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Goodwill and Impairment
Cover Note

Objective

1 The objective of the session is to:

(a) Provide an update of the IASB deliberations of the IASB's discussion paper *Business Combinations – Disclosures, Goodwill and Impairment* ('the DP').

(b) Obtain feedback from EFRAG TEG-CFSS members on the questions the IASB will raise at the December 2021 ASAF meeting regarding the disclosure proposals for business combinations and the IASB staff examples illustrating what the staff expect an entity would disclose when applying the proposals.

Key discussion points for the session

2 The purpose is to focus on the disclosure examples prepared by the IASB staff and included in agenda paper 06-02 (ASAF agenda paper 4A). The IASB staff plan to discuss these examples with the IASB at a future meeting.

3 The examples illustrate the IASB staff's view of what entities might disclose based on the IASB's preliminary views. The examples have been developed for the purpose of discussion and have not been reviewed or approved by the IASB. The following is a brief description of the examples:

(a) Example 1 - Westferry Inc acquired Cannon Street Enterprises on 1 July 20X5 and recognised CU300 million of goodwill on acquisition.

(b) Example 2 – Libra acquired Scorpio on 1 January 20X7 and recognised CU55 million of goodwill on acquisition.

4 Each example includes:

(a) a background section illustrating the information available to the entity's Chief Operating Decision Maker (CODM); and

(b) disclosures in the entity's financial statements applying the IASB's preliminary views.

5 The examples are not reproduced in this paper, but in the agenda paper 06-02 provided for this session. EFRAG TEG-CFSS members are asked to analyse the **background details provided in the two examples and the disclosures provided by the entities in their financial statements** for financial years ended 31 December 20X5 and 20X6 (Example 1) and financial years ended 31 December 20X7 and 20X8 (Example 2).

Background and IASB discussions and tentative decisions so far

6 The IASB published the DP on its goodwill and impairment project in March 2020. The project responds to concerns identified during the IASB's post-implementation review of IFRS 3 *Business Combinations* related to the timeliness and effectiveness of the current annual impairment test in IAS 36 *Impairment of Assets*.

7 In summary, the IASB preliminary views expressed in the DP were:

(a) To disclose management's objectives for acquisitions and subsequently disclose the performance against those objectives including targeted improvements to existing Standards.

(b) To retain the impairment-only model for goodwill and simplify the impairment test.

(c) To present the amount of total equity excluding goodwill and leave unchanged the recognition of intangibles separately from goodwill.

8 EFRAG published its final comment letter on the DP in January 2021. EFRAG TEG-CFSS discussed the feedback received by the IASB on its DP in its June 2021 meeting.

9 The table below provides an overview of the project development and IASB tentative decisions so far.

March – May 2021	• IASB discussed a summary of the feedback received on its preliminary views expressed in the DP. • In April 2021, the IASB received a summary that focused only on **user feedback** (agenda paper 18B). • In May 2021, the IASB discussed a **literature review** that summarised the evidence from academic papers on topics relevant to the questions in the DP. The literature review was based on an academic literature review that provides an overview of academic papers on empirical goodwill research published in the last 20 years, published articles and other academic material.
June 2021	• **ASAF** members discussed the areas that the IASB should consider in its redeliberation process and the importance of convergence on this topic with US GAAP. The outcome of the discussion can be found in the ASAF meeting summary published on the IASB website. The main messages from ASAF members were: o Decisions on the subsequent accounting of goodwill, including improvements to the impairment test, should be prioritised over disclosures, because the IASB's decisions on the subsequent accounting of goodwill could affect the disclosures that would be required. o ASAF members expressed various opinions on the importance of convergence with US GAAP. The FASB member said the FASB is leaning towards reintroducing amortisation of goodwill.
July 2021	• The IASB redeliberated its preliminary views on the subsequent accounting for goodwill and whether to reintroduce amortisation of goodwill and discussed disclosures about business combinations and improving the effectiveness of the impairment test in IAS 36.

