September 20, 2023

Ms. Kris Nathanail
International Organization of Securities Commissions (IOSCO)
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Spain

By e-mail: k.nathanail@iosco.org

Re: Consultation on Goodwill

The New York State Society of Certified Public Accountants (NYSSCPA), representing more than 19,000 CPAs in public practice, industry, government and education, welcomes the opportunity to respond to the above-captioned exposure draft.

The NYSSCPA's International Accounting and Auditing Committee deliberated the document and prepared the attached comments. If you would like additional discussion with us, please contact International Accounting and Auditing Committee Chair Jean-Pierre Henderson at (347) 522-1598, or Keith Lazarus, NYSSCPA staff, at (212) 719-8378.

Sincerely,

N Y S S C P A

N Y S S C P A

Liren Wei
President

Attachment

NEW YORK STATE SOCIETY OF

CERTIFIED PUBLIC ACCOUNTANTS

COMMENTS ON

CONSULTATION ON GOODWILL

September 20, 2023

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New York State Society of Certified Public Accountants

Comments on

Consultation on Goodwill

We welcome the opportunity to respond to the International Organization of Securities Commissions ("IOSCO") invitation to comment on Consultation on Goodwill.

General Comments

We acknowledge and agree with the IOSCO conclusions as stated in Chapter 5, that it is important to carefully watch the current financial reporting environment especially with respect to the reporting on goodwill for changing economic conditions and that management and different industries, companies and entity-specific should reflect these economic assumptions, specific economic challenges and uncertainties assumptions used in the goodwill impairment tests and related disclosures, that goodwill is not stated in excess of its recoverable amount and that impairment losses are recognized in a timely manner.

While we broadly agree with the goal of enhancing disclosures around the recording of the initial recording of goodwill at acquisition and provide for more timely impairment recognition, we differ on how these may be performed and have concerns that despite additional guidance the stated goals of a more timely determination of impairment may not be fully accomplished.
We recommend that IOSCO consider additional guidance outside of the financial statements and related footnote disclosures on goodwill or deprioritize this for IASB in alignment with FASB position. As discussed in the following response in greater detail, while we understand the need to support the IASB's initiative to enhance disclosures that provide investors with better information about the performance of an acquisition and more effectively hold management to account for its acquisition decisions, we are not certain that further enhancements and disclosures around goodwill and impairment should all be incorporated into the financial statement balance sheet and footnote disclosures.

Further, we have responded to the four different stakeholders' questions based on our collective experience either in those roles, as a participant in those processes or as our understanding of those participants' views. For example, we have responded based on our dealings with the information and discussions to and with audit committee members but not necessarily as being an audit committee member.

Comments on Specific Questions for Respondents

We offer our responses to the Chapter 5 – IOSCO Consultation Questions for Stakeholders (reprinted in italics) below.

4.1. General

Question 1: *Is there anything we can add in Chapter 1, 2 and 3, in order to adequately describe the background and issues surrounding goodwill?*

Response: While the background and issues surrounding goodwill are appropriately explained, there are areas which we believe should be mentioned and taken into consideration as follows:

<u>Users of Accounting Standards</u>

We noted that the IOSCO Consultation is obviously concerned with public filers and is addressed from the perspective of IOSCO, however, it does not address the issues based on the concerns of non-public filers who are also users of the IASB. While we appreciate the position of IOSCO members, we disagree that the IASB should be approaching this matter as a public entity issue and that as support for additional disclosures and enhancements that level of transparency <u>is a given</u> as indicated in Sec 2.3.2. Support for IASB's Objective, paragraph 2, third bullet, ["*IOSCO members think that commercial sensitivity should not prevent companies from disclosing information about management's objectives for an acquisition. <u>When a company accesses the public capital markets, it is accepting that transparency will be required to continue as a listed company</u>.*"]

We believe that the IASB approach to addressing the identified issues concerning goodwill and impairment and accounting standards generally, must be inclusive of all reporting entities, public and non-public. The use of IASB and FASB standards to improve transparency of public entities will also create additional requirements for non-public entities. If a carve-out is under consideration for non-public companies, that would also create additional big-GAAP, little-GAAP issues, which we do not support.

