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Goodwill and Impairment

Disclosure requirements – possible ways forward
Issues paper

Objective

1 This paper:

(a) Discusses possible alternatives the IASB could consider on how to proceed with the proposed disclosures in its Discussion Paper *Business Combinations – Disclosures, Goodwill and Impairment* (‘the DP’).

(b) Asks for EFRAG FR TEG’s views on these alternatives.

2 This paper is a summary of the IASB agenda paper 18B which was discussed at the IASB meeting in April 2022.

3 This paper is structured as follows:

(a) IASB proposals and summary of practical concerns;

(b) Assessing costs and benefits of applying the preliminary views;

(c) Possible alternatives; and

(d) IASB discussion in April 2022 on the alternatives.

IASB proposals and summary of practical concerns

4 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.

5 The proposed disclosure should be the information reviewed by management; defined using the concept of the Chief Operating Decision Maker (CODM) in IFRS 8 *Operating Segments*.

6 As described in agenda paper 05-02 (for this meeting) feedback on these preliminary views, including EFRAG in its Final Comment Letter on the DP, identified **four practical concerns**:

(a) commercial sensitivity—that information could contain sensitive information that, if disclosed, could harm the entity;

(b) forward-looking information—that information could contain information about the future that, if disclosed, could increase litigation risk;

(c) integration—an entity may not be able to disclose information that is representative of the performance of a business combination if the acquired business is integrated into the entity's existing operations; and

(d) auditability—some information that would be required by preliminary views may be costly, or impossible, to audit.

Assessing costs and benefits of applying the preliminary views

Costs

7 Paragraph 2.39 of the *Conceptual Framework* informs that the IASB should consider the costs and benefits when developing IFRS standards. If the benefits of a proposal do not outweigh the costs, the IASB should not proceed with standard-setting on the proposal.

8 Regarding the practical concerns identified by respondents, IASB staff concluded that:

(a) Practical costs—the cost of collection, processing, verification and dissemination of financial information, including costs arising from practical concerns about integration and auditability.

(b) Specific economic effects—including potential consequences that may arise from disclosing commercially sensitive information and from additional litigation risk entities might be subject to because of disclosing information required by the preliminary views.

Benefits

9 Paragraph 1.2 of the *Conceptual Framework* informs that the objective of financial statements is to provide information that is useful to users of financial statements in making decisions relating to providing resources to the entity.

10 The PIR of IFRS 3 *Business Combinations* identified that users need better information about the subsequent performance of the acquiree. The DP tried to respond to those concerns.

11 As outlined in agenda paper 05-02 (for this meeting), subsequent outreach conducted by the IASB staff and EFRAG staff confirms that users agreed that companies should disclose information about the subsequent performance of a business combination. This would help them assess management's stewardship of the entity's resources and whether the business combination was a successful acquisition.

Should the IASB proceed with the preliminary views in the DP

12 The IASB staff noted that the IASB could:

(a) proceed with the preliminary views;

(b) abandon the preliminary views; or

(c) proceed with an amended version of the preliminary views.

13 Proceed with the proposals – this alternative would respond to the concerns of users of financial statements with regards to information on the subsequent performance of a business combination but would receive significant push-back from preparers because of the practical concerns they expressed.

Even though the information might be available internally, preparers would remain reluctant to provide it because of commercial sensitivity and litigation risk associated with some of the information (like disclosing forward-looing information). However, the IASB could counter-argue that there are other IFRS Standards that require what could be considered as commercially sensitive information. Furthermore, the IASB could develop application guidance and accompanying examples that could help preparers to clarify the requirements (see paragraphs 25-27 of the IASB agenda paper 18B).

14 Abandon the preliminary views - The IASB could conclude that despite the benefits of disclosing the information that would be required applying the preliminary views, the costs of disclosing that information outweigh those benefits. In this case, the IASB would not proceed with the proposals.

If the IASB decides not to continue with the preliminary views it could include some of the requirements in *IFRS Practice Statement 1 Management Commentary*. However, not all entities applying IFRS Accounting Standards are required to, or choose to, apply the Practice Statement. Therefore, this approach may not provide users with better information unless those requirements are also included in local regulatory requirements.

15 Amend the preliminary views - The IASB could also conclude that there are significant benefits of disclosing the information that would be required by the preliminary views but acknowledge the practical concerns of preparers and amend the preliminary views to better balance the costs to preparers with the benefits to users.

Possible alternatives

16 The IASB staff developed the following four alternative courses of action based on the premise that the IASB amend its preliminary views and find a more balanced solution:

(a) Disclosing information about only ‘significant’ business combinations;

(b) Comply or explain;

(c) Not require quantitative disclosures in the year of acquisition; and

(d) Specifying metrics.

17 In developing these alternatives, the IASB staff noted that there are two variables that can be adjusted to better balance the costs and benefits of any proposed requirements:

(a) the **population of business combinations** for which information would be disclosed, for example by requiring disclosure of information about only ‘significant’ business combinations; and

(b) the **amount of information** required to be disclosed.

