IFRS Accounting

Staff paper

Agenda reference: 5

Accounting Standards Advisory Forum meeting

Date	**July 2024**
Project	**Business Combinations—Disclosures, Goodwill and Impairment**
Topic	**Exposure Draft Outreach**
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Purpose of this session

To seek Accounting Standards Advisory Forum (ASAF) members' views on the following aspects of the IASB's proposals included in the Exposure Draft *Business Combinations—Disclosures, Goodwill and Impairment*:

- Identifying strategic business combinations
- Exemption
- Impairment test

Slides 5–9 detail the questions that we would like ASAF members' feedback on.

Information for ASAF members

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Questions

Identifying strategic business combinations (slide 22)

We would like to understand whether the IASB has identified the appropriate quantitative and qualitative thresholds to identify a strategic business combination. Considering feedback from stakeholders in your jurisdiction:

1

a) Do you agree with the threshold approach?

b) Do you think the proposed thresholds would appropriately capture what your stakeholders view as being strategic business combinations? If not, what additional or different quantitative or qualitative thresholds would you suggest considering?

Exemption (slide 24)

We would like to understand if the proposed exemption can be applied in—and only in—those circumstances for which it is appropriate. Considering feedback from stakeholders in your jurisdiction:

2

a) Would the exemption address preparers' concerns with disclosing the information in financial statements? If not, why and what changes would you suggest to the principle and/or application guidance of the proposed exemption?
b) Are there situations in your jurisdiction in which the proposed exemption might be applied but which you view as inappropriate?

Disclosure proposals - overall

3

Considering feedback from stakeholders in your jurisdiction, do you think the proposals to improve disclosures about business combinations would meet investors need for better information while appropriately considering the costs of disclosing that information?

Restructuring and asset enhancement cash flows (slide 35)

The IASB is proposing to remove the restriction on including cashflows from uncommitted future restructuring and asset enhancements. Considering feedback from stakeholders in your jurisdiction:

4

a) Do you think the change would help reduce the complexity of the impairment test while enhancing the relevance of information provided to users?

b) Can you give examples of additional cash flows that would be included applying the proposals?

Impairment test

5

Do you have comments or concerns about the other proposed changes to the impairment test? Considering feedback from stakeholders in your jurisdiction, do you think the proposed changes to IAS 36 would improve the effectiveness and reduce the cost and complexity of the test?

Background

Summary of the Exposure Draft

Objective

- Improve information entities provide about their business combinations at a reasonable cost

Package of proposals

- A package of improved disclosure requirements in IFRS 3 *Business Combinations*
- Changes to the impairment test of cash-generating units containing goodwill in IAS 36 *Impairment of Assets*

Comment period

- Comments requested by 15 July 2024

Better information for better decisions
– increases transparency and usefulness of information

Project history

- **2013–2015** — Post-implementation review of IFRS 3 *Business Combinations*
- **March 2020** — Published Discussion Paper
- **2021–2023** — Consideration of feedback
- **March 2024** — Published Exposure Draft
- **15 July 2024** — Comment letter deadline

Why is the IASB publishing an Exposure Draft?

High value transactions

- Acquisitions—referred to as ‘business combinations’ in IFRS Standards— are often large transactions for the entities involved
- These transactions play a central role in the global economy. For example, deals announced in 2023 totalled $3.2 trillion[1]

Information about acquisition’s performance

Investors receive insufficient information about an acquisition’s performance – investors sometimes use information from impairment test as a proxy to assess an acquisition’s success

Impairment test

Impairment losses on goodwill sometimes recognised too late.