<u>Divergent Views of IOSCO and Task Force Members</u>

Further, considering the divergent views of IOSCO and its Task Force members, the basic issues should be mentioned as to the diversity in the use of Goodwill information as it currently stands; especially the differences over the following:

1) Requiring the impairment only approach, permitting or requiring a capitalization/amortization approach or considering other accounting and reporting options such as having goodwill on balance sheet indefinitely.

2) Revising the current goodwill impairment method to simplify the computation and/or address preparer's concerns about the cost of performing and documenting the current impairment approach, particularly for SMEs.

3) Improving the required goodwill-related disclosures consistent with the diverse need of financial statements users, where those items should be disclosed in public documents v. required for non-public issuers.

4) Discussion of IOSCO member views about the components of goodwill which might be subject to separate recognition and measurement at acquisition.

<u>Fair Value v. Historic Cost</u>

While we support the IASB's initiative to improve the impairment tests, we strongly agree with the FASB's conclusions to deprioritize its project on the reconsideration of Goodwill accounting and reporting, as we do not foresee the IASB arriving at a solution that will be acceptable to its diverse constituency of preparers and financial statement users absent considering periodic revaluation for noncurrent assets on an on-going basis.

Goodwill accounting, especially as it relates to impairment, has always been a compromise between historic cost accounting and attempts to reflect fair value accounting. While concerns are mostly stated over impairments to get to fair value, we support an approach that permits both write-downs and write-up of goodwill, perhaps back to original cost, similar to the accounting for identifiable intangible assets, and, if a full-scale fair value model were applied ,which might result in fair value exceeding the original cost amount.

<u>Other Areas which should be enhanced (Red Flags)/Other Considerations</u>

While securities regulators may believe that goodwill accounting should continue to be a focus in the coming years, as a broader base of stakeholders, we understand that there may be some opportunities for enhanced disclosures, better current best practices, better communications with the audit committees and auditors' evidence and documents. Accordingly, we recommend that IOSCO and security regulators also consider other areas within public filing documents for enhancement, beyond the financial statements, such as, but not limited to:

- A review or roll-forward of the proceeds associated with the acquisition including the subsequent use of proceeds.
- An analysis of the buy-decision process and post-acquisition review.
- A review of roll-forward of the Proforma Balance Sheet from the date of acquisition and if potential goodwill impairment exists at that point, then maybe difference should go directly to a restricted equity section.
- A review of Legal and Regulatory Risk Factors and Disclosures as indicators of impairment.

4.2. Questions for Investors and other users of the financial statements

Question 2: *How can the impairment test for goodwill in IAS 36 be improved to address the concerns around the timely identification and recognition of an impairment charge?*

Response: Other financial and non-financial red flags should be identified to determine early warnings of possible impairments. However, impairment itself becomes a self-fulfilling issue and is problematic for preparers, issuers, and auditors to make the threshold "decision" to impair and should not be taken lightly.

<u>Criteria</u>: Perhaps in conflict with the principles-based approach under IFRS, the IASB should establish either bright line criteria of specific factors which requires an assessment of the possibility of an impairment, which, if present, would mandate that an early warning be disclosed and that an impairment assessment must be performed.

As an example, if seven out of 10 of specifically identified factors are present, then a possibility of impairment must be disclosed, and if the entity determines that goodwill is not impaired, they must disclose the factors leading to that determination (i.e., the mitigating factors). However, if all of the specified factors are present, then an impairment exists and the entity is required to perform a formal impairment assessment, including the related impairment computation.

Listing and Placement of Disclosures: Not all factors and risks need to be included with the formal financial statements and related disclosures, but instead should be presented with other reported information to avoid voluminous, unwieldly and repetitive disclosures within the related financial statement disclosure section of an entities periodic reports. Further, as impairment is assessed by management and reviewed/audited by an entities independent public accountant, disclosing management's perspective about the reported amount of goodwill gives financial statement users their thinking regarding the recoverability of the reported amount throughout the filing documents and provides the auditors the needed evidence regarding managements' position with respect to the risk factors associated with goodwill recoverability, which could indicate an impairment was properly and consistently represented throughout the filing documents beyond the financial statement and footnotes itself.

