IFRS® Foundation

Goodwill and Impairment

Accounting Standards Advisory Forum meeting

ASAF Agenda Paper 1
July 2022

Purpose of this session

Purpose

- Update ASAF members on the Goodwill and Impairment project.
- Seek advice on possible ways forward for the preliminary views related to additional disclosure objectives in IFRS 3 and improving disclosures about subsequent performance of business combinations and expected synergies (see slide 9). In particular we have questions about:
  - requiring disclosures for only a specific population of business combinations; and
  - exempting entities from disclosing particular information in specific circumstances.
- **Questions for ASAF members are set out in slides 17 and 24.**

Agenda

- Project status (slides 4–7)
- Feedback on disclosure preliminary views and possible alternatives (slides 8–11)
- Population of business combinations (slides 12–17)
- Exemption (slides 18–24)

Project status

Project update

Project objective

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

Preliminary views (2020 Discussion Paper)	Project update
• Disclose management's objectives and the metrics management will use to monitor performance and subsequently disclose performance against those objectives using those metrics • Targeted improvements to existing requirements	• Discussed feedback in April 2021 • IASB tentatively decided that conceptually this information can be required in financial statements (tentative decision in October 2021) • IASB discussed additional research and possible ways forward in April 2022 (slide 6)
• Retain impairment-only model • Simplify impairment test	• Discussed feedback in May 2021 • IASB discussed additional research on specific aspects of feedback in May 2022 (slide 6)
• Do not change recognition of intangibles separately from goodwill	• IASB discussed feedback in May 2021

Recent IASB discussions

Project priority

The IASB is prioritising analysis of feedback on:
- disclosures about business combinations; and
- whether to retain the impairment-only model or to reintroduce amortisation for goodwill.

April 2022	May 2022
The IASB discussed: • 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 • how to advance those preliminary views (see slide 11). The IASB was not asked to make any decisions.	The IASB discussed additional research on: • whether it is feasible to estimate a useful life of goodwill and the pattern in which it diminishes; and • the potential consequences of transitioning to an amortisation-based model. The IASB was not asked to make any decisions.

Next steps

Q3 2022

- the 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;
- the IASB to decide on whether to proceed with those preliminary views.

Q4 2022

- the IASB to decide on:
  - whether to reintroduce amortisation of goodwill; and
  - whether to move the project from the research to standard-setting phase.

After Q4 2022

- the IASB to decide on other aspects of the project (for example, simplifying how value in use is estimated).

Feedback on disclosure preliminary views and possible alternatives

The preliminary views

Additional disclosure objectives

- Add additional disclosure objectives to IFRS 3 that would require entities to disclose information that would help users understand:
  - the benefits an entity expected from a business combination when agreeing the price to acquire that business; and
  - the extent to which management's objectives are being met.

Disclosure about performance of business combinations

- Require entities to disclose in the year of a business combination, the strategic rationale and objectives for that business combination and the metrics management plan to use to monitor achievement of those objectives.
- In subsequent years, disclose management's review of the entity's performance against those objectives.

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.

The Discussion Paper contained other preliminary views about the disclosure requirements on business combinations but they are not the focus of this discussion.

Feedback on the preliminary views

Feedback from users	• Users said the information described on slide 9 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.

Feedback from preparers	• Preparers responding to the Discussion Paper identified four practical concerns about disclosing the information described on slide 9. These concerns were confirmed in the subsequent staff outreach on this topic. The concerns are:
	  • commercial sensitivity—that information could contain sensitive information that, if disclosed, could harm the entity;
	  • forward-looking information—that information could contain information about the future that, if disclosed, could increase litigation risk;
	  • 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
	  • auditability—some information that would be required by the preliminary views may be costly, or difficult, to audit.

See Agenda Paper 18A to the April 2022 IASB meeting for more details on the feedback.

Possible alternatives to address practical concerns

In April 2022 the IASB discussed two variables that can be adjusted to better balance the costs and benefits of any proposed requirements:

- the **population** of business combinations for which information would be disclosed; or
- the **amount** of information to be disclosed for each affected business combination.