Impairment test complex and costly

Looking Back at M&A in 2023: Who Wins in a Down Year? | Bain & Company

Package of proposals

Proposed changes to IFRS 3

- Disclose information used by key management personnel about performance of **strategic business combinations**
  - Key objectives, targets in year of acquisition
  - Performance against key objectives, targets in subsequent periods
- Other improvements to existing disclosures, including disclosing quantitative information about expected synergies
- **Exempt** an entity from disclosing some information in specific circumstances

Proposed changes to IAS 36

- Clarify how an entity allocates goodwill to cash-generating units (CGU)
- Require entities to disclose which reportable segment contains a CGU
- Simplify value in use calculation

How the package responds to concerns

Information about an acquisition's performance

- Require an entity to disclose information about the performance of an acquisition
- Balance benefit and costs through targeting only strategic acquisitions and proposing an exemption

Concerns about the impairment test

- Proposed disclosure requirements about performance of an acquisition reduce reliance on the impairment test
- Reduce shielding through clarifying how an entity allocates goodwill for testing
- Changes to calculation of value in use to reduce cost

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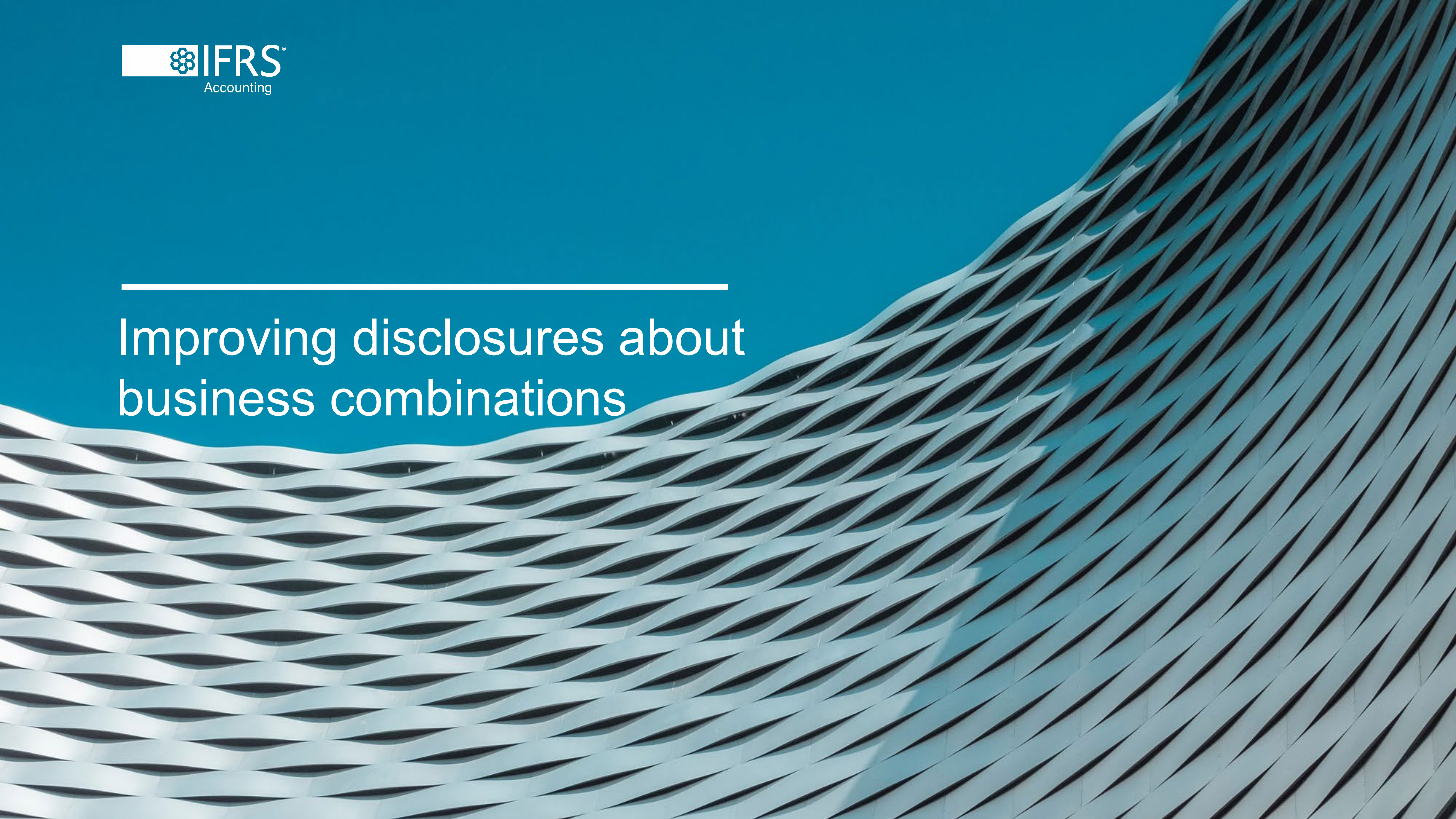
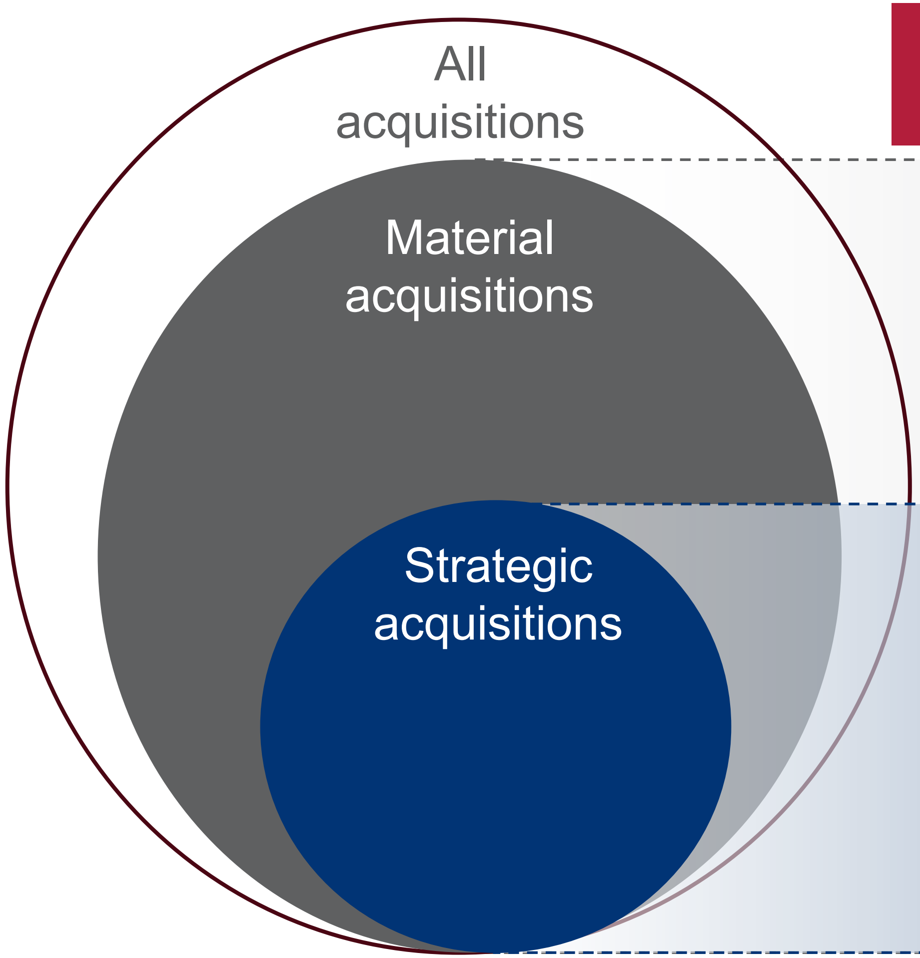
Improving disclosures about business combinations



Summary of key disclosure proposals



In year of acquisition	In years after acquisition
▪ Expected synergies* ▪ Strategic rationale for the acquisition	
▪ Key objectives and targets*	▪ Actual performance of the acquisition ▪ Statement of whether the actual performance is meeting expectations (e.g. interim targets)*

*Exemption available if requirements are met

Key disclosure proposals

Performance of business combinations

Quantitative information about expected synergies

Exemption

Stakeholder feedback leading to proposals

Acquisitions are a large and risky use of capital. Investors need better information to help assess:

- the price paid;
- why management paid that price; and
- subsequently, whether the acquisition is meeting management's expectations

Some investors use impairment losses on goodwill as a signal of an unsuccessful acquisition but sometimes impairment losses are recognised too late

Investors

Information about the performance of acquisitions and information about expected synergies could be commercially sensitive and forward-looking.

