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## **Disclosures: business combinations, goodwill and impairment**

### **Issues Paper**

#### **Purpose of this paper**

- 1 The purpose of this paper is to seek input from EFRAG CFSS and EFRAG TEG on disclosures about business combinations and goodwill and impairment in preparation for the July 2018 ASAF meeting. In particular, the paper seeks views on:
  - (a) Disclosures that the IASB tentatively decided to consider;
  - (b) Additional disclosures the IASB Staff are considering; and
  - (c) Other disclosures, not identified above, that can improve the information for users on business combinations including goodwill and impairment without imposing costs on preparer that exceed the benefits.
- 2 In addition to this paper, **agenda paper 13-02** (presentation for the ASAF meeting prepared by the IASB Staff) has been made available for this session.

#### **IASB tentative decisions**

- 3 The IASB has discussed a number of possible approaches to improve the quality of information provided to investors through disclosures about business combinations, goodwill and impairment in response to stakeholder feedback during and after its post-implementation review of IFRS 3 *Business Combinations*.
- 4 Specifically, investors reported that there was insufficient information about the key drivers that justified the consideration paid and whether the acquisition had been successful. Preparers on the other hand cautioned about having to provide more information than already required under current IFRS Standards.
- 5 At its meeting in December 2017, the IASB tentatively decided to consider introducing requirements for an entity to disclose:
  - (a) **Premium paid** - Reasons for paying a premium in a business combination, key targets supporting the purchase consideration and comparison of actual performance with targets;
  - (b) **Breakdown of goodwill amounts** - Breakdown of the carrying amount of goodwill by past business combination explaining why the carrying amount of goodwill is recoverable; and
  - (c) **Headroom** - Disclosing the headroom of a business combination each year.
- 6 These tentative decisions were made at a time when the IASB was still developing the headroom approach (later called the updated headroom approach), as well as

simplifications to the value in use (VIU) calculation in IAS 36 *Impairment of Assets*. At this stage, it is unclear whether the updated headroom approach will be developed further given the resistance from preparers due to the costs involved and the lack of support from investors.

*Premium paid- Reasons for paying of premium, key targets supporting the purchase considerations and comparison of actual performance with targets*

- 7 The IASB tentatively decided to require the following information:
- (a) The reasons for payment of premium over and above the value of the net identifiable assets.
  - (b) The key performance assumptions or targets supporting the purchase price paid (and the amount of goodwill recognised). These might include the level of expected revenues of the acquiree (if the acquiree is not integrated), increases in revenue for an existing operating segment that benefits from the acquisition, and cost savings through economies of scale.
  - (c) A comparison of actual performance against the key performance targets for a number of years following the acquisition. The comparison period could be decided by management subject to a minimum period.
- 8 Although users support having more information about the acquired business, many preparers have expressed concerns that for those disclosures to be meaningful an entity would have to disclose commercially sensitive information, and for this reason they would probably resort to boilerplate information. Furthermore, preparers explained that changes in the business after a business combination could make it difficult to track the information post-acquisition.

*Breakdown of goodwill and explanation justifying recoverability*

- 9 Several users said that disaggregation of the carrying amount of goodwill by each past business combination would highlight goodwill from acquisitions that investors consider as unsuccessful.
- 10 To respond to this request, the IASB tentatively decided to require a breakdown of the amount of goodwill by business combination, with an explanation for each combination, of why management considers that the amount of goodwill is recoverable, and consider evidence that justifies ongoing synergies and going concern from prior business combinations. However, the IASB acknowledged that these disclosures could be costly because it may be difficult to isolate the benefits arising from those combinations especially in cases of reorganisations and changes to the group structure over time.
- 11 Users have reported that they support a breakdown of goodwill. However, preparers have questioned the usefulness of the information, especially long after a business combination.

*Disclosing the headroom each year*

- 12 Currently, IAS 36 requires disclosure about the headroom only when a reasonably possible change in a key assumption, would cause the carrying amount of the cash generating unit (CGU) to exceed its recoverable amount.
- 13 The IASB tentatively decided to require disclosure of the unrecognised headroom for a CGU (or group of CGU's) on an annual basis. This information, together with other disclosures, would help users to assess the reliability of the goodwill impairment test. The IASB observed that headroom information is generally

available from the current impairment testing model, although in some circumstances determining the precise headroom may involve some additional costs to obtain a precise recoverable amount.

