EFRAG Secretariat: Isabel Batista-Pirhonen, Galina Borisova, Laura Abeni, Didrik Thrane-Nielsen



# Goodwill and Impairment

# Possible alternatives to the IASB preliminary views on disclosures on business combinations
# Cover Note

## Objective

1 The objectives of the session are to:

(a) Discuss feedback on the IASB preliminary views on disclosure on business combinations and possible alternatives on the IASB preliminary views

(b) Provide a project update

(c) Seek feedback from EFRAG FR TEG-CFSS members on the alternatives and specifically whether it would be better to:

(i) Require disclosures for only a specific population of business combinations.

(ii) Exempt entities from disclosing particular information in specific circumstances.

## Structure of this paper

2 This paper is structured as follows:

(a) Key discussion points

(b) IASB preliminary views on disclosure

(c) Project Update

(d) EFRAG Secretariat analysis and preliminary views

(e) Next steps

(f) Appendix - Background information (feedback on the IASB preliminary views, recent IASB discussions, and recent EFRAG discussions)

## Key discussion points

3 The IASB published the discussion paper *Business Combinations – Disclosures, Goodwill and Impairment* (the “DP”) in March 2020.

4 This session will focus primarily on the IASB preliminary views on the disclosure proposals in the DP and disclosure alternatives discussed in **slides 11-23 of the ASAF presentation in Agenda Paper 07-02**.

5 EFRAG FR TEG and CFSS members are expected to read agenda paper 07-02 which includes a detailed analysis of the disclosure alternatives discussed at the IASB April 2022 meeting. These alternatives were developed by the IASB staff and are based on two variables (population of business combinations and amount of information) that can be adjusted to balance the costs and benefits of any proposed requirements.

**IASB preliminary views**

6 The IASB's preliminary views on disclosure of business combinations are[1]:

(a) **Additional disclosure objectives** – proposed to include additional disclosure objectives to IFRS 3 *Business Combinations* that would require entities to disclose information that would help users understand:

(i) the benefits an entity expected from a business combination when agreeing the price to acquire that business; and

(ii) the extent to which management's objectives are being met.

(b) **Disclosure about performance of business combinations** – this proposal is two-fold and requires that:

(i) in the year of a business combination, entities disclose the strategic rationale and objectives for that business combination and the metrics management plan to use to monitor achievement of those objectives; and

(ii) in subsequent years post-acquisition, entities disclose management's review of the entity's performance against those objectives.

*This preliminary view builds on the requirement in paragraph B64(d) of IFRS 3[2] and is based on the information reviewed by the Chief Operating Decision Maker (CODM) to identify the population of business combinations being monitored.*

(c) **Disclosure about expected synergies** – require entities to disclose in the year of a business combination quantitative information about the synergies expected as a result of the business combination.

*This preliminary view is relevant only in the year of acquisition and builds on the requirement in paragraph B64(e) of IFRS 3[3]. The information under this preliminary view is not linked to the information reviewed by the CODM.*

7 The Appendix includes a summary of the feedback the IASB received on its preliminary views. In summary, users supported having improved information on the objectives and subsequent performance of business combinations. However, preparers and others noted that the proposed disclosures raised concerns about commercial sensitivity of information, reliability, practicability and auditability of the information.

[1] The DP contained other preliminary views about the disclosure requirements on business combinations but they are not the focus of this discussion.

[2] Paragraph B64(d) of IFRS 3 requires an entity to disclose the primary reasons for the business combination and a description how the acquirer obtained control of the acquiree.

[3] Paragraph B64(e) of IFRS 3 requires a qualitative description of the factors that make up goodwill recognised, such as expected synergies from combining operations of the acquiree and the acquirer, intangible assets that do not qualify for separate recognition or other factors.

**Project Update**

8 The table below summarises the IASB discussions so far.

| Proposal in the DP | IASB discussion |
|---|---|
| Improvements to disclosure requirements for business combinations | Feedback received discussed in April 2021 IASB meeting<br>Tentative decisions taken in October 2021 IASB meeting<br>Further research and alternative disclosure requirements discussed in April 2022 IASB meeting |
| Subsequent account accounting for goodwill | Discussed feedback in May 2021<br>IASB discussed additional feedback on specific aspects of feedback in May 2022 |
| Recognition of intangibles separately from goodwill | IASB discussed feedback in May 2021 |

**EFRAG Secretariat analysis and preliminary views**

9 We note that the IASB preliminary views in paragraph 6 are intended to be included in IFRS 3 as they build on the requirements in IFRS 3 notably paragraph B64(d) and B64(e) of IFRS 3.