Disclosing information about only ‘significant’ business combinations

18 The IASB could require disclosure about the subsequent performance of business combinations and quantitative information about expected synergies for only ‘significant’ business combinations rather than for all ‘material’

business combinations[1]. This would follow an approach similar to that in the DP but would use a different method for identifying the 'significant' business combinations. However, the IASB would need to specify what constitutes a 'significant' business combination.

19 The proposal to focus on 'significant' business combinations could help address the practical concerns reported by preparers for the following reasons:

(a) Would help would reduce the population of business combinations an entity would disclose information about.

(b) Outreach conducted by the IASB staff indicated that some preparers said that that there are some business combinations that are so 'significant' that information needs to be disclosed to users; in such cases the benefits of disclosing outweigh the costs of not doing so.

(c) Address concerns about integration (and the associated concern about auditing integrated metrics). This is because when an entity undertakes a 'significant' business combination, the effect of the business combination on the combined business' performance is likely to be more obvious, and the information is likely to be readily available and tracked by management.

20 This alternative could however have the following drawbacks:

(a) Although some users said information is needed for only 'significant' business combinations, many users said information is needed for all 'material' business combinations.

(b) This approach could also lead to complexity—it would result in the IASB having different levels of disclosure requirements for different populations of business combinations (IFRS 3 already refers to individually immaterial business combinations that are collectively material). Introducing 'significant' would add an extra sub-set to the mix.

(c) It may also be difficult for the IASB to specify what constitutes a 'significant' business combination – the IASB could develop a quantitative threshold or a qualitative threshold, but those these might be difficult to do.

Comply or explain

21 The IASB could adopt a comply or explain approach in which an entity would disclose information based on the preliminary views but in specific situations the entity would be permitted to not disclose some or all of that information. Instead, the entity would explain the reason for not doing so.

22 A similar approach in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, which permits entities to not disclose information about contingent liabilities if doing so may prejudice seriously the entity's position in a legal dispute (IAS 37 exemption). Paragraph 92 of IAS 37 states that such situations are expected to be extremely rare.

23 The IASB could design particular criteria that would have to be met for the disclosure exemption to apply in IFRS 3 - these criteria could be broad (allow

[1] Paragraph B64 of IFRS does not specify a particular population of business combinations to which it applies. However, paragraph B65 of IFRS 3 includes specific disclosure requirements that apply to 'individually immaterial business combinations occurring during the reporting period that are material collectively'. In the rest of this paper, we refer to 'material business combinations' as those that are not 'individually immaterial'.

exemption in a broad range of situations) or restrictive (allow exemption in a narrow set of situations).

24 Having an exemption to disclose information could:

(a) Mitigate concerns about commercial sensitivity, and forward-looking information and about business integration.

(b) Be a practical way to balance the need to provide users better information and address preparers' concerns about commercial sensitivity. This alternative could incentivise an entity to disclose information if the cost is acceptable because the entity risks being penalised by the market if its explanation for not disclosing the information is deemed unsatisfactory.

25 However, this alternative may have the following drawbacks:

(a) The option to avoid disclosing specific information may be abused.

(b) The approach could be difficult to apply consistently, particularly when entities operate in different markets and regulatory environments.

(c) The explanation for not disclosing information could itself contain information that could be commercially sensitive or forward-looking, and therefore would not necessarily address the practical concerns.

(d) The approach would require entities to exercise judgement and could lead to tension among preparers, regulators and auditors.

(e) It might be difficult for the IASB to develop robust criteria to develop an exemption that works for all.

Not require quantitative disclosures in the year of acquisition

26 The IASB could allow entities to disclose qualitative information, instead of quantitative information, in the year of a business combination. Under this approach, an entity would be required to disclose:

(a) In the year of the business combination, qualitative information about management's key objectives for a business combination and the metric(s) management will use to monitor whether the objectives of the business combination are being met without disclosing the quantitative target(s) for the metric(s).

(b) In subsequent periods, an entity would be required to disclose the actual result(s) using the metric(s) disclosed in the year of acquisition and whether the target was met.

27 Paragraph 54 of IASB agenda paper 18B provides an example that illustrates this alternative.

28 However, one drawback of this this alternative is that it might not provide all the information users seek regarding the subsequent performance of a business combination. Providing qualitative information about management's objectives could be boilerplate and not address user needs.

29 Furthermore, the IASB staff inform that academic research shows that information about expected synergies in the year of acquisition provides market participants with useful information, and that this information is used as a yardstick to judge the success of a business combination.

Specifying metrics

30 Under this alternative, the IASB would require entities to disclose specific metrics for all business combinations.

31 For example, paragraph B64(q) of IFRS 3 requires an entity to disclose information about the revenue and profit of an acquired business in the year of acquisition—the IASB could require an entity to continue to provide this information for a specified period of time after the acquisition. Other examples of metrics suggested by some respondents include: (a) operating margin; (b) return on investment or return on capital employed; and (c) estimated payback period for the investment.

