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Project	Goodwill and Impairment		
Paper topic	Improvements to existing IFRS 3 disclosure requirements		
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Purpose and structure of this paper

1. This paper provides the International Accounting Standards Board (Board) with a summary of the feedback received on its preliminary view to improve the information an entity provides to users of financial statements (users) about business combinations. In particular, the Board's preliminary views for improvements to existing disclosure requirements in IFRS 3 *Business Combinations*.

2. This paper does not ask the Board for any decisions.

3. The paper contains:

    (a) Key messages (paragraphs 4–5);

    (b) Overall balance of disclosures (paragraphs 6–8);

    (c) Disclosure Objectives (paragraphs 9–18);

        (i) Summary of the Board's preliminary views (paragraphs 9–13);

        (ii) Feedback received (paragraphs 14–18);

    (d) Synergies (paragraphs 19–68);

        (i) Summary of the Board's preliminary views (paragraphs 19–23);

        (ii) Feedback received (paragraphs 24–68);

    (e) Defined benefit pension liabilities & debt (paragraphs 69–75);

        (i) Summary of the Board's preliminary views (paragraphs 69–71);

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   (ii) Feedback received (paragraphs 72–75);

(f) Contribution of the acquired business (paragraphs 76–102);

   (i) Summary of the Board's preliminary views (paragraphs 76–79); and

   (ii) Feedback received (paragraphs 80–102).

(g) Question for the Board.

Key messages

4. Respondents generally supported the Board's preliminary views to add additional disclosure objectives to IFRS 3 and to require the disclosure of material liabilities arising from financing activities and defined benefit pension liabilities at the time of a business combination.

5. There were mixed views on the Board's preliminary views to add a requirement to IFRS 3 to require an entity to provide quantitative information on the amount of expected synergies arising from a business combination, and to retain and amend the information provided about the contribution of the acquired business. Preparers in particular, disagreed with providing additional, quantitative information about synergies.

Overall balance of disclosures

6. A few respondents, mainly preparers, commented on the overall balance of disclosure requirements in IFRS 3. Those respondents repeated the feedback the Board received during the Post-implementation Review (PIR) of IFRS 3 that the disclosure requirements in IFRS 3 are voluminous and costly to comply with.

7. Respondents said the cost of complying with each of the Board's proposed new disclosure requirements may be small in isolation but when considered with the existing requirements the aggregate cost is high.

8. Those respondents said the Board should perform a comprehensive review of the existing requirements to identify any requirements that do not provide useful information to users. A few respondents said that the Board should only add new

disclosure requirements to IFRS 3 if it first removes some existing requirements. Those respondents said that the Board could remove the requirements in:

(a) Paragraph B64(m) of IFRS 3—the disclosure of acquisition-related costs (although other respondents highlight this requirement might be useful for the Board's other preliminary views, see paragraph 95 of this paper); and

(b) Paragraph B66 of IFRS 3—a requirement to provide information about business combinations completed after the end of the reporting period. A few respondents said this duplicates information required by IAS 10 *Events after the Reporting Period*.

Disclosure Objectives

Summary of the Board's preliminary views

9. Paragraphs 59 and 61 of IFRS 3 contain the disclosure objectives for the Standard:

> 59 The acquirer shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of a business combination that occurs either:
>
> (a) during the current reporting period; or
>
> (b) after the end of the reporting period but before the financial statements are authorised for issue.
>
> ...
>
> 61 The acquirer shall disclose information that enables users of its financial statements to evaluate the financial effects of adjustments recognised in the current reporting period that relate to business combinations that occurred in the period or previous reporting periods.

10. The purpose of including disclosure objectives in IFRS Standards is to require an entity to assess whether information provided in complying with specific disclosure requirements is sufficient to meet the user needs described in the disclosure objectives. If such information is insufficient, the entity would need to provide additional information to meet those user information needs.

11. During the PIR of IFRS 3, stakeholders said that entities often use the current disclosure requirements of IFRS 3 mechanically as a checklist. The resulting disclosures can be 'boilerplate' and can provide insufficient information for users, even though the information required is extensive. The Board therefore considered whether the generic nature of the disclosure objectives in IFRS 3 could be the reason for this feedback.

12. The Board's preliminary view is that it should develop a proposal to add further disclosure objectives that require an entity to provide information to help users to understand:

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

    (b) the extent to which management's objectives for a business combination are being met.

Questions asked in the Discussion Paper

13. Question 3 in the Discussion Paper asked:

> Paragraphs 2.53–2.60 [of the Discussion Paper] explain the Board's preliminary view that it should develop, in addition to proposed new disclosure requirements, proposals to add disclosure objectives to provide information to help investors to understand:
>
> • the benefits that a company's management expected from an acquisition when agreeing the price to acquire a business; and
>
> • the extent to which an acquisition is meeting management's (CODM's) objectives for the acquisition.
>
> Do you agree with the Board's preliminary view? Why or why not?

Feedback received

14. Many respondents agreed with the Board's preliminary view to add additional disclosure objectives to IFRS 3.

15. In outreach meetings with users the staff asked whether the objectives described in paragraph 12 would meet the needs of users. The majority of users agreed that the objectives set out by the Board accurately describe user needs in this area.

