CFA Institute

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16 July 2024

Dr. Andreas Barckow
Chair
International Accounting Standards Board
7 Westferry Circus, Canary Wharf
London E14 4HD
United Kingdom

RE: Exposure Draft: Business Combinations – Disclosures, Goodwill and Impairments – Proposed Amendments to IFRS 3 and IAS 36

Dear Dr. Barckow,

CFA Institute[1], in consultation with its Corporate Disclosure Policy Council ("CDPC")[2], appreciates the opportunity to comment and provide our perspectives on the International Accounting Standards Board's (the "IASB" or "Board") *Exposure Draft: Business Combinations - Disclosures, Goodwill and Impairments – Proposed Amendments to IFRS 3 and IAS 36* (the "Exposure Draft") and the associated *Basis for Conclusions on Business Combinations - Disclosures, Goodwill and Impairments – Proposed Amendments to IFRS 3 and IAS 36* (the "Basis for Conclusions").

CFA Institute has a long history of promoting fair and transparent global capital markets and advocating for strong investor protections. An integral part of our efforts toward meeting those goals is ensuring that corporate financial reporting and disclosures and the related audits provided to investors and other end users are of high quality. Our advocacy position is informed by our global membership who invest both locally and globally.

EXECUTIVE SUMMARY

We thank the Board and IASB staff for their multi-year effort in developing the Exposure Draft to improve entities' disclosures about acquisitions. Acquisitions are among the largest uses of capital by entities, yet disclosures are often scant. Investors have requested more information for many years to address this unmet need.

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1 With offices in Charlottesville, VA; New York; Washington, DC; Brussels; Hong Kong SAR; Mumbai; Beijing; Abu Dhabi; and London, CFA Institute is a global, not-for-profit professional association of more than 190,000 members, as well as 160 member societies around the world. Members include investment analysts, advisers, portfolio managers, and other investment professionals. CFA Institute administers the Chartered Financial Analyst® (CFA®) Program. For more information, visit www.cfainstitute.org or follow us on LinkedIn and X.

2 The objective of the CDPC is to foster the integrity of financial markets through its efforts to address issues affecting the quality of financial reporting and disclosure worldwide. The CDPC is comprised of investment professionals with extensive expertise and experience in the global capital markets, some of whom are also CFA Institute member volunteers. In this capacity, the CDPC provides the practitioners' perspective in the promotion of high-quality financial reporting and disclosures that meet the needs of investors.

While we support the proposed disclosures, our support for the Exposure Draft overall is tempered by the significant compromises the Board has made including the optional exemption for disclosing information, the weakening of impairment testing, and not strengthening disclosure requirements for past financial performance of acquired businesses at the time of acquisition. We oppose these compromises as they weaken the overall decision-usefulness of the Exposure Draft for investors.

Because the proposed disclosures are based on how management monitors acquisitions internally and broadly give management discretion on crafting disclosures, we urge the Board to conduct a fast-tracked post-implementation review of the standard shortly after its effective date (e.g., 3 years) to understand if investors are receiving incremental decision-useful information. The review could focus on a sample of the largest, most-publicized acquisitions. This is necessary to understand if the degree of management discretion in the standard has gone too far.

In our comments below, we first make several overarching remarks, including a comparison of the Exposure Draft to the Board's *Discussion Paper: Business Combinations - Disclosures, Goodwill and Impairment* (the "Discussion Paper") issued in March 2020. We then answer questions posed to respondents, before closing with concluding remarks.

OVERARCHING REMARKS

Exposure Draft Strongly Resembles March 2020 Discussion Paper: We generally agreed with the Discussion Paper on disclosures, but disagreed with its proposed changes to impairment testing and the use of the CODM approach.

Since the Exposure Draft is similar in most respects to the Board's Discussion Paper, we begin our comments by briefly reviewing the Discussion Paper and our comment letter in response to it.[3] The Board's preliminary views in the Discussion Paper were: [4]

(a) ***Disclosures:*** Create new disclosure requirements and objectives.
Require entities to disclose the strategic rationale, expected synergies, management's (defined as the Chief Operating Decision Maker ("CODM") as used in IFRS 8, *Operating Segments*[5]) objectives, and subsequent performance against those objectives, for acquisitions that are monitored by the CODM.

(b) ***Impairment:*** Simplify impairment testing.
The Board decided it could not design an impairment test significantly more effective – at recognizing impairment losses at a timely basis and at a reasonable cost – than the existing

3 We compare the Board's Discussion Paper to the proposals in the Exposure Draft in detail in the Appendix.
4 Basis for Conclusions, Paragraph BC7.
5 IFRS 8, *Operating Segments*, Paragraph 7, notes: "The term 'chief operating decision maker' identifies a function, not necessarily a manager with a specific title. That function is to allocate resources to and assess the performance of the operating segments of an entity. Often the chief operating decision maker of an entity is its chief executive officer or chief operating officer but, for example, it may be a group of executive directors or others."

impairment test in IAS 36, *Impairment of Assets*. However, the Board decided it should develop proposals to reduce the cost and complexity of performing impairment tests by:

i. Removing the requirement to quantitatively test goodwill and indefinite-lived intangibles annually for impairment; and
ii. Allowing more optimistic cash flow assumptions in value-in-use calculations and permit flexibility to use either pre- or post-tax cash flows and discount rates.

(c) ***Goodwill Amortization:*** Not to reintroduce amortization of goodwill.

(d) ***Recognition of Intangible Assets:*** Not change the range of identifiable intangible assets recognized separately from goodwill in a business combination.

(e) ***Presentation (Equity Net of Goodwill):*** Create a new requirement to present total equity excluding goodwill on the balance sheet.

As we wrote in our comment letter, we generally agreed with all points except (b) on simplifying impairment testing.

Our objection with respect to impairment testing centered on the following views:

- **We disagreed with “simplifying” impairment testing because calls to reduce costs and complexity of the impairment test lack empirical evidence** about the actual costs of impairment testing and ignore the fact that investors must perform similar analyses with far less information than management. Allowing more optimistic cash flow assumptions in value-in-use calculations would not “simplify” impairment testing; by allowing more management discretion in valuation estimates, impairment testing would lose its decision usefulness to investors entirely.