32 When developing the DP, the IASB rejected this approach because in its view, it is not feasible to prescribe a set of metrics that would be applicable for all business combinations. In addition, prescribing specific metrics might require entities to produce, solely for the purpose of financial reporting, information that is not readily available. This would increase the cost of preparation.

33 However, outreach with users shows that some users suggested requiring an entity to disclose specified metrics for all material business combinations. In their view, prescribing specific metrics for all material business combinations would provide relevant information and could enhance comparability.

Summary of the four alternatives discussed above

34 The table below summarises the pros and cons for each alternative.

Alternative	Could mitigate concerns above	Drawback
Disclosing information about only 'significant' business combinations	• Commercial sensitivity • Forward-looking information • Integration (and related auditability concern)	• Difficult to determine appropriate threshold
Comply or explain	• Depends on the scope for possible exemption but particularly relevant for concerns about commercial sensitivity and forward-looking information	• Risk of abuse • Limits usefulness of information provided
Not require quantitative disclosures in the year of acquisition	• Commercial sensitivity • Forward-looking information • Some audit concerns	• Would not mitigate concerns about integration • Could create new audit concerns • Limits usefulness of information provided
Specifying metrics	• Commercial sensitivity • Forward-looking information	• Specified metric may not be relevant or applicable for the business combination • Could worsen integration concerns

Combining Alternatives

35 The IASB could combine some of the alternatives discussed above to maximise the benefits or limit the drawbacks of each individual alternative. Two possible combinations could be:

(a) 'significant' business combinations and specific metrics; and

(b) 'significant' business combinations and comply or explain.

'Significant' business combinations and specific metrics

36 In this approach, the IASB could require:

(a) for 'significant' business combinations, entities to disclose information about the subsequent performance of business combinations similar to that described by the preliminary views and quantitative information about expected synergies; and

(b) for business combinations that are not 'significant', require entities to disclose information about prescribed metrics (for example revenue and operating profit of an acquired business for a particular number of years after a business combination).

37 This alternative could provide users with better information about ‘significant’ business combinations for which some would say the benefits of disclosing information outweighs the costs, while also addressing users’ needs for information about other business combinations. By requiring entities to disclose at least some information for business combinations that are not ‘significant’, this alternative could also partly respond to feedback from some users that the preliminary views would not require entities to provide users with sufficient information when an entity enters into a series of smaller acquisitions.

‘Significant’ business combinations and comply or explain

38 This approach would be based on preparers being willing to provide the proposed disclosure information for ‘significant’ business combinations. In those cases where this is not possible, or preparers are unwilling to provide the information, they would need to explain why.

IASB discussion in April 2022

39 The IASB were asked to provide direction to the IASB staff on the proposed alternatives and any other suggestions on the way forward. No decisions were taken.

40 IASB members agreed that there is inconsistency on the information about subsequent performance that users receive. Users are getting the information from different sources other than the financial statements.

41 IASB members also acknowledged that the information need requested from users is on subsequent performance of business combinations, particularly when these are significant. This was confirmed in the outreach conducted with users. However, IASB members also noted that if integration occurs, it would be very difficult to track an individual business combination making it difficult to provide information on the subsequent performance of that business combination.

42 IASB members had mixed views on the proposed alternative in paragraph 18. A summary of the comments provided is provided below:

- (a) There was a concern that preparers would not accept disclosing the proposed disclosure for ‘significant’ business combinations as these would be the ones most impacted by the practical concerns reported by preparers.
- (b) The IASB would have to define ‘significant’ in the context of business combinations which could be challenging.
- (c) The IASB user representative thought that one approach could be to repurpose the impairment test under IAS 36 – there was a concern about the effects of integration and the information that goes into the impairment test.
- (d) The ‘comply and explain’ alternative had limited support – some said that it was different to the IAS 37 impracticable exemption which focused mainly on litigation issues. It would be challenging and subjective to apply this alternative.
- (e) Replacing quantitative information with qualitative information might result in boilerplate information and therefore not help users.
- (f) One IASB member noted that none of the alternatives could solve the practical concerns noted by preparers. The only solution was to drop the proposal to provide information on subsequent performance.

(g) The IASB staff could see whether they could distinguish between (1) information that is impracticable to provide (because its not available) and (2) other circumstances that are similar to the exemption in IAS 37. The staff could also explore further whether a combination of alternatives could work.

Questions for EFRAG FR TEG

43 Does EFRAG FR TEG have a preference as to whether to focus on the population of business combinations or the information disclosed about each business combination as mentioned in paragraph 17?

44 Does EFRAG FR TEG have any preferences for the IASB staff proposed alternatives in paragraph 16 or combining alternatives as discussed in paragraph 35?

45 Do you have any other suggestions that the IASB could consider on alternatives not discussed in this paper?