December 22, 2020

SENT ELECTRONICALLY

International Accounting Standards Board
IFRS Foundation
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Dear Sirs/Mesdames:

Discussion Paper DP/2020/1 – Business Combinations—Disclosures, Goodwill and Impairment (the "DP")

Thank you for the opportunity to comment on the above DP.

MNP LLP ("MNP") supports initiatives to improve the information entities provide to stakeholders, including information about the acquisitions those entities make.

The proposals would apply to all entities that prepare financial statements in accordance with International Financial Reporting Standards ("IFRS"). In Canada, a wide range of entities prepare their financial statements in accordance with IFRS, including public and private entities, government business enterprises, government business partnerships and other government organizations and not-for-profit organizations.

Additionally, Canada has many small to mid-size entities ("SME"s) who file financial statements prepared in accordance with IFRS with the Securities and Exchange Commission ("SEC"). For these entities, it is important that the SEC's regulations continue to allow IFRS compliant financial statements. We recommend that the IASB communicate with the SEC to identify and address any concerns they have with the proposed changes that could affect the ability of foreign issuers to file IFRS compliant financial statements with the SEC.

We agree that the Board should assess whether there is compelling evidence that changes to IFRS Standards are necessary and would justify the cost of change.

1) Enhanced disclosure about business combinations and subsequent performance of the acquired business

We believe that the costs to implement these proposals would significantly outweigh any potential benefits, therefore, we strongly object to these proposals.

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Usefulness of information

We do not believe that the proposal to require disclosure of management's objectives for a business acquisition, and how the acquisition subsequently performs against those objectives, would result in better information being provided to financial statement users. Management's objectives are often subjective, therefore, even if management's historical objectives for the subsequent performance of the acquisition were met, an investor may not be able to conclude that the acquisition was successful.

Many factors affect the subsequent performance of an acquired business, including macroeconomic factors which are outside of management's control e.g. domestic and world demand, commodity prices, inflation, foreign exchange rates and interest rates. The amount of purchase consideration for a business acquisition is also dependent on other factors, such as revenue and earnings multiples, which are also subject to change over time.

We do not believe that the proposed additional disclosure would enable investors to assess whether management paid a reasonable price for the acquisition, nor would this information assist investors with holding management to account for acquisition decisions. Additional commentary or sensitivity analysis would be needed. We question whether investors, particularly for SMEs, would use this information to perform analysis and assess management's decisions and hold management to account.

For early stage growth entities, the benefits of acquisitions may take several years to be realised. Disclosure of management's acquisition date objectives may have limited value since project milestones and objectives can change significantly, often soon after the acquisition.

We also question whether the users of private entity financial statements, for example banks or other creditors, need this type of information to assess management's performance. Investors in private entities often have greater access to management to obtain the information they need to perform their analysis.

Management may use a variety of metrics to assess whether their objectives for business acquisitions have been met. We expect that disclosure of business acquisition metrics in the notes to the financial statements would increase financial statement complexity and reduce comparability across entities. The metrics used by management to monitor a business acquisition may not be prepared in accordance with professional standards. Entities may use metrics that are entity-specific and not applicable to other entities in the same industry. As a result, the metrics disclosed may not be comparable to metrics used by other entities in the same or other industries and may be misunderstood by financial statement users.

Including non-GAAP acquisition metrics in the financial statement notes may cause confusion among financial statement users as additional "non-IFRS information" disclosure can obscure or undermine more important and relevant information required to comply with IFRS.

It may be necessary to add additional disclosure to explain each metric, and the lack of comparability to other entities. If the IASB proceeds with the Management Performance Measures ("MPM") disclosure requirements (as proposed in the Exposure Draft *General Presentation and Disclosure),* the MPM disclosures would apply which would further add to the volume of information in the note disclosure.

