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Business Combinations: Disclosures, Goodwill and Impairment

The management approach Issues Paper

Objective

- 1 To ask EFRAG FR TEG members for their views on the IASB's tentative decisions on specifying a level of management to identify the information to be disclosed on the subsequent performance of a business combination.
- 2 In this paper 'information about the subsequent performance of a business combination' includes information about:
 - (a) management's objectives for the business combination;
 - (b) the metrics and targets management will use to monitor whether those objectives are being met; and
 - (c) in subsequent periods, the extent to which management's objectives are being met, using those metrics, for as long as management monitors the business combination against its objectives.
- 3 This paper is based on the [IASB Agenda Paper 18A](#) discussed at the February 2023 IASB meeting.

Background

- 4 The IASB issued the Discussion paper [Business Combinations – Disclosures, Goodwill and Impairment](#) ('the DP') in March 2020 with a comment period that ended on 31 December 2020.

Structure of this paper

- 5 This paper is structured as follows:
 - (a) Proposals in the DP
 - (b) Feedback on the proposals
 - (c) IASB Staff analysis
 - (d) IASB tentative decisions
 - (e) EFRAG Secretariat observations

Proposals in the DP

- 6 Paragraph 2.36 of the DP states that:

The Board's preliminary view discussed in paragraphs 2.8–2.32 is that it should require disclosures about management's objectives for an acquisition and its subsequent performance using the metrics that management uses to monitor an acquisition's performance and subsequent progress against those metrics. The Board's preliminary view is that this information should be required only for those acquisitions monitored by a company's chief operating decision maker (CODM), as described in IFRS 8 *Operating Segments* paragraph 8.11. The information provided for those acquisitions would be the objectives the CODM has set for the acquisition and the information the CODM uses to monitor whether those objectives are being met.

7 Paragraph 2.37 of the DP explained that:

The role of the CODM is to allocate resources to operating segments and assess their performance. In the Board's view, the role is likely to include monitoring the performance of acquisitions. This is because the performance of the operating segments, which the CODM would monitor, would include the performance of the acquisition, and deciding to acquire a business would involve allocating resources to those operating segments that include the acquisition.

8 Paragraph 2.38 of the DP explains that requiring disclosure about subsequent performance only for those acquisitions monitored by the CODM would have the following advantages:

- (a) this approach is a logical extension of the management approach discussed in paragraphs 2.13–2.32, which bases the information provided on what the CODM uses to monitor an acquisition.
- (b) basing the information on what the CODM uses to monitor an acquisition may help minimise the costs of preparing the information, focusing on the most important information about the most important acquisitions.
- (c) stakeholders will be familiar with this approach from applying IFRS 8.
- (d) the Board would not need to provide guidance on what is meant by 'management' and 'monitors'. 'Monitors' would mean the same as the role the CODM plays in assessing performance described in IFRS 8, based on the information the CODM reviews for this purpose.

9 However, in paragraph 2.39 of the DP the IASB acknowledged that there may be drawbacks to requiring these disclosures only for those acquisitions monitored by the CODM. Investors may not receive material information on acquisitions if those acquisitions are not monitored by the CODM.

Feedback on the proposals

Feedback to the IASB

- 10 The IASB received mixed feedback on whether the CODM is the right level of management to determine the business combinations an entity is required to disclose information about and what information an entity should disclose. Many respondents said using the CODM as the threshold is a practical approach that provides a reasonable cost-benefit balance.
- 11 However, some said that the CODM reviews information about few large business combinations that are strategically important and that using the CODM might result in users of financial statements (users) not receiving all material information. They said detailed monitoring of business combinations is performed by a lower level of management—for example by the head of individual segments (business units) into which the business combination is integrated.
- 12 A few users expressed concern about the use of the CODM—they said their experience of segment disclosures has been disappointing and are therefore

concerned that using the CODM to identify information may not provide useful information.

- 13 The IASB Staff performed fieldwork during 2021-2022 on the use of the CODM in the context of information on business combinations and received the following feedback:
- (a) The amount and frequency of information about business combinations reviewed by the CODM differs by entity.
 - (b) There is an approval process for undertaking business combinations. Approval from the CODM is typically needed for only particularly large business combinations. As part of the approval process, the CODM is provided with information on the business combinations. The content and amount of information provided varies by entity but can include a valuation of the target business as a stand-alone entity, an estimate of potential synergies and a future business plan.
 - (c) The CODM might not review actual performance of the business combination in subsequent periods using information that is prepared on the same basis as was used to approve the business combination (, for example initial targets may change and the monitoring process may change as the integration of the acquired business evolves).
 - (d) Additional information may be received after the date of the acquisition – this information could be available at a lower level than the CODM.
 - (e) If the IASB decides to use the CODM as the filter for identifying the information to be disclosed, the IASB should specify the type of information reviewed by the CODM that needs to be disclosed - for example, whether an entity would be required to disclose only information provided to the CODM as part of regular performance monitoring, or also information provided on an ad-hoc basis such as information provided in a 'post-acquisition review' which some entities conduct.

