

IFRS Foundation
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

28 June 2024

EFRAG Sustainability Reporting Board
35 Square de Meeüs
1000 Brussels
Belgium

Exposure Draft: Business Combinations – Disclosures, Goodwill and Impairment

The Danish Funding Mechanism for EFRAG consisting of the above-mentioned organisations representing large parts of the Danish Business Community and both preparer and user perspectives (we) welcome the opportunity to comment on the IASB's Exposure Draft: Business Combinations – Disclosures, Goodwill and Impairment and EFRAG's draft comment letter.

IFRS 3

In general, we support the IASB's effort to develop more useful and improved disclosures on business combinations for investors, and we appreciate the efforts to strike a right balance between costs for preparers and benefits for users.

We disagree, however, with the proposed rules-based approach and thresholds for defining strategic business combinations, some of the proposed disclosure requirements, e.g. quantitative information on synergies, and question the location of the new proposed disclosures.

In our opinion, the proposed rules-based approach risk determining acquisitions as strategic even though they are not regarded and consequently not reviewed as strategic acquisitions by management.

As regards location, it is in our opinion more appropriate to present forward-looking, highly uncertain, and subjective disclosures in the management commentary since they will be difficult and disproportionately costly to document and audit. Insisting that such disclosures must be given in the financial statements rather than in the management commentary may lead to unnecessary reluctance from preparers to provide otherwise relevant information to the detriment of the users. In addition, it might introduce litigation risk if included in the financial statements when covered by the true and fair view opinions by management and auditor.

IAS 36

As regards the proposed changes to impairment testing, we are supportive of both introducing the possibility to use a post-tax discount rate and allowing future restructurings and asset enhancements to be included in the value in use calculations. The latter calls, however, for additional guidance and examples to help preparers, auditors, and enforcers assess whether future restructurings/asset enhancements qualify to be included or not.

We question whether the "too little, too late" – issue regarding recognition of impairment losses is solved by the proposed clarifications regarding allocation of goodwill at CGU-level and the proposed additional disclosures, cf. above. The shielding effect is difficult to eliminate in practice since acquired businesses typically are integrated into the existing operations and accounting systems and often only monitored at segment level. We recommend IASB to reconsider whether the "too little, too late" – issue would be best solved by reintroducing amortization of goodwill.

Please see our more detailed responses to the raised questions below.

Kind regards,
The Danish Funding Mechanism for EFRAG

Confederation of Danish Industry
Tina Aggerholm

Insurance & Pension Denmark
Anne-Mette Munck

FSR – Danish Auditors
Marianne Ploug

Danish Chamber of Commerce
Mikkel Møller Rasmussen

Finance Denmark
Martin Thygesen

Question 1—Disclosures: Performance of a business combination (proposed paragraphs B67A–B67G of IFRS 3)

In the PIR of IFRS 3 and in responses to the Discussion Paper the IASB heard that:

- users need better information about business combinations to help them assess whether the price an entity paid for a business combination is reasonable and how the business combination performed after acquisition. In particular, users said they need information to help them assess the performance of a business combination against the targets the entity set at the time the business combination occurred (see paragraphs BC18–BC21).
- preparers of financial statements are concerned about the cost of disclosing that information. In particular, preparers said the information would be so commercially sensitive that its disclosure in financial statements should not be required and disclosing this information could expose an entity to increased litigation risk (see paragraph BC22).

Having considered this feedback, the IASB is proposing changes to the disclosure requirements in IFRS 3 that, in its view, appropriately balance the benefits and costs of requiring an entity to disclose this information. It therefore expects that the proposed disclosure requirements would provide users with more useful information about the performance of a business combination at a reasonable cost.

In particular, the IASB is proposing to require an entity to disclose information about the entity's acquisition-date key objectives and related targets for a business combination and whether these key objectives and related targets are being met (information about the performance of a business combination). The IASB has responded to preparers' concerns about disclosing that information by proposing:

- to require this information for only a subset of an entity's business combinations – strategic business combinations (see question 2); and
- to exempt entities from disclosing some items of this information in specific circumstances (see question 3).

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

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

We support the split of business combinations into strategic and other business combinations and only requiring disclosures on subsequent performance from the strategic acquisitions. As mentioned in our comments to question 2, we do, however, not agree with the proposed thresholds and the rules-based approach for determining strategic business combinations.