Population of business combinations

- Require disclosure about the strategic rationale, management objectives and subsequent performance of business combinations and expected synergies for **only a subset of business combinations**.*

Amount of information

- Requiring only qualitative information in the year of acquisition rather than quantitative information.
- Specifying the metrics an entity would disclose.
- **Exempt entities from disclosing particular information in specific circumstances.***

The IASB could combine some of the alternatives, for example by requiring disclosure of information provided applying the IASB's preliminary views for a subset of business combinations but allow entities to apply an exemption in specific circumstances.

*Discussion at the April 2022 IASB meeting focussed on identifying a subset of business combinations for which additional disclosures would be required (slides 12–17) and whether to exempt entities from disclosing particular information in specific circumstances (slides 18–24).

Population of business combinations

Background

Require disclosure about the subsequent performance of business combinations and quantitative information about expected synergies for only a subset of business combinations.

This could address some concerns about

Commercial sensitivity / Forward-looking

A few of the preparers who expressed concerns about commercial sensitivity nonetheless disclosed information about some business combinations. This implies there is a population of business combinations for which the benefits of disclosure outweigh commercial sensitivity concerns. A similar argument could be made about concerns the information is forward-looking.

Integration / Auditability

If the subset of business combinations are the most important ones, those are more likely to be a separate segment or have a significant impact on existing segments. Therefore the effect of such business combinations would be easier to identify and audit.

Also, the alternative could…

- be a compromise between preparers and users. By focusing on a subset of business combinations, users would receive the most important information while preparers could avoid disclosing information for a large number of business combinations.

- introduce complexity—it would result in different disclosure requirements for different populations of business combinations.

Identifying subset of business combinations

We have identified three ways the IASB could identify a subset of business combinations:

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 a similar to the approach used in paragraph 13 of IFRS 8.

Qualitative threshold

a 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 to identify discontinued operations.

A factor/ indicator based threshold

A list of factors/ indicators—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 for identifying an investment entity (paragraphs 27–28 of IFRS 10 define and then list characteristics of an investment entity).

Research on identifying a subset of business combinations

Research performed	To gather information on whether it is possible to identify a subset of business combinations for which disclosure should be required we: • discussed with preparers that expressed concerns about commercial sensitivity but nonetheless disclosed information about some business combinations; and • reviewed the CapitalIQ database of business combinations to assess how many business combinations might be captured by different thresholds.
Information from preparers	The preparers we spoke to identified different reasons for sometimes disclosing information similar to that described on side 9 outside of financial statements: • one preparer said in their jurisdiction an entity is required to disclose the basis of their valuation in a tender offer. That preparer concluded information about expected revenue and profit of the target business met that requirement and therefore disclosed that information. • one preparer said that the business combination they disclosed information for was one for which the entity decided users need additional information. The purchase price for that business combination represented about 20% of the entity's market capitalisation.

Research on identifying a subset of business combinations

Review of CapitalIQ

We reviewed business combinations in Europe, Asia-Oceania and the Americas.* In each region we:

- compared the number of discontinued operations reported by entities in those jurisdictions to the total population of disposals by entities in those jurisdictions (as an example of the application of a qualitative threshold in IFRS Accounting Standards);
- compared the number of business combinations that met specific thresholds on any one of four criteria to the total population of acquisitions by entities in those jurisdictions. The criteria we used were revenue, profit, total assets and net assets of the acquired and acquiring entities prior to the acquisition. We used thresholds of 5% and 25%.

Region	Discontinued Operations	One of the criteria is over 5%***	One of the criteria is over 25%***
Europe	26%	25%	11%
Asia-Oceania	74%**	16%	6%
Americas	16%	14%	5%
Average	39%	18%	7%

* We were unable to obtain sufficient information to be able to perform this analysis for African jurisdictions.
** This number is an outlier. The large percentage appears to be driven by transaction information for entities listed on the Hang Seng index in Hong Kong. It is not clear why the figure for that index is higher than in other jurisdictions.
*** The figures in these columns are based on the list of all business combinations in CapitalIQ. Some of those business combinations have incomplete data (eg no purchase price). Excluding such business combinations, the average proportion of combinations meeting the 5% and 25% thresholds would be 77% and 29% respectively.

Question 1: Population of business combinations

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

– 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?
– If you think the subset should be identified using a qualitative threshold, what should that qualitative threshold be?
– 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?
– If you suggest another approach or a combination of approaches on slide 14 please provide additional information.

