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EFRAG Survey Business Combinations – Disclosures, Goodwill and Impairment: Disclosures

Summary of responses

Objective

1 To provide the EFRAG FRB with a summary of responses to a survey on proposed disclosures on the IASB project *Business Combinations – Disclosures, Goodwill and Impairment*.

Background

2 The survey, published in October 2023, was aimed at preparers of IFRS financial statements which conducted business combinations during the three-year period 2020-2022.

3 The purpose of the survey was to collect feedback on whether the IASB's proposed disclosure requirements can be applied in practice and whether they meet the intended objectives at a reasonable cost. The survey is provided as a **background document** (please refer to paper 06-03).

Definition of terms

4 The following terms are used to describe the extent to which particular feedback was shared among respondents:

Term	Extent of response among respondents
Almost all	90%-100%
Most	75%-89%
Majority	50%-74%
Many, significant	25%-49%
Some, others	0%-24%

Executive Summary

5 EFRAG received 11 completed surveys from entities in 9 European jurisdictions and operating in 8 different industries. For the purposes of this analysis, the EFRAG Secretariat consolidated responses for all three years by reporting on a three-year period (2020-2022).

6 2 out of 11 entities that responded to the survey, did not conduct any business combinations over the three-year period.

Quantitative and qualitative thresholds for determining a strategic business combination

7 Most respondents (9 out of 11) considered that a **combination** of qualitative and quantitative thresholds[1] should be used for determining "strategically important"[2] business combinations, which suggests that **most respondents do not agree with the IASB's proposal** (which focuses on **one** of the proposed thresholds being met when determining a strategic business combination – either a quantitative threshold or a qualitative threshold).

8 However, there were **mixed views** on whether the proposed quantitative and qualitative thresholds would alleviate preparers' concerns on the costs for complying with the proposed disclosure requirements with some respondents asking for higher quantitative thresholds and others for different qualitative thresholds. One respondent noted that IFRS usually should not prescribe mandatory quantitative thresholds and another respondent asked for more flexibility in what information an entity should provide on business combinations.

9 The majority of respondents (6 out of 11) define "new geographical area" and/or "new major line of business" for internal purposes. However, only some respondents considered "new geographical area" and/or "new major line of business" as the most appropriate qualitative threshold.

10 The majority of respondents (6 out of 9), whose entity has conducted business combinations noted that **none of the business combinations conducted in the three-year period (2020-2022) would meet the qualitative or quantitative thresholds** of "strategically important" business combination. For these entities, this could imply that they did not conduct a "strategically important'' business combination. On the other hand, it could also

[1] A business combination is "strategically important" if it meets any of the quantitative (**10%** or higher of acquirer's **operating profit** or **revenue** or **total assets**) **<u>or</u>** qualitative thresholds (**new geographical area** or **new major line of business**). For more details, please refer to Part (b) of EFRAG's survey (Paper 06-03 document).

[2] The final working in the ED may refer to ''strategic'' business combinations rather than "strategically important.

indicate that the proposed thresholds are inappropriate to capture the right level of strategic business combinations and therefore result in the omission of useful information to users of financial statements. One could therefore conclude that more work is needed to test the proposed thresholds.

Exemption

11 The majority of respondents (7 out of 11) **did not consider** that the proposed exemption[3] would be satisfactory in order to address concerns on commercial sensitivity.

12 The majority of respondents (5 out of 9) that have conducted business combinations in the three-year period would **not have been eligible** to apply the exemption to any business combinations.

13 The majority of respondents (7 out of 11) **did not consider** that the IASB should specify that the exemption would only apply "in extremely rare cases", as specified in paragraph 92 of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

Synergies

14 The majority of respondents (6 out of 11) disagreed with the IASB's proposal of not defining "synergies".

15 The majority of respondents (6 out of 11) considered that the aggregation of the categories of synergies as proposed by the IASB would not solve concerns on commercial sensitivity and questioned how the information on synergies could be aggregated, as each business combination is different.

Overall concerns

16 The overall main concerns of respondents are listed below:

(a) Cost-benefit balance;

(b) Commercial sensitivity of information;

(c) Level-playing field between IFRS-adopters and non-IFRS-adopters;

(d) Difficulty to determine whether synergies and targets are met, once the acquired business is integrated into the existing business.

