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Business Combinations – Disclosure, Goodwill and Impairment

Reduce costs and complexity of impairment test
Issues Paper

Objective

1 The objective of this paper is to provide an update to EFRAG FR TEG members on the IASB's tentative decisions in March 2023 on its preliminary views in the Discussion Paper *Business combinations – Disclosures, Goodwill and Impairment* ("the DP"), on how to reduce costs and complexity of the goodwill impairment test.

Structure of the document

2 For each of the topics listed below and where applicable, a summary is provided of the proposals in the DP, EFRAG's position in its Comment Letter, and the latest IASB discussions and tentative decisions.

3 The topics discussed in this paper are:

(a) Value in use: future restructuring, improvements and enhancements (IASB AP18A, March 2023);

(b) Value in use: post-tax cash flows and discount rate (IASB AP18A, March 2023);

(c) Impairment test: difference between value in use and fair value less costs of disposal (IASB AP18B, March 2023);

(d) Impairment test: a single method for measuring recoverable amount (IASB AP18B, March 2023);

(e) Impairment test: other suggestions (IASB AP18B, March 2023); and .

(f) Disclosure requirements in IFRS 3 *Business Combinations* (IASB AP18C, March 2023).

Value in use: future restructuring, improvements and enhancements

IASB's preliminary views in the DP

4 The IASB's preliminary view was that it should develop a proposal to remove from IAS 36 the restriction on including cash flows arising from a future restructuring to which a company is not yet committed or from improving or enhancing an asset's performance. This proposal would apply not only to cash-generating units containing goodwill but to all assets and cash-generating units within the scope of IAS 36. The IASB reached this view because it considered that this approach would:

(a) reduce cost and complexity;

(b) make the impairment test less prone to error because estimates of value in use (VIU) would probably be based on cash flow projections which are prepared, monitored and used internally for decision-making regularly;

(c) make the impairment test easier to understand; and

(d) make the impairment test easier to perform and therefore could make it easier to audit and enforce.

EFRAG Comment Letter

5 EFRAG supported the IASB's proposal to remove the restriction in IAS 36 that prohibits companies from including cash flows arising from a future uncommitted restructuring, or from improving or enhancing the asset's performance.

6 However, EFRAG considered that additional clarification would be needed on whether to include cash flows from capacity investments in the asset enhancements. In EFRAG's view, the IASB should clarify that such cash flows could be included to ensure that value in use calculations are based on cash flow projections which are prepared and monitored internally.

IASB discussions and tentative decisions

7 In response to the DP, many stakeholders agreed with the preliminary view and considered that further discipline is unnecessary because IAS 36 already requires an entity to use reasonable and supportable assumptions.

8 However, many respondents noted that it could be difficult and judgemental assessing whether cash flows form future restructurings or asset enhancements are reasonable and supportable. Therefore, they suggested developing requirements on when to include cash flows arising from a restructuring or enhancing the asset's performance for further discipline.

9 The IASB Staff analysed this feedback and considered the following points:

(a) the IASB discussed whether additional safeguards were needed when developing its preliminary view, but decided that additional safeguards were unnecessary (see AP18E, June 2019).

(b) IAS 36 already incorporates safeguards. In particular:

(i) paragraph 33(b) of IAS 36 requires an entity to base cash flows projections on the most recent financial budgets/forecasts <u>approved by management</u>;

(ii) paragraph 44 of IAS 36 requires an entity to estimate future cash flows for the asset or cash-generating unit (CGU) <u>in its current condition</u>; and

(iii) paragraphs 134(d) and 134(f) of IAS 36 require entities to <u>disclose information about the assumptions</u> on which management based its estimates of the recoverable amount.

10 Therefore, the IASB Staff recommended the IASB maintain its preliminary view.

11 After discussing this topic in March 2023, the **IASB tentatively decided** to propose:

(a) to remove a constraint on cash flows used to estimate value in use. An entity would no longer be prohibited from including cash flows arising from future restructuring to which the entity is not yet committed or from improving or enhancing an asset's performance;

(b) to retain the requirement to assess assets or CGUs in their current condition; and

(c) to add no additional constraints on the inclusion of those cash flows beyond those already in IAS 36.

12 Eleven of 13 IASB members agreed with these decisions.

Value in use: post-tax cash flows and discount rate

IASB's preliminary views in the DP

13 The IASB's preliminary view was that it should develop a proposal to:

(a) remove the explicit requirement to use pre-tax cash flows and pre-tax discount rate in estimating VIU;

(b) require use of internally consistent assumptions for cash flows and discount rates regardless of whether VIU is estimated on a pre-tax or post-tax basis; and

(c) retain the requirements to disclose the discount rates used but remove the requirement that the discount rate disclosed should be a pre-tax rate.