Companies should not be required to disclose this information in financial statements.

Preparers

Performance of business combinations

Information to be disclosed

- **Key objectives** and **targets**
- **Performance** against key objectives and targets

Population of business combinations

Strategic business combinations

Exemption

Applied to some items of **commercially sensitive** information

Information to be disclosed

What information?

- Key objectives and targets for a business combination
- Subsequent performance against those key objectives and targets

Disclosure based on information reviewed by an entity's **key management personnel**

For how long?

Information required for **as long as** key management personnel **review the performance of that business combination**

Additional information required if:

- key management personnel **do not start** reviewing the performance of a business combination
- key management personnel **stop** reviewing the performance of a business combination before the end of the second year after the year of acquisition

Strategic business combinations

Business combinations for which failure to meet any one of an entity’s key objectives would put the entity at serious risk of failing to achieve its strategy for maintaining or developing the entity’s business model.

A business combination meeting any one of proposed thresholds would be considered a strategic business combination.

Quantitative thresholds	Qualitative thresholds
Revenue, **operating profit** or **assets (including goodwill)** of acquired business constitutes at least 10% of the acquirer’s comparative amounts	Business combination results in entity entering a **new major line of business or geographical area of operation**

Expected synergies

Information to be disclosed

In year of acquisition only, information aggregated by category about:

- Expected **synergies**
- **Cost** to achieve synergies
- Expected **timeframe**

Population of business combinations

All **'material'** business combinations

Exemption

Applied to some items of **commercially sensitive** information

Exemption

Principle

An entity may be exempted from disclosing some information if doing so can be expected to prejudice seriously an entity's objective for a business combination

Application guidance

For example:

- disclosing the reason for applying the exemption for each item of information
- factors to consider in identifying the appropriate circumstances for applying the exemption

Responds to preparer concerns

In particular, concerns about commercial sensitivity and some concerns about forward-looking information

Other proposed amendments to disclosure requirements in IFRS 3

Disclosure objectives	New disclosure objectives would require an entity to disclose: • the benefits an entity expects from a business combination when agreeing the price to acquire a business; and • for a strategic business combination, the extent to which the benefits an entity expects from the business combination are being met
Strategic rationale	Replacing the requirement for entities to disclose the primary reasons for a business combination with a requirement to disclose the strategic rationale for the business combination

Example disclosures—Strategic business combination

Strategic rationale	As a result of the acquisition, AC expects to be the leading provider of data networking products and services in Canada and Mexico, contributing to AC's strategy of being the leading provider of data networking products and services in North America. AC also expects to reduce costs through economies of scale.

This section illustrates only some of the new disclosures that would be required applying the proposed amendments. An entity would also be required to disclose other information about the business combinations that is required by IFRS 3.

Example disclosures—Strategic business combination

Key objectives and related targets

AC plans to integrate TC into its North American operations. In line with AC's strategy, management's key objectives and related targets for this business combination are:

- to increase annual revenue and profit of AC's North American operations by 45% and 40% respectively by 20X4 (compared to 20X1).
- to launch product X by 20X4
- to increase AC's market share in North America to approximately 20% by 20X4 (from approximately 15% in 20X1).

An entity might be exempt from disclosing information about a key objective and related target (for example, the key objective to launch product X by 20X4) if it determines that disclosing that information before the product is launched would prejudice seriously the achievement of the objective.

Example disclosures—Strategic business combination

Actual performance

For the financial period ended 31 December 20X2, AC increased:

- its annual revenue by 20% and profit by 18% for the North American operations; and
- its market share to approximately 16% in North America.