[3] The IASB has proposed an exemption in specific circumstances that would permit an entity not to disclose some of the information required under the proposed disclosure requirements. For more details, please refer to Part (c) of EFRAG's survey (Paper 06-03 document).

General information

Figure 1: Geographical split of respondents

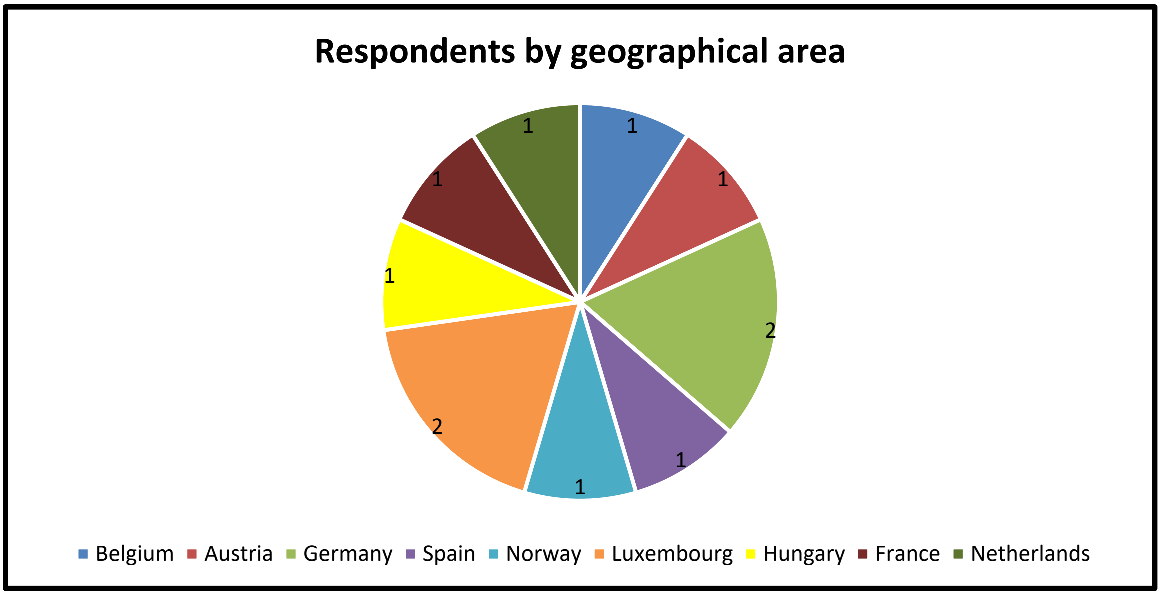
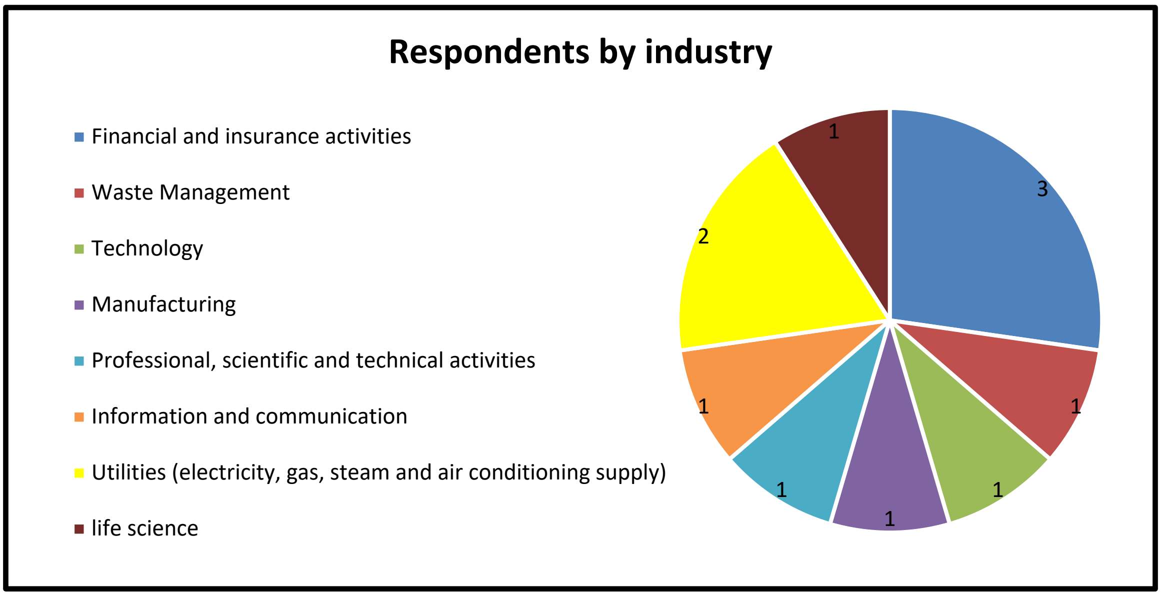