	• The IASB was not asked to make any decisions at this meeting. • The IASB had a joint meeting with the FASB (education purposes) where both boards discussed various aspects of their respective projects on goodwill and impairment and their tentative decisions (these projects do not constitute a joint project).
IASB tentative decisions	
June 2021	• The IASB tentatively decided to retain the objective of the project unchanged from that described in its DP. The objective is to explore whether entities can, at a reasonable cost, provide users with more useful information about the acquisitions those entities make. • The IASB also tentatively decided to make no changes to the project scope. The IASB considers its preliminary views as a package that meets the project objective.

September 2021	• The IASB decided on a project plan. As part of that project plan the IASB is prioritising analysis of feedback on:
	   o disclosures about business combinations; and
	   o whether to retain the impairment-only model or whether to reintroduce amortisation for goodwill (the subsequent accounting for goodwill).
	• The IASB staff sent a request to **IFASS** members asking for information on how goodwill is accounted for under local GAAP and views on the estimation of goodwill useful lives and possible challenges on transition should amortisation be reintroduced.

October 2021	• The IASB tentatively decided that, based on the *Conceptual Framework for Financial Reporting*, information can be required in financial statements about the benefits an entity's management expects from a business combination and the extent to which management's objectives are being met. • The IASB discussed practical concerns over requiring entities to include such information in financial statements. In particular, the IASB discussed the staff's additional research and analysis of concerns over requiring entities to disclose information that might be considered forward-looking in some jurisdictions. • The IASB will continue its redeliberations on its preliminary views on the package of disclosure requirements at future meetings, including whether not to proceed with some or all of the disclosure requirements for practical reasons.
November 2021	• **CMAC** – The IASB asked for CMAC members' views on various aspects of the DP including information investors need about subsequent performance of business combinations, usefulness of amortisation model based on management's expectations of the useful life of goodwill; and how difficult investors find a comparison of financial statements if IFRS Standards and US GAAP had different requirements for goodwill. • **Global Preparers Forum** – The IASB sought GPF members' views on the difference between business combinations for which an entity's Chief Operating Decision Maker (CODM) reviews the

	performance and 'material' business combinations; feasibility of estimating a useful life of goodwill; and possible effects of transitioning to an amortisation model. • On 16 November 2021, the IASB discussed: o Expected synergies arising from a business combination and the IASB staff analysis and recommendation of aspects of feedback on the IASB's preliminary view to require entities to disclose quantitative information about synergies expected from a business combination. o Contribution of the acquired business—the IASB staff analysis and recommendation of feedback on the IASB's preliminary views to amend the requirement in IFRS 3 related to the disclosure of information about the contribution of an acquired business.

IASB's preliminary views on disclosure requirements and feedback so far

10 The IASB's preliminary views on disclosure of business combinations are:

(a) To require companies to disclose in the year of a business combination the strategic rationale and objectives for the acquisition as well as the metrics management plan to use to monitor achievement of those objectives. This includes:

(i) a description of the synergies expected from combining the operations of the acquired business with the entity's business;

(ii) when the synergies are expected to be realised;

(iii) the estimated amount or range of amounts of the synergies; and

(iv) the estimated cost or range of costs to achieve those synergies.

(b) In subsequent years require a company to disclose performance against those objectives and the metrics set by management.

11 The disclosure proposed in paragraph 7 should be the information reviewed by management. Management would be defined using the concept of the Chief Operating Decision Maker (CODM) from IFRS 8 *Operating Segments*.

Feedback received so far on the IASB's preliminary views

12 The IASB discussed feedback on disclosure proposals at its meetings in April and July 2021. Feedback received, including from preparers, highlighted **practical challenges** in providing the information, including that the information could be:

(a) Forward-looking;

(b) Commercially sensitive;

(c) Difficult to audit; or

(d) Difficult to provide upon integration of the acquired business.

13 Many respondents who disputed the **location of the information,** said that the IASB should not require disclosure of information about the benefits an entity's management expect from a business combination and the extent to which management's objectives are being met in financial statements. Instead, those respondents said entities should provide this information in management commentary, and the IASB could consider this as part of its *Management Commentary* project.

14 Appendix 2 provides a more detailed overview of the feedback received.

15 At its meeting in October 2021:

(a) The IASB tentatively decided that, based on the *Conceptual Framework for Financial Reporting*, information can be required in financial statements about the benefits an entity's management expects from a business combination and the extent to which management's objectives are being met—such as information about the subsequent performance of a business combination, and quantitative information about expected synergies. Nine of 12 Board members agreed with this decision.