In addition, we question whether it is appropriate to require that the proposed disclosures shall be included in the financial statements. The proposed disclosures will often be forward-looking, highly uncertain, and subjective and thus both difficult and disproportionately costly to document and audit. Further, the proposed disclosures represent in our view alternative information rather than additional information about the line items presented in the primary financial statements as otherwise required in IFRS 18, para 17, explaining the role of the financial statements notes:

“The role of the notes is to provide material information necessary: (a) to enable users of financial statements to understand the line items presented in the primary financial statements (see paragraph B6); and (b) to supplement the primary financial statements with additional information to achieve the objective of financial statements (see paragraph B7).”

The appropriate location of the proposed disclosures would in our opinion be in the management commentary. Thus, we recommend the IASB to include the proposed disclosure requirements in the “IFRS Practice Statement: Management Commentary” rather than in IFRS 3.

Irrespective of the location, we have severe concerns regarding the requirement to disclose quantitative information on expected synergies (para 36 (da)). We acknowledge that companies already today must provide qualitative information on synergies, but it is a completely different task to have to give quantitative information specified on different types of synergies given synergies nature of being forward-looking, highly uncertain and subjective.

We strongly recommend IASB not to introduce the proposed requirements about quantitative synergies. If IASB, however, insists on introducing the requirements, they should only be introduced for strategically important business combinations and IASB should develop a clear and unambiguous definition of synergies and the different types of synergies. We acknowledge that it can and shall not be exhaustive, but without a clear definition of synergies and the different types, we foresee many fruitless discussions between preparers, auditors, and enforcers about the calculation of synergies, lack of comparability and unnecessary uncertainty for the users.

In addition, the information on synergies should only be on total level and not specified on individual items. Providing detailed information on synergies might introduce litigation risk as well as risk of breaching legal requirements regarding restructuring, termination of employees and contracts, if such have to be disclosed in the annual report before the initiation of the legal proceedings, negotiations etc. Furthermore, the expected synergies will usually change and materialise differently during the integration process when management gain detailed information of the acquired business. Too detailed information might thereby not provide accurate information.

Finally, we recommend the IASB to carry out a comprehensive field-testing to ensure that the proposed disclosures can be provided without unproportionate costs and efforts for the preparers, are relevant for the users and auditable for the auditors.

Question 2—Disclosures: Strategic business combinations (proposed paragraph B67C of IFRS 3)

The IASB is proposing to require an entity to disclose information about the performance of a business combination (that is, information about the entity's acquisition-date key objectives and related targets for the business combination and whether these key objectives and related targets are being met) for only strategic business combinations – a subset of material business combinations. A strategic business combination would be one for which failure to meet any one of an entity's acquisition-date key objectives would put the entity at serious risk of failing to achieve its overall business strategy.

The IASB is proposing that entities identify a strategic business combination using a set of thresholds in IFRS 3 – a business combination that met any one of these thresholds would be considered a strategic business combination (threshold approach) (see paragraphs BC56–BC73).

The IASB based its proposed thresholds on other requirements in IFRS Accounting Standards and the thresholds regulators use to identify particularly important transactions for which an entity is required to take additional steps such as providing more information or holding a shareholder vote. The proposed thresholds are both quantitative (see paragraphs BC63–BC67) and qualitative (see paragraphs BC68–BC70).

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

We support distinguishing between strategic business combinations and other business combinations and only requiring disclosures on the subsequent performance from the strategic acquisitions. Further, we support the IASB's understanding of what constitutes a strategic business combination, as stipulated in BC 54-55:

“A strategic business combination would be one for which failure to meet any one of an entity's acquisition-date key objectives would put the entity at serious risk of failing to achieve its overall business strategy.”

In the IASB's view, strategic business combinations would capture business combinations of significant strategic value to an entity. An entity's overall business strategy could be put at serious risk if, for example, the entity: a) committed a large amount of capital to a business combination that subsequently failed to meet the entity's expectations; or b) failed to enter major new lines of business or geographies that are essential to the entity's overall business strategy through the business combination.”

The proposed thresholds and the “if any one threshold – approach” does, however, not seem to be aligned with this understanding. A business combination exceeding for

instance the 10 % revenue test or the 10 % asset test will in many cases not “*put the entire business at serious risk of failing to achieve its overall business strategy.*” The 10 % profitability test is even more problematic as it will imply that all business combinations no matter how immaterial are strategic for companies with temporary earnings difficulties and results close to zero.

In our opinion a principle-based approach based on IASB’s understanding stipulated in BC 54-55, cf. above, taking all facts and circumstances, including impacts on revenue, profits, assets, equity, capital, liquidity etc. into consideration would be more appropriate and more in line with the IFRS principle-based accounting rules in general. Rule based approaches often lead to unintended consequences to the detriment of both preparers and users. The proposed rules-based approach risk determining acquisitions as strategic even though they are not regarded and consequently not reviewed as strategic acquisitions by management, e.g. when operating margins are low or when either the acquirer or acquiree have completed transactions, disposal of entities etc. whereby historic revenue or earnings are not representative to the expected future earnings.