EFRAG Comment Letter

14 EFRAG supported the IASB's proposal to remove the explicit requirement to use pre-tax inputs and pre-tax discount rates to calculate value in use.

15 However, EFRAG noted that the IASB would have to provide guidance on possible issues, such as how deferred taxes should be reflected in the future cash flows or if the carrying amount of the CGU should be adjusted.

IASB discussions and tentative decisions

16 Almost all respondents to the DP agreed with the IASB's preliminary view.

17 With regard to further guidance and illustrative examples, the IASB Staff noted that, as mentioned in paragraph 4.52 of the DP, the IASB intended to adopt the same approach used in making similar change to IAS 41 *Agriculture* where the IASB simply deleted 'pre-tax' and did not add any further guidance.

18 Furthermore, the IASB Staff considered that feedback highlighted that entities already use post-tax cash flows and discount rate to estimate VIU.

19 Considering that the pre-tax discount rate is the post-tax discount rate adjusted to reflect the specific amount and timing of future tax cash flows, the IASB Staff also noted that an entity using pre-tax cash flows and discount rates would make the same adjustments about the tax effects but would make those adjustments to the discount rate rather than the cash flows.

20 Therefore, the IASB Staff considered that the IASB should not provide additional guidance on how to reflect tax effects in estimating VIU.

21 In March 2023, the IASB tentatively decided in line with the IASB Staff's recommendations. In particular, the **IASB tentatively decided to propose**:

(a) to remove from IAS 36 the requirement to use pre-tax cash flows and pre-tax discount rates in estimating value in use;

(b) to require an entity 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;

(c) to retain the requirement to disclose the discount rates used;

(d) to remove the requirement that the discount rate disclosed be a pre-tax rate; and

(e) to require an entity to disclose whether a pre-tax or a post-tax discount rate was used in estimating value in use.

Impairment test: difference between value in use and fair value less costs of disposal

IASB's preliminary views in the DP

22 The IASB considered whether to add more guidance on the difference between entity-specific inputs used in value in use and market-participant inputs used in fair value less costs of disposal (FVLCD), but decided not to do so because the guidance in IAS 36 and IFRS 13 *Fair Value Measurement* was considered sufficient.

EFRAG Comment Letter

23 EFRAG supported the IASB's preliminary view to not add more guidance on the difference between entity-specific inputs used in value in use and market-participant inputs used in fair value less costs of disposal.

IASB discussions and tentative decisions

24 The IASB Staff noted that few respondents to the DP suggested providing additional guidance on the difference between entity-specific inputs used in value in use and market-participant inputs used in fair value less costs of disposal. In the view of these stakeholders, the additional guidance should clarify how to adjust inputs to reflect a market participant's perspective and elaborate further the list of factors in paragraph 53A of IAS 36.

25 Nevertheless, the IASB Staff noted that responses from those disagreeing with the DP did not raise new information.

26 Therefore, in March 2023, the IASB **tentatively decided not to add more guidance to IAS 36** about the difference between value in use and fair value less costs of disposal.

Impairment test: a single method for measuring recoverable amount

IASB's preliminary views in the DP

27 In the DP, the IASB consider whether to make only one method mandatory for estimating the recoverable amount of an asset (either value in use or fair value less costs of disposal), or to require a company to select the method that reflects the way the company expects to recover an asset.

28 However, as paragraph 4.56(b) of the DP illustrated, the IASB decided not to do so because the IASB considered that the reasons for basing the definition of recoverable amount on both value in use and fair value less costs of disposal when developing IAS 36 remain valid.

29 In summary, determining the recoverable amount as the higher of the VIU and the FVLCD better reflects the different options available to an entity to recover the value of an asset.

EFRAG Comment Letter

30 EFRAG supported the IASB's preliminary view to not make only one method mandatory for estimating the recoverable amount of an asset, or to require a company to select the method that reflects the way the company expects to recover an asset.

IASB discussions and tentative decisions

31 Some respondents to the DP did not agree with the IASB's preliminary view. The primary reason for the disagreement was that the IASB's preliminary view to remove the restriction on including cash flows from future restructuring and asset enhancements in the estimation of VIU will result in a similar estimation of VIU and FVLCD.

32 Nevertheless, the IASB Staff was of the view that those who disagreed did not provide compelling evidence that the IASB had not considered in developing its preliminary view. In fact, in September 2017, the IASB considered that differences in estimating VIU and FVLCD will remain (e.g., VIU can only be measured for an individual asset if it generates cash flows that are largely independent of those from other assets, while FVLCD does not).

