at which the business associated with goodwill is monitored by management, we believe that entities would be forced to consider only the guidance in IAS 36.80(a) to allocate goodwill to the lowest possible level. We believe that this is the intention of the IASB’s proposals and could be an effective way of addressing the issue of shielding. We note that deletion of the cap would make it obvious that there would be a change to existing practice to allocate goodwill. This would effectively resolve the question that we posed above regarding the clarifying versus substantive nature of the amendments and that transition guidance should be included.

  We also believe that removing the cap would not allow entities to test at a higher level than the cap, because management would not be able to argue that the business associated with goodwill is monitored at above operating segment levels if there is financial information being provided to the chief operating decision maker (CODM) as part of segment reporting. Hence the cap removal would not be detrimental to shielding.

- *Alignment to IAS 21 requirements*

  To reduce shielding, the principles of IAS 21 could be used for a lower level goodwill allocation and subsequent lower level testing.

  Under IAS 21.47, goodwill should be allocated to the level of each functional currency of the acquired foreign operation. As it stands, this means that the level to which goodwill is allocated for foreign currency translation purposes is typically lower than the level at which the goodwill is tested for impairment. Currently entities follow the requirements in IAS 36 to determine the level at which goodwill is tested for impairment. If the IASB wanted to reduce shielding, it could amend IAS 36 and require companies to test for impairment at the IAS 21 allocated level. If there are no foreign operations acquired, the same principles could be used to allocate goodwill to acquired entities or acquired operations in local currency. On that basis, goodwill would be allocated to subsidiaries or operations acquired irrespective of whether these are foreign or have the same functional currency using the principles in IAS 21.

  To address concerns about the increase in the number of impairment tests that an entity would need to perform – since goodwill has to be tested annually – we suggest switching to an indicator-only based test. The underlying business, with goodwill allocated to it, would only be tested for impairment if there was a trigger. This would be independent of how many CGUs are present in the underlying operation to which that goodwill was allocated. For example, an acquired entity that has goodwill allocated to it under this alternative method might still have a number of CGUs within. These underlying CGUs would still need to be tested individually and independently if there is an impairment indicator; that is, they would be tested independently from the higher-level test at the entity level with goodwill allocated to the entity.

The normal procedures on goodwill reallocations for reorganisations or disposals and subsequent testing at resulting different levels would continue to apply.

We acknowledge that this solution would be a fundamental change to the current impairment model, and it might require more time and effort to be finalised and so it might not be feasible at this stage. However, we believe that this would be more effective in tackling the issue of shielding than the IASB's current proposals. In addition, many of the underlying principles and processes are already in place since entities have to apply IAS 21 for many goodwill allocations.

- **Level of monitoring the business associated with goodwill for internal management purposes**

  We propose that the IASB should provide clarification on what 'internal management' means in the context of IAS 36, where goodwill is required to be allocated to the lowest level at which the associated business is monitored. IAS 36.83(b) addresses the potential difference in the level of management for IFRS 3 disclosure purposes compared to the IAS 36 goodwill allocation purposes. In our experience, it is not apparent what would be considered 'internal management' in the IAS 36 context since entities might have multiple layers of management and it might be difficult to identify the appropriate management level. An example or additional guidance would help to clarify how to apply the amended principles and possibly reduce shielding and risk of defaulting to a higher level of internal management (for example, monitoring by CODM-type management at the operating segment level).

  We believe that a proper identification of the level of internal management is fundamental to the effective application of the proposals. This is especially important if the IASB believes that this proposal would reduce shielding.

In addition to our recommendations above, we have identified a number of other possible improvements as follows:

- We note that the proposals do not specify whether the 'business associated with the goodwill' relates only to the newly acquired business, or the acquirer's existing business, or a combination of both. Providing an example where the level of testing includes both the acquired and existing businesses would help to clarify the requirement.
- We understand that IAS 36.IE4 is meant to be an example demonstrating a lower level of impairment testing. However, we are not sure how the current example helps to

illustrate this principle. We suggest that the example could highlight the challenges in determining whether the appropriate CGU is each individual store or the chain, and whether this assessment depends on how the original goodwill was created. It would also be useful for the example to discuss how monitoring by management is considered in this context. These enhancements would help to build a more holistic example to illustrate the application of the revised principles.

Question 6(b) – Management over-optimism

We see limited value in the proposals to reduce over-optimism. We do not agree with the characterisation that management over-optimism is a pervasive issue resulting in ineffective impairment tests. Accordingly, we see limited practical differences resulting from the proposal.

IAS 36.33 states that an entity should "*base cash flow projections on the most recent financial budgets/forecasts approved by management*". Therefore, management's forecasts might inherently have some degree of optimism built into them. IAS 36.134(d) and IAS 36.134(f) require information about management key assumptions to be disclosed, which helps users to determine if these assumptions are reasonable and supportable. IAS 36.33 also states that greater weight should be given to external information when assessing the reasonableness of cash flow projections. However, in many cases there is limited external information to challenge management's forecasts. Nevertheless, these cash flow projections are required to be based on reasonable and supportable assumptions, which we believe management and auditors work towards achieving. Therefore, while some management estimates might tend more towards the optimistic side, they cannot objectively be disputed as incorrect based on the IAS 36 requirements.