Performance to date is in line with expectation.*

* An entity might be exempt from disclosing this information in some situations.

Example disclosures—Synergies

Expected synergies	The business combination is expected to generate recurring annual revenue synergies of CU80–CU100 and recurring annual cost synergies of CU100–CU125.
Cost to achieve synergies	The costs to achieve these synergies are expected to include recurring costs of CU15 to achieve the revenue synergies and a one-off cost of CU75 to achieve the cost synergies.
Expected timeframe	Management expects the benefit of the revenue synergies to start from 20X4 and the benefit from the cost synergies to be fully realised by 20X3.

Disclosure of expected synergies is only required at the acquisition date. An entity might be exempt from disclosing information about synergies in some situations.

Proposed changes to the impairment test

Proposals

Effectiveness of the impairment test

Proposals to reduce:

- **shielding**; and
- **management over-optimism**

Cost and complexity of the impairment test

Changes to the calculation of **value in use**

The IASB decided not to reintroduce amortisation for subsequent accounting of goodwill.

Effectiveness of the impairment test

Impairment losses on goodwill sometimes recognised too late.
Investors can't tell whether a business combination is a success until too late

Could be the result of:

- shielding; or
- over optimistic assumptions in cash flow estimates.

The IASB is not proposing a new impairment test

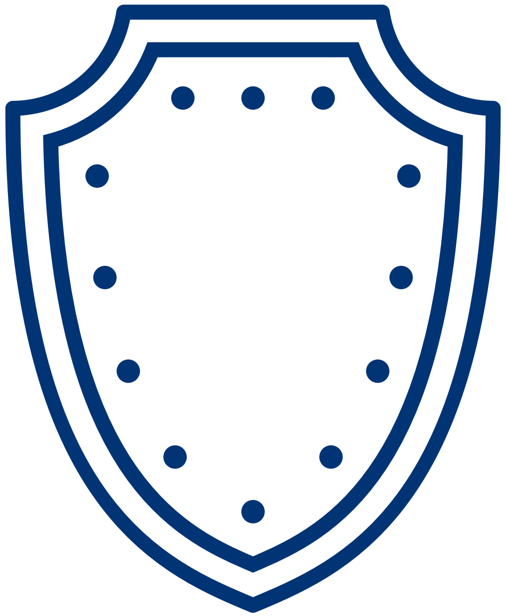
However, the IASB is proposing amendments to the impairment test to address some of the reasons for this concern

- The impairment test is designed to assess the recoverability of assets in CGUs containing goodwill, not the success of a business combination.
- The IASB's disclosure proposals would more directly provide information investors try to get from the impairment test

Reducing shielding

Proposed clarifications to how an entity allocates goodwill to cash-generating units including:

- Changing reference to ‘goodwill is monitored’ with ‘**business associated with the goodwill** is monitored’
- Clarifying that allocating goodwill no higher than an operating segment is a **safeguard** and not a default
- Clarifying why an entity might allocate goodwill to a **group of CGUs** rather than individual CGUs



Reducing management over-optimism

Disclose in which reportable segment a CGU containing goodwill is included

Better links the current disclosure of assumptions used in the impairment test to segment information

Example:

Segment	CGU	Value of goodwill
A	CGU 1	CU175
	Group of CGUs X	CU300
B	CGU 2	CU250

Cost and complexity of the impairment test

The impairment test is complex and costly

The IASB proposes targeted improvements to calculation of value in use including:

- removing restriction on including cash flows from uncommitted future restructurings or asset enhancements
- allowing use of post-tax discount rates and post-tax cash flows

- removing restrictions brings impairment test closer to information used by management which should **reduce cost** for preparers and result in investors receiving more **relevant information**
- there are sufficient other restrictions in IAS 36 on the cash flows a company can include in calculating value in use to ensure the **robustness** of the impairment test. For example, the requirements to:
  - base cash flow forecasts on management's budgets and forecasts; and
  - assess an asset in its current condition

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