January 2023

In brief

Business Combinations—Disclosures, Goodwill and Impairment

Project update

The IASB's Business Combinations—Disclosures, Goodwill and Impairment project aims to help companies provide users of financial statements (investors) with more useful information about the mergers and acquisitions (business combinations) companies make, at a reasonable cost.

Following its review of feedback on the Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment*, the International Accounting Standards Board (IASB) decided to prioritise examining:

- how companies could disclose better information about business combinations; and
- whether to retain the impairment-only model to account for goodwill or to explore reintroducing amortisation of goodwill.[1]

The IASB recently made decisions on those two topics and, in its December 2022 meeting, decided to move the project to its standard-setting work plan.

In this update, Rika Suzuki, a member of the IASB, discusses the IASB's decisions regarding these two topics, the reasons it made those decisions and the additional work the IASB plans to do before publishing an exposure draft of related proposals.

Why did we start this project?

We started this project after completing our Post-implementation Review (PIR) of IFRS 3 *Business Combinations*. In response to stakeholder feedback, we researched whether:

- companies could provide better information about business combinations to investors, in particular, information on the subsequent performance of a business combination;
- we could make the impairment test more effective at recognising impairment losses on goodwill on a timely basis and at a reasonable cost;
- we should reintroduce amortisation of goodwill;
- we should amend the impairment test to reduce its cost and complexity; and
- companies should include some intangible assets within goodwill.

What is a PIR?

The IASB, as part of its due process, performs a PIR after a new Accounting Standard or a major amendment to an Accounting Standard has been applied internationally for at least two years.

The objective of a PIR is to assess whether the effects of applying the new requirements on investors, preparers, auditors and regulators are as the IASB intended when developing those requirements.

1 Reintroducing amortisation of goodwill means reintroducing a model that includes amortisation of goodwill and an impairment test.

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In March 2020, we published our preliminary views on the topics within the scope of the project in our Discussion Paper. In response to feedback from stakeholders on our preliminary views, we prioritised two topics because of their significance to meeting the project's objective, namely:

- how companies could disclose better information about business combinations; and
- whether to retain the impairment-only model to account for goodwill or to explore reintroducing amortisation of goodwill.

This update focuses on our decisions regarding these two topics and our reasons for making those decisions.

What did we decide?

Disclosures about business combinations

Our preliminary views in the Discussion Paper were to require a company to disclose in the year of acquisition:

- the amount of synergies expected from a business combination;
- management's objectives for a business combination; and
- the metrics and targets management plan to use in its internal reporting to monitor whether these objectives are being achieved.

In subsequent reporting periods, a company would be required to disclose their progress in achieving the objectives using those metrics.

Almost all investors agreed with our preliminary views. They said that, currently, they do not get enough useful information, particularly about the subsequent performance of business combinations, and the information described in the Discussion Paper would help them better understand the rationale of the business combination and to hold management to account for those business combinations.

However, many stakeholders, particularly preparers, had concerns about providing such information. Their main concerns were:

- commercial sensitivity—that some of the information, if disclosed, could harm the company, for example because competitors would use the information to prevent a company from achieving its objectives for the business combination;
- forward-looking information—that the information could be about the future and if disclosed could increase litigation risk; and
- integration—that information representing the performance of a business combination might not be available if the acquired business were integrated into the company's operations, because separate information about the acquired business is no longer reported.

We spent time with our stakeholders to better understand these concerns and then considered how we could respond to these concerns. At our September 2022 meeting, we made decisions on how to amend our preliminary views to balance these concerns with investors' needs for better information about business combinations.

Exemption

We decided to exempt companies from disclosing some of the information required in specific circumstances. A company could choose not to disclose information about management's objectives, the metrics and targets management plans to use to monitor the business combination, and quantitative information about expected synergies. The company would, however, still be required to disclose information about the performance of the business combination in subsequent periods. We intend to allow a company to use this exemption only if disclosure of that information can be expected to prejudice seriously the achievement of the objectives of the business combination.

We also discussed application guidance to help ensure the exemption is used only in appropriate circumstances. For example, we discussed whether to specify when a company would not be allowed to use the exemption and any disclosures a company would need to make when using the exemption.[2]

We think the exemption would help allay companies' concerns about commercially sensitive information and the litigation risk that could arise in some circumstances.

Subset

When we developed our preliminary views, we tried to respond to concerns we heard at the time about the cost of providing the information described in the Discussion Paper for all material business combinations. Some investors said they need this information only for 'major' or 'fundamental' business combinations. Our preliminary views would have resulted in a company disclosing this information for the business combinations its chief operating decision maker (CODM) reviewed and we thought this would result in companies disclosing the most important information for the most important business combinations.[3]

However, we received mixed views on whether review by the CODM was the appropriate way to identify the business combinations for which the information should be disclosed.

We still think the information should be required for only a subset of material business combinations to help reduce companies' costs and to balance the costs with the benefits of providing the information.