Figure 2: Industry breakdown of respondents

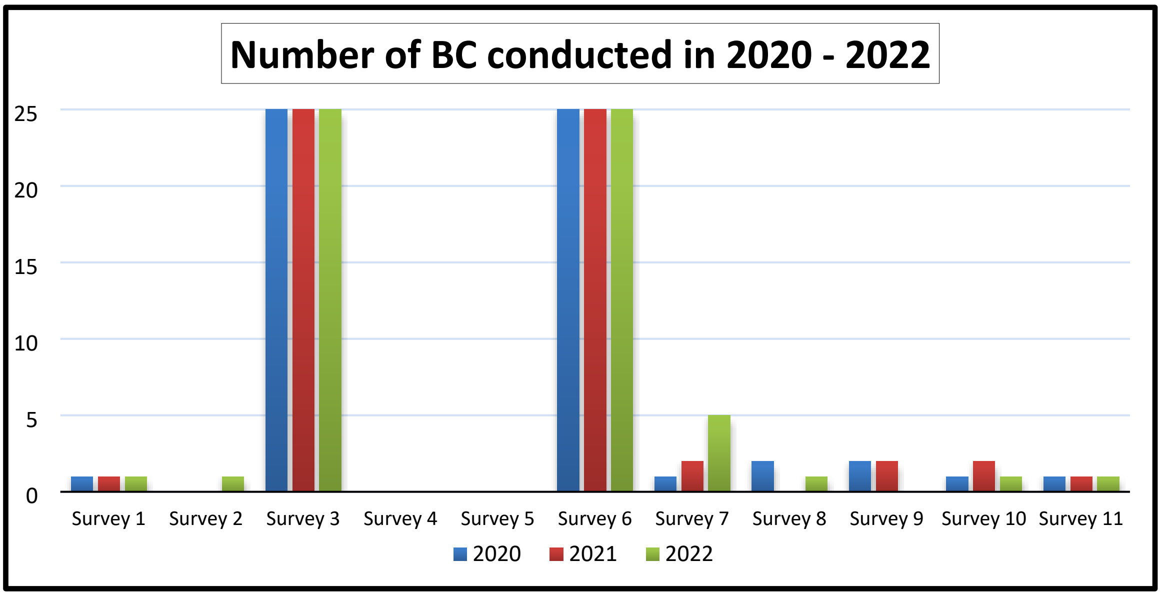


17 Concerning the number of business combinations conducted in the three-year period (2020-2022), some respondents (2 out of 11) reported more than 25 transactions each year while most respondents (7 out of 11) reported 5 or less transactions for each of the three years. Other respondents (2 out of 11) did not have any transactions in the three-year period.

18 There are several questions in the survey that are **only relevant to entities that have conducted at least one business combination in the three-year period**, and therefore the

two entities that have not conducted **any** business combinations in the three-year period **are not considered in the analysis**.

Figure 3: Number of business combinations conducted in the three-year period (2020-2022)



Structure of this paper

19 The rest of this paper is structured as follows:

(a) Thresholds for determining a "strategically important" / "strategic" business combination;

(b) Exemption from disclosing information in specific circumstances;

(c) Quantitative information about expected synergies in the year of acquisition (Optional); and

(d) Other comments on proposed disclosures.