- 14 The EFRAG Secretariat thinks that any decision around 'headroom disclosure' should also depend on whether the IASB decides to abandon or further develop the updated headroom proposal.

*Previous TEG/CFSS/ASAF discussions*

- 15 EFRAG TEG/CFSS were broadly supportive of the IASB's tentative decisions on improving disclosure requirements for goodwill and impairments when these were briefly discussed at its meetings in March and April 2018.
- 16 Similarly, ASAF members were supportive of improvements to the disclosure requirements but expressed some concerns on the IASB's tentative decisions. Some ASAF members suggested a more fundamental review to determine the extent to which the existing disclosures in IFRS 3 and IAS 36 were helpful for users (or not helpful) before developing additional disclosures, which could perhaps replace some of the existing requirements.

**IASB Staff proposals for additional improvements to disclosure**

- 17 Based on recent feedback from users the IASB Staff are considering the following additional possible disclosures:
- (a) **Amount of revenue and operating profit of the acquisition** - The information would be required for the first few years after the business combination. The IASB Staff observed that:
- (i) Investors could assess whether the entity effectively allocated its capital through the transaction which would help them to assess the economics of the business combination; and
  - (ii) There are no incremental costs for preparers because many entities would be tracking that information internally. However, it would require further discussion because operating profit is not defined in IFRS.
- IFRS 3 already requires similar disclosure in term of: i) revenue and profit or loss for the acquisition period and ii) revenue and profit or loss of the combined entity for the acquisition period.
- (b) **Debt assumed for each acquisition** - Currently, IAS 7 *Statement of Cash Flows* (amended in 2016) requires the total amount of debt assumed to be disclosed but not the amount of debt assumed for each individual combination. Disclosing for each acquisition would permit investors to better assess the total capital employed in a business combination without increasing the costs because preparers already have this information.
- (c) **Effective tax rate** - Disclosure of the effective tax rate on the underlying operating profit of the acquired business to help investors to assess potential performance of the combination more precisely. However, it would probably add additional costs to preparers because calculating the effective tax rate for each business combination could be complex and require additional work.
- 18 The EFRAG Secretariat notes that disclosure of the amount of revenue and operating profit of the acquisition may duplicate the disclosure on the comparison of actual performance against key performance targets. It is therefore important to examine the proposed package of disclosure as a whole.

- 19 In addition, other possible disclosures considered by the IASB Staff, but not discussed in detail in the ASAF paper, are set out below:
- (a) Disclosure of indicators that triggered the quantitative impairment test;
  - (b) Improvements to the disclosure requirements in IFRS 8 *Operating Segment*; and
  - (c) Disclosure of total net assets, less goodwill.
- 20 The EFRAG Secretariat notes that under IAS 36 the goodwill impairment test is required regardless of the existence of indicators.

**Other possible disclosures suggested in the EFRAG, OIC, ASBJ 2014 Discussion paper: *Should goodwill still not be amortised?***

- 21 In July 2014, a Research Group from the European Financial Reporting Advisory Group (EFRAG), the Organismo Italiano di Contabilità (OIC), and the Accounting Standards Board of Japan (ASBJ) (collectively, the EFRAG/OIC/ASBJ Research Group) published a discussion paper (the DP): “*Should goodwill still not be amortised? – Accounting and Disclosure for goodwill*”.
- 22 The DP, among the other things, suggested a number of possible new disclosures about impairment testing for goodwill, although it also highlighted that additional disclosure should be justified from a cost-benefit perspective given that disclosure under IAS 36 and IFRS 3 was already quite extensive. New disclosures should focus on user needs and provide information that assists users to:
- (a) Understand the robustness of the modelling and the entity’s assumptions;
  - (b) Confirm the reasonableness of the entity’s past assumptions; and
  - (c) Predict future goodwill impairment.