- **We noted that we believe the Board can make impairment testing significantly more decision useful to investors by requiring greater transparency in disclosures**, including the identity and description of cash-generating units and the reportable segments they belong to, how goodwill is allocated to the cash-generating units, management’s estimates of the cash-generating units’ recoverable amounts, the size of the difference between the cash-generating units’ carrying and recoverable amounts, and the key drivers of those differences.

As it relates to disclosures regarding business combinations in item (a) above, we emphasized that:

- **While we supported the proposed disclosure objectives and requirements, we encouraged the Board to pursue a different approach to identifying the information that must be disclosed than what is reviewed by the CODM (the “CODM approach”), based on our experience with and member feedback on IFRS 8, *Operating Segments*.** CODM is almost always defined as a single person, the entity’s chief executive officer. Investors have been clear in telling us that they are surprised to learn that the “management approach” means a single person because it is highly unlikely that performance is monitored, and resources are allocated in companies, by a single person. Companies are often organized

with a team of leaders that oversee lines of business, functional areas, and/or geographies. Multiple leadership team members participate in investor conferences and events, and the compensation of leadership team members beyond the C suite strongly suggests that they have a great deal of responsibility. Finally, the sheer complexity of most listed companies today makes it unlikely that resource allocation decisions are made by a single person.

- We believe the same holds true for monitoring acquisition performance: acquisitions might be monitored at a high level by the CODM but are monitored in detail at a segment or divisional level. We are also concerned that by basing disclosures on what the CODM reviews, companies could manage disclosures simply by managing the flow of information to the CODM. For these reasons, **the proposed disclosures in IFRS 3, *Business Combinations,* and existing disclosures in IFRS 8, *Operating Segments,* should be based on information reviewed by "senior management," not a single CODM.**

Most Significant Change from Discussion Paper to Exposure Draft: Introduction of an optional exemption to some of the proposed disclosures, an extraordinary step that favors preparers.

The most material changes from the Board's Discussion Paper to its proposals in the Exposure Draft are:

(a) ***Disclosures:***

1. *Exemption From Disclosing Information*. The Exposure Draft introduces an optional exemption to some of the proposed disclosures, if management judges that disclosure can be "expected to prejudice seriously the achievement of any of the acquirer's acquisition-date key objectives for the business combination."
2. *Threshold for Disclosure.* The Exposure Draft changes the threshold for business combinations subject to some of proposed disclosures from those that are reviewed by the CODM to those that meet the definition of "strategic business combination," which has both quantitative (e.g., acquiree revenue >10% of acquirer's revenue) and qualitative criteria.
3. *Definition Of Management.* While the Exposure Draft retains the management approach to identifying the information to disclose, the definition of "management" throughout was changed from CODM to Key Management Personnel[6], as defined in IAS 24, *Related Party Disclosures*. This is broader concept that includes not only the chief executive but other senior managers.
4. *Content Of Proposed Disclosures.* The Exposure Draft makes three material changes to the content of proposed disclosures from the Discussion Paper:
   i. Adds a requirement to disclose a statement of whether actual performance of a strategic business combination is meeting expectations.

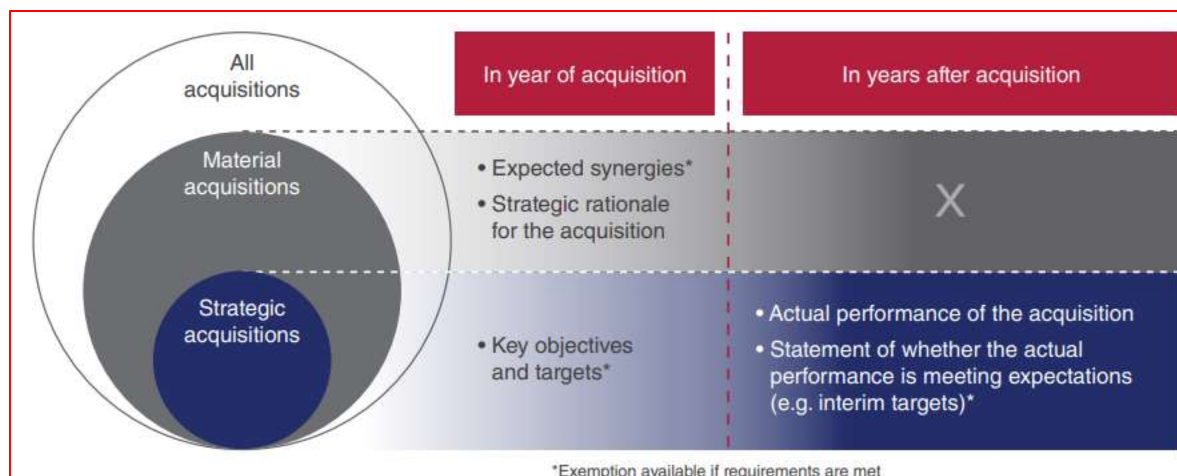
[6] IAS 24, *Related Party Disclosures,* Paragraph 9 notes: "Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity."

ii. Removes the requirement proposed in the Discussion Paper to disclose changes and reasons for changes in metrics used to measure actual performance of a strategic business combination.
iii. Removes the requirement proposed in the Discussion Paper to disclose cash flows from operations in the year of acquisition for the acquired business and on a pro forma basis for the combined entity.

(b) ***Impairment:*** *Quantitative impairment test.* Unlike the Discussion Paper, the Exposure Draft maintains the requirement for entities to test cash-generating units that contain goodwill and indefinite-lived intangible assets with indefinite life quantitatively each year.

(c) ***Presentation (Equity Net of Goodwill)*** – The Exposure Draft removes the proposed requirement to present total equity excluding goodwill on the balance sheet.

The most significant change, in our view, relates to disclosures and the introduction of an optional exemption to each of the disclosures marked with an asterisk in the diagram[7] below:



The proposed exemption from disclosing information is broadly available and **the decision to use the exemption will be a private matter among managers, boards of directors, and external auditors.**

The IASB has provided two non-exhaustive factors for entities to consider in determining of whether information is eligible for the exemption:

- *A Specific Negative Effect from Disclosure* – An entity must be able to describe a specific reason for not disclosing an item of information that identifies the seriously prejudicial effect the entity expects to result from disclosing the information. General risks of a potential weakening of competitiveness from disclosure and or that the information may be considered unfavorable by the capital markets are insufficient.

