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Business Combinations – Disclosure, Goodwill and Impairment

Development of key messages for EFRAG's DCL

Objective

1 The objectives of this session are to:

(a) Present the feedback received on the **EFRAG survey** regarding the IASB's tentative decisions on the proposed disclosures on its project on *Business Combinations – Disclosure, Goodwill and Impairment* (BCDGI); and

(b) Present the development of **key messages for EFRAG's draft comment letter** based on recent EFRAG discussions and seek EFRAG FR TEG-CFSS members views on the IASB proposals on its project on BCDGI. (This paper is not an ASAF topic)

2 The IASB exposure draft ('the ED') is expected in mid-March 2024 with a comment period of 120 days. The ED will propose amendments to the disclosures in IFRS 3 *Business Combinations* and amendments to the impairment test in IAS 36 *Impairment of Assets.*

3 Questions to EFRAG FR TEG-CFSS members are at the end of this paper.

4 In addition to this paper, agenda paper 11-02 – Summary of responses – EFRAG Survey on BCDGI Disclosures is provided for the session.

Background on the project

Project Background

5 The IASB issued the Discussion paper *Business Combinations – Disclosures, Goodwill and Impairment* ('the DP') in March 2020 and started redeliberating the proposals in 2021.

6 Specifically, the IASB has considered:

(a) How to improve the disclosures about business combinations;

(b) Whether to change the accounting for goodwill.

7 EFRAG published its final comment letter in January 2021.

EFRAG Survey

8 In October 2023, the EFRAG project team has launched a survey aimed at preparers of financial statements to collect input on the IASB's proposed disclosure requirements for business combinations. In particular, the survey's objective was to collect information on whether the proposed disclosure requirements can be applied in practice and whether they meet the intended objectives at a reasonable cost.

9 The survey addressed three main topics: the thresholds for determining a 'strategically important' business combination, the exemption from disclosing some information under certain circumstances, and the quantitative information about expected synergies.

10 The results on the survey are provided in agenda paper 11-02.

Developing the key messages

11 **EFRAG FR TEG** discussed the key messages developed by the EFRAG project team at its meeting on 14 February 2024 EFRAG FR TEG meeting. The project team developed the key messages based on EFRAG discussions on the project and the results of the surveys.

12 **At the February meeting, EFRAG FR TEG expressed, on balance, a general support for the IASB proposals.**

13 EFRAG FR TEG acknowledged that the survey results expressed several reservations and concerns on some of the key disclosure proposals. However, EFRAG FR TEG also noted that the surveys represented only 11 respondents with some respondents not having undertaken business combinations during the period requested. Furthermore, EFRAG FR TEG noted that:

(a) Some respondents provided mixed views.

(b) The majority of respondents whose entity has conducted business combinations noted that none of the business combinations conducted in the three-year period (2020-2022) would meet the qualitative or quantitative thresholds of "strategically important" business combinations. Nonetheless, several of these respondents still disagreed with the proposals.

14 Overall, EFRAG FR TEG considered that the outcome of the survey responses was important but needed further consideration especially given that users have reiterated that they consider the information useful for their analysis.

15 **In summary EFRAG FR TEG:**

(a) Acknowledged the efforts made by the IASB on requiring most of the information only for strategically important business combinations rather than for all material business combinations.

(b) Welcomed the proposed exemption which an entity could use in cases where the information (information on synergies, targets and objectives) was considered prejudicial to the entity.

(c) Considered that the reduced disclosure proposals combined with the proposed exemption achieved the right balance both for preparers and for users. Users had emphasised that the proposed information would be useful for their assessment of the business combinations an entity undertakes, and given that this information is already available, EFRAG FR TEG supported providing this information in the financial statements.

16 After the EFRAG FR TEG meeting, the EFRAG project team met with the EFRAG IAWG (26 February 2023), EFRAG FIWG (27 February 2024) and with the EFRAG FRB (29 February 2024). The EFRAG IAWG expressed several reservations on the proposals while the EFRAG FIWG was generally supportive.

17 **Feedback from the EFRAG FRB was less supportive of the IASB proposals** and asked the EFRAG staff to tone down the support in key messages included in the DCL.

18 In summary, the EFRAG FRB:

(a) Expressed concerns about the location of information and with some of the proposed information (e.g., quantitative information on expected synergies in the year of acquisition).

(b) Considered that the improvements to the impairment test do not go far enough.

(c) Overall, considered that the package of proposed disclosures and the limited amendments to the impairment test would not solve the so-called 'goodwill problem'.

19 Once the ED is published, the EFRAG project team will plan a joint EFRAG FR TEG and FRB meeting to develop EFRAG's preliminary position in the EFRAG draft comment letter.

Summary of discussions

20 For each of the main proposals expected in the ED, this section provides a short description of the of the feedback provided during the recent discussions of the key messages on the main proposals.