Exemption

Background

The IASB could exempt an entity from disclosing some information that would be required by the preliminary views if specific conditions are met. The entity would explain the circumstance and the reason for not doing disclosing the information that would otherwise be required.

An exemption could address some practical concerns, such as:

Commercial sensitivity

If disclosing particular information would result in the entity being unable to realise its objective for the business combination, an entity could be exempted from disclosing that information.

Forward-looking information

If disclosing particular information creates a higher risk of litigation compared to disclosing outside financial statements, an entity could be exempt from disclosing that information.

However, there are concerns about introducing an exemption…

- 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.
- 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.
- it could be difficult to draft an exemption so that it is applied only in the situations the IASB intended.

Agenda Paper 18B to the IASB's April 2022 meeting discussed a 'comply or explain' model. The model in that Agenda Paper focussed on identifying an exemption from disclosing particular information in specific circumstances rather than a unrestricted 'comply or explain' model (for example, as used in the UK Corporate Governance Code).

Possible ways to draft criteria for exemption

There are two broad ways in which the IASB might exempt entities

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.

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.

Evidence about use of exemptions in other IFRS Accounting Standards

Existing requirements

Exemption due to negative consequences
IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* permits entities to not disclose information about contingent liabilities if doing so may prejudice seriously the entity's position in a legal dispute.

Exemption due to impracticability
IFRS 3 *Business Combinations* permits entities to not disclose information required by paragraph B64(q) if it is impracticable to do so. The acquirer shall disclose that fact and explain why the disclosure is impracticable.

Prevalence in practice*

We found approximately 110 entities* citing the exemption in the 2021 calendar year.

We found 3 entities citing the exemption in the 2021 calendar year.

*Data based on keyword search of financial statements using AlphaSense. The result for IAS 37 was extrapolated based on a sample of database entries. The result for IFRS 3 was based on a search of the entire population. We understand that the database contains over 37,000 entities globally.

Examples of exemptions from regulatory requirements

Regulatory requirements

- The Australian *Corporations Act 2001* allows an entity to omit information that is likely to result in 'unreasonable prejudice' to the entity. In 2019 the Australian Securities & Investments Commission (ASIC) published Regulatory Guidance 247 for entities applying this exemption.
- Regulation (EU) No 575/2013 allows entities to omit information that is immaterial, or contains proprietary or confidential information. In 2014 the European Banking Authority (EBA) published guidance on the application of this exemption.

Key features of the requirements

- Both include a statement that the circumstances in which the exemption is used are expected to be rare.
- Both set out circumstances in which it would be inappropriate to use the exemption (eg if the information has already been disclosed elsewhere).
- The ASIC guidance requires an entity to assess the likelihood of 'unreasonable prejudice' when applying the exemption.
- The EBA guidance states that the exemption cannot be used for particular items of information.

Effectiveness of regulatory requirements

Regulatory exemptions

- We are unaware of comprehensive research on the effectiveness of exemptions such as those described on slide 22. However, anecdotal evidence suggests the guidance published by ASIC and EBA is effective at ensuring the exemption is applied only in appropriate circumstances.

UK Corporate Governance Code

- A report published by UK regulator found that entities try to comply but the information disclosed when not complying tends to be boilerplate and lacks substance.
- Academic evidence[1] on the UK Corporate Governance Code found increasing compliance over time, but also found frequent use of standard, boilerplate explanations when the ‘explain’ option was used.

1 For example, Arcot, S., Bruno, V. and Faure-Grimaud, A. (2010), ‘Corporate governance in the UK: Is the comply or explain approach working?’, *International Review of Law and Economics*, 30.

Question 2: Exemption under specific circumstances

a) Which, if any, of the practical concerns described on slide 10 should an exemption be used for?

b) What information in the disclosure preliminary views on slide 9, if any, should an exemption apply or not apply to?

c) How would you draft an exemption to target the practical concern you identified?
   - Are there any features of exemptions in IFRS Accounting Standards or other regulatory guidance that you think would be useful in effectively targeting the circumstances that practical concern?

Find us online

ifrs.org

@IFRSFoundation

IFRS Foundation

IFRS Foundation

International Accounting Standards Board

International Sustainability Standards Board

IFRS