[7] Investor Perspectives- IASB Member Zach Gast discusses proposed improvements to acquisitions reporting

- *The Public Availability of Information* – If an entity has made information publicly available, for example in press releases, investor presentations and regulatory filings, it would be inappropriate to apply the exemption to that information.

The proposed exemption from disclosing information is extraordinary for IFRS Accounting Standards.

The only analogue we're aware of is the exemption from the disclosure requirements in IAS 24 *Related Party Disclosures* for some government-owned entities that the IASB created in 2009. The scope of the proposed exemption is far broader, as it applies to entities of all types and will be used to exempt disclosures related to transactions that are highly significant to the value of the entity (strategic business combinations).

We strongly oppose the proposed exemption from disclosing information. It is unnecessary given the flexibility with which entities are given to make the proposed disclosures, it is likely to be abused because it cannot be verified by investors, and it will introduce diversity of practice among entities as they interpret the exemption differently, which will challenge comparability. We discuss our objections in more detail in our answer to Question 3.

We find the other changes from the Discussion Paper to the Exposure Draft to be more balanced. The Board choosing to remove the requirements to disclose changes and reasons for changes in metrics used to measure the actual performance of a strategic business combination and the disclosure of cash flows from operations in the year of acquisition for the acquired business are losses of decision useful information for investors, but the Board choosing to maintain annual impairment testing and adding the requirement to disclose a statement of whether actual performance of a strategic business combination is meeting expectation are gains of decision useful information for investors.

Proposed Disclosures are Built on Management Approach:
Investors don't know what they'll get until implementation and experience with the management approach in segment reporting is uninspiring.

Fundamental to the Exposure Draft is the Board's decision to use the "management approach" to disclosure. Rather than prescribe specific measures to disclose about business combinations, the information an entity is required to disclose each business combination's key objectives and related targets, actual performance, and expected synergies are based on the information reviewed internally by key management personnel.[8]

The proposed disclosures are needed because they would give investors information that has long been lacking. That said, because the content of the disclosures is largely up to management, it's impossible for us to state a conclusion about the decision usefulness of any disclosures which might be made for investors until we see what gets disclosed, investors gain experience using the

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[8] Basis for Conclusions, Paragraph BC108 notes: "Applying the IASB's proposals, an entity would be required to disclose information about the acquisition-date key objectives, related targets and subsequent performance of a strategic business combination by following a management approach."

disclosures, and investors determine if the disclosed information have predictive or confirmatory value.

We appreciate the effort the Board has made in widening the definition of "management" from the CODM to "key management personnel," which may improve disclosure outcomes. **Investors' experience with the CODM approach in segment reporting does not inspire optimism or confidence that disclosures will be robust and decision useful when left to management discretion.**

As we recently wrote in our 2023 comment letter to the Financial Accounting Standards Board (FASB) on segment reporting, based on our 2018 member survey and publication, *Segment Disclosures: Investor Perspectives*, investors are broadly dissatisfied with segment disclosures. In our survey, only 13% of respondents were satisfied with segment disclosures. Segment reporting does not fully deliver for investors because the requirements related to the identification of operating segments, their aggregation, and quantitative thresholds are subject to gamesmanship, such as by managing the flow of information to the CODM. A little over half (57%) of respondents to our survey agreed with maintaining the management approach, but with modifications.

Despite the core principle of IFRS 8, *Operating Segments*, requiring disclosure of information that enables users to "evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates,"[9] most entities do not provide sufficient disaggregation to achieve that core principle. Over 60% of respondents to our aforementioned segment survey agreed that "reportable segments are not always consistent with how management discusses their business in other publicly available information."

Despite the change from CODM to "key management personnel," we fear that gamesmanship with the proposed disclosures could be even more severe than in segment reporting because the disclosure requirements are less prescriptive, and management is given an optional disclosure exemption over disclosure.

One of the examples in the Basis for Conclusions highlights a possible unsatisfactory disclosure outcome[10]: an entity may only review the performance of an acquisition against acquisition-date key objectives and targets for one year after the acquisition closes. After that, the acquisition is integrated into the annual budgeting process, where acquisition-date key objectives and targets are replaced with annual targets that integrate the acquired business with existing business. Therefore, in this example, the entity would disclose performance against its acquisition-date key objectives and the related targets for up to a year after the business combination occurs, and afterwards then it would cease disclosure. Comment letters on this Exposure Draft from preparers of financial statements suggests that this disclosure outcome is rather likely.[11]

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[9] IFRS 8, *Operating Segments*, Paragraph 1.
[10] Basis for Conclusions, Paragraph BC118(a).
[11] See comment letters from the European CFO Network, Swedish Bankers Association, Finance Finland, and Deutsche Telekom AG.

Another unsatisfactory disclosure outcome for investors would be pervasive use of the proposed exemption to disclose information. We are not sure how frequently the exemption will be used, but we expect it to be not uncommon based on the fact that preparers advocated for its inclusion in the Exposure Draft[12] and because entities choose not to disclose information about the subsequent performance of acquisitions voluntarily in management reporting today.

We urge the Board to consider:

- **Requiring a standardized measure of actual performance of a strategic business combination such as return on assets.** We disagree with the Board's conclusion that it is not feasible to specify metrics that would be relevant for all business combinations "because business combinations are entered into for different reasons."[13] While there are myriad reasons for entering a business combination, the bottom line of all investment decisions is whether the return on investment exceeds its opportunity cost. If an entity's management does not measure and monitor the return on investment for a strategic business combination, the entity should disclose that fact and the reasons why it does not do so.

  We are aware of the complexity of measuring returns[14] but that complexity could be addressed by, for example, prescribing a standardized measure of return on assets such as operating profit before acquisition-related amortization as a percentage of total assets acquired including goodwill while permitting entities to present that measure differently so long as assumptions and methods are clearly disclosed. Additionally, we note that there is probably no measurement in accounting that stakeholders unanimously agree on, so stakeholder disagreement should not discourage the Board.

  A standardized measure of actual performance of strategic business combinations would enhance the comparability of disclosures for investors and allow for more effective investor oversight of capital allocation decisions by management and those charged with governance.

- **A post-implementation review shortly after issuing the final standard to understand if investors are receiving decision useful information from the proposed disclosures.** A targeted review of large, well-publicized acquisitions and the disclosures made in the year of, and following, the acquisition should be reviewed in the years immediately following adoption (e.g., 3 years) to test the efficacy of the proposed approach.