If IASB, however, insists on introducing the rules-based approach, we suggest that the “if any one threshold” is replaced by a “two out of three thresholds” in order to mitigate the risk of business combinations being classified as strategic when management does not regard them as strategic and artificial overstatement of the relevance of business combinations.

As regards series of business combinations, we agree that a management approach shall be applied and IASB should abstain from setting additional specific thresholds that likely would conflict with management’s reviewing practices.

Question 3—Disclosures: Exemption from disclosing information (proposed paragraphs B67D–B67G of IFRS 3)

The IASB is proposing to exempt an entity from disclosing some of the information that would be required applying the proposals in this Exposure Draft in specific circumstances. The exemption is designed to respond to preparers' concerns about commercial sensitivity and litigation risk but is also designed to be enforceable and auditable so that it is applied only in the appropriate circumstances (see paragraphs BC74–BC107).

The IASB proposes that, as a principle, an entity be exempt from disclosing some information if doing so can be expected to prejudice seriously the achievement of any of the entity's acquisition-date key objectives for the business combination (see paragraphs BC79–BC89). The IASB has also proposed application guidance (see paragraphs BC90–BC107) to help entities, auditors and regulators identify the circumstances in which an entity can apply the exemption.

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

We support the introduction of the exemption from disclosing information and agree that it shall cover the requirement to provide quantitative information on synergies (B64(ea)), if retained, cf. above. We question, however, why only a part of the disclosure requirements for strategic business combinations is covered. In our opinion all the disclosure requirements for strategic business combination should be covered by the exemption. For instance, it is not only the formal “*statement of whether actual performance is meeting or has met the acquisition-date key objectives and related targets*” (B67A(ii)) that in some situations may seriously prejudice achievement of key objectives, cf. the textbox above, but obviously also the “*information about actual performance being reviewed to determine whether acquisition-date key objectives and the related targets are being met*” (B67A(i)).

As regards litigation risk, we take note of IASB's view in BC83 that litigation risk arising from an entity failing to meet its acquisition-date key objectives for a business combination, because it disclosed the information, cf. BC82, (a), would be addressed by the exemption. We question, however, why other types of litigation risk shall not be covered by the exemption. This could have severe consequences for future acquisitions. Share Purchase Agreements (SPAs) often have strict clauses on confidentiality which the acquirer potentially risk violating when providing the proposed disclosures.

Further, we recommend IASB to include guidance and examples of what qualifies as “seriously prejudicial”, cf. above, instead of only giving guidance on what does not qualify,

to assist preparers, auditors, and enforcers and thereby improve comparability. Without such additional “positive” guidance and examples, we are concerned that it in practice will be overly hard / nearly impossible for the preparers to be allowed to use the exemption.

<p>Question 4—Disclosures: Identifying information to be disclosed (proposed paragraphs B67A–B67B of IFRS 3)</p> <p>The IASB is proposing to require an entity to disclose information about the performance of the entity’s strategic business combinations (that is, information about its acquisition-date key objectives and related targets for a strategic business combination and whether these key objectives and related targets are being met) that is reviewed by its key management personnel (see paragraphs BC110–BC114).</p> <p>The IASB’s proposals would require an entity to disclose this information for as long as the entity’s key management personnel review the performance of the business combination (see paragraphs BC115–BC120).</p> <p>The IASB is also proposing (see paragraphs BC121–BC130) that if an entity’s key management personnel:</p> <ul style="list-style-type: none">• do not start reviewing, and do not plan to review, whether an acquisition-date key objective and the related targets for a business combination are met, the entity would be required to disclose that fact and the reasons for not doing so;• stop reviewing whether an acquisition-date key objective and the related targets for a business combination are met before the end of the second annual reporting period after the year of acquisition, the entity would be required to disclose that fact and the reasons it stopped doing so; and• have stopped reviewing whether an acquisition-date key objective and the related targets for a business combination are met but still receive information about the metric that was originally used to measure the achievement of that key objective and the related targets, the entity would be required to disclose information about the metric during the period up to the end of the second annual reporting period after the year of acquisition. <p>(a) Do you agree that the information an entity should be required to disclose should be the information reviewed by the entity’s key management personnel? Why or why not? If not, how do you suggest an entity be required to identify the information to be disclosed about the performance of a strategic business combination?</p> <p>(b) Do you agree that:</p> <ul style="list-style-type: none">(i) an entity should be required to disclose information about the performance of a business combination for as long as the entity’s key management personnel review that information? Why or why not?(ii) an entity should be required to disclose the information specified by the proposals when the entity’s key management personnel do not start or stop reviewing the achievement of a key objective and the related targets for a strategic business combination within a particular time period? Why or why not?
--

Acquired businesses are in many situations, especially when not strategic business combinations, within a relatively short time integrated into the existing operations and accounting systems and subsequently not separately monitored by the key management personnel. On this basis, we agree with the proposed basic principle that disclosures shall only be provided, if received and reviewed by the key management personnel.