The Chief Operating Decision Maker ("CODM") often reviews several metrics for acquisitions in internal management accounts e.g. for an oil and gas business acquisition, metrics may include forecast production, operating costs per barrel, operating netbacks per barrel, G&A expenses per barrel, capital

expenditures, and reserve volumes. These metrics may be monitored on an individual property basis for major properties and may not be prepared on a consolidated basis for the acquired business. This could result in multiple metrics being disclosed in the financial statements.

IFRS compliant financial statements are becoming increasingly complex and difficult to follow for many users. Such IFRS financial statements contain a large volume of information which some users may not find relevant to their requirements. There is an issue of information overload, where additional information disclosed sometimes obscures or undermines more important and relevant information.

We believe that the notes to the financial statements already provide users with sufficient information regarding the subsequent performance of acquisitions, including revenue and profit or loss subsequent to the acquisition date, disaggregation of revenue, and operating segment disclosures. The information in the financial statements is further supplemented by the commentary in the management's discussion and analysis ("MD&A") that is required to be filed by reporting issuers in Canada and SEC registrants in the United States. We believe that it is more appropriate for disclosure of information and commentary about the subsequent performance of an acquisition to be included in the MD&A than in the notes to the financial statements. MD&A disclosure is subject to the requirements of securities law relating to misrepresentations.

Implementation challenges and cost

We believe that the proposals would be challenging for SMEs to implement. Specifically, we have concerns about the substantial time and cost that would be necessary for these entities to implement and comply with the new disclosure requirements. Even with the management approach, significant time and cost will be necessary to analyse the disclosure requirements for each business combination, prepare the required disclosure, and design and implement internal controls around the preparation of this information. Management's internal forecasts, especially for SMEs, may not provide sufficient appropriate audit evidence to support the metrics disclosed; therefore, new, and more detailed, forecasts may need to be prepared to support the disclosure. SMEs generally have fewer accounting resources available and simpler accounting systems.

We therefore expect that the proposed changes will result in both increased internal costs to prepare the required information, and increased audit fees charged to these entities.

Audit challenges

We have specific concerns about the verifiability of the proposed disclosure.

The proposals would result in a wide range of metrics being disclosed in the notes to the financial statements, which, as noted above, may not be prepared in accordance with professional standards and may not be comparable to the metrics used by other entities in the same or other industries. As a result, we expect that it will be challenging to obtain sufficient appropriate audit evidence to support certain metrics.

Paragraph 2.17(a) of the DP states that the Board expects it will be possible to verify whether the information "faithfully represents what it purports to represent". As noted above, the metrics used by management to monitor a business acquisition may not be prepared in accordance with professional

standards. This could create subjectivity and audit challenges. Additionally, it may be necessary to engage experts to assist with auditing the metrics which would further increase cost.

Additionally, it will be challenging to design and perform audit procedures that are appropriate for the purpose of obtaining sufficient appropriate audit evidence to support the disclosed range of expected synergies, especially for entities in early stage growth industries where there is a lack of historical information and many of the assumptions are based on subjective estimates.

We also expect to encounter difficulties with verifying whether the information disclosed is the information that the CODM receives to monitor the acquisition. For many SMEs, including early stage growth companies, the review by the CODM may not be as formal as may be the case with more mature entities. The review may not occur on a periodic basis, and documented evidence of which metrics the CODM "monitors" may not exist.

Pro forma information

We strongly object to the proposal to require entities to disclose cash flows from operating activities of the acquired business after the acquisition date, and of the combined business on a pro forma basis for the current reporting period. We believe that the costs to comply with this disclosure requirement would significantly outweigh any potential benefits. The proposal would require the preparation of a full cash flow statement for the acquired business for the period subsequent to the acquisition. If more than one legal entity was acquired, this may require a combined cash flow statement to be prepared for the stub period. This would result in significant costs to obtain the information for each line item of the cash flow statement on a combined basis for the acquired business for the stub period, prepare the statement, comply with internal controls, prepare sufficient and appropriate audit evidence to support this information and audit the statement. To prepare a pro forma cash flow statement for the current reporting period would result in similar incremental costs.