The Board Risks Confusion with Thresholds, Management Approach, and Exemptions

Under the proposed requirements, an entity's disclosures for a business combination will be driven by:

- Whether the transaction is immaterial, immaterial alone but collectively material with other acquisitions, individually material but not strategic, or strategic.

[12] Basis for Conclusions, Paragraphs BC74 – BC78.
[13] Basis for Conclusions, Paragraph BC77(b).
[14] See, for example, *Return on Capital (ROC), Return on Invested Capital (ROIC) and Return on Equity (ROE): Measurement and Implications* by Aswath Damodaran.

- If it is the year of acquisition or a subsequent period. If it is a subsequent period, is it before or after two full years after the acquisition date.
- What information is reviewed and made available to key management personnel.
- What, if any, disclosure exemptions are taken by management for the information they review.

These steps afford entities considerable discretion in managing disclosure outcomes and introduce complexity for investors. A single entity, over the course of a few years, may close several acquisitions and make different judgments on each of the aforementioned factors. These are practically guaranteed to differ from the judgments made by a different entity's management.

Without close reading of the IFRS standard, investors are unlikely to know what constitutes "full disclosure" and what is withheld.

To prevent some confusion, in addition to our recommendation to remove the proposed disclosure exemption discussed in our answer to Question 3, we recommend the Board:
- Write an explanatory paragraph that must be shown at the top of each entities' business combination footnote that briefly describes how IFRS disclosure requirements vary by the materiality of the business combination, how management monitors the acquisition internally, and the acquisition date.
- Requires entities to list the business combinations completed in the years for which the financial statements are presented, identify each as immaterial, material, or strategic, and, briefly, state the key factors that management used to make each materiality decision.

The Board Must Not Weaken Impairment Testing Further by Allowing Even Greater Management Optimism

In the Exposure Draft, like the Discussion Paper, the Board identifies management over-optimism as one of the key reasons that impairment losses on goodwill are delayed long after losses are apparent to capital markets participants.[15] Management's forecasts of the recoverable amounts of cash-generating units containing goodwill are too rosy, most likely reflecting an unwillingness to admit to mistakes in acquisitions.

But the Board proposes to allow even more management optimism in impairment testing, exacerbating the problem and potentially spelling the end of impairment charges by removing the restrictions on including cash flows from a future restructuring to which the entity is not yet committed or from "enhancing an asset's performance." Management's forecasts would only be disciplined internally and by the auditor, as disclosures to investors regarding these restructurings and enhancements are not required.

We urge the Board to withdraw this proposed amendment as it does not achieve the objectives of the project; it does not help users assess performance of business combinations, it does not make impairment testing less complex, and it does not shorten the delay between an impairment occurring and an impairment loss being recognized in the financial statements (i.e., an observed problem with impairment testing.)

[15] Basis for Conclusions, Paragraph BC188.

The Board could reconsider the proposal in a broader project on IAS 36, *Impairment of Assets*, which is needed given the significant shortcomings of impairment testing discussed in the Exposure Draft.

We're disappointed that the Board is not moving forward with the proposal in the Discussion Paper to require entities to present total equity excluding goodwill on the balance sheet

As we wrote in our comment letter to the Discussion Paper, presentation of equity less goodwill is a useful illustration to investors of the magnitude of goodwill balances relative to entities' total equity. We highlight work we performed in our publication and investor survey Goodwill: Investor Perspectives, which shows that goodwill accounts for more than 30% of listed entities' total equity in many of the jurisdictions in which entities report using IFRS, and that over 10% of entities in those jurisdictions have negative equity excluding goodwill – a metric that we believe should be highlighted for investors on the face of the balance sheet.

ANSWERS TO QUESTIONS FOR RESPONDENTS

Question 1 – Disclosures: Performance of A Business Combination (proposed paragraphs B67A–B67G of IFRS 3 *Business Combinations*).

(a) Do you agree with the IASB's proposal to require an entity to disclose information about the performance of a strategic business combination, subject to an exemption? Why or why not? In responding, please consider whether the proposals appropriately balance the benefits of requiring an entity to disclose the information with the costs of doing so.

(b) If you disagree with the proposal, what specific changes would you suggest to provide users with more useful information about the performance of a business combination at a reasonable cost?

We agree with the IASB's proposal to require an entity to disclose information about the performance of strategic business combinations. We disagree with the proposed exemption. We discuss that disagreement in our answer to Question 3 which asks about that topic specifically.

Our outreach to members has found the same need among investors as the IASB's outreach: investors need better information about business combinations to help them assess whether the price an entity paid for a business combination is reasonable and how the business combination performed after acquisition. In our member survey and 2021 publication Goodwill: Investor Perspectives, respondents indicated broad dissatisfaction with business combination accounting and disclosures today:

- 88% agreed that "there should be an improvement in disclosure regardless of whether the accounting model for goodwill changes."
- 70% of investors indicated that impairment disclosures needed improvement
- And virtually all respondents agreed with a broad menu of disclosure improvements, including the valuation models that management uses to estimate value in use, quantitative information about the estimates' assumptions, measures of subsequent performance of the acquisition, qualitative information, and the board's assessment of the acquisition.

Investors need more information about business combinations from acquirers because business combinations are unique among uses of capital by entities in that they:

- **Are often the largest uses of capital (and goodwill an entity's largest asset).** M&A consistently represents as the largest or among the largest uses of the capital by entities, regularly exceeding capital expenditures and returns of capital of shareholders[16]. Our work in Goodwill: Investor Perspectives shows that goodwill is close to 10% of assets and 30-40% of equity for listed companies in developed markets.

- **Have a high likelihood of destroying value.** Studies have consistently shown that the majority of acquisitions do not increase acquirers' shareholder wealth, but rather transfer value to the shareholders of the acquiree.[17, 18, 19] The often-cited number from McKinsey is that roughly 70% of acquisitions fail. More anecdotally, Warren Buffett has been writing about the perils of mergers and acquisitions for decades: "Corporate acquisition programs almost never do as well and, in a discouragingly large number of cases, fail to get anything close to $1 of value for each $1 expended."[20]

- **Can signal changes in the health of the existing business or management's overall strategic direction.** Investors of acquirers often react negatively to acquisition announcements, particularly large ones, as acquisitions are believed to "plug" a shortfall in the performance of the existing business. Additionally, a large acquisition may be a signal that the existing strategy is not working, because why else would an acquisition rank higher than other uses of capital?