To avoid information overload, it could, however, also be considered to set an explicit backstop that would apply even if the disclosures were still received and reviewed by the key management personnel, for instance 5 years.

Question 5—Disclosures: Other proposals
<p>The IASB is proposing other amendments to the disclosure requirements in IFRS 3. These proposals relate to:</p> <p><i>New disclosure objectives (proposed paragraph 62A of IFRS 3)</i></p> <p>The IASB proposes to add new disclosure objectives in proposed paragraph 62A of IFRS 3 (see paragraphs BC23–BC28).</p> <p><i>Requirements to disclose quantitative information about expected synergies in the year of acquisition (proposed paragraph B64(ea) of IFRS 3)</i></p> <p>The IASB proposes:</p> <ul style="list-style-type: none">• to require an entity to describe expected synergies by category (for example, revenue synergies, cost synergies and each other type of synergy);• to require an entity to disclose for each category of synergies:<ul style="list-style-type: none">• the estimated amounts or range of amounts of the expected synergies;• the estimated costs or range of costs to achieve these synergies; and• the time from which the benefits expected from the synergies are expected to start and how long they will last; and• to exempt an entity from disclosing that information in specific circumstances. <p>See paragraphs BC148–BC163.</p> <p><i>The strategic rationale for a business combination (paragraph B64(d) of IFRS 3)</i></p> <p>The IASB proposes to replace the requirement in paragraph B64(d) of IFRS 3 to disclose the primary reasons for a business combination with a requirement to disclose the strategic rationale for the business combination (see paragraphs BC164–BC165).</p> <p><i>Contribution of the acquired business (paragraph B64(q) of IFRS 3)</i></p> <p>The IASB proposes to amend paragraph B64(q) of IFRS 3 to improve the information users receive about the contribution of the acquired business (see paragraphs BC166–BC177). In particular, the IASB proposes:</p> <ul style="list-style-type: none">• to specify that the amount of profit or loss referred to in that paragraph is the amount of operating profit or loss (operating profit or loss will be defined as part of the IASB’s Primary Financial Statements project);• to explain the purpose of the requirement but add no specific application guidance; and• to specify that the basis for preparing this information is an accounting policy. <p><i>Classes of assets acquired and liabilities assumed (paragraph B64(i) of IFRS 3)</i></p> <p>The IASB proposes to improve the information entities disclose about the pension and financing liabilities assumed in a business combination by deleting the word ‘major’ from paragraph B64(i) of IFRS 3 and adding pension and financing liabilities to the illustrative example in paragraph IE72 of the Illustrative Examples accompanying IFRS 3 (see paragraphs BC178–BC181).</p>

As mentioned in our comments to question 1, we disagree with the proposal to require quantitative information on expected synergies. Please refer to these comments.

As regards the requirement in B64(q) (ii), we take note of the clarification regarding “operating profit” but question this proforma disclosure requirement altogether. In most cases it is highly complicated, burdensome, and subjective to calculate the revenue and (operating) profit or loss of the combined entity as if the acquisition date had occurred as of the beginning of the annual reporting period. Typically, the acquirer does not have access to the necessary data relating to the period before control of the acquiree was gained.

On this basis, we suggest that the requirement is either deleted or as a minimum modified to reflect the uncertain and judgmental character of these disclosures. In this regard, the proposal to specify that the basis for preparing the proforma information is an accounting policy, is a step in the wrong direction. Availability of data and the consequently possible approaches varies from business combination to business combination which cannot be reflected in an accounting policy.

Question 6—Changes to the impairment test (paragraphs 80–81, 83, 85 and 134(a) of IAS 36)

During the PIR of IFRS 3, the IASB heard concerns that the impairment test of cash-generating units containing goodwill results in impairment losses sometimes being recognised too late.

Two of the reasons the IASB identified (see paragraphs BC188–BC189) for these concerns were:

- shielding; and
- management over-optimism.

The IASB is proposing amendments to IAS 36 that could mitigate these reasons (see paragraphs BC192–BC193).

Proposals to reduce shielding

The IASB considered developing a different impairment test that would be significantly more effective at a reasonable cost but concluded that doing so would not be feasible (see paragraphs BC190–BC191).