We also object to the proposal to replace the requirement to disclose 'profit or loss' of the acquired business after the acquisition date and pro forma information with a requirement to disclose 'operating profit before deducting acquisition-related transaction and integration costs' (operating profit or loss would be defined as in the Exposure Draft *General Presentation and Disclosures*). We believe that the costs to comply with this revised disclosure requirement for the pro forma information disclosure (period prior to acquisition) would significantly outweigh any potential benefits. Since the operating category excludes income or expenses classified in the other defined categories such as the investing category or the financing category , the change would require an assessment of each item of income and expenditure for the period prior to acquisition to assess whether the item met the definition of investing, financing, or one of the other prescribed categories. Further, not all income and expenditures which are not classified in the investing, financing, or other prescribed categories arise from an entity's main business activities. For example, a bargain purchase gain or changes in the fair value of contingent consideration related to a business combination may not meet the criteria to be classified in the investing category for purposes of the statement of profit or loss and, if so, would be classified in the operating category.

The change would also require that foreign exchange gains and losses be split between operating, financing and investing activities. As noted above, SMEs generally have simple accounting systems and accounting processes; therefore, this change would be an administrative burden and costly for some of these entities to comply with.

We do not support adding specific guidance about how to prepare the pro forma information or requiring disclosure about how the pro forma information was prepared. We believe that the costs to analyse any new guidance and assess how it should be applied to each business combination, and for the auditors to assess whether the entity has correctly applied the guidance, would significantly outweigh any potential benefits.

Overall, our experience has been that the pro forma information can involve significant cost to prepare and audit. For example, the acquired business may not previously have prepared IFRS financial information and so the pro forma disclosure requirement results in a GAAP conversion being necessary for the pre-acquisition period's results. Additionally, we believe that the historical pro forma information has limited value since the acquired business often changes significantly after the acquisition date such that historical results are not comparable to post acquisition results. For example, the acquirer may integrate the business into its own operations with a different cost structure, provide additional funding to the business, increase growth capital expenditures, renegotiate contracts (customers or suppliers), change delivery methods and price discounts, or make management changes.

Other comments

Paragraph 2.26 of the DP states that if management receives some commentary so that management can understand whether the objectives set for the acquisition are being met, and if investors need this information to understand whether those objectives are being met, entities would be required to disclose this commentary. We are unclear what the scope of this proposal would be. For example, if verbal commentary is provided during monthly business unit presentations, would this commentary be required to be disclosed? Additionally, further guidance would be necessary on the nature of the audit procedures that are appropriate for this commentary.

Paragraph 2.33 of the DP contemplates creating definitions of 'major' or 'fundamental' acquisitions using thresholds similar to those set by jurisdictions that require additional disclosures for acquisitions above a specified threshold. We do not support using thresholds to determine which acquisitions should be disclosed. We believe that adding additional significance tests would introduce unreasonable cost and complexity, especially if they are based on historical information which may not be available or was prepared using a different GAAP. Securities regulators have the ability to grant exemptive relief from significant acquisition disclosure if facts and circumstances support that the significance test did not have the intended result.

We also note that as a result of the amended definition of a business in IFRS 3, material acquisitions are often accounted for as asset acquisitions versus business combinations. The proposed disclosure in the DP would only apply to business combinations. We question why the proposed disclosure would provide necessary and meaningful information about business combinations but not be applicable to asset acquisitions.

Finally, we believe that it would be rare that SMEs would estimate the expected the range of synergies when agreeing the price for an acquired business. Additionally, that we expect that companies in some industries would not estimate this range.

2) Relief from annual quantitative impairment test for CGUs containing goodwill

We support the proposal to provide relief from annual quantitative impairment test for CGUs containing goodwill if there is no indication that an impairment may have occurred. We agree with the IASB's view that any reduction in the robustness of the impairment test as a result of this relief would be marginal since we believe that it is unlikely that material impairment losses occur without an indicator of impairment. If an appropriate analysis of impairment indicators is performed at each reporting period, impairment tests would be performed at the appropriate time.