Opposition to the proposed disclosures regarding the location of the information, its auditability, and because "forward-looking information doesn't belong in the financial statements" is flawed.

- **The financial statements are the right location for disclosures about business combinations** based on the Board's *Conceptual Framework* and the fact that goodwill and acquired assets and liabilities are recognized on the financial statements, which will be further explained by the proposed disclosures.

- **If management reporting is the proper place for these disclosures, as critics suggest, why don't entities disclose the information there now?** Comment letters from preparers and auditors of financial statements state that they support the principle behind the proposed

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[16] Maubossin et al. at Morgan Stanley found mergers & acquisitions to be the largest use of capital by Russell 3000 companies from 1985-2021, averaging 9% of revenues annually but exhibiting great cyclicality, in some years exceeding 20% of revenues. https://www.morganstanley.com/im/publication/insights/articles/article_capitalallocation.pdf

[17] See "Aswath Damodaran on Acquisitions: Just Say No." CFA Institute *Enterprising Investor*. February 2019.

[18] See Moeller, Sara B. and Schlingemann, Frederik Paul and Stulz, Rene M., *Do Shareholders of Acquiring Firms Gain from Acquisitions?* in which the authors examined a sample of 12,023 acquisitions by public firms from 1980 to 2001 and found that shareholders of these firms lost a total of $218 billion.

[19] See the Council of Institutional Investors response to the Securities and Exchange Commission's proposed "Amendments to Financial Disclosures About Acquired and Disposed Businesses." July 29, 2019.

[20] 1984 Berkshire Hathaway Letter to Shareholders.

disclosures but that their proper place is in the management report, not the financial statements. Some commenters suggest the Board should consider including the proposed disclosures in its project updating the non-binding practice statement on management reporting, rather than an IFRS standard.

To be clear: there is nothing preventing entities from disclosing the information in the proposed disclosures, and beyond it, in management reporting today. If it were commonly disclosed, this project would be unnecessary. Unless these disclosures are required, and subject to the rigor of the external audit, they will not be made.

- **The proposed disclosures are auditable.** We agree with the Board's conclusion that the proposed disclosures are auditable because they are based on information reviewed internally by management and that there is often extensive documentation with a large acquisition. Additionally, we're unable to reconcile the supposed un-auditability of the proposed disclosures with audit practitioners' expressed interest in assuring sustainability information, which is far more difficult to verify.

- **Forward-looking information is already on the financial statements.** The argument that forward-looking information doesn't belong in the financial statements is a well-worn common refrain but defies logic.

  - The simplest examples of assets and liabilities – accounts receivable and payable – are forward-looking. They are future inflows and outflows of cash from operating activities. Their recognition and measurement are forward-looking: what do we expect to receive from customers and what have we committed to pay to suppliers at a future date? The originating transactions that gave rise to the accounts receivable and payable occurred in the past, but they are records of what is expected to be received or paid in the future.

  - Other examples of assets and liabilities make the forward-looking nature of financial statements even more obvious. Goodwill represents acquired future economic benefits like synergies and going concern value that are not separately identifiable under the Board's definition of an asset. The impairment testing process for all assets and cash-generating units containing goodwill is inherently forward-looking, requiring the estimation of the recoverable amount which is driven by future cash flows.[21] Pension liabilities are recognized and measured using information that looks forward many years into the future and requires the use of forward-looking discount rates.

  - When an asset's future economic benefits are received or no longer expected to be received, it is derecognized. When a liability is settled, it is derecognized. The financial statements are not intended to be mere records of the past.

[21] We note that the Board is proposing to make impairment testing even more forward-looking by allowing management to include cash flows from future uncommitted restructurings and enhancements to assets' performance in value-in-use calculations.

Question 2 – Disclosures: Strategic Business Combinations
(proposed paragraphs B67C of IFRS 3 *Business Combinations*).

(a) Do you agree with the proposal to use a threshold approach? Why or why not? If you disagree with the proposal, what approach would you suggest and why?
(b) If you agree with the proposal to use a threshold approach, do you agree with the proposed thresholds? Why or why not? If not, what thresholds would you suggest and why?

We agree with the proposal to use a threshold approach.

We agree with the proposed thresholds, particularly with the quantitative criteria as we believe it will capture significant business combinations for which investors have greater information needs. While quantitative criteria pose the risk of creating arbitrary bright lines (i.e., an acquiree with revenue equal to 9.4% of the acquirer's revenue may escape disclosure), purely qualitative criteria or a principles-based approach would allow for too much management discretion in a proposed standard that already has plenty.

The Board should apply the same thresholds for individual acquisitions in a single year that are not individually strategic but share strategic rationale, to ensure that a series of smaller strategic acquisitions does not escape disclosure.

Finally, the Board should consider naming the term "significant business combination," not "strategic business combination," to use more neutral, objective language.

Question 3 – Disclosures: Exemption from Disclosing Information

(proposed paragraphs B67D – B67G of IFRS 3 *Business Combinations*).

(a) Do you think the proposed exemption can be applied in the appropriate circumstances? If not, please explain why not and suggest how the IASB could amend the proposed principle or application guidance to better address these concerns.
(b) Do you think the proposed application guidance would help restrict the application of the exemption to only the appropriate circumstances? If not, please explain what application guidance you would suggest to achieve that aim.

We strongly oppose the proposed exemption from disclosing information. It is unnecessary, is likely to be abused because it cannot be verified by investors and will introduce diversity of practice that erodes comparability. <u>We urge the Board to withdraw the proposal.</u>

- **The exemption is unnecessary because the proposed disclosures are already highly principles-based and flexible**. Under the management approach, entities will have wide discretion in the information they disclose and the manner in which they disclose it, including the level of aggregation.

- **Given that the majority of acquisitions already destroy value, we find it hard to believe that additional disclosure of information will change that outcome.** The Board has not identified past examples where disclosure posed real adverse economic consequences, only citing hypotheticals posed by preparers. Without actual evidence that disclosure would

imperil acquisition objectives, we cannot accept the premise of potential significant harm from greater disclosure.

