

STAFF PAPER

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FASB | IASB[®] Meeting

Project	Goodwill and Impairment research project
Paper topic	Improving disclosures about business combinations, goodwill and impairment

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Purpose

1. The purpose of this paper is to inform the FASB about:
 - (a) feedback from stakeholders during and after the IASB's Post-implementation Review (PIR) of IFRS 3 *Business Combinations* in relation to the current disclosure requirements about business combinations, goodwill and impairment; and
 - (b) approaches that the IASB has considered for improving the quality of information provided to investors through disclosures about business combinations, goodwill and impairment without imposing costs that exceed the benefits.
2. This paper is mostly a reproduction of Agenda Paper 18F for the December 2017 IASB meeting.

The IASB's tentative decision

3. The IASB discussed the following possible approaches to improve the quality of information provided to investors through disclosures about business combinations, goodwill and impairment in response to feedback and suggestions from stakeholders during and after PIR of IFRS 3:

- (a) *requiring new disclosures (ie disclosures that are currently not required by IFRS Standards)*—requiring entities to disclose one or more of the following:
- (i) in the year in which a business combination occurs, the reasons for paying a premium that exceeds the value of the net identifiable assets acquired in a business combination, together with key assumptions or targets supporting the purchase consideration; and subsequently each year, a comparison of actual performance with those assumptions or targets.
 - (ii) breakdown of the carrying amount of goodwill by business combination, with an explanation for each combination, of why management considers that the goodwill is recoverable.
 - (iii) headroom in a cash-generating unit (group of units) that include(s) goodwill or intangible assets with indefinite life.¹ Headroom is the excess of the recoverable amount of a cash-generating unit (group of units) over its carrying amount.
 - (iv) a measure of total assets and total liabilities for each reportable segment.
 - (v) expected payback period of the entity’s investment in the business combination, ie the expected time to recover the cost of the acquisition (either with or without considering the effect of discounting).
- (b) *reviewing current disclosure requirements in IAS 36 Impairment of Assets* to determine whether any of those requirements should be modified or removed.
- (c) *reviewing current disclosure requirements in IFRS 3 Business Combinations* to determine whether the drafting of those requirements could be improved.

¹ Any reference in this paper to disclosure of headroom should be read as disclosure of headroom in a unit (group of units) that include(s) goodwill or intangible assets with indefinite life.

4. The IASB decided to consider introducing requirements for an entity to disclose:
 - (a) in the year in which a business combination occurs, the reasons for paying a premium that exceeds the value of the net identifiable assets acquired in a business combination, together with key assumptions or targets supporting the purchase consideration; and subsequently each year, a comparison of actual performance with those assumptions or targets.
 - (b) each year, a breakdown of goodwill by past business combination, explaining why the carrying amount of goodwill is recoverable.
 - (c) each year, information about the headroom in a cash-generating unit (or groups of units) to which goodwill is allocated for impairment testing.

5. This paper sets out the analysis of the possible disclosures that the IASB decided to consider. For the analysis of the other possible disclosures that the IASB tentatively decided not to consider any further, see [Agenda Paper 18F](#) for the December 2017 IASB meeting.

Structure of the paper

6. The rest of this paper is structured as follows:
 - (a) stakeholder feedback during and after the PIR of IFRS 3 (paragraphs 7–10)
 - (b) disclosure improvements that the IASB decided to consider (paragraphs 11–41)

Stakeholder feedback during and after the PIR of IFRS 3

7. During and after the PIR, investors gave a mixed feedback about the information provided by entities on acquisitions, goodwill and impairment.
 - (a) some said that the disclosures provided by entities applying the requirements in IFRS 3 do not provide sufficient information for

assessing whether the acquisition was a good or a bad investment decision. For example, they said that:

- (i) the qualitative description of the factors that make up the acquired goodwill is generally a boilerplate repetition of the wordings used in IFRS 3.
 - (ii) not all entities separately disclose debt assumed in an acquisition.
 - (iii) IFRS 3 requires disclosure of amounts of revenue and profit or loss of the acquired business only for the annual reporting period in which the acquisition happens. Disclosure of amounts of revenue and operating profit for the first few years after an acquisition would provide useful information to investors.
- (b) some said the information currently provided by applying the requirements in IAS 36 is useful because it provides an insight into stewardship by management, and thus has confirmatory value.
- (c) some say the current information has limitations for the following main reasons:
- (i) impairment calculations are inherently very judgemental and the assumptions used in the calculations are subjective.
 - (ii) disclosures are not sufficient to assess whether the main inputs/assumptions are reasonable. However some investors said that some of the current disclosures are useful; these included discount rates used, long-term growth rates, profit and capital expenditure assumptions and sensitivities.
 - (iii) insufficient information is provided to help them understand the subsequent performance of the acquired business and whether main targets/synergies of the acquisition are achieved.
- (d) some investors focus more on the timing of the impairment write-down and its overall magnitude rather than the specific amount of impairment recognised.

8. Investors appear to be particularly interested in understanding (a) the key drivers that justified the price paid for an acquisition (and hence the amount of goodwill); and (b) whether the acquisition has been successful.
9. Although this topic was not initially added to the research agenda, on the basis of feedback from investors during and after the PIR, the IASB directed the staff to consider various ways in which information about subsequent performance of the acquired business could be provided. The IASB thought that the form of the disclosure could range from detailed financial information about the acquired business to the key financial performance indicators. The staff has limited its consideration to the latter.
10. Preparers generally think that the current disclosure requirements about goodwill and impairment are already excessive. The feedback from the PIR of IFRS 3 and subsequent outreach provided some evidence that the current disclosure requirements in IAS 36 are not being properly applied in practice.

Disclosure improvements that the IASB decided to consider

Reasons for payment of premium, key assumptions or targets supporting the purchase consideration and comparison of actual performance with targets

Description

11. The IASB considered requiring an entity to disclose:
 - (a) the reasons for payment of premium over and above the value of the net identifiable assets acquired in a business combination;
 - (b) key assumptions or targets supporting the purchase consideration and (consequently the measurement of goodwill acquired) in a business combination; and
 - (c) comparison of actual performance vis-à-vis the targets for a specified number of years following a business combination.
12. Key assumptions or targets might include, for example:
 - (a) the expected revenue of the acquiree (if the acquiree is not integrated);

- (b) a specified level of increase in revenue for an existing operating segment that benefits from the acquisition because of access to new markets;
 - (c) increased operating margins on a product line through removing a competitor from the market; and
 - (d) identified cost savings through economies of scale etc.
13. The entity would also identify the periods over which it expects to achieve these targets (for example an increase in revenue of five per cent per year for three years).
14. The number of years for which an entity should continue to provide the comparison of actual performance vis-à-vis the targets could be driven by the time horizon used by the entity's management when making the assumptions or targets. The IASB could also consider requiring a minimum period, for example three years after the business combination.

Staff analysis

15. Paragraph B64 of IFRS 3 *Business Combinations* requires an acquirer to disclose:
- (a) the primary reasons for the business combination and a description of how the acquirer obtained control of the acquiree; and
 - (b) a qualitative description of the factors that make up the 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.
16. The IASB learned from the PIR of IFRS 3 that the disclosures in financial statements are either limited or boilerplate repetition of phrases used in IFRS 3. Investors said that the disclosures do not provide any insight into the real economic reasons for the business combination or the key drivers that support the valuation.
17. The requirement in paragraph B64 of IFRS 3 could be expanded to require an entity to disclose the information described in paragraph 11. To satisfy this requirement, entities would need to disclose information specific to the business

combination instead of boilerplate repetition of the Standard. The expanded disclosure would provide investors with useful information (a) about the key drivers that justified the valuation of the acquiree; and (b) that will help them make their own assessments of whether it is reasonable to view the carrying amount of goodwill as recoverable. Comparison of actual performance vis-à-vis the targets would inform investors about the subsequent performance of the acquired business and whether the entity is realising any synergies that it targeted.

Feedback from past discussions with the IASB's consultative groups

18. Members of the Capital Markets Advisory Committee (CMAC) generally supported a possible requirement to disclose more information about the acquired business. However, many members of the Global Preparers Forum (GPF) expressed concerns that for those disclosures to be meaningful an entity would have to disclose commercially sensitive information. Consequently, in their view, if the IASB requires those disclosures, entities are likely to disclose only boilerplate information.
19. A few GPF members argued that providing the disclosures for each individual acquisition would be difficult because post-acquisition integration could make it difficult for management to track those targets or assumptions vis-à-vis actual performance.