20 The structure follows the same structure (questions) as the survey.

Thresholds for determining a "strategically important" business combination

Questions on the internal definitions of "new geographical area" and "new major line of business"

21 Many respondents (5 out of 11) define "new geographical area" and/or "new major line of business" for internal purposes. Examples of the definitions include:

(a) New geographical area:

(i) The term "home countries" is defined in the company's business unit reporting;

(ii) It is defined as each country in which the group had no operations before the acquisition; and

(iii) It is defined based on the materiality of amount of goodwill on the financial statements applying judgement.

(b) New major line of business:

(i) The term “line of business” is defined in the company’s business unit reporting, e.g. split by banking and insurance;

(ii) It is defined based on the materiality of the amount of goodwill on the financial statements applying judgement;

(iii) It is defined as new type of services different to the core activities; and

(iv) New segment.

Questions on the appropriateness of combination of quantitative and qualitative thresholds to define a “strategically important” business combination

22 Most respondents (9 out of 11) considered that **both** quantitative **and** qualitative thresholds should be used to define a “strategically important” business combination. The IASB proposal says that a business combination that meets **any one** of the thresholds (quantitative **or** qualitative) would be a strategic business combination.

23 The two respondents who disagreed (2 out of 11) provided the following comments:

(a) One respondent considered that **only** quantitative thresholds should be used but noted that the thresholds should be increased.

(b) Another respondent considered that entities should be allowed to perform their own assessment to determine when a business combination is ‘’strategically important” with an open list of factors to consider. They noted that IFRS usually do not prescribe mandatory quantitative thresholds.

This respondent added that the assessment of “strategically important” business combination **should be based on the amount of goodwill and the strategic rationale**, as these were considered to be the main triggers to identify strategically important business combinations. In the view of this respondent, the higher price a company is willing to pay, the most valuable the business combination is, because of the expected synergies which are often unique to each acquisition. The relative importance of the amount of goodwill should be internally defined by management for each business combination considering specific facts and circumstances.

Quantitative thresholds

24 Of the respondents who agreed with the proposed quantitative thresholds, the majority (5 out of 9) agreed that “operating profit”, “revenue” and “total assets” were the most appropriate quantitative properties.

25 The respondents that disagreed (4 out of 9) with the proposed quantitative thresholds provided different views and suggestions of the possible thresholds:

(a) Acquisition price compared to total equity of the acquirer.

(b) Only “revenue” and “total assets” are appropriate; “operating profit” is considered too volatile to be an appropriate threshold. The impact of fair value changes, cyclical markets and impacts of impairment creates year-on-year variations that make “operating profit” less relevant as a threshold.

(c) Only “operating profit” and “revenue” are appropriate, and acquiring an entity with high levels of cash does not imply that the business combination is “strategically important”.

(d) “Operating profit” and “revenue” are not clearly defined for all types of business. For insurance undertakings, it is recommended to use “profit before taxes” and “insurance and investment income” instead.

26 Concerning the percentage to be used as a quantitative threshold there were mixed views, however, **the majority (5 out of 9) of respondents agreed with the IASB proposal to set it at 10%**. Those who disagreed recommended a higher percentage (e.g., 20%, 25%).

Qualitative thresholds

27 Most respondents disagreed with the proposed qualitative thresholds mainly because in their view they would result in including immaterial business combinations. For example, one respondent said that:

“In our view entering into a new business line or into a new geographical area via a business combination does not by itself mean, that that business combination is of strategical importance. The new business line or the business in the new geographical area could still be immaterial for the future development of the acquiring company. In our view a combined quantitative and qualitative threshold would make sense (e.g. to be a strategically important business combination one of the qualitative indicators and one of the quantitative indicators/figures with a threshold >5% must be met).”

28 Only some respondents (2 out of 9) considered “new geographical area” and/or “new major line of business” as the most appropriate qualitative criteria.

29 Respondents made following other suggestions/comments:

(a) Both quantitative and qualitative thresholds should be always combined, to avoid minor business combinations being considered as “strategically important”;

(b) Technology and other aspects related to production should be added to the list of qualitative criteria;

(c) It is difficult to define the criteria – diversity in practice may arise; and

(d) For groups with worldwide activities, the “new geographical area” criterion would be less relevant.