While it is reasonable to state that auditors have a responsibility to apply professional scepticism and to challenge management's assumptions, we believe that the financial statements are the responsibility of management and those charged with governance. Accordingly, we do not agree with the statement in IAS 36.BC189 that "*overly optimistic estimates of cash flows are best addressed by auditors and regulators, instead of by changing IFRS Accounting Standards*".

Overall, we believe that application of the existing requirements of IAS 36 by management and auditors results in reasonable and supportable assumptions and estimates being used in impairment tests. Consequently, we believe that the focus of the IASB should be on improving the impairment test to reduce the effect of shielding (refer to our response to question 6(a) above).

While it might allow the users to compare assumptions used in the goodwill impairment test to other data publicly reported for the segment, the additional disclosure requirement on goodwill by segment does not in itself reduce over-optimism.

7—Changes to the impairment test: Value in use (33, 44–51, 55, 130(g), 134(d)(v) and A20 of IAS 36)
The IASB is proposing to amend how an entity calculates an asset's value in use. In particular, the IASB proposes: ● to remove a constraint on cash flows used to calculate value in use. An entity would no longer be prohibited from including cash flows arising from a future restructuring to which the entity is not yet committed or cash flows arising from improving or enhancing an asset's performance (see paragraphs BC204–BC214). ● to remove the requirement to use pre-tax cash flows and pre-tax discount rates in calculating value in use. Instead, an entity would be required to use internally consistent assumptions for cash flows and discount rates (see paragraphs BC215–BC222).

Question 7(a) – Future restructuring and asset enhancement cash flows

We agree with the proposal, but recommend several improvements as follows:

- **Differences between value-in-use (VIU) and fair value less costs of disposal (FVLCD)**

  We note that the removal of the constraints on future restructuring and asset enhancement cash flows will result in fewer differences between the VIU and FVLCD models. We believe that it is important for stakeholders to understand the remaining differences and where they arise. In our view, an example would be management's expectations being incorporated in entity-specific cash flows for the VIU model. A general market participant might not be able to benefit from or access certain synergies and consequently would not be able to include those in their calculations of FVLCD. We recommend that the IASB should provide an explanation of the remaining differences between VIU and FVLCD in IAS 36.

  This would also be an opportunity to re-emphasise the requirement in IAS 36.33(a) that appropriate VIU assumptions, whilst incorporating management's expectations and company-specific circumstances, still need to be market-oriented.

- **'Like-for-like' principle in relation to future restructuring cash flows**

  We agree with the proposed new IAS 36.44B in relation to the effect of restructuring cash flows on the estimation of VIU. IAS 36.44B(b) specifies that the VIU "*excludes estimates of future cash outflows for the restructuring because these cash outflows are included in the restructuring provision in accordance with IAS 37*". We understand that this should be read in conjunction with IAS 36.43, which states that "*[t]o avoid double-counting, estimates of future cash flows do not include… cash outflows that relate to obligations that have been recognised as liabilities*". In addition, we note that IAS 36.76(b) states "*[t]he carrying amount of a cash-generating unit… does not include the carrying amount of any recognised liability, unless the recoverable amount of the cash-generating unit cannot be determined without consideration of this liability*".

However, we believe that excluding both the restructuring liability from the carrying amount of the CGU and the restructuring cash outflows from the VIU is not the only acceptable way of performing the impairment test. An entity can choose to include both items, and it might not derive a materially different result. Accordingly, the guidance in IAS 36.44B(b) and IAS 36.76(b) should be amended to focus on the 'like-for-like' principle that is also applicable to other cash flows.

We also note that example 5 (Treatment of a future restructuring) in IAS 36 is a useful example that should be retained to illustrate the 'like-for-like' principle.

- **Future cash flows associated with the current potential of the asset**

  We observe that the cash flows associated with the 'current potential' of an asset are now included as part of the asset's 'current condition' (see IAS 36.44A(b)). We recommend that this should be stated upfront in the first sentences of IAS 36.44 and IAS 36.44A to prevent any potential misunderstanding of this requirement by stakeholders, because an asset's 'current potential' might not be intuitively considered in its 'current condition'. For example, IAS 36.44 could state: "*Future cash flows shall be estimated for the asset in its current condition, including its current potential*".

- **Proposed additional application guidance**

  We believe that the existing examples 5 (Treatment of a future restructuring) and 6 (Treatment of future costs) in IAS 36 provide useful guidance to preparers. We propose to retain and amend them to illustrate how expected cash flows on a future restructuring that is part of approved budgets could be included.

  Similarly, an example that addresses improvements, enhancements and restructurings should be provided to guide stakeholders in applying the new requirements.