Instead, the IASB is proposing changes to the impairment test (see paragraphs 80–81, 83 and 85 of IAS 36) to reduce shielding by clarifying how to allocate goodwill to cash-generating units (see paragraphs BC194–BC201).

Proposal to reduce management over-optimism

The IASB's view is that management over-optimism is, in part, better dealt with by enforcers and auditors than by amending IAS 36. Nonetheless, the IASB is proposing to amend IAS 36 to require an entity to disclose in which reportable segment a cash-generating unit or group of cash-generating units containing goodwill is included (see paragraph 134(a) of IAS 36). The IASB expects this information to provide users with better information about the assumptions used in the impairment test and therefore allow users to better assess whether an entity's assumptions are over-optimistic (see paragraph BC202).

- (a) Do you agree with the proposals to reduce shielding? Why or why not?
- (b) Do you agree with the proposal to reduce management over-optimism? Why or why not?

Question 7—Changes to the impairment test: Value in use (paragraphs 33, 44–51, 55, 130(g), 134(d)(v) and A20 of IAS 36)

The IASB is proposing to amend how an entity calculates an asset's value in use. In particular, the IASB proposes:

- to remove a constraint on cash flows used to calculate value in use. An entity would no longer be prohibited from including cash flows arising from a future restructuring to which the entity is not yet committed or cash flows arising from improving or enhancing an asset's performance (see paragraphs BC204–BC214).
 - to remove the requirement to use pre-tax cash flows and pre-tax discount rates in calculating value in use. Instead, an entity would be required to use internally consistent assumptions for cash flows and discount rates (see paragraphs BC215–BC222).
- (a) Do you agree with the proposal to remove the constraint on including cash flows arising from a future restructuring to which the entity is not yet committed or from improving or enhancing an asset's performance? Why or why not?
- (b) Do you agree with the proposal to remove the requirement to use pre-tax cash flows and pre-tax discount rates in calculating value in use? Why or why not?

As mentioned in the beginning of this comment letter, we support both introducing the possibility to use a post-tax discount rate and allowing future restructurings and asset enhancements to be included in the value in use calculations. The latter calls, however, for additional guidance and examples to help preparers, auditors, and enforcers assess whether future restructurings/asset enhancements qualify to be included or not. For instance, more guidance is needed to understand the interaction between the new possibilities to include future restructurings and asset enhancements while at the same time retaining the requirement in para 44 that “*future cash flows shall be estimated for the asset in its current condition*”.

While the responsibility for the financial statements initially lies with the management, we agree that cases of management over-optimism shall be addressed by auditors and enforcers rather than by additional standard setting.

We question whether the “too little, too late” – issue regarding impairment losses is solved by the proposed clarifications regarding allocation of goodwill at CGU-level and the proposed additional disclosures, cf. above. The shielding effect is difficult to eliminate in practice since acquired businesses typically are integrated into the existing operations and often only monitored at segment level. We recommend IASB to reconsider whether the “too little, too late” – issue would be best solved by reintroducing amortization of goodwill.

<p>Question 8—Proposed amendments to IFRS X <i>Subsidiaries without Public Accountability: Disclosures</i></p> <p>The IASB proposes to amend the forthcoming IFRS X <i>Subsidiaries without Public Accountability: Disclosures</i> (Subsidiaries Standard) to require eligible subsidiaries applying the Subsidiaries Standard to disclose:</p> <ul style="list-style-type: none">• information about the strategic rationale for a business combination (proposed paragraph 36(ca) of the Subsidiaries Standard);• quantitative information about expected synergies, subject to an exemption in specific circumstances (proposed paragraphs 36(da) and 36A of the Subsidiaries Standard);• information about the contribution of the acquired business (proposed paragraph 36(j) of the Subsidiaries Standard); and• information about whether the discount rate used in calculating value in use is pre-tax or post-tax (paragraph 193 of the Subsidiaries Standard). <p>See paragraphs BC252–BC256.</p> <p>Do you agree with the proposals? Why or why not?</p>

Our comments above, including our reservations regarding quantitative information on synergies, are also valid for these requirements.

Question 9—Transition (proposed paragraph 64R of IFRS 3, proposed paragraph 140O of IAS 36 and proposed paragraph B2 of the Subsidiaries Standard)

The IASB is proposing to require an entity to apply the amendments to IFRS 3, IAS 36 and the Subsidiaries Standard prospectively from the effective date without restating comparative information. The IASB is proposing no specific relief for first-time adopters. See paragraphs BC257–BC263.

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

We agree with the proposed prospective application.