21 The main proposals discussed in this paper are:

Amendments to IFRS 3

(a) Location of Information;

(b) Information on expected synergies;

(c) New information for (only) 'strategically important' business combination;

(d) Definition of a 'strategically important' business combination; and

(e) Exemption.

Amendments to IAS 36

22 Amendments to the impairment test including value-in-use calculation.

Improvements to IFRS 3 Business Combinations

Location of Information

23 The IASB tentatively decided that based on the Conceptual Framework for Financial Reporting the proposed information can be required in financial statements.

Agreement

24 The majority of EFRAG FR TEG members agreed that the financial statements is the best place to provide the proposed disclosure information.

25 Most EFRAG FIWG members did not disagree.

26 Members from a user background supported having the information in the financial statements.

Disagreement

27 Most EFRAG IAWG members (preparers and auditors) did not support providing information in the financial statements noting that the information should be in the management report.

28 Most EFRAG FRB members (except for the user representative) had concerns with providing the information in the financial statements and questioned why the IASB had decided that the financial statements were the right place. On this point many FRB members said that the IASB was creating a precedent with requiring this type of information (stewardship related) in the financial statements which was not required under other IFRS Standards.

29 The general concerns noted were:

(a) Some information is difficult to quantify, and therefore could be subjective and costly to produce

(b) Auditability of information would be difficult as the information involves forward-looking statements

(c) The information provided to users in investor presentations is different which means that it would require different level of assurance

(d) For other similarly strategically important investment decisions, there are no similar disclosure requirements (e.g., investments in IT systems)

(e) There is a lot of stewardship information that is presented outside of the financial statements

(f) Overall, the proposed information proposed would not solve the fundamental 'goodwill' issue.

Information on expected synergies

30 The IASB tentatively decided to:

(a) Require an entity to disclose additional information about expected synergies from combining operations of the acquiree and the acquirer, including:

    (i) quantitative information about expected synergies disclosed by category;

    (ii) a description of the expected synergies from combining operations of the acquiree and the acquirer by specifying each category of expected synergies when the benefits from the synergies are expected to start and how long they will last.

(b) Require the information only in the year of acquisition (and not in subsequent periods);

(c) Not to define synergies; and

(d) Provide an exemption for quantitative information about expected synergies in specific circumstances (e.g., legally sensitive information such as restructuring).

Agreement

31 Most EFRAG FR TEG supported the IASB tentative decisions on expected synergies. This because:

(a) The proposal is a follow-up from information that is currently required in IFRS 3 (qualitative information on synergies)

(b) Analysts/users use quantitative information on expected synergies (and different categories of synergies) to forecast profits and cash flows over future years, and to assess the future evolution of an entity's risk profile and assess the success of a business combination.

(c) This information is already available to the entity as part of the M&A process or other internal sources.

(d) Requiring disclosure to be disaggregated by category of synergy could help entities identify which categories can be quantified (considering the high level of uncertainty of information about synergies), and which are considered commercially sensitive in which case an entity could potentially apply the proposed exemption.

32 EFRAG FIWG members also generally supported the proposals for similar reasons as EFRAG FR TEG.

Disagreement

33 Most EFRAG IAWG members disagreed with the proposals noting that:

(a) the information was forward-looking and would be difficult to quantify and audit.

(b) it was different to provide information on expected synergies in the financial statements compared to presenting it at investor presentations as the level of assurance required would be different.

34 The EFRAG IAWG user representative supported having the information on expected synergies but noted that the IASB was proposing information only at acquisition date and this was not enough – it would be necessary to know whether the synergies reported on the date of the acquisition were realised in subsequent periods.

35 Several EFRAG FRB members disagreed with providing information on expected synergies for similar reasons as in paragraph 33.

36 Some FRB members added the information involved forward-looking statements with a stewardship role on business acquisitions which was not required under other IFRS Standards for significant investments undertaken by an entity.

New information for (only) 'strategically important' business combination

37 For 'strategically important' business combinations, the IASB proposed adding to IFRS 3 requirements to disclose the following information:

(a) in the year of acquisition, the key objectives and related targets the acquirer will use to determine whether the key objectives are being met. (target information can be disclosed as a range or as a point estimate)

(b) in the year of acquisition and in subsequent reporting periods, the extent to which the key objectives for the business combination and the related targets are being met. This includes:

(i) actual performance against the key objectives and targets for the business combination; and

(ii) a statement of whether actual performance is meeting or has met the key objectives and targets for the business combination.

38 The information in (b) above is required for as long as the acquirer's key management personnel reviews the performance of the business combination against its acquisition-date key objectives and targets.

39 An entity can apply the exemption from disclosing the information described in a) and b) under certain circumstances.

Agreement

40 EFRAG FR TEG supported the IASB tentative decision proposing new information and highlighted the usefulness of the information on subsequent performance for users (e.g., in assessing how profitable/successful the acquisition had been).