In response to the feedback, we decided to amend our preliminary views so that a company would be required to disclose:

- management's objectives for the business combination;
- the metrics and targets management plans to use to monitor the business combination; and
- progress in subsequent reporting periods in achieving the objectives using those metrics,

only for 'strategically important' business combinations.[4]

A 'strategically important' business combination would be one that:

- meets any one of three quantitative thresholds—the acquiree's revenue or the acquiree's operating profit (to be defined by our Primary Financial Statements project) or the assets recognised (including goodwill) on acquisition, exceed 10% of the acquirer's equivalent measures; or
- results in a company entering a new geographical area of operations or a new major line of business.

In developing our preliminary views we considered concerns about integration. The preliminary views describe a management approach and the information required to be disclosed would be based on how management are monitoring the business combination. If the business combination were integrated, management might use combined information to monitor the business combination and the company would disclose the combined information (not the separate information for the acquired business).

Requiring a company to disclose some of the information for only 'strategically important' business combinations would also help with integration because the probable effect of such business combinations on the combined business' performance would be more obvious.

We have additional work to do before finalising our proposals in an exposure draft. We look forward to hearing whether those proposals would appropriately balance investors' needs for better information and the concerns other stakeholders expressed. We are also keen to understand which business combinations would meet our definition of 'strategically important' and whether using this definition would appropriately balance the benefits and costs of providing the information.

2 Further discussions on the application guidance were held at the January 2023 meeting of the International Accounting Standards Board (IASB).

3 Paragraph 7 of IFRS 8 *Operating Segments* discusses the meaning of the term 'chief operating decision maker'.

4 A 'strategically important' business combination is one that, if a company fails to meet the objectives of the business combination, would seriously jeopardise the company achieving its overall business strategy.

Summary of proposed changes to disclosures about business combinations

	All material business combinations	Only 'strategically important' business combinations
Proposed exemption applies	In year of acquisition, quantitative information about expected synergies (expands requirement to disclose qualitative information about factors making up goodwill)	In year of acquisition, information about management's: • objectives; • metrics; and • targets
No proposed exemption	In year of acquisition, strategic rationale for undertaking the business combination (replaces requirement to disclose 'primary reasons for the business combination' in IFRS 3)	In subsequent periods, information about the extent to which management's objectives are being met, using those metrics

Accounting for goodwill

Our preliminary view in the Discussion Paper was to retain the impairment-only model to account for goodwill rather than to reintroduce amortisation of goodwill. Feedback on the Discussion Paper was mixed—many stakeholders agreed with our preliminary view, but many disagreed and said amortisation of goodwill should be reintroduced.[5]

In reconsidering our preliminary view, we were not trying to decide whether the impairment-only model or an amortisation-based model would be better to account for goodwill, as if we were introducing the requirements for the first time. We were deciding whether evidence gathered, since IFRS 3 was issued, provided a compelling case for change. This is because frequent changes back and forth between the different approaches, resulting in costs of change, would not help our stakeholders.

What is goodwill and how is it accounted for?

When the amount a company pays for a business exceeds the fair value of the identifiable assets and liabilities acquired, the difference is called goodwill and is recognised in the company's balance sheet.

An acquirer is willing to pay for goodwill because it expects to derive other future economic benefits from the acquisition, such as future synergies or benefits that are not reported in the balance sheet separately on acquisition, for example, an assembled workforce.

When the IASB issued IFRS 3 in 2004, it replaced the requirement to amortise goodwill over its useful life with a requirement to test goodwill for impairment at least annually (impairment-only model).

5 Our preliminary view was also that it would not be feasible to design a different impairment test that is significantly more effective than the impairment test in IAS 36 *Impairment of Assets* at recognising impairment losses on goodwill on a timely basis at a reasonable cost.

We considered extensive evidence and feedback gathered during the PIR, in response to our Discussion Paper and throughout the course of this project. In our November 2022 meeting, many IASB members thanked stakeholders for their contributions and some IASB members said there was no more evidence that could be provided on the topic.

In considering whether there was a compelling case to change the accounting for goodwill, we considered two possible objectives for exploring reintroducing amortisation of goodwill:

- improving the information provided about business combinations; and
- reducing costs.

Improving information

The evidence shows that stakeholders continue to hold strong and divergent views about the nature of goodwill and whether it is predominantly a wasting asset or an asset with an indefinite life. Stakeholders therefore have differing views on the appropriate model to account for goodwill.

Stakeholders who view goodwill as predominantly a wasting asset want the model to reflect a steady decline in the value of goodwill and its consumption—an amortisation-based model best meets this objective. Those stakeholders who view goodwill as predominantly an asset that has an indefinite life want the model to reflect that goodwill does not decline in value systematically but reduces in value due to events that do not usually occur consistently over time—an impairment-only model best meets this objective.

In our November 2022 meeting, some of my fellow IASB members commented on the diversity of views and said this diversity would never be reconciled. Some IASB members said the problem is that the nature of goodwill varies by transaction and goodwill can comprise both wasting and indefinite life elements. Opinions also differed about whether companies could reliably estimate the useful life of goodwill and the pattern by which it diminishes—something an amortisation-based model relies upon. Some IASB members accepted that neither an amortisation-based model nor an impairment-only model is perfect.