(b) The IASB also discussed the practical challengers noted by many respondents (see paragraph 12) but did not take any decisions.

16 At its meeting in November 2021, the IASB discussed its preliminary view to require entities to disclose quantitative information about synergies expected from a business combination. At the time of writing this paper, the outcome of the IASB meeting was not known.

Feedback from users

17 However, other respondents, including users, said that the information that would be required applying the IASB's preliminary view is possible to provide and that it would be useful – for example, that the information would not be commercially sensitive.

18 Almost all users supported the IASB's preliminary views to enhance disclosures for business combinations noting that existing disclosure requirements do not provide them with sufficient useful information. Many users said they were particularly interested in information about subsequent performance of business combinations and about expected synergies from business combinations to help them better understand the rationale of the transactions, as well as to hold management to account. However, some users were sceptical whether the enhanced disclosure requirements would be effective in providing more useful information.

19 At the CMAC meeting in November 2021, users confirmed the above feedback. However, some CMAC members were sceptical about linking the disclosure requirements to the CODM. Some members requested the IASB to provide examples of what the IASB is proposing, especially the metrics management plan to use to monitor achievement of those objectives.

EFRAG's final comment letter

20 In its final comment, EFRAG shared similar concerns to those highlighted above in paragraphs 1212 and 13. An extract from the EFRAG final comment letter on EFRAG's views on the proposed disclosures is reproduced in Appendix 1 of this paper.

Questions for EFRAG TEG-CFSS members

21 Based on outreach/information about your jurisdiction, do you consider that the aggregation of information in the disclosures section of the IASB staff examples, compared to the background section, achieve the right balance between providing useful information to users of financial statements while not disclosing information that is overly commercially sensitive?

22 Based on legislation and regulations in your jurisdiction, is there any information in the disclosure section that would result in significant additional litigation risk if disclosed in the financial statements and why? (For example, would any of the information be considered forward looking in your jurisdiction and therefore not benefit from 'safe harbour' protections (that is, protection from litigation) that might be available to forward looking information disclosed outside financial statements?

23	In the proposed disclosures references are made to "the synergies expected from combining the operations of the acquired business with the entity's business". The IASB staff does not recommend providing a definition of synergies. Do you agree with the IASB staff recommendation not to define or describe synergies?
24	Do you have any other comments or observations regarding the IASB staff examples?

Agenda Papers

25 In addition to this cover note, agenda papers for this session are:

(a) Agenda paper 06-02 – *ASAF paper AP04A – Goodwill and Impairment – Staff examples* – to be read*;* and

(b) Agenda paper 06-03 – *ASAF paper AP04 – Goodwill and Impairment – Presentation* – for background only.

Appendix 1 – Extract from EFRAG Comment Letter

1 The following is an extract of the views EFRAG expressed in its final comment letter on the IASB's preliminary views on disclosures about business combinations.

2 "… EFRAG sees merits in including disclosure objectives to provide information to help investors to understand the benefits that a company's management expects from an acquisition when agreeing the price to acquire a business and the extent to which an acquisition is meeting management's objectives for the acquisition.

EFRAG acknowledges that information about the strategic rationale and management's objectives for an acquisition as at the acquisition date and subsequent disclosures about whether an acquisition is meeting those objectives would be useful. However, EFRAG notes that there would be some practical issues to consider in relation to those disclosures, both to ensure that users receive sufficient and relevant information and that IASB DP 2020/1 *Business Combinations—Disclosures, Goodwill and Impairment* the costs of preparing/disclosing the information would not outweigh the benefits. In this regard, EFRAG notes that some of the quantitative information suggested is based on management expectations and would often be non-GAAP measures. EFRAG thus considers that the IASB should further examine whether some of the disclosures should rather be included in the management commentary. When doing so, the IASB should take into account both the arguments that some of the proposed information would rather belong to the management commentary as well as the concerns and practical issues that would be related to allowing the information to be provided in the management commentary. EFRAG also notes that some of the proposed information would be considered commercially sensitive. Although the hurdle should be high, EFRAG considers that it should be possible for entities not to present commercially sensitive information. EFRAG notes that entities may find it particularly harmful if they would have to provide sensitive information that their competitors reporting under another GAAP would not have to disclose.