41 However, EFRAG FR TEG noted that at there could be cases where an entity undertakes a series of smaller (non-strategic) business combinations, that if combined could be considered as a strategic acquisition. EFRAG FR TEG therefore recommended the IASB to consider whether specific guidance is needed for cases of series of acquisitions that have a strategic acquisition objective.

42 EFRAG FIWG members generally supported the proposals and noted that for users the proposed disclosure went in the right direction.

Disagreement

43 IAWG members were less supportive of the proposed new information.

(a) Some members expressed a concern that the IASB proposals were opening a door to include this type of information in the financial statements which was currently not required under IFRS Standards for other types of investments undertaken by an entity.

(b) The financial statements should report numbers and not details on the reasons (and follow-up) for making acquisitions.

44 The EFRAG FRB generally supported the IASB's efforts but noted that the information underlined a stewardship role and would not solve the 'goodwill' issue.

Definition of a 'strategically important' business combination

> 45 A 'strategically important' business combination would be a business combination for which not meeting the objectives would seriously put at risk the entity achieving its overall business strategy.
>
> 46 A business combination that meets any one of the following thresholds would be 'strategically important':
>
> (a) Quantitative—a business combination in which:
>
> (i) the acquiree's operating profit* exceeds 10% of the acquirer's operating profit
>
> (ii) the acquiree's revenue exceeds 10% of the acquirer's revenue; or
>
> (iii) the recognised assets acquired (including goodwill) exceed 10% of the carrying value of the assets of the acquirer
>
> (b) Qualitative—a business combination that results in an entity entering:
>
> (i) a new geographical area of operations; or
>
> (ii) a new major line of business.

Agreement

47 EFRAG FR TEG agreed with the proposal to meet one of the proposed thresholds for the following reasons:

(a) A combination of both quantitative and qualitative thresholds (as supported in the survey responses) could further reduce the population of business combinations for which the proposed information would be required (the IASB had already made efforts to reduce the information required by focusing on a subset and developing an exemption)

(b) The concept of materiality would apply in cases where the proposed thresholds would capture business combinations that the entity would consider to be immaterial business combinations. Some survey respondents had noted that the qualitative thresholds would capture immaterial acquisitions. EFRAG FR TEG recommended the IASB to elaborate on this point in the Basis of Conclusions of the prospective exposure draft.

(c) The thresholds (10%) were already used in other IFRS Standards (IFRS 8 *Operating Segments*).

48 Like EFRAG FR TEG, EFRAG FIWG considered that the thresholds would capture the right level of business combinations considered to be strategic acquisitions.

Disagreement

49 The majority of IAWG members disagreed with the proposal to meet one of the proposed quantitative and qualitative thresholds and considered that a combination of both would be more appropriate. This view is consistent with the view of most survey respondents. Other comments noted were:

(a) One IAWG member noted that applying the proposed thresholds may not result in comparable information as it involved management judgement.

(b) Other IAWG members commented that the thresholds would lead to discussions with the auditors if for example one of the qualitative thresholds are met. This would potentially result in immaterial business combinations being captured by the thresholds.

50 Overall, the EFRAG FRB did not disagree with the proposed thresholds. However, some members acknowledged that survey respondents preferred a combination of the thresholds rather than just meeting one. This point needed to be reflected in EFRAG's key messages.

Exemption from disclosing some information

51 The IASB tentatively decided to propose an exemption* in specific circumstances that would permit an entity not to disclose information about:

(a) management's objectives for a business combination

(b) the metrics and targets management will use to monitor whether the objectives for the business combination are being met

(c) quantitative information about synergies expected to arise from the business combination

(d) qualitative statement of whether actual performance in subsequent periods met the entity's target for the business combination

* No exemption is proposed from disclosing information about the strategic rational and the subsequent performance

52 In applying the exemption an entity would consider the following:

(a) factors in determining whether the exemption is applicable (including the effect of disclosing and the availability of information)

(b) whether it is possible to disclose information at a sufficiently aggregated level to resolve concerns while still meeting the disclosure objectives

(c) to disclose the fact and the reason for applying the exemption, for each item of information to which an entity has applied the exemption

(d) to reassess in each reporting period whether the application of the exemption to an item of information is still appropriate, and if no longer appropriate, the entity would be required to disclose the item of information previously exempted (the reassessment should be performed for as long as the disclosure is required.

Agreement

53 EFRAG FR TEG welcomed the IASB's efforts to address concerns (such as commercial sensitivity), by proposing an exemption to some items of information under specific circumstances. EFRAG FR TEG noted that:

(a) The purpose of the exemption is not to provide entities with an exit route not to provide the information, but rather to use it in those situations in which publicly disclosing the information is expected to seriously prejudice any of the entity's objectives for the business combination; and

(b) The exemption would be used in rare cases (for example in jurisdictions where information on restructuring is subject to legal requirements before being made public).