Original Goodwill – enhanced disclosures: Allow for further recognition of estimated components, such as reputational value, future intangible value, established workforce, synergies, and assemblage value. Also, having the information of Cash Generating Unit (CGU) would allow the user to understand which events gave rise to the possible impairment of goodwill and where other net assets recorded with the related goodwill are reported (i.e., are those net assets also recorded in the same CGU).

Other disclosures that might be considered include:

- Mandatory annual qualitative assessment of consolidated goodwill balances with disclosures about the issues considered in the assessment (i.e., technological changes, revenue and return assumptions for the related CGU not realized and not expected to be realized due to changes in market conditions or the related economic environment, increasing competition, etc.) and whether (and/or to what extent) a goodwill impairment was recorded.

- Reporting the goodwill impairment using an allowance for impairment account rather than a direct write-down, like accounting for non-current long-term tangible assets.

- Disclosures about the related acquisition associated with the impaired goodwill, where the impairment adjustment is significant.

- Simplifying the goodwill computation, similar to the approach used by the FASB.

Question 3: *Do disclosures around business combinations, including qualitative descriptions of what makes up the goodwill balance at acquisition (such as expected synergies from combining operations, intangible assets that do not qualify for separate recognition or other factors), currently provide decision useful information? If not, how can they be improved?*

Response: No. To assess the value of the goodwill recorded with an acquisition, the user needs information on whether the net assets acquired will be realized or are realizable, post-acquisition.

So, goodwill cannot be assessed as a discrete asset but rather it must be assessed as a part of a business event in which the goodwill recorded represents underlying attributes that were not realizable separately.

The current accounting model assesses goodwill as a component of a CGU that might or might not record 100% of the net assets acquired in the related transaction.

We believe that enhancements should be made at the date of acquisition and in the Use of Proceeds sections, with adequate and full subsequent accounting of the use of proceeds. This would be only one factor to consider for impairment within the financial statements.

Question 4: *Do you agree with the IASB's tentative decisions16 about business combinations, particularly regarding the disclosure of the performance of business combinations after acquisition?*

Response: We recognize that views on the subsequent accounting for goodwill vary. While not a perfect solution, we support a mandatory amortization model as opposed to leaving goodwill indefinitely on the balance sheet subject to management's determination that such goodwill is impaired (until such time that another M&E transaction happens).

We support enhanced disclosure regarding the factors considered when goodwill is reported **at inception** and, subsequent to acquisition, when management makes an annual qualitative assessment regarding the remaining goodwill asset.

If the impairment only model is retained, we would support an impairment model that takes into consideration the value of the net acquired when the goodwill was recognized, not the current CGU model, which is a valuation of a business unit that might or might not contain the net assets acquired at acquisition.

Question 5: *Do disclosures around the impairment tests of goodwill currently provide sufficient detail about the assumptions used and the sensitivity of the estimate to changes in those assumptions? If not, what is lacking?*

Response: While current disclosures are generally adequate and appropriate, there may be opportunities and reasons for public entities to enhance disclosures as discussed elsewhere in this response.

Question 6: *Have you identified instances where the assumptions used in the impairment test of goodwill are inconsistent with other assumptions used for other financial and non-financial estimates? If yes, in what* instances?

Response: Without addressing a specific instance, conclusions and assumptions throughout the financial statements should be consistent. For example, the recoverability of certain deferred tax assets and tax allowances should be consistent with going concern assumption considerations and, if needed, adequately explained.

Question 7: *Do disclosures around the initial recognition of goodwill and the impairment tests of goodwill provide appropriate entity-specific information?*

Response: The disclosure requirements for non-public entities are generally adequate assuming they are properly applied. Public entities, as discussed in the IASB and FASB projects, may require additional disclosures as investors do not believe that current disclosures provide sufficient acquisition, including the related goodwill recorded.