- **The exemption is likely to be abused** because the decision to apply the exemption will be a private one between management, boards of directors, and external auditors. Investors will not be able to verify whether the exemption is applied judiciously.
    - "Competitive harm" is a common used reason for nondisclosure by management, an argument that is accepted without empirical evidence and thus has become more a matter of faith. In our 2018 member survey and publication *Segment Disclosures: Investor Perspectives*, 68% of respondents agreed that with the statement that "'competitive harm' is overstated by companies as a reason to not improve segment disclosures."

    - The Board has not identified past examples where disclosure posed real adverse economic consequences, only citing to hypotheticals posed by preparers. It is our impression that an entity's competitors often have significantly more inside, industry-specific knowledge than what is publicly disclosed through discussions in the marketplace, with consultants, and because employees and managers tend to move within industries. **Without actual evidence that disclosure would imperil acquisition objectives, we do not agree with the proposal.**

- Finally, the **exemption is likely to be interpreted differently across entities and even by the same entity** for different items of information and for different business combinations, resulting in diversity in practice that will challenge comparability for investors.
  Again, we urge the Board to **withdraw the proposed disclosure exemption**.

Question 4 – Disclosures: Identify Information to Be Disclosed
(proposed paragraphs B67A – B67B of IFRS 3 *Business Combinations*).

(a) Do you agree that the information an entity should be required to disclose should be the information reviewed by the entity's key management personnel? Why or why not? If not, how do you suggest an entity be required to identify the information to be disclosed about the performance of a strategic business combination?

(b) Do you agree that:

i. an entity should be required to disclose information about the performance of a business combination for as long as the entity's key management personnel review that information? Why or why not?

ii. an entity should be required to disclose the information specified by the proposals when the entity's key management personnel do not start or stop reviewing the achievement of a key objective and the related targets for a strategic business combination within a particular time period? Why or why not?

As we said above in our Overarching Remarks, we're not optimistic about the disclosure outcomes under a management approach based on our experience with the management approach to segment reporting. These proposed disclosures have an even greater likelihood of being the subject of gamesmanship than segment disclosures because the Board's requirements are less prescriptive, and the Board has offered an exemption from disclosing information.

That said, at this time we do not have a better idea than the management approach, but a superior alternative may become evident once entities begin making the new disclosures.

We agree with the Board's change in the definition of management from the CODM to key management personnel and suggest the Board make the same change to IFRS 8, *Operating Segments*.

Question 5 – Disclosures: Other Proposals
The IASB is proposing other amendments to the disclosure requirements in IFRS 3 Business Combinations. Do you agree with the proposals? Why or why not?

We agree with the proposals, but we urge the Board to

- Reconsider the proposals in the Discussion Paper to require disclosure of cash flows from operations in the year of acquisition for an acquired business and on a pro forma basis for the combined entity and to require the presentation of total equity excluding goodwill on the balance sheet.
- Require prominent disclosure of the number of shares issued as part of consideration transferred in a business combination and their value. This is often buried elsewhere and can be difficult for investors to ascertain.

Question 6 – Changes to the Impairment Test

(paragraphs 80-81, 83, 85, and 134(a) of IAS 36 *Impairment of Assets*)
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).

The IASB is proposing changes to clarify how to allocate goodwill to cash-generating units (see paragraphs BC194–BC201) and 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).

Do you agree with the proposals? Why or why not?

We do not agree with the Board that impairment testing cannot be improved. **The Board can make impairment testing significantly more decision useful to investors by requiring greater transparency in disclosures**, including:

- the identity and description of cash-generating units,
- the location of cash-generating units among reportable segments,
- how goodwill is allocated to the cash-generating units,
- management's estimates of the cash generating units' recoverable amounts, and
- the size of the difference between the cash generating units' carrying and recoverable amounts and the key drivers of that difference.

The proposed disclosures on the subsequent performance of a strategic business combination are a step in the right direction, but greater transparency in IAS 36 disclosures is needed.

We agree with the Board's proposal to clarify how to allocate goodwill to cash-generating units and 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.

Question 7 – Changes To the Impairment Test: Value In Use (paragraphs 33, 44-51, 55, 130(g), 134(d)(v) and A20 of IAS 36).

(a) Do you agree with the proposal to remove the constraint on including cash flows arising from a future restructuring to which the entity is not yet committed or from improving or enhancing an asset's performance? Why or why not?

(b) Do you agree with the proposal to remove the requirement to use pre-tax cash flows and pre-tax discount rates in calculating value in use? Why or why not?

As we said in our Overarching Remarks above, **we urge the Board to withdraw the proposal to allow value-in-use calculations to include cash flows arising from a future restructuring to which the entity is not yet committed or from improving or enhancing an asset's performance.**

The proposal does not achieve the objectives of the project in that it does not:

- help users assess performance of business combinations,
- make impairment testing less complex, and
- shorten the delay between an impairment occurring and an impairment loss being recognized in financial statements.

The Board is proposing to allow even more management optimism in impairment testing, after it identified management over-optimism as one of the key failures of impairment testing. By removing the restrictions from including cash flows from a future restructuring to which the entity is not yet committed or on cash flows from "enhancing an asset's performance," management's forecasts would only be disciplined internally and by the auditor, as disclosure or external commitment to investors are not required.

The Board could reconsider the proposal in a broader project on IAS 36, *Impairment of Assets*, which is needed given the well-known failures of the impairment test.

We agree with the proposal to remove the requirement to use pre-tax cash flows and pre-tax discount rates and instead require entities to use internally consistent assumptions for cash flows and discount rates.

Question 8 – Proposed Amendments To IFRS X, *Subsidiaries without Public Accountability: Disclosures*.

Do you agree with the proposals? Why or why not?

We do not have an opinion on this question.

Question 9 – Transition
(proposed paragraph 64R of IFRS 3, proposed paragraph 140O of IAS 36 and proposed paragraph 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. See paragraphs BC257–BC263.

Do you agree with the proposals? Why or why not? If you disagree with the proposals, please explain what you would suggest instead and why.

While we typically advocate for retrospective adoption and comparative information so that investors can observe trends and draw inferences, in this case we agree with the IASB's proposal to apply the amendments prospectively. Retrospective adoption would require entities to "forecast the past," stating their past objectives, metrics, and performance against those metrics today, which would allow for revisionist history.

We agree with the proposal for no specific relief for first-time adopters.