54 The EFRAG FIWG and the EFRAG FRB did not disagree with the proposed exemption.

Disagreement

55 EFRAG IAWG members did not disagree with the proposed exemption, however it was noted that *'specific circumstances'* should be clarified, as the interpretation could differ across jurisdictions, sectors, entities. Another point made was that the '*specific circumstances*' would be hard to document, and therefore guidelines should be provided on what information had to be disclosed when applying the proposed exemption.

56 EFRAG FRB members considered that further guidance on when the exemption could be applied could potentially address the concerns noted by the majority of respondents that the proposed exemption would not be satisfactory to address concerns on commercial sensitivity.

Improvements to IAS 36 Impairment of Assets

Retaining the impairment only model

57 The IASB tentatively decided:

(a) to maintain its preliminary view to retain the impairment-only model for the subsequent accounting for goodwill.

(b) to retain the requirement to perform a quantitative impairment test annually, and not to pursue any of the alternatives to it that were suggested by respondents.

(c) that it is not feasible to design a different impairment test that would, at a reasonable cost, be significantly more effective than the impairment test currently required by IAS 36.

Agreement

58 EFRAG FR TEG and EFRAG FIWG agreed with the IASB tentative decisions to retain the annual impairment testing requirement. There was no disagreement on this part from the EFRAG FRB.

Disagreement

59 Some EFRAG IAWG members expressed a preference for amortisation of goodwill with one member saying that the IASB should reconsider amortisation.

Reduce shielding and management over-optimism

60 To reduce shielding and management over-optimism, the IASB tentatively decided:

(a) to replace 'goodwill is monitored for internal management purposes' in paragraph 80(a) of IAS 36 with 'business associated with the goodwill is monitored for internal management purposes';

(b) to clarify the meaning of the proposed new wording for paragraph 80(a) by providing limited clarifications of what is meant by 'monitoring' a business associated with goodwill;

(c) to clarify that 'operating segment' in paragraph 80(b) of IAS 36 is intended to show the highest level that can be used by an entity in the impairment test when applying paragraph 80(a);

(d) to clarify why IAS 36 requires an entity to allocate goodwill to a cash-generating unit or a group of cash-generating units; and

(e) to take no further action on any of the other suggestions from respondents to the Discussion Paper for improving the effectiveness of the impairment test.

61 The IASB tentatively decided to require an entity to disclose the reportable segments in which cash-generating units containing goodwill are included.

62 The IASB also tentatively decided to explain the difference between management monitoring 'strategically important' business combinations for the purpose of subsequent performance disclosure and management monitoring a business associated with the goodwill for the purpose of impairment testing.

Agreement

63 EFRAG FR TEG and FIWG generally agreed with the IASB tentative decisions to reduce shielding and management over-optimism.

64 EFRAG FR TEG was supportive of the key message to ask for more guidance on how to deal with right of use assets.

Disagreement

65 One EFRAG FR TEG member noted that the issues on climate transition, in particular the horizon of cash flow projections are still not addressed.

66 One EFRAG FRB member suggested that consideration of the US GAAP guidance, which allowed impairment at a lower level, should also be included.

Value in use

67 On future restructurings, the IASB tentatively decided to remove a constraint on cash flows used to estimate value in use. An entity would no longer be prohibited from including cash flows:

(a) arising from future restructuring to which the entity is not yet committed;

(b) from improving or enhancing an asset's performance.

(c) to retain the requirement to assess assets or cash-generating units in their current condition; and

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

68 On the pre-tax cash flows, the IASB also tentatively decided:

(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.

69 On other suggestions to reduce cost and complexity, the IASB tentatively decided:

(a) not to add more guidance to IAS 36 about the difference between:

(i) value in use; and

(ii) fair value less costs of disposal;

(b) not to mandate a single method for measuring recoverable amount;

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

(d) not to provide additional guidance to clarify the interaction between IAS 36 and either IFRS 13 Fair Value Measurement or IAS 21 The Effects of Changes in Foreign Exchange Rates.

Agreement

70 EFRAG FR TEG and FIWG were supportive of the IASB proposals to remove the prohibitions on inclusion of cash flows relating to future restructuring and asset enhancements in the estimate value in use and to remove from IAS 36 the requirement to use pre-tax cash flows and pre-tax discount rates in estimating value in use.

Disagreement

71 The EFRAG FRB while not disagreeing with the IASB tentative decisions noted the lost opportunity to make more ambitious improvements to the impairment test.

Questions to EFRAG FR TEG-CFSS

72 At this stage do EFRAG FR TEG – CFSS members have any comments on the key messages on the IASB tentative decisions?

73 Do you envisage any outreach in your jurisdiction once the ED is published?