EFRAG's views in its Final Comment Letter

- 14 In EFRAG's Final Comment Letter, EFRAG acknowledged that there are advantages of referring to the information used by the CODM, as this term is already defined in IFRS 8. However, EFRAG considered that it should also be possible to define 'the relevant decision maker' level on which the disclosures on the success (or failure) of acquisitions should be based.
- 15 EFRAG noted that it was not concerned that from the perspective of users, the volume of disclosures would be onerous if companies' disclosures are not based on the acquisitions that the CODM reviews. On the contrary, EFRAG is concerned that users may not receive sufficient information if the disclosures would only be based on the information that the CODM reviews.
- 16 EFRAG also considered that the cost of providing information about all acquisitions (and having this information audited) could result in a situation in which the cost of preparing the information would outweigh the benefits. However, as long as the information about an acquisition is prepared internally, the additional costs of preparing the information might be reasonable compared with the benefits of the information.
- 17 EFRAG, therefore, believed that if the information is to be provided, it should be based on:
- (a) Firstly, a general materiality level. That is, if an acquisition is material, information about it should be provided.

- (b) Secondly, the information provided should be based on the information used to monitor the acquisition internally by the relevant decision maker. The relevant decision maker may correspond to the CODM or to a lower level, depending on the entity's strategy and organisation.
- 18 EFRAG also suggested that the IASB should consider whether, and if so how, an entity should provide the suggested information if it undertakes many small acquisitions, as part of an overall strategy, that combined are material. EFRAG notes that this suggestion should not mean that an entity would have to provide disclosures on intended future acquisitions when describing the objectives of the acquisitions.

IASB Staff analysis

- 19 In analysing the issue, the IASB Staff considered the following:
- (a) whether the IASB should specify a level of management to help identify the information an entity should disclose; and
 - (b) if so, what that level of management should be.

Specifying a level of management

- 20 The IASB Staff noted that the IASB could decide not to specify a level of management when identifying the information an entity would be required to disclose about the subsequent performance of a business combination.
- (a) This would be less prescriptive and result in an entity disclosing information about the subsequent performance of a business combination no matter what level of management reviews that information.
 - (b) It is not uncommon under IFRS to refer to information reviewed or used by management, without specifying the exact level of management. Various IFRS¹ refer to information or estimates that are reviewed/approved etc. by "management".
- 21 However, the IASB Staff considered that there were several benefits to specifying a level of management, in particular a senior level of management, because:
- (a) Doing so may better help hold management to account for 'strategically important' business combinations than not specifying a level of management. If the IASB does not link the information required to be disclosed to the information reviewed by an entity's senior management, users might not be informed of this fact. This may happen, for example, if the performance of a 'strategically important' business combination is reviewed only by an entity's junior management but not by its senior management.
 - (b) If a level of management is not specified, there may be greater pressure to accurately define 'monitoring' the performance of a business combination in a way that distinguishes the information an entity would disclose about the business combination from information the entity uses to monitor the performance of the business as a whole.
 - (c) Specifying a level of management could help identify the most important information about a business combination. This emphasis would be particularly helpful when different levels of management within an entity monitor the performance of a business combination using information with differing levels of detail.

¹ IFRS 15 *Revenue from Contracts with Customers*, IAS 1 *Presentation of Financial Statements*, IAS 36 *Impairment of Assets* to name a few.

- 22 The IASB Staff concluded that there were more benefits than drawbacks of setting a level of management (at senior level) to identify the information an entity would be required to disclose about the subsequent performance of a business combination.
- 23 For the above reasons, the IASB Staff **recommended the IASB to specify a level of management** within an entity to identify the information the entity is required to disclose.