Staff thoughts on availability of information

20. To enable management to discharge its responsibilities, the staff expect that management would generally need to:
 - (a) ensure that there is a rational basis for paying premium in a business combination;
 - (b) set key performance targets that reflect the synergies expected to be realised by management; and
 - (c) monitor the subsequent performance of a business combination both for internal purposes and for reporting to existing and potential investors, lenders and other creditors.
21. The staff expect that the information described in paragraph 11 is usually readily available. For large combinations, management is often subject to a legal or

regulatory requirement to seek approval from shareholders. In most cases, in documents seeking that approval, management explains the basis for paying a premium and identifies the key performance targets. This information would have also been included in regulatory filings.

22. Furthermore, if entities prepare a management commentary, the staff believe that it is probably common practice for entities to disclose some or all of the information described in paragraph 11. (The IASB could consider whether to allow the entity to incorporate the information by cross-reference from the financial statements to the management commentary (see discussion in the Discussion Paper *Disclosure Initiative—Principles of Disclosure*)).
23. The staff expect that requiring the disclosure in the financial statements would encourage entities to prepare the information more rigorously so that it stands up to scrutiny by the auditors. In addition, not all entities may be subject to a requirement to produce a management commentary.
24. In respect of subsequent performance after a business combination, the staff considered whether it would be complex and subjective to identify or isolate data, especially when the acquired business is integrated into the acquirer's existing business. In the staff's view, this is not likely to be a concern. The acquirer's management's decision to integrate the acquired business with existing business would be reflected in the key performance targets. The targets in such situation are likely to relate to both the acquired business and the existing business affected by the business combination.
25. The staff expect that an entity would consider materiality in disclosing this information. For smaller combinations, the staff presume that goodwill and impairment issues are less likely to have a material effect.

Breakdown of goodwill and explanation justifying recoverability

Description

26. The IASB could consider requiring an entity to:
 - (a) disclose a disaggregation of the carrying amount of goodwill at the reporting date by each past business combination; and

- (b) explain, for each significant business combination, why the carrying amount of goodwill is recoverable.

Staff analysis

27. Disclosure of disaggregation of goodwill by each past combination was suggested by CMAC members at CMAC’s November 2015 meeting, and by other investors during the PIR of IFRS 3. The disaggregation would highlight goodwill acquired in combinations that investors consider as unsuccessful. Consequently, there may be pressure on the entity to justify why that goodwill is recoverable and to perform a more rigorous impairment test of that goodwill.
28. Disaggregation of goodwill by each past combination together with information described in paragraph 11 would help users make their own assessment of whether goodwill acquired in a past combination is recoverable.
29. The IASB could also require a reconciliation of this disaggregation with goodwill allocated to cash-generating units.

Feedback from past discussions with the IASB’s consultative groups

30. CMAC members stated that disclosing a breakdown of goodwill by past acquisition can provide useful information. That information helps them in identifying the carrying amount of goodwill relating to acquisitions that they consider unsuccessful. However, GPF members questioned the usefulness of this information, especially long after an acquisition.

Staff thoughts on availability of information

31. IAS 36 does not require tracking of goodwill by each past business combination. For impairment testing, goodwill acquired in a business combination is allocated to a unit or group of units expected to benefit from the synergies of the combination. Consequently, if a unit (or units) contains goodwill allocated from different acquisitions, the goodwill in the unit (or units) will be regarded as a single asset for impairment testing.
32. In applying IAS 21 *The Effects of Changes in Foreign Exchange Rates*, an entity would be tracking goodwill acquired in past combinations of foreign operations with a functional currency that is different from the entity’s presentation currency.

However, the entity may have to incur some costs to track goodwill acquired in other past combinations.

33. To be able to explain why goodwill from a past acquisition is still recoverable, an entity would need to consider whether there is evidence that synergies from that acquisition still exist. For old combinations, gathering the evidence would be costly because it may become very difficult to identify or isolate the benefits arising from those combinations. Consequently, an entity's explanation of why management considers goodwill to be recoverable may end up being boilerplate and of no use to investors.
34. Alternatively, the IASB could consider requiring disclosure of goodwill recognised in the preceding 3–5 years by each business combination. The sum of those amounts need not necessarily equal the carrying amount of goodwill.