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Thank you for your consideration of our views and perspectives. We would welcome the opportunity to meet with you to provide more details. If you have any questions or seek further elaboration of our views, please contact Sandra J. Peters at sandra.peters@cfainstitute.org and Matthew P. Winters at matt.winters@cfainstitute.org.

Sincerely,

/s/ Sandra J. Peters

Sandra J. Peters, CPA, CFA
Senior Head
Global Financial Reporting Policy Advocacy
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/s/ Matthew P. Winters

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APPENDIX: COMPARISON OF DISCUSSION PAPER TO EXPOSURE DRAFT

OVERARCHING CHANGES

<table>
<tr><th>Discussion Paper</th><th>Exposure Draft</th></tr>
<tr><td>Definition of management.
“Management” is defined throughout the Discussion Paper as the entity’s Chief Operating Decision Maker (CODM), which is defined in IFRS 8 Operating Segments.</td><td>Unlike the Discussion Paper, “management” is defined in the Exposure Draft as the entity’s Key Management Personnel, which is defined in IAS 24, Related Party Disclosures, as those “persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity.”</td></tr>
<tr><td>Threshold of business combinations subject to proposed disclosures.
The proposed disclosures in the Discussion Paper would apply to business combinations that are monitored by the CODM.</td><td>The Exposure Draft changes the subset of material business combinations that some of the proposed enhanced disclosures would apply to from those that monitored by the entity’s CODM to those that meet the definition of “strategic business combination.”

A business combination is a strategic business combination if it meets one of three criteria:
in the most recent annual reporting period before the acquisition date:
the absolute amount of the acquiree’s operating profit or loss is 10 per cent or more of the absolute amount of the acquirer’s consolidated operating profit or loss;
the acquiree’s revenue is 10 per cent or more of the acquirer’s consolidated revenue;
the amount recognized as of the acquisition date for all assets acquired (including goodwill) is 10 per cent or more of the carrying amount of the total assets recognized in the acquirer’s consolidated statement of financial position as at the acquirer’s most recent reporting period date before the acquisition date; <u>or</u>
the business combination resulted in the acquirer entering a new major line of business or geographical area of operations.</td></tr>
</table>

Disclosure exemption. None.	Unlike the Discussion Paper, the Exposure Draft offers an exemption for some of the proposed enhanced disclosures if disclosure can be "expected to prejudice seriously the achievement of any of the acquirer's acquisition-date key objectives for the business combination." To determine whether an item of information is eligible for the exemption, an acquirer considers this non exhaustive list of factors: • the effect of disclosing the item of information—an entity must be able to describe a specific reason for not disclosing an item of information that identifies the seriously prejudicial effect the entity expects to result from disclosing the information. General risks of a potential weakening of competitiveness or because that item of information might be considered unfavorably by the capital markets are not acceptable. • the public availability of information—for example, if an entity has made information publicly available, it would be inappropriate to apply the exemption to that information Before applying the exemption, the acquirer shall first consider whether, instead of applying the exemption, it is possible to disclose information in a different way—for example, at a sufficiently aggregated level. If it is impossible to do so, the acquirer shall disclose the fact that it has applied the exemption and the reasons it has not disclosed the item of information. The acquirer shall reassess at the end of each reporting period whether the item of information is still eligible for the exemption.

DISCLOSURE OBJECTIVES

Discussion Paper	Exposure Draft
Add a disclosure objective to provide information to help investors understand the benefits that a company's management expected from an acquisition when agreeing the price to acquire a business.	Like the Discussion Paper, the acquirer shall disclose information that enables users of its financial statements to evaluate the benefits an entity expects from a business combination when agreeing on the price to acquire a busines
Add a disclosure objective to provide information to help investors understand the extent to which an acquisition is meeting management's (CODM's) objectives for the acquisition. CODM is defined in IFRS 8 *Operating Segments*	Unlike the Discussion Paper, the acquirer shall disclose information that enables users to evaluate the extent to which the benefits an entity expects from the business combination are being obtained <u>only for a strategic business combination.</u>

DISCLOSURES: YEAR OF BUSINESS COMBINATION - OBJECTIVES AND SYNERGIES

Discussion Paper	Exposure Draft
Replace the requirement to disclose the primary reasons for an acquisition with a requirement to disclose the strategic rationale for undertaking an acquisition.	Like the Discussion Paper, the Exposure Draft requires the acquirer to disclose the strategic rationale for a business combination.
Require a company to disclose a description of the synergies expected from combining the operations of the acquired business with the company's business.	Like the Discussion Paper, the Exposure Draft requires the acquirer to disclose, for each business combination that occurs during the reporting period, each category of expected synergies (for example, revenue synergies, cost synergies and each other type of synergy) and a description of the synergies in each category. Unlike the Discussion Paper the acquirer can apply the disclosure exemption for this item.
Require a company to disclose • When the synergies are expected to be realized • The estimated amount or range of amounts of the synergies; and • The estimated cost of range of costs to achieve those synergies.	Like the Discussion Paper, the acquirer shall disclose, for each business combination that occurs during the reporting period, and for each category of expected synergies: • the time from which the benefits from the synergies are expected to start and for how long they are expected to last. o This would require the acquirer to specify whether the benefits from the synergies are expected to be finite or indefinite • the estimated amounts or range of amounts of the expected synergies. • the estimated cost or range of costs to achieve these synergies. Unlike the Discussion Paper the acquirer can apply the disclosure exemption for this item.
Require companies to disclose, in the year in which an acquisition occurs, • management's objectives for the acquisition and • the metrics that management will use to monitor whether the objectives of the acquisition are being met.	Like the Discussion Paper, the acquirer shall disclose, in the year of acquisition, for each strategic business combination, the acquisition-date • key objectives and • the related targets. Targets can be disclosed as a range or as a point estimate. Unlike the Discussion Paper the acquirer can apply the disclosure exemption for this item.
Specify that liabilities arising from financing activities and defined benefit pension liabilities are major classes of liabilities;	Similar to the Discussion Paper, the Exposure Draft 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 accompanying IFRS 3.