33 Therefore, the IASB **tentatively decided not to mandate a single method** for measuring recoverable amount.

Impairment test: other suggestions

IASB discussions and tentative decisions

34 In March 2023, the IASB considered whether to:

(a) provide additional guidance on applying IAS 36 in the financial sector;

(b) clarify whether the FVLCD of a listed CGU should reflect a control premium; and

(c) provide additional guidance on the estimation of the VIU in foreign currency.

35 The IASB Staff noted that IFRS Standards are industry agnostic. In addition, control premium and foreign currency cash flows matters are beyond the scope of this project because they relate more to the interaction between IAS 36 and IFRS 13 or IAS 21 *The Effects of Changes in Foreign Exchange Rates*.

36 Therefore, **the IASB tentatively decided**:

(a) not to provide additional guidance on performing the impairment test for entities in the financial services sector; and

(b) not to provide additional guidance to clarify the interaction between IAS 36 and either IFRS 13 or IAS 21.

Disclosure requirements in IFRS 3

IASB discussions and tentative decisions

37 As a last topic, in March 2023, the IASB discussed whether to remove any of the disclosure requirements in IFRS 3.

38 This discussion is in the light of the feedback from the Post-implementation Review of IFRS 3 and the DP that suggested performing a comprehensive review of the existing disclosure requirement to identify those that are not providing useful information to users.

39 Therefore, the IASB Staff considered a list of IFRS 3 disclosure requirements suggested to be removed by stakeholders, the Capital Markets Advisory Committee and the Global Preparers Forum (see June 2019 CMAC and GPF meeting).

40 The table below summarises the IFRS 3 disclosure requirements considered, and the decisions taken by the IASB.

IFRS 3 disclosure requirements	*IASB tentative decisions*
Para B64(h): information about acquired receivables Paragraph B64(h) of IFRS 3 states: *To meet the objective in paragraph 59[2] the acquirer shall disclose the following*	 The IASB tentatively decided <u>to remove</u> from IFRS 3 requirements to disclose information

information for each business combination that occurs during the reporting period: *[…]* *(h) for acquired receivables:* *(i) the fair value of the receivables;* *(ii) the gross contractual amounts receivable; and* *(iii) the best estimate at the acquisition date of the contractual cash flows not expected to be collected.* *The disclosures shall be provided by major class of receivable, such as loans, direct finance leases and any other class of receivables.*	about acquired receivables (paragraph B64(h)). The IASB considered that this information would be disclosed applying paragraphs 35A-35M of IFRS 7 *Financial Instruments: Disclosures*.
Paragraph B64(k): the amount of goodwill expected to be deductible for tax purposes Paragraph B64(k) of IFRS 3 states: *To meet the objective in paragraph 59, the acquirer shall disclose the following information for each business combination that occurs during the reporting period:* *[…]* *(k) the total amount of goodwill that is expected to be deductible for tax purposes.*	The IASB tentatively decided to make <u>no changes</u> to the requirements to disclose the amount of goodwill expected to be deductible for tax purposes (paragraph B64(k) of IFRS 3). Feedback form CMAC members highlighted that this information helps users estimate the post-tax effect of a business combination on the reporting entity's profit or loss.
Paragraph B64(m) of IFRS 3: acquisition-related costs Paragraph B64(m) of IFRS 3 states: *To meet the objective in paragraph 59, the acquirer shall disclose the following information for each business combination that occurs during the reporting period:* *[…]* *(m) the disclosure of separately recognised transactions required by (l) shall include the amount of acquisition-related costs and, separately, the amount of those costs recognised as an expense and the line item or items in the statement of comprehensive income in which those expenses are recognised. The amount of any issue costs not recognised as an expense and how they were recognised shall also be disclosed.*	The IASB tentatively decided to make <u>no changes</u> to the requirements to disclose information about acquisition-related costs (paragraph B64(m) of IFRS 3). The IASB considered that this information could be useful because: (a) acquisition-related costs are part of the total cost of the business combination and therefore some users consider those costs to be part of the capital employed by the entity to complete the business combination; and (b) information about the line item in which the expense is recognised assists users in