Question 8: *How can disclosures around the goodwill impairment test be improved? What additional information would be useful? Would disclosure of the percentage by which the fair value or the value in use exceeds the carrying amount of the cash generating unit provide decision useful information?*

Response: As indicated in our general comments, additional information of possible risks are useful and should be provided elsewhere in the filing documents, not within the financial statements unless there is a clear impairment. Too little and too lates and **close** calls are not the primarily functions of a financial statements balance sheet at a point in time or a financial audit.

Question 9: *When disclosed, do key audit matters (KAMs) related to impairment tests of goodwill provide sufficient entity-specific information to users of the financial statements? If not, what additional information could be provided to enhance transparency in KAMs?*

Response: See our General Comments. KAMs for entities with significant goodwill balances should be disclosed, perhaps as a percentage of total assets, and assurance providers should discuss the entity's goodwill impairment evaluation and their views on that evaluation in all KAMs.

4.3. Questions for Audit Committees (or TCWG)

Question 10: *How would you describe your oversight and governance over the financial reporting process for the timely identification and recognition of goodwill impairment? In what ways do you think it could be improved?*

Response: An entity's Audit Committee (or TCWG) should be involved in the corporate planning and forecasting process with considerations as to possible impairments as early as possible and should be proactively involved in the decision-making process over when an impairment is required.

It is managements' responsibility to perform the impairment assessment and prepare and provide the related disclosures; they should be involved long before when the auditor receives and evaluates the recoverability of the reported goodwill amount. However, this approach then creates a move away from annual impairment testing, except when an identified triggering event occurs.

A solution to write-off the entire goodwill balance or assessing a partial impairment write-down creates an unrealistic expectation of precision, which does not usually exist. We believe entities should disclose information concerning the factors considered in assessing the recoverability of reported goodwill amounts, so that financial users understand the "uncertainties" or lack of precision of reported impairment adjustments. Such disclosures should be presented elsewhere in the regulatory filings and financial statements, such as with the related litigation risks, environmental risks, and non-compliance with laws and regulations.

Question 11: *How does the audit committee/TCWG consider whether it has the requisite skills to oversee and challenge management's process?*

Response: Audit Committee members themselves must have adequate skills to understand and assess management's process or to consider engaging a third-party expert to assess management's goodwill evaluation on their behalf.

Question 12: *How would you describe your oversight over the independent auditor, specifically around accounting estimates such as the accounting for business combinations and goodwill impairment? In what ways do you think it could be improved?*

Response: The independent auditor should not be tasked with determining the accounting estimates as this responsibility falls to management and valuation experts. The oversight over the independent auditors should focus on their processes to determine the reasonableness of management's estimates and assumptions, the reasonableness of the evidence provided by management to the auditors, the level of aggressiveness or conservativeness, and consistency in applications of these factors.

Question 13: *Describe the Audit Committee's/TCWG's process for holding discussions with the independent auditor. Are discussions between the audit committee and the independent auditor sufficiently robust to understand the procedures performed and conclusions reached by the auditor, including how the auditor maintained professional scepticism and appropriately challenged management's assumptions. If not, how can they be improved?*

Response: If the Audit Committee is sufficiently involved upfront with management in the preparation of the financial statements and management's assessment over impairments, then the Audit Committee should be adequately prepared to discuss any issues or findings which the auditors may have.

Question 14: *What type of information do you need to better execute your oversight and governance responsibilities?*

Response: See the above response.

Question 15: *In your experience, do you think key audit matters (KAMs) over goodwill impairment provide enough information for investors and other users of the financial statements to understand the audit procedures performed? What additional information could be provided to enhance transparency in drafting KAMs?*

Response: See the discussion on other areas where information can be enhanced.

4.4. Questions for Issuers

Question 16: *How can the impairment test for goodwill in IAS 36 be improved to address the concerns around the timely identification and recognition of an impairment charge?*

Response: Impairment considerations are usually very complicated especially around gradually deterioration of conditions and can cover a broad range of estimates, which could influence managements' decision on considering a goodwill impairment evaluation and computation and the timing of such impairment consideration and recognition.