Questions on whether the proposed thresholds would address preparers’ concerns about the costs of complying with the proposed disclosure requirements

30 There were mixed views on whether the proposed thresholds would address preparers’ concerns on costs with **only 5 of 11 respondents agreeing**.

31 The respondents that **disagreed** (6 out of 11 respondents), recommended the following alternative approaches:

(a) To allow entities to perform their own assessment for determining “strategically important” business combinations, with an open list of factors to consider. (3 out of 6). A respondent suggested: “*The assessment should be performed considering the facts and circumstances of the business, as well as its strategic rationale. It should be explain why or why not meeting the objectives of the business combination would seriously put at risk the entity achieving its overall business strategy. A high amount of goodwill could be an indicator that the business combination is strategically important*”.

(b) To increase quantitative thresholds (1 out of 6);

(c) Other approaches (1 out of 6): A respondent mentioned: “*The costs of complying should be assessed from the perspective of the complexity of the assessment, the level of the integration of the acquired business into the acquirer's activities (dilution of boarders between an acquirer and an acquiree), accuracy of management assertions and subjective judgments*”.

(d) To combine quantitative and qualitative thresholds. For example, to be a strategically important business combination one of the quantitative thresholds and one of the qualitative thresholds should be met.

Question on whether qualitative and/or quantitative thresholds would have been met for each business combinations undertaken in 2020, 2021 and 2022

32 The majority of respondents (6 out of 9), whose entity has conducted business combinations noted that **none of the business combinations conducted in the three-year period (2020-2022) would meet the qualitative or quantitative thresholds** of "strategically important" business combination.

33 One respondent reported that less than 7% of the business combinations conducted in the specified period would have met the qualitative threshold of "new geographical area", while the remaining would not have met them.

34 Two respondents noted that **all business combinations conducted in the specified period would have met the qualitative thresholds** ("new geographical area"; both "new geographical area" and "new major line of business"). Both respondents expressed concerns with the proposed thresholds and noted that the proposals would not address preparers' concerns about the costs of applying the proposed disclosure requirements with one respondent saying that the quantitative thresholds should be increased and that the focus should also be on strategically influencing the acquired business.

35 For these entities, this could imply that they did not conduct a "strategically important" business combination. On the other hand, it could also indicate that the proposed thresholds are inappropriate to capture the right level of strategic business combinations and therefore result in the omission of useful information to users of financial statements. One could therefore conclude that more work is needed to test the proposed thresholds.

Exemption from disclosing information in specific circumstances

Question on whether the exemption would address preparers' concerns on commercial sensitivity

36 The majority of respondents (8 out of 11) were of the view that the exemption **does not** alleviate preparers' concerns about commercial sensitivity. These respondents provided the following comments:

(a) *"The specific reasons for not disclosing, can be itself commercially sensitive*";

(b) "*The wording used in IAS 37 is interpreted very narrowly and does not provide real relief*";

(c) "*The exemption alone, would not address commercial sensitivity. There is a need to consider factors of aggregation for entities with high volume of transactions*";

(d) "*The issue of commercial sensitivity, feasibility of the assessment and relevance of the goodwill impairment study cannot be resolved with proposing only several exemptions*";

(e) "*It would be mainly used as an option to not disclose this information*"; and

(f) "*Quantitative synergies and actual performance metrics should be deleted from the proposal. Only qualitative information should be required*".

Question on whether the exemption would have been applied and to what item of information

37 The majority of respondents (5 out of 9) said that none of the business combinations conducted in the last three years would **have been eligible** for the exemption.

38 One respondent said that would be able to apply the exemption to 50% of the business combinations conducted in the three-year period, to "management's objectives" and "metrics and targets".

39 Two respondents said that would be able to apply the exemption for all business combinations conducted in the last three years to the following items:

(a) management's objectives;

(b) metrics and targets;

(c) expected synergies; and

(d) qualitative statement on actual performance.

40 Another respondent noted that none of the business combinations undertaken in the last three years have surpassed the proposed quantitative thresholds but if that had been the case, the exemption would have been applied to information related to "metrics and targets" and "synergies expected" due to commercial sensitivity.