The considerations above also apply to the disclosures suggested on expected synergies. In addition, EFRAG notes that in order for the benefits of these disclosures – for which reliability would depend on the specific circumstances – to outweigh the costs, it may be necessary to introduce some flexibility in relation to when/how quantitative information should be presented. EFRAG does not consider that the benefits would outweigh the costs for the proposal to disclose cash flows from operating activities as part of the requirements currently included in paragraph B64(q) of IFRS 3 *Business Combinations*. …"

Appendix 2 – Feedback from respondents on the IASB disclosure proposals

1 The following summary of feedback by respondents on the IASB's preliminary views on the disclosure requirements has been taken from the IASB agenda papers 18B on feedback from users (April 2021) and agenda paper 18A on feedback from other respondents (July 2021).

2 Many respondents (other than users) noted the following concerns:

(a) Forward looking;

(b) Commercially sensitive;

(c) Difficult to audit; and

(d) Difficult to provide upon integration of the acquired business.

Forward-looking

3 Many preparers and national standard-setters disagreed that the information was not forward-looking and said the information would, in their view, meet the definition of forward-looking information in:

(a) IFRS Practice Statement 1 *Management Commentary* which defines forward-looking information as 'information about the future. It includes information about the future (for example, information about prospects and plans) that may later be presented as historical information (as results). It is subjective and its preparation requires the exercise of professional judgement.'

(b) Regulation or legislation in various jurisdictions (for example Canada and the United States).

4 Respondents who said the information is forward-looking said providing such information in financial statements might result in increased litigation or regulatory risk if management's targets are not subsequently met. Some respondents said including forward-looking information in financial statements would not allow them to benefit from 'safe harbour' protections in some jurisdictions. [1]

Commercially sensitive

5 Commercial sensitivity was the most common practical challenge cited by respondents, especially preparers, to providing the information required by applying the IASB's preliminary views. Examples of commercially sensitive information provided by respondents included:

(a) Management targets—such information could reveal how the entity prices deals. Competitors could use this information to outbid the entity in future deals. Respondents said this is a particular concern if an entity is undertaking a series of strategically linked acquisitions.

(b) Information about cost-based targets—such information could reveal an entity's cost structure. Competitors could use such information to outbid the entity in future tenders for sales contracts and customers could request some of the cost savings be passed on to them.

(c) Information related to employees (for example cost synergies)—disclosing such information could demotivate employees. In addition, disclosing details about expected cost synergies in the financial statements could preempt some

[1] The IASB staff understand that some jurisdictions have statutory 'safe harbour' provisions that protect entities from litigation risks that may arise from forward-looking statements. Generally, entities would need to include those forward-looking statements, accompanied with cautionary statements, in management commentary in order to benefit from such 'safe harbour' provisions.

jurisdictions' legal requirements to inform employees or trade unions about potential redundancies before any other party.

6 On the other hand, some respondents, including many users, did not view commercial sensitivity as a valid basis for not providing useful information about business combinations.

Difficult to audit

7 Many respondents expressed concerns about the auditability of the proposed disclosures about management's objectives for, and subsequent performance of, business combinations, as well as expected synergies from business combinations. Their concerns include:

(a) It may be difficult for an auditor to confirm the objective and targets for a business combination because the Chief Operating Decision Maker (CODM) might have many objectives and targets. An entity might selectively disclose only some objectives and targets.

(b) Targets and metrics are likely to be subjective and non-GAAP in nature Accordingly, it might be difficult for an auditor to confirm those targets are appropriate and realistic.

(c) Some respondents said the concern is less about whether the information can be audited and more about the cost of auditing the information. The costs include preparing supporting documentation in a way that is auditable and the cost of the audit itself.

Difficult to provide upon integration of the acquired business

8 Many preparers and a few accounting firms said integrating an acquired business with the existing business might prevent an entity from being able to provide useful information about the subsequent performance of the acquired business. Some national standard-setters also said this concern was common in their jurisdiction. The concerns raised by respondents are that:

(a) It may be costly or impracticable to provide information about the acquired business as a stand-alone entity if it is quickly integrated into the entity's existing business.

(b) Information about the acquired business on a stand-alone basis may be misleading because it does not reflect the objective of the business combination.