Enhanced guidelines which can facilitate an objective list of factors would, but not absolutely, create a better environment for the various stakeholders to assess, decide, report, and use the related financial statements and related disclosures around goodwill.

Question 17: *What challenges do you have in complying with the current disclosure requirements for: business combinations, the initial recognition of goodwill, and the impairment tests of goodwill? To which extent does the management need to engage external experts in impairment testing?*

Response: See above. Much of the current goodwill impairment process and related reporting requirements include a great deal of management subjectivity and estimation. In making such an assessment, management should have adequate in-house expertise or should engage independent third parties in support of their impairment assessment.

Question 18: *How can disclosures around the impairment tests of goodwill be improved? Would disclosure of the percentage by which the fair value or the value in use exceeds the carrying amount of the cash generating unit provide decision useful information to financial statement users?*

Response: No. If considering a percentage disclosure, then providing the amount may be more useful. If the intent is to provide a threshold, such as the valuation percentage is in excess of 20% or some indicators or quantitative information that could give financial statement users an early warning, otherwise, beyond that it would not be helpful in and itself.

On the issue of early or timely warning of an impairment, absent disclosing the value, only a list of indicating (non-quantified) factors would be helpful in determining an impeding or gradual impairment.

Would disclosure of the extent to which management engages external experts in impairment testing be useful information to financial statement users?

Response*:* Best practices should include a disclosure if an independent third-party valuation expert is used or not to assist users of the financial statements on the reliance of outside consultants.

What additional disclosures would provide decision useful information to financial statement users?

Response: Additional disclosures in other sections of the filings should be considered as part of the assessment if an impairment is indicated. A simple statement in the disclosures that these considerations by management are aligned with disclosures elsewise in a filing would help financial statement users understand management's position as consistently held.

These abovementioned disclosures would also clarify how the auditors came to their conclusion and should then be easily able to verify if the statements appears to be consistent by the auditors as part of their procedures, but without expanding the responsibilities for the auditors to audit statements not within the financial statements.

Question 19: *Do disclosures around the impairment tests of goodwill currently provide sufficient detail about the assumptions used and the sensitivity of changes in those assumptions on the calculation of the impairment test? What additional disclosures around assumptions would provide decision useful information to financial statement users?*

Response: See general comments and other responses.

4.5. Questions for Independent Auditors

Question 20: *How can the impairment test for goodwill in IAS 36 be improved to address the concerns around the timely identification and recognition of an impairment charge?*

Response: The key for auditors is to have clear evidence of management's assessments and assumptions in order to allow auditors to conclude on the original recording of goodwill and the subsequent impairment decisions, as applicable.

Question 21: *What good practices have you observed of management applying IAS 36 to timely identify and recognize goodwill impairment charges?*

Response: Good practices would include having good segregation of duties over the budgeting and forecasting process, board approvals of budgets and the valuations used to assess goodwill. In addition, the use of independent third parties for the valuation process adds to the integrity of the valuation and assessment process.

Question 22: *The evaluation of whether goodwill is impaired requires significant management judgment and is subject to significant estimation uncertainty. What challenges have you experienced in executing audit procedures to test the reasonableness of management's assumptions used in the impairment tests of goodwill?*

Response: Sufficient documentation and written evidential materials can be challenging, especially around estimates and where there are questions of possible impairment.

How do you maintain and demonstrate your professional scepticism when auditing management's estimates used in the goodwill impairment tests?

Response: The main audit team can use a separate goodwill valuation expert within the audit firm, or consult with outside consultants, if needed, to allow some distance between the direct engagement team and the client.

Question 23: *Does management's documentation adequately support the reasonableness of their assumptions and judgments made?*

Response: See responses elsewhere in this letter.

Question 24: *In your experience, does management give objective consideration to both corroborative and contradictory information when setting assumptions? If not, please explain areas within the estimate where unconscious bias may be present.*

Response: See responses elsewhere in this letter, this can be a challenge to document.

Question 25: *Would additional educational material on auditing management's estimates be useful? If yes, which educational material would be relevant and useful?*

Response: See discussion elsewhere in this letter.