Question 7(b) – Pre-tax cash flows and pre-tax discount rates

We agree with the proposal to remove the requirement to only use pre-tax cash flows and pre-tax discount rates in calculating VIU. However, we note that several complex areas exist in the computation of VIU for which additional guidance or further simplifications would be beneficial. Today, while many entities use a post-tax approach, the methodologies are varied and subject to diversity in practice. These are set out as follows:

- While allowing the use of a post-tax cash flow model for VIU is a positive change, complexities with taxes continue to cause challenges in practice. For example, there is diversity in practice with regard to the treatment of deferred taxes (DT) in the carrying amount of CGUs and consequential implications on determination of the relevant cash flows to reflect future tax consequences associated with temporary differences. Some are of the view that DT balances should always be included in the net assets of CGUs; others would include DT balances in the CGU for a FVLCD but not a VIU; some would adjust for DT relating to past tax losses as well as future losses; and some would adjust for future losses only. We believe that clearer guidance from the IASB on the appropriate treatment of DT balances is required to ensure consistency in practice. In addition, the IASB should also clarify whether the choice of a pre-tax or post-tax cash flow model is an accounting policy that should be applied consistently.

- Foreign currency exposures introduce multiple complexities to the goodwill impairment test, such as for CGUs with assets or cash flows denominated in varying currencies. While we understand the logic explained in IAS 36.BCZ46–BCZ51, we observe that this is an area that entities struggle with in practice. There are also incremental costs involved in having to estimate the appropriate discount rate for the foreign currency cash flows. As a result, many entities apply the approach in IAS 36.BCZ51 to translate the foreign currency cash flows into the functional currency of the entity using the forward rates, applying a single discount rate thereafter. The IASB could consider revising the requirements in this aspect to explicitly allow the use of forward rates when appropriate. Whilst we appreciate that this might not be a perfect solution, we believe that this approach might be justifiable on cost-benefit grounds.
- It is our experience that preparers and auditors in the financial services sector find the IAS 36 guidance difficult to apply in practice. For example, the majority of the assets and liabilities of a bank are typically financial in nature. It might be unclear whether these financial assets and liabilities are included in the carrying amount of a CGU containing goodwill. Also, the bank's significant cash flows arise from financial assets and are already considered in their measurement, which makes it unclear as to which cash flows should be considered in estimating VIU of the CGU. Other regulatory capital ratio requirements further complicate the application of IAS 36's VIU requirements for these financial services-type businesses. Additional application guidance in the form of an illustrative example would benefit these types of preparers.
- We suggest edits to IAS 36.IE89 of example 9 (Disclosures about cash-generating units with goodwill or intangible assets with indefinite useful lives). We question how the benefits from a 10-year patent can be used to support an above-market growth rate into perpetuity. Realistically, competitors would be able to produce the same product once the patent ends, which should reduce unit C's growth rate. We believe that the IASB should apply a growth rate that is more aligned with market growth, which would present a fairer view of the recoverable amount of unit C.

8—Proposed amendments to IFRS 19
The IASB proposes to amend IFRS 19 (Subsidiaries Standard) to require eligible subsidiaries applying the Subsidiaries Standard to disclose: ● information about the strategic rationale for a business combination (proposed paragraph 36(ca) of the Subsidiaries Standard); ● quantitative information about expected synergies, subject to an exemption in specific circumstances (proposed paragraphs 36(da) and 36A of the Subsidiaries Standard);

- information about the contribution of the acquired business (proposed paragraph 36(j) of the Subsidiaries Standard); and
- information about whether the discount rate used in calculating value in use is pre-tax or post-tax (paragraph 193 of the Subsidiaries Standard).

We agree with the proposals and do not have further comments to highlight.

Question 9—Transition (64R of IFRS 3, 140O of IAS 36 and B2 of the Subsidiaries Standard)
The IASB is proposing to require an entity to apply the amendments to IFRS 3, IAS 36 and the Subsidiaries Standard prospectively from the effective date without restating comparative information. The IASB is proposing no specific relief for first-time adopters.

We agree with the proposal on prospective transition. However, as we noted in our response to question 6(a) above, the IASB will need to first consider whether the proposed amendments to IAS 36 in relation to goodwill allocation for the purpose of impairment testing are substantive changes or just clarifications.

The IASB believes that the proposed amendments are clarifications to existing requirements (IAS 36 para BC199(b)). Yet the IASB also expects that these proposed amendments will reduce shielding by requiring entities to allocate goodwill at a lower level than before. These expectations appear inconsistent.

Expecting changes to practice if the amendments are just clarifications would indicate that entities that allocate goodwill to a different, lower level, after the amendments are effective, have performed the allocation erroneously in prior periods.

If the IASB's desire is to change practice, it should clarify that the changes are amendments rather than clarifications, and it should include appropriate guidance on transition.

The IASB might want to consider transition relief for these entities and as an example allow for any change to their goodwill allocation and any resultant impairment loss in prior periods to be recognised as an adjustment to the opening retained earnings in the period of adoption of the amendments with no impact on the prior period.

We believe that an alternative transition method of recognising any impairment loss in the profit or loss in the period of adoption might result in significant impairment losses being recorded in the current period. This will not provide an accurate reflection of the financial performance of the entity in the current period. A full retrospective transition requiring restatement of the comparative period might also not be cost-beneficial.