*Robustness of the modelling and the entity’s assumptions*

- 23 This information could include:
- (a) **Timing profile of value in use (VIU):** information about estimates used to calculate the VIU and the terminal value, so that users can understand how much of it is supported by cash flows in the short and longer term.
  - (b) **Discount rate:** information on how the discount rate was determined, although IAS 36 already requires information on key assumptions of cash flow projections. The objective would be to help users better understand how the rates were determined.

*Reasonableness of the entity’s past assumptions*

- 24 This could include an **analysis of variances**, explaining the differences between the forecast and actual results of the current period or a cumulative basis since the date of the acquisition. The purpose would be to help users assess goodwill impairment.

*Predicting future goodwill impairment*

- 25 This information could include:
- (a) **Information on performance of the acquired business:** provide a predictive value given the correlation between performance of the acquired business and the timing of goodwill impairment. However, the DP noted that

this information might not be available, or become irrelevant after the acquired business is integrated into the acquiring entity's operations.

- (b) **Expected timing of impairment:** the time period over which the acquisition expects to consume the excess earnings from the synergies existing at the acquisition date (expected payback period). This could help reduce any incentive to defer the recognition of goodwill impairment losses.
- (c) **Acquisition characteristics that point to future impairment:** in some cases the goodwill could include an overpayment for which the likelihood of impairment is higher. Disclosing some characteristics of the original acquisition might help provide an indication of possible overpayment. For instance, the amount of the premium paid over the acquiree's market price.
- (d) **Reconciliation of total goodwill:** a reconciliation of the total goodwill allocation to the CGUs, which could be useful in the case of the disposal of businesses or modification in the composition of the CGUs.

26 The feedback received on the DP disclosure was mixed. Some respondents considered that no additional disclosure would be justified in terms of cost-benefit balance. Others supported new disclosures, but only after assessing the needs of users and expressed concerns about potential commercial harm to the entities such as the information on key assumptions.

#### **EFRAG Secretariat observations and analysis**

27 The combined disclosure proposals discussed above are summarised as follows:

<b>IASB tentative decisions</b>	Premium paid for the business combination
	Breakdown of goodwill per business combination
	Headroom
<b>IASB Staff proposals</b>	Amount of revenue and operating profit
	Debt assumed for each business combination
	Effective tax rate
	Other possible disclosure
<b>DP proposals</b>	Understand the robustness of the modelling and the entity's assumptions
	Help users confirm the reasonableness of the entity's past assumptions
	Assist users to predict future goodwill impairment

28 The EFRAG Secretariat notes that each disclosure proposal implies a cost-benefit trade-off. In our view, developing a set of disclosure objectives would provide a helpful roadmap. Each proposed disclosure, alone or in combination, could improve the understanding of the effects of each business combination. For instance, the first two IASB's tentative decisions in paragraphs 5(a) and 5(b) (premium paid and breakdown of goodwill amounts) could provide useful information to users to help assess the expected timing of goodwill impairment.

- 29 While the IASB Staff proposals are based on users' input, the EFRAG Secretariat recommends more work on the cost-benefit analysis to test the overall 'disclosure menu', comprising the IASB's tentative decisions, additional IASB Staff and other disclosure suggestions.
- 30 Furthermore, the IASB should consider the interaction with the other IASB's tentative decisions on the goodwill and impairment project. For instance, the benefit of the headroom disclosure in paragraph 13 largely depends on the IASB's decision on the updated headroom approach as its role in the goodwill impairment test. Similarly simplifications to the VIU calculation being considered by the IASB may require a change to existing (or additional) disclosure.
- 31 Finally, we think that some of the disclosures proposed by the IASB are similar to those contained in the DP, such as the information on key performance forecasts and expected or reconciliation of goodwill, which together with the other disclosures could be considered by IASB and be brought as suggestions to the July 2018 ASAF meeting.

**Questions for EFRAG TEG-CFSS**

- 32 Do you agree with the IASB's tentative decisions on disclosures?
- 33 Do you have any comments or feedback on those disclosures and on the additional possible disclosures that the IASB Staff are considering further?
- 34 Do you agree that the majority of the disclosures suggested in the DP might be considered for the July 2018 ASAF meeting? Do you have any new ideas or suggestions about other possible disclosures that can provide better and timely information about business combination, goodwill and impairment for users without imposing costs on preparers that exceed the benefits?