	identifying possible 'one-off' costs that might need to be adjusted for when projecting future profit.
Paragraph B66: business combinations completed after the end of the reporting period Paragraph B66 of IFRS 3 states: *If the acquisition date of a business combination is after the end of the reporting period but before the financial statements are authorised for issue, the acquirer shall disclose the information required by paragraph B64 unless the initial accounting for the business combination is incomplete at the time the financial statements are authorised for issue. In that situation, the acquirer shall describe which disclosures could not be made and the reasons why they cannot be made.*	The IASB tentatively decided to make no changes to the requirements to disclose information about business combinations completed after the end of the reporting period (paragraph B66 of IFRS 3). The IASB considered that the possible information disclosed applying paragraph 21 of IAS 10 *Events After the Reporting* period are not sufficient to meet information needs to users because (e.g., the primary reason for a business combination and how an entity obtain control might not be capture by the requirements in paragraph 21 of IAS 10).
Paragraph B67(d)(iii): a line item in the required reconciliation between opening and closing goodwill balances Paragraph B67(d) of IFRS 3 requires an entity to disclose '*a reconciliation of the carrying amount of goodwill at the beginning and end of the reporting period*' and then specifies particular line items to be included in that reconciliation. Paragraph B67(d)(iii) of IFRS 3 specifies that one of those line items is: *adjustments resulting from the subsequent recognition of deferred tax assets during the reporting period in accordance with paragraph 67.*	The IASB tentatively decided to remove from IFRS 3 requirements to disclose in the reconciliation between opening and closing goodwill balances, adjustments resulting from the subsequent recognition of deferred tax assets (paragraph B67(d)(iii)). The IASB considered that for any business combinations completed after the application of IFRS 3, acquired deferred tax benefits that an entity realises after the business combination are required to be recognised in profit or loss rather than as an adjustment to goodwill. Accordingly, the application of paragraph 67 of IFRS 3 would never result in changes to the carrying value of goodwill during the reporting period. Paragraph B67(d)(iii) of IFRS 3 became redundant when the IASB amended IFRS 3 in 2008.

Paragraph B67(e): the amount and an explanation of any material gain or loss recognised in the current reporting period Paragraph B67(e) of IFRS 3 states: *To meet the objective in paragraph 61, the acquirer shall disclose the following information for each material business combination or in the aggregate for individually immaterial business combinations that are material collectively:* *[…]* *(e) the amount and an explanation of any gain or loss recognised in the current reporting period that both:* *(i) relates to the identifiable assets acquired or liabilities assumed in a business combination that was effected in the current or previous reporting period; and* *(ii) is of such a size, nature or incidence that disclosure is relevant to understanding the combined entity's financial statements.*	✔ The IASB tentatively decided to remove from IFRS 3 requirements to disclose the amount and an explanation of any material gain or loss recognised in the current reporting period that relates to the identifiable assets acquired or liabilities assumed in a business combination that was effected in the current or previous reporting period (paragraph B67(e)). The IASB considered that paragraph B67(e) of IFRS 3 is unnecessary because other requirements in IFRS Accounting Standards already require an entity to disclose this information (see paragraph 97 of IAS 1 *Presentation of Financial Statements* and paragraph 63 of IFRS 3).
Interim financial statements Paragraph 16A(i) of IAS 34 *Interim Financial Reporting* states: *In addition to disclosing significant events and transactions in accordance with paragraphs 15–15C, an entity shall include the following information, in the notes to its interim financial statements or elsewhere in the interim financial report… The information shall normally be reported on a financial year-to-date basis.* *[…]* *(i) the effect of changes in the composition of the entity during the interim period, including business combinations, obtaining or losing control of subsidiaries and long-term investments, restructurings, and discontinued operations. In the case of business combinations, the entity shall disclose the information required by IFRS 3 Business Combinations.*	✖ The IASB tentatively decided to make no changes to the requirements to disclose in interim financial statements, information about business combinations (paragraph 16A(i) of IAS 34). Although a few stakeholders said disclosing information about the subsequent performance of business combinations (if such information is material) in interim financial statements would be onerous, other evidence gathered in this project suggests information about the entity's objectives and targets would be available when an entity preparers interim financial statements.

EFRAG Secretariat analysis

41 The EFRAG Secretariat notes that most of the IASB's tentative decisions are in line with the EFRAG's suggestions included in its Comment Letter to the DP.

42 In addition, the EFRAG Secretariat notes that the IASB's tentative decisions go in the direction of reducing the cost and complexity of applying the impairment test, as well as responding to requests from stakeholders for an alignment between the practice and the requirements of IAS 36 (e.g., post-tax cash flows and discount rates).

43 Furthermore, the EFRAG Secretariat notes that the possible need of additional guidance (in some cases also indicated by EFRAG in its Comment Letter to the DP) could be highlighted in response to the forthcoming exposure draft.

44 Therefore, the EFRAG Secretariat generally welcomes the IASB's tentative decisions and shares the arguments presented by the IASB Staff.

Questions for EFRAG FR TEG

45 Do EFRAG FR TEG members have any comments on the IASB's tentative decisions on the topics listed in paragraph 3?

46 Do EFRAG FR TEG members agree with the EFRAG Secretariat analysis?