10 Given the FASB decision to discontinue the project[4], it is likely that improved disclosures for business combinations will be the focus point of the project. Careful consideration will be needed to find the right balance and selection of alternative(s) that can provide users with better information on business combinations, yet not cause 'unreasonable prejudice' to entities.

*The alternatives*

11 The two alternatives aim to reduce the concerns around commercial sensitivity of information and other concerns noted by preparers and others and some of the concerns raised by EFRAG in its Final Comment Letter (see Appendix paragraphs 5) by either:

(a) **Population of business combination** - reducing the population of business combinations for which information would be disclosed; or

(b) **Exemption** - reducing the **amount of information** to be disclosed for each affected business combination

[4] The EFRAG Secretariat understands that on 15 June 2022[4], the FASB voted unanimously to discontinue work on the goodwill and impairment project. The FASB had previously tentatively decided to revert to amortisation of goodwill under US GAAP. The article that announced this decision, cited the following:

*"Companies and their accountants have complained for years that the test is too complicated and subjective. But a major investor group told FASB in December that investors and analysts don't want a rule revamp; instead they want businesses to divulge details about deals so they can understand how well acquisitions pan out."*

*Population of business combinations (Slide 14 of agenda paper 07-02)*

12 Under this alternative, entities would be required to disclose information about the strategic rationale, management objectives and subsequent performance of business combinations and expected synergies for only a **subset of business combinations.** This could be done using one of the following three ways:

(a) Quantitative threshold - a quantitative threshold—for example a business combination in which the acquired business represents more than 5% of the reporting entity's revenue, profit, total assets or net assets. This is similar to the approach used in paragraph 13 of IFRS 8 *Operating Segments*.

(b) Qualitative threshold - for example business combinations that comprise a significant portion of a particular reportable segment or are separate reportable segments. This is similar to the approach used in IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* to identify discontinued operations.

(c) A factor / indicator-based threshold - for example by describing the type of business combinations information would be required for, and then listing some factors /indicators for an entity to consider in determining whether a business combination is in that subset. This is similar to the approach used in IFRS 10 *Consolidated Financial Statements* for identifying an investment entity (paragraphs 27–28 of IFRS 10 - define and then list characteristics of an investment entity).

*Exemption*

13 Under this alternative, an entity would be exempt from disclosing some information (proposed in the DP) if specific conditions are met. The entity would explain the circumstance and the reason for not disclosing the information.

14 The IASB staff identified two possible ways to develop an exemption (slide 20 of Agenda Paper 07-02):

(a) Information unavailable / Impracticability - An entity could be exempted from disclosing particular information if it would be impracticable to do so. This is similar to the exemption in paragraph B64(q) of IFRS 3, which permits an entity not to disclose information required by that paragraph if doing so is impracticable.

(b) Information available but negative consequences of disclosing - An entity could be exempted from disclosing particular information if, for example, doing so would result in the entity being unable to realise its objective for the business combination. This is similar to paragraph 92 of IAS 37, which permits an entity not to disclose information if doing so may prejudice seriously the entity's position in a legal dispute.

15 Based on a keyword search using AlphaSense[5], the IASB staff found that approximately 110 entities applied the exemption in IAS 37 in the 2021 calendar year. Very few entities used the exemption in IFRS 3.

16 The IASB staff also noted the following possible concerns with having an exemption:

(a) The approach could be difficult to apply consistently, particularly when entities operate in different markets and under different regulatory environments. It could lead to tension between preparers, regulators and auditors.

(b) The explanation for not disclosing information could itself contain information that could be commercially sensitive or forward-looking, and therefore would

[5] The IASB staff understand that the database contains over 37,000 entities globally

not necessarily address the practical concerns reported by preparers and others.

(c) It could be difficult to draft an exemption so that it is applied only in the situations the IASB intended.

17 The IASB staff notes that exemptions to regulatory reporting requirements already exist in some jurisdictions where information is considered to prejudice the entity or the information contains confidential information (slide 22 Agenda Paper 07-02).

*EFRAG Secretariat preliminary views*

18 Recent EFRAG discussions inform that one solution could be for the IASB to consider whether to integrate the subsequent disclosure proposals with the disclosure requirements on the goodwill impairment test in IAS 36 *Impairment of Assets*.

19 In the EFRAG's Secretariat view, an IAS 36 solution would be appropriate if the purpose was to justify recoverability of goodwill, and/or other assets that are recognised in the financial statements. However, it the objective is to provide information on the business combination as a whole and a follow-through on its success, then we think that IFRS 3 might be a better place. Nonetheless, the location of the information in terms of which IFRS Standard is something we think the IASB could consider further.