DISCLOSURES: YEAR OF BUSINESS COMBINATION - CONTRIBUTION OF THE ACQUIRED BUSINESS

Discussion Paper	Exposure Draft
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’ 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 for the Primary Financial Statements Project.	Similar to the Discussion Paper, the Exposure Draft replaces ‘profit or loss’ with ‘operating profit or loss’ for both the pro forma information and information about the acquired business after the acquisition date. Operating profit or loss is defined in the IASB’s *Primary Financial Statements* project.
Not applicable.	The Exposure Draft specifies, for the pro forma disclosure, that “the acquirer shall develop an accounting policy to prepare this information” with the objective of helping “users of its financial statements forecast future performance of the combined entity.”
Require disclosure of cash flows from operating activities of the acquired business after the acquisition date, and of the combined entity on pro forma basis for the current reporting period.	Unlike the Discussion Paper, the Exposure Draft does not require disclosure of cash flows from operating activities of the acquired business after the acquisition date or of the combined entity on pro forma basis for the current reporting period.
Not applicable.	The Exposure Draft proposes to delete three disclosures from IFRS 3: • information about acquired receivables as it is somewhat redundant with IFRS 7, which requires an entity to disclose such information, but at an aggregated level (i.e., not specific to each business combination). • the line item showing changes resulting from the subsequent recognition of deferred tax assets in the required reconciliation between opening and closing goodwill balances. This requirement became redundant when the IASB amended IFRS 3 in 2008. • the amount and an explanation of any material gain or loss recognized in the current reporting period that relates to the identifiable assets acquired or liabilities assumed in a business combination that was affected in the current or previous reporting period. The IASB views this requirement as unnecessary because IAS 1 requires an entity to disclose separately the nature and amounts of items of income or expense when they are material.

DISCLOSURES: SUBSEQUENT PERFORMANCE OF BUSINESS COMBINATION

Discussion Paper	Exposure Draft
Add requirements for companies to disclose the extent to which CODM's objectives for the acquisition are being met for as long as CODM monitors the acquisition against its objectives.	Like the Discussion Paper, the acquirer shall disclose, in the year of acquisition and in each subsequent reporting period, for each strategic business combination, information about actual performance, for as long as management monitors the acquisition against its key objectives and related targets.
	Unlike the Discussion Paper, the acquirer shall also disclose a statement of whether a strategic business combination's actual performance is meeting or has met the acquisition-date key objectives and related targets. Unlike the Discussion Paper, the acquirer can apply the disclosure exemption for this item.
Add requirements for companies to disclose • if management does not monitor whether its objectives for the acquisition are being met, that fact and the reasons why it does not do so. • if management 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 • if management changes the metrics it uses to monitor whether the objectives of the acquisition are being met, the new metrics and the reasons for the change.	Like the Discussion Paper, the acquirer shall disclose, for strategic business combinations • if management has not started and do not plan to monitor whether its key objectives and related for the acquisition are being met, that fact and the reasons why it does not do so. • if management stops monitoring whether its key objectives and related targets 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. ○ However, unlike the Discussion Paper, if management stops monitoring yet continues to receive information based on the metric originally used to measure the achievement of that key objective and the related targets during the period up to the end of the second annual reporting period after the year of acquisition, the acquirer shall disclose that fact, the reasons why, and performance measured using the original metric. Unlike the Discussion Paper, there is no requirement for the acquirer to disclose if management changes the targets it uses to monitor whether the key objectives of the acquisition are being met, the new targets, or the reasons for the change.

CHANGES TO THE IMPAIRMENT TEST

Discussion Paper	Exposure Draft
It is not feasible to design a different impairment test for goodwill that is significantly more effective at recognizing impairment losses on goodwill on a timely basis at a reasonable cost.	Like the Discussion Paper, the Exposure Draft states that developing a different impairment test that would be significantly more effective at a reasonable cost would not be feasible.
Not applicable.	Unlike the Discussion Paper, the Exposure Draft clarifies that goodwill shall be allocated to the lowest level cash-generating unit for which there financial information that management regularly uses to monitor the business associated with the goodwill.
Not applicable.	Unlike the Discussion Paper, the Exposure Draft requires entities to disclose the reportable segment that contains a cash-generating unit or group of units with goodwill.
Relief from the annual impairment test Remove the requirement for entities to perform a quantitative impairment test annually for goodwill, intangible assets with indefinite life, and intangible assets not yet available for use. Entities would be required to perform a quantitative impairment test only if there is an indication that the cash-generating unit containing goodwill or intangible asset is impaired.	Unlike the Discussion Paper, the Exposure Draft maintains the annual quantitative impairment test requirement for goodwill and indefinite-lived intangibles.
Value in use—future restructuring or enhancements Remove the restriction on including cash flows from future restructurings, improvements, or enhancements when entities determine the value-in-use of a cash-generating unit containing goodwill or any asset as part of a quantitative impairment test.	Like the Discussion Paper, the Exposure Draft removes the restriction on including cash flows from future restructurings, improvements, or enhancements when entities determine the value-in-use of a cash-generating unit containing goodwill or any asset as part of a quantitative impairment test.
Value in use—post-tax cash flows and discount rates • Remove the explicit requirement to use pre-tax cash flows and pre-tax discount rates in estimating value in use; • Require a company to use internally consistent assumptions for cash flows and discount rates regardless of whether value in use is estimated on a pre-tax or post-tax basis; and • Retain the requirement for companies to disclose the discount rates used but remove the requirement that the discount rate disclosed should be a pre-tax rate.	Like the Discussion Paper, the Exposure Draft • Removes the explicit requirement to use pre-tax cash flows and pre-tax discount rates in estimating value in use; • Requires a company to use internally consistent assumptions for cash flows and discount rates regardless of whether value in use is estimated on a pre-tax or post-tax basis; and • Retains the requirement for companies to disclose the discount rates used and whether the rate(s) are pre-tax or post-tax.

GOODWILL PRESENTATION, AMORTIZATION, AND AGGREGATION WITH ACQUIRED INTANGIBLES

Discussion Paper	Exposure Draft
Require companies to present, on their balance sheets, the amount of total equity excluding goodwill.	Unlike the Discussion Paper, the Exposure Draft does not require entities to present, on their balance sheets, the amount of total equity excluding goodwill.
Not reintroduce amortization of goodwill (i.e., retain the impairment-only accounting model).	Like the Discussion Paper, the Exposure Draft does not reintroduce amortization of goodwill.
Not change the recognition criteria for identifiable intangible assets acquired in a business combination that would allow some intangible assets to be included in goodwill	Like the Discussion Paper, the Exposure Draft does not change the recognition criteria for identifiable intangible assets acquired in a business combination.