Many IASB members acknowledged the pros and cons of both models and said the proposals we are developing to require companies to disclose better information about business combinations are what we should focus on in order to make tangible improvements to the information provided to investors.

> I think the impairment model does have informational value; it's not ideal, but there is informational value there … the other argument we heard was that the amortisation model would bring in accountability. I think on both of those scores the point that the disclosure portion of the project actually handles both of those things better really resonates as well.
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> **IASB Member, November 2022 IASB meeting**

One IASB member said the impairment test was not working as the IASB had intended. However, others said that some criticisms of the impairment test arose from a misunderstanding of what the impairment test is designed to achieve.

Some IASB members noted that we are still to explore whether we can improve the impairment test of cash-generating units containing goodwill.

What is the objective of the impairment test of cash-generating units containing goodwill?

IAS 36 *Impairment of Assets* includes requirements for the impairment test and aims to ensure that a company's assets are carried at no more than their recoverable amount.

Goodwill does not generate cash flows independently; instead it contributes to the generation of cash flows in combination with other assets. Thus, the impairment test appropriately focuses on testing the group of assets (called the cash-generating unit), rather than on testing the individual asset.

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The impairment test does not test goodwill directly—this is consistent with the IASB's conclusion that goodwill is measured as a residual because it cannot be directly measured.

Some assertions that the impairment test does not work could possibly be due to unrealistic expectations of what the impairment test can achieve. The impairment test cannot test goodwill directly and cannot reflect the consumption of goodwill for those who consider goodwill a wasting asset.

However, the impairment test ensures that the carrying amounts of goodwill and other assets in the cash-generating unit are recoverable from the cash flows jointly generated by these assets. Concerns that goodwill balances are 'too high' might not be compelling because the impairment test should ensure the assets, collectively, are not overstated.

Reducing costs

We heard from stakeholders that the impairment-only model is costly and complex.

However, feedback on whether reintroducing amortisation of goodwill would reduce costs was mixed. Some IASB members were also concerned that we would face similar difficulties to those the US Financial Accounting Standards Board (FASB) encountered when it recently explored reintroducing amortisation of goodwill.[6] There is therefore doubt regarding how significant a reduction in costs for companies would result from reintroducing amortisation of goodwill.

Many IASB members commented on the importance of maintaining the substantial convergence on this topic between IFRS Accounting Standards and US generally accepted accounting principles. Some said the evidence did not justify divergence. One IASB member reflected on the International Organization of Securities Commissions' public statement in February 2021 encouraging the IASB and the FASB to work together on this topic.

Many IASB members considered the effect that exploring amortisation of goodwill would have on our resources and those of our stakeholders.

On balance, having considered the wealth of evidence we were provided with, we decided we had no compelling case to justify exploring reintroducing amortisation of goodwill—either to improve the information provided to investors or to reduce costs and complexity. We therefore decided to retain the impairment-only model to account for goodwill.

Ten of 11 IASB members agreed with this decision—that is, the case for change was not compelling. Nonetheless, some of those IASB members would, if asked which model they preferred, have supported reintroducing amortisation of goodwill.

My personal thanks

I would like to thank our stakeholders for their contributions to the project thus far.

Their help in explaining the concerns about the proposed disclosures has allowed us to modify those proposals and find a compromise between investor needs and those concerns. I hope our stakeholders agree that the revised proposed disclosures could significantly improve managements' communication with investors regarding business combinations.

On the topic of whether to explore reintroducing amortisation of goodwill, my fellow IASB members and I are very grateful to our stakeholders for providing a wealth of feedback and evidence to help our decision. The final decision was reached after careful consideration of this feedback and evidence.

I hope our stakeholders will continue to join us on this journey as we pursue the objective of our project.

6 The US Financial Accounting Standards Board (FASB) had on its agenda a project on similar topics to the IASB's project. In June 2022, the FASB reviewed the package of leanings they had provided to date, considered their effects on benefits and costs, and decided to deprioritise and remove the project from its technical agenda.

What happens next?

In December 2022, we decided to move the project to our standard-setting work plan, which signals the end of the research phase. We have more work to do, but we believe we have identified a feasible standard-setting solution and are now progressing towards an exposure draft.

In future IASB meetings we will:

- finalise our proposals for improving the disclosures about business combinations.
- consider whether improvements can be made to the impairment test of cash-generating units containing goodwill (for example, by considering ways to ensure goodwill is tested for impairment at an appropriate level). We will also consider whether the test can be simplified.

Once we have made decisions on all the topics in the scope of the project, we will consider the package of tentative decisions and decide whether they meet the project's objective and whether to publish an exposure draft.

To read further information about the project or to receive project updates

Visit the Business Combinations—Disclosures, Goodwill and Impairment project page on the IFRS Foundation's website.

To get in touch

Contact Craig Smith at csmith@ifrs.org.

Follow @IFRSFoundation on Twitter to keep up with changes in the world of IFRS Accounting Standards.

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