Disclosure of headroom

Description

35. At a past joint meeting of CMAC and GPF, a few GPF members suggested that the staff should focus on headroom to improve effectiveness of the impairment test. A simple approach could be to require entities to disclose the headroom annually.
36. Currently, IAS 36 requires disclosure of the headroom only when a reasonably possible change in a key assumption on which management has based its determination of the unit's (group of units') recoverable amount would cause its (their) carrying amount to exceed its (their) recoverable amount.

2004 revisions to IAS 36

37. When revising IAS 36 as part of the first phase of the business combinations project in 2004, the IASB considered requiring entities to disclose a range of information about units (groups of units) that included goodwill or indefinite-lived intangibles. The IASB's objective was to achieve a reasonable balance between (a) providing investors with useful information for evaluating the reliability of the estimates used in testing goodwill for impairment; and (b) the potential magnitude of the disclosures that an entity should provide in its financial statements.

38. One proposal made in the Exposure Draft of those revisions to IAS 36 was to require entities to disclose the amount by which a unit's recoverable amount exceeded its carrying amount. The IASB did not finalise the proposal as exposed but decided, in its redeliberations, to require an entity to disclose that information only in situations described in paragraph 36 (ie when a reasonably possible change in a key assumption would cause the carrying amount to exceed recoverable amount).
39. As explained in paragraph BC207 of the Basis for Conclusions on IAS 36, the IASB was sympathetic to the feedback on the Exposure Draft and concerns of field visit participants that the proposals went beyond their intended objective. For example, field visit participants and respondents to the Exposure Draft argued that:
- (a) it would be extremely difficult to distil the recoverable amount calculations into concise but meaningful disclosures because those calculations typically are complex and do not normally result in a single point estimate of recoverable amount—a single value for recoverable amount would normally be determined only when the bottom-end of the recoverable amount range is less than a unit's carrying amount. These difficulties make it doubtful that the information, particularly the sensitivity analyses, could be produced on a timely basis.
 - (b) disclosing the proposed information, particularly the values assigned to, and the sensitivity of, each key assumption on which recoverable amount calculations are based, could cause significant commercial harm to an entity. Users of financial statements might, for example, use the quantitative disclosures as the basis for initiating litigation against the entity, its board of directors or management in the highly likely event that those assumptions prove less than accurate. The increased litigation risk would either encourage management to use super-conservative assumptions, thereby resulting in improper asset write-downs, or compel management to engage independent experts to develop all key assumptions and perform the recoverable amount calculations. Additionally, many of the field visit participants

expressed concern over the possible impact that disclosing such information might have on their ability to defend themselves in various legal proceedings.

Staff analysis

40. The staff think that the IASB could consider the following factors in assessing whether it could require disclosure of headroom:
- (a) the trend in the headroom, together with the other disclosures currently required in IAS 36, provide relevant information to investors to assess the effectiveness of the impairment test. Requiring an entity to disclose headroom for a unit (group of units) containing goodwill or indefinite-lived intangible assets might not impose a significant additional burden because headroom information is generally available from the current impairment testing model. However, determining the precise headroom may involve some additional costs. This is because the current measurement basis does not produce a single point estimate of recoverable amount, and consequently, an entity would have to perform additional work to determine a precise recoverable amount.
 - (b) another possible concern from preparers is that, using the headroom information and other disclosures currently required by IAS 36, an investor would then be able to perform a reverse calculation to derive an entity's budgets. A GPF member had already raised this concern in the context of the current requirement in IAS 36 to disclose headroom as part of sensitivity analysis, in some circumstances (see paragraph 36) and suggested that the IASB should consider removing that requirement. However, other GPF members and CMAC members did not support the suggestion.
 - (c) the current higher-of-the-two basis for determining recoverable amount means that the trend in the headroom is likely to become distorted if an entity needs to switch between value in use and fair value less costs of disposal.

41. The IASB concluded that the disclosure of headroom is best considered together with the headroom approach that the IASB is considering for improving the effectiveness of impairment testing of goodwill.