Definition of management

- 24 The IASB Staff identified two possible definitions of senior management, where the IASB could define management as either:

- (a) an entity's CODM (as included in the DP); or
- (b) the key management personnel (KMP) of the reporting entity

CODM

- 25 Regarding the CODM the IASB Staff noted that:

- (a) As explained in paragraph 10, the IASB received mixed feedback on whether the CODM is the right level of management to determine the business combinations an entity is required to disclose information about and what information an entity should disclose. While some said that they are familiar with the term and therefore it would result in reasonable cost-benefit balance when applying it, others (especially users) said that detailed monitoring of business combinations is performed by a lower level of management; referring to the CODM might result in users not receiving the information or receiving less or insufficient information.
- (b) There is diversity in the information CODMs in different entities review. This could lead to different entities disclosing different information based only on the way the entity's internal controls are structured.
- (c) The CODM is linked with the information an entity is required to disclose applying IFRS 8. This may not always be relevant for the information being sought for a business combination. Some stakeholders expressed confusion as to how information about the subsequent performance of a business combination would differ from the information already disclosed applying IFRS 8.

Entity's KMP's

- 26 The IASB staff noted that an alternative is to use an entity's KMP as defined in IAS 24 *Related Party Transactions*.
- 27 IAS 24 defines KMP as persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity.
- 28 The IASB Staff considered that KMP has the following benefits:
- (a) KMP are typically senior management within an entity and therefore, using KMP has some similar benefits to using CODM because using KMP:
 - (i) utilises existing terminology within IFRS Accounting Standards that stakeholders would be familiar with; and
 - (ii) could provide useful information regarding management's stewardship if this level of management does not monitor the performance of a 'strategically important' business combination.
 - (b) Unlike an entity's CODM, KMP is not linked with segment reporting. This could avoid confusion regarding the relationship between the proposed disclosure requirements and disclosure requirements in IFRS 8.

- 29 There are several IFRS Standards that refer to information based on what is provided to/ reviewed by KMP. For example:
- (a) paragraph 34(a) of IFRS 7 *Financial Instruments: Disclosures* requires an entity to disclose summary quantitative data about its risk exposures based on information provided internally to the entity's KMP;
 - (b) paragraph B4.1.1 of IFRS 9 *Financial Instruments* requires an entity to determine the classification of financial assets based on the entity's business model as determined by its KMP; and
 - (c) paragraph 135 of IAS 1 *Presentation of Financial Statements*, requires an entity to disclose information about its objectives, policies and processes for managing capital based on information provided internally to the entity's KMP.
- 30 The IASB Staff considered that using KMP would retain the idea of identifying a senior level of management while avoiding some of the problems with using an entity's CODM. Using KMP would help to identify the most important information about a business combination.
- 31 For the above reasons, the IASB Staff **recommended the IASB to amend its preliminary view and describe that level of management** as the key management personnel as defined in IAS 24.
- 32 The IASB Staff did not think it was necessary to define or provide application guidance on 'monitoring' as this would be inconsistent with the management approach and could restrict management from telling "their story".

IASB tentative decisions

- 33 At its February 2023 meeting, the IASB agreed with the IASB Staff recommendations to amend its preliminary views and took the following tentative decisions on the use of the management approach:
- (a) to specify a level of management within an entity to identify the information the entity is required to disclose about the subsequent performance of business combinations; and
 - (b) to describe that level of management as the key management personnel of the reporting entity, as defined in IAS 24.
- 34 All 12 IASB members agreed with these decisions.
- 35 During the discussion some IASB members noted that it was important that whoever is reviewing the "strategically important" business combinations should be the person(s) responsible for determining and providing the required information.
- 36 Some IASB members noted that the CODM was more a "function role" rather than a "person(s) role" and that specifying a level of management to be KMP could broaden the management level responsible for monitoring strategically important business combinations. This would therefore help to address the concerns of respondents, particularly users, that were concerned that using the CODM to identify information may not provide useful information (experience of segment disclosures has been disappointing) or provide insufficient information (because it might be at too high a level).

EFRAG Secretariat analysis

- 37 The EFRAG Secretariat notes that, following the IASB tentative decision in September 2022, information on subsequent performance of a business combination will only be required for 'strategically important' business combinations, rather than for business combinations, regardless of who reviews the information.

This decision will help address the EFRAG concern on materiality in paragraph 17(a).

- 38 We agree with the IASB tentative decisions in paragraph 33 for the reasons cited in the IASB Staff analysis.
- 39 In our view, the IASB tentative decisions are closely aligned with EFRAG's recommendations in its Final Comment Letter in paragraphs 14 - 18 and address the concerns EFRAG mentioned regarding the reference to CODM.

Questions for EFRAG FR TEG

- 40 Do EFRAG FR TEG members agree with the IASB's tentative decisions in paragraphs 33? If not, please explain.
- 41 Do you agree with the EFRAG Secretariat observation in paragraph 39? If not, please explain.