Question on whether the IASB should specify that the exemption would only apply "in extremely rare cases", as specified in paragraph 92 of IAS 37

41 **The majority of respondents** (7 out of 11) did not agree that the IASB should specify that the exemption would only apply "in extremely rare cases", as specified in paragraph 92 of IAS 37.

Quantitative information about expected synergies in the year of acquisition.

Question on the necessity of an IASB defining "synergies"

42 **The majority of respondents** (6 out of 11) considered that the IASB should define "synergies". A definition would be helpful to avoid diversity in practice and achieve better comparability of business combinations. It could also help to identify components of goodwill and avoid disclosing as least as possible.

43 The remaining respondents agreed with the IASB tentative decision not to define synergies.

Question on whether disclosing synergies at an aggregate level would resolve respondents concerns while still meeting the objectives of the disclosure requirements

44 **Many respondents** (5 out of 11) considered that the disclosure of synergies at an aggregate level **would resolve their concerns**.

45 However, the **majority** of respondents (6 out of 11) **disagreed**, and some provided the following reasons:

(a) The only way to resolve the preparers' concerns would be to remove the proposal to disclose information on synergies;

(b) Each business combination is different, which could lead to heterogenous information; and

(c) Aggregation would only be possible for entities that conduct several business combinations in a given year. Otherwise, it would be difficult to know what kind of information to aggregate.

Question about the number of business combinations for which the entity does not estimate expected synergies per category

46 Half of the respondents (4 out of 8) that have conducted business combinations in the last three years and responded to this question, replied that for all their business combinations **they estimated expected synergies** per category.

47 Many respondents (3 out of 8) replied that only for a few of their business combinations expected synergies per category were not estimated. These respondents provided the following reasons:

(a) Insignificance of a business combination;

(b) The allocation of total synergies to certain categories can be complex and the resulting information is not relevant for investors; and

(c) Quick integration of the acquired business into the existing one.

48 One respondent affirmed that they did not estimate expected synergies for any of its business combinations conducted in the period. This respondent noted that "*Given the highly unpredictable and versatile nature of our business, whether the expected synergies originally envisioned actually materialise or fail to do so is not a pertinent indicator of the degree of success of the acquisition. Also, one of the fundamental objectives and characteristics of such acquisitions is to be integrated into our existing business as quickly and fully as possible, making a pertinent follow up of such synergies unrealistic and impossible in practice".*

Question on whether any information on synergies was disclosed for any of the business combinations conducted in the last three years.

49 Only 3 respondents out of 11 affirmed to have disclosed information on synergies, while 2 out of 3 suggested that the disclosures were only qualitative.

Other comments

General comments on the IASB's tentative decisions

50 Respondents provided the following additional comments:

(a) The proposed disclosures are only second-best solutions compared to the reintroduction of goodwill amortisation.

(b) Repeated cost-benefits concerns and noted that the IASB expectations about availability of information were too optimistic and the underlying assumptions did not adequately reflect the complexity of corporate structures and acquisitions occurring in practice. It was suggested that the IASB carries out thorough cost-benefit analysis of the proposed disclosures and justifies its cost-benefit conclusions.

(c) Repeated concerns about commercial sensitivity of the proposed disclosure requirements, resulting in potential competitive disadvantages for IFRS adopters against competitors applying other accounting standards. It was stressed that maintaining an economic level playing field is of utmost importance.

(d) Repeated concerns about the integration: when business combinations are integrated/ merged with existing business, it will be impossible to reliably determine whether the business combination itself met its targets as the businesses have merged.

(e) Expressed doubts that the proposed disclosures would bring additional value for users as they would rely mostly on the subjective management assertions that would not be possible to audit.

(f) Expressed concerns about prescription of mandatory quantitative thresholds (10%) in IFRS literature.

(g) Suggested that the quantitative and qualitative thresholds should be considered from the perspective of the consolidated group, i.e. it should not matter whether the business combination is acquired by the holding or a subsidiary.

(h) Suggested that proposed disclosures should not be required for a business combination under common control (i.e. when a company is relocated within the group).

(i) Acknowledged that although burdensome, the proposed disclosures are necessary for large acquisitions. The requirements should be sufficiently flexible to allow information to be tailored to the specific transaction and entity. The proposed wording strikes a reasonable balance.