16. Some respondents disagreed with the Board's preliminary view. Those respondents said:

    (a) information about the management's expectations and the extent to which an entity is meeting management's expectations belongs in management commentary and not in financial statements;

    (b) some information that would be required to explain management's expectations is commercially sensitive;

    (c) disclosure objectives need to be accompanied by detailed and specific requirements to assist with auditing;

    (d) there is no link between the objectives described in paragraph 12 of this paper and goodwill; and

    (e) the disclosure objectives focus too much on explaining the price paid in a business combination, which is not an exact science. The price is typically a product of negotiations between the buyer and seller.

17. A few respondents said they agreed with the proposed disclosure objective to require an entity to explain the benefits that an entity's management expected from an acquisition when agreeing the price to acquire a business only.

18. A few respondents said the Board should have developed disclosure objectives before developing preliminary views on the potential detailed disclosure requirements set out in the Discussion Paper.

Synergies

Summary of the Board's preliminary views

19. Paragraph B64 of IFRS 3 requires an entity to provide, in the year of a business combination, a qualitative description of the factors that make up the goodwill

recognised, including any expected synergies from combining operations of the acquiree and the acquirer.

20. Users have said that this requirement often results in entities providing a generic description that is not useful. In addition, achieving synergies is often an important objective of a business combination. Users have said that information on the nature, timing and amount of expected synergies is important.

21. The Board's preliminary view is that it should require an entity to disclose in the year a business combination occurs:

    (a) a description of the synergies expected from combining the operations of the acquired business with the entity's business;

    (b) when the synergies are expected to be realised;

    (c) the estimated amount or range of amounts of the synergies; and

    (d) the estimated cost or range of costs to achieve those synergies.

22. In the Discussion Paper the Board noted that it expects that management would have already made an estimate of expected synergies in agreeing the price for an acquired business. For example, when an entity enters into a business combination that requires shareholder approval, the information provided to shareholders requesting that approval often sets out synergies that management expects from the business combination. An entity would not be required to provide a single point estimate, but could provide a range.

Questions asked in the Discussion Paper

23. Question 4 in the Discussion Paper asked:

> Paragraphs 2.62–2.68 [of the Discussion Paper] … explain the Board's preliminary view that it should develop proposals:
>
> • to require a company to disclose:
>
> ○ a description of the synergies expected from combining the operations of the acquired business with the company's business;
>
> ○ when the synergies are expected to be realised;

> ○ the estimated amount or range of amounts of the synergies; and
>
> ○ the expected cost or range of costs to achieve those synergies; and
>
> …
>
> Do you agree with the Board's preliminary view? Why or why not?

Feedback received

24. The Board received mixed feedback on its preliminary view to require more quantitative information on the synergies an entity expects at the time of a business combination.

25. Respondents agreeing with the Board's preliminary view include some national standard-setters, accounting bodies, a few accounting firms, a few preparers and almost all regulators who commented. Most users agreed with the Board's preliminary view. Those respondents said the information will be useful to users.

26. The academic evidence shows that disclosures about expected synergies are value relevant and that disclosures of expected synergies are valued by users.

27. Those disagreeing include some accounting firms, some national standard-setters and most preparers that commented on this topic.

28. The respondents who disagreed with the Board's preliminary view gave similar reasons for disagreeing as respondents did for disagreeing with the Board's preliminary views on disclosures on subsequent performance of business combinations discussed in Agenda Paper 18C to this meeting. In particular, those disagreeing with the Board's preliminary views on additional disclosures on synergies said quantified information on synergies is:

    (a) commercially sensitive (paragraphs 30–38);

    (b) difficult and costly to quantify and audit (paragraphs 39–48);

    (c) forward-looking (paragraphs 49–50);

    (d) better provided in management commentary (paragraph 51); and

(e) already provided in other communication material such as in an entity's management commentary or in a prospectus issued by the entity raising capital for the acquisition.

29. The few users who disagreed with the Board's preliminary views said that they were concerned that practical challenges like commercial sensitivity of information would result in boilerplate information that is not useful.

Commercially sensitive

30. As with the Board's preliminary view to add requirements to IFRS 3 to require an entity to disclose the subsequent performance of business combinations, many respondents said that information about the amount of synergies expected in a business combination is commercially sensitive.

31. Preparers said that information about expected synergies could be sensitive, and could affect an entity's ability to realise the synergies, if the information:

    (a) relates to potential restructurings. Some preparers said that there is a legal requirement in their jurisdiction to communicate any potential restructurings to the affected employees and trade unions first. Others said that information on synergies related to a potential restructuring could have a negative effect on employee morale.

    (b) is used by competitors to understand the entity's cost base or plan for future revenue generation.

    (c) is used by customers to demand a lower price, obtaining some of the benefits of the expected synergies.

32. Some users said that they expect entities to use commercial sensitivity of information as an excuse to provide boilerplate information that is not useful. Those users said that they do not expect such information to be commercially sensitive if provided at a sufficiently high level.

33. In addition, a