20 Regarding the alternatives in paragraph 11, we are inclined to prefer developing an exemption rather than reducing the population of business combinations. We think this would be more aligned to the suggestions made by EFRAG in its Final Comment Letter (see Appendix paragraph 7). The exemption(s) could be developed along the lines of the one(s) in IAS 37 (when disclosing information is harmful to the entity) and/or in IFRS 3 (when disclosing information is impracticable). The applicability of the exemption could depend on the circumstances. It would also be aligned with what already exists in some local regulatory frameworks regarding disclosure of certain information in specific circumstances.

21 Furthermore, an exemption could be developed in line with the suggestion made by one of EFRAG's Academic Panel members (see Appendix paragraph 17(c)) who supported a sort of "rebuttable assumption" similar to the concept introduced by the sustainability reporting. Additional information would need to be disclosed, and in cases of commercial sensitivity, entities should disclose why they will not provide such information with a very specific reason.

22 On the alternative to reduce the population and require additional disclosure for only a subset of business combinations, we generally consider that it would be difficult for the IASB to develop a threshold or set of criteria that would be able to appropriately capture all intended material acquisitions based on the information that the relevant decision-maker monitors.

## Next steps

23 The next steps are foreseen as follows:

(a) In Q3 2022, the IASB staff will complete research on practical concerns about the preliminary views to add (a) disclosure objectives to IFRS 3; and (b) requirements to disclose information about the subsequent performance of business combinations and quantitative information about expected synergies and ask the IASB to decide on whether to proceed with those preliminary view.

(b) In Q4 2022, the IASB will decide on (1) whether to reintroduce amortisation of goodwill; and (2) whether to move the project from the research to standard-setting phase.

(c) After Q4 2022, the IASB will decide on other aspects of the project (for example, simplifying how value in use is estimated).

**Questions for EFRAG FR TEG-CFSS members**

*Population of business combinations*

24 If the IASB were to require additional disclosure for only a subset of business combinations, how should that subset be identified? Why?

(a) If you think the subset should be identified using a quantitative threshold, what criteria should an entity be required to consider and what should the threshold be?

(b) If you think the subset should be identified using a qualitative threshold, what should that qualitative threshold be?

(c) If you think the IASB should use a factor/ indicators based threshold, how would you (a) describe the subset of business combinations and (b) what factors/indicators would you suggest?

(d) Do you suggest another approach or a combination of approaches for identifying a subset of business combinations in paragraph **Error! Reference source not found.** for which information should be provided? Please provide additional information.

*Exemption*

25 Which, if any, of the practical concerns described in paragraph 7 (slide 10 of Agenda Paper 07-02) should an exemption be used for?

26 What information in the disclosure preliminary views in paragraph 6 (slide 9 of Agenda Paper 07-02), if any, should an exemption apply or not apply to?

27 How would you draft an exemption to target the practical concern you identified?

28 Are there any features of exemptions in IFRS Standards or other regulatory guidance that you think would be useful in effectively targeting the circumstances that practical concern?

## Agenda Papers

29 In addition to this cover note, agenda paper 07-02 – *ASAF Paper AP1 Goodwill and Impairment* – has been provided for the session.

# Appendix – Background information

## Feedback on the IASB preliminary views

*Users*

1 Users said the information described in the preliminary views is needed, in particular to understand the price an entity paid to acquire a business; and assess management's stewardship of the entity's capital.

2 Essentially users want to know whether management's objectives for an acquisition are being met. This information would help them assess management's ability to realise the expected benefits from an acquisition and assess whether an acquisition's subsequent performance indicates that management paid a reasonable price for the acquired business. Information about whether management's objectives are being met would allow investors to assess performance and more effectively hold management to account for its decision to acquire the business. Hence, investors would use the information to assess management's stewardship of the company's economic resources.

3 Additional outreach conducted by the EFRAG Secretariat in recent months confirmed the above. Furthermore, users informed that they would like to have all this information at one place, preferably in the financial statements. It can be less detailed than in the prospectus, but preferably standardised.

*Preparers*

4 Preparers responding to the DP identified four practical concerns about disclosing the information proposed. These concerns were confirmed in the subsequent IASB staff outreach on this topic (see IASB Staff Paper 18A of the IASB April 2022 meeting). The concerns are:

(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 the preliminary views may be costly, or difficult, to audit.