We believe that this relief would result in significant cost savings for many entities. SMEs often need to engage external experts to assist with the performance of the annual impairment test. For example, experts are often engaged to assist with determining appropriate discount rates. Additionally, cash flow forecasts for purposes of the impairment test usually require additional work beyond the work completed to prepare internal cash flow forecasts, as a result of the need to comply with internal control procedures and provide sufficient and appropriate audit evidence, including addressing the requirements of CAS 540 *Auditing Accounting Estimates and Related Disclosures* ("CAS 540").

We agree that the IASB should develop additional guidance around the assessment of impairment indicators. Further, we note that US GAAP[1] requires an assessment of whether is it "more likely than not that the fair value of a reporting unit is less than its carrying amount" which is a more defined test than the current IAS 36 *Impairment of Assets* impairment indicator assessment.

3) Simplification of value in use ("VIU") estimation

We support the proposal to remove the restriction that prohibits entities from including cash flows arising from a future uncommitted restructuring or from improving or enhancing the asset's performance. We agree that these changes would simplify management's VIU estimation process and reduce the cost and complexity of performing impairment tests. Currently, management typically has to adjust internal cash flow forecasts to remove these cash flows for purposes of the VIU determination. We acknowledge that removing these restrictions could potentially result in a risk of manipulation of cash flows, however, we believe that the current restriction that cash flows must use reasonable and supportable assumptions based on the most recent financial budgets or forecasts approved by management is sufficient, and it is not necessary to set a probability threshold, or require additional qualitative disclosures, for the cash flows. We do foresee some challenges with auditing these cash flow estimates, particularly if the entity is an early stage growth industry, however, we expect these can be addressed through compliance with CAS 540.

We also support the proposal to allow entities to use post-tax cash flows and post-tax discount rates in estimating VIU. The possibility to use post-tax discount rates and cash flows would better align with general business valuation practices, but careful consideration on the interplay with deferred tax assets and deferred tax liabilities and related cash flows will be needed.

4) Total equity excluding goodwill

We do not believe it is necessary to present a subtotal for equity excluding goodwill in the statement of financial position. IAS 1 *Presentation of Financial Statements* states that financial statements are prepared

[1] ASC 350-20-35-3D

for users who have a reasonable knowledge of business and economic activities and who review and analyse the information diligently. Users can calculate this amount if they believe the subtotal is relevant.

5) The impairment test for CGUs containing goodwill

We agree with the the IASB's view is that if estimates of cash flows are too optimistic, this is best addressed by auditors and regulators, not by changing IFRS Standards. We believe that if the impairment test is applied correctly, the test should meet its objective of ensuring that the combined assets, including goodwill, are carried at no more than their combined recoverable amount.

6) Amortisation of goodwill

We agree with the IASB's preliminary view that it should not reintroduce amortisation of goodwill, and that the impairment only approach should continue to apply. We agree that amortization of goodwill would provide no useful information to investors. The primary performance measures used by many investors are EBITDA and cash flow measures which would exclude goodwill amortization.

We do not believe that amortising goodwill would significantly reduce the cost of performing the impairment test, particularly in the first few years after an acquisition. We also agree that estimating the useful life of goodwill would require significant judgment, such that goodwill amortisation expense would be an arbitrary estimate of the consumption of goodwill.

We believe that goodwill arising from business combinations is best reflected in the financial statements through the impairment-only approach.

We would be pleased to offer our assistance to the IASB in further exploring issues raised in our response and in helping to find alternative solutions which meet the needs of the financial statement users.

MNP LLP is one of Canada's largest chartered professional accountancy and business advisory firms. Our clients include small to mid-size owner-managed businesses in agriculture, agribusiness, retail and manufacturing as well as credit unions, co-operatives, Indigenous, medical and legal professionals, not-for-profit organizations, municipalities and other public sector entities. In addition, our client base includes a sizable contingent of publicly traded companies.

Yours truly,

MNP LLP

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