*EFRAG Final Comment Letter*

5 EFRAG considered that the proposed disclosure requirements could result in useful information to assess business acquisitions. However, for the requirements to be most useful, the information should be provided for all material acquisitions based on the information that the relevant decision-maker monitors.

6 EFRAG noted some practical concerns including what information will be provided noting that some information might be better provided in the management commentary instead of in the financial statements. In that regard, EFRAG noted that the information is based on management expectations and refers to non-GAAP indicators. However, EFRAG would also have reservations about allowing entities to present the information in the management commentary by either including the requirements in the management commentary practice statement or allowing entities to provide the information in the management commentary by cross reference.

7 EFRAG also noted that the IASB would have to consider how to avoid entities having to disclose commercially sensitive information. EFRAG thus disagrees that

commercial sensitivity would never be a reason to prevent disclosure of information that investors would find useful. EFRAG made some suggestions how the IASB could address the issue of commercial sensitivity:

(a) One approach could be a 'disclose or explain' approach under which an entity does not disclose specified information, if disclosing the information would seriously harm the entity's possibilities to achieve the expected objectives (or by other means result in a significant unfavourable position for the entity). This approach would be similar to the approach included in paragraph 92 of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. Under a 'disclose or explain' approach, the IASB would have to consider how the approach should be applied when some information might be commercially sensitive while others might not to avoid that, for example, only the 'good' information is disclosed.

(b) Another approach, the IASB could consider in the case an entity would not provide the required disclosures, would be to either require entities to determine the additional information it would need to meet the disclosure objectives or to specify alternative information to allow users making some assessment of the management's decisions to acquire a business.

**Recent IASB discussions**

*October 2021*

8 At its meeting in 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—such as information about the subsequent performance of a business combination, and quantitative information about expected synergies.

9 Nine of 12 IASB members agreed with this decision.

*April 2022*

10 The IASB discussed:

(a) feedback from additional research, including feedback on staff examples illustrating application of the preliminary views on improvements to the disclosure requirements about business combinations (discussed with ASAF in December 2021); and

(b) how to advance those preliminary views.

11 The IASB was not asked to make any decisions.

*May 2022*

12 The IASB discussed additional research on:

(a) whether it is feasible to estimate a useful life of goodwill and the pattern in which it diminishes; and

(b) the potential consequences of transitioning to an amortisation-based model.

13 The IASB was not asked to make any decisions.

**Recent EFRAG discussions**

*EFRAG FR TEG*

14 In May 2022 EFRAG FR TEG members had mixed views on commercial sensitivity of the proposed disclosures, some considering it to be one of the main topics, while others referring to the existing similar disclosures required under IAS 37 which raised no commercial sensitivity concern.

15 Some EFRAG FR TEG members noted that the subject of the IASB proposals was different to the issues to which IAS 37 applies and pointed out the difference in timing. They noted, that when IAS 37 refers, for example, to a restructuring provision, the restructuring is already announced and is known, whereas the proposed disclosure requirements relate to the expected restructuring. This information may be commercially sensitive and also in conflict with certain legal regulations.

16 One EFRAG FR TEG member questioned in which way the business acquisitions were different from normal investment schemes, other restructurings and product roll-outs, for which information was provided to the market when an entity undertakes any significant transformation.

*EFRAG Academic Panel discussion in June 2022*

17 The EFRAG Academic Panel met on 10 June 2022 and discussed commercial sensitivity of the proposed disclosure requirements. Members made the following comments and suggestions:

(a) A balance between the concerns of preparers and the needs of users was needed. One member noted that more information could be useful for a standard setter perspective, but it could also reduce the M&A market.

(b) There was support for the “complain or explain” solution proposed by IASB staff would help initiate the discussion on what type of information is available and whether it is useful or not.

(c) One member was in favour of a sort of “rebuttable assumption” similar to the concept introduced by the sustainability reporting. Additional information needs to be disclosed about the reason for the acquisition, and in cases of commercial sensitivity, entities should disclose why they will not provide such information with a very specific reason.

(d) One member noted that research highlighted the fact that some companies are complying with the current disclosure requirements of IFRS 3. The concern for commercial sensitivity is linked to the information already required by the standard if it is followed correctly. So, perhaps asking for more disclosure and information is not the right way to address the issue but finding a way to guide entities to be fully comply with the current requirements could be more effective.

(e) Another member noted that IAS 36 already provides a well-develop framework for explaining how the impairment test on goodwill is performed. So, he wondered whether it might be appropriate to integrate the subsequent disclosure requirements discussed in the IASB DP with the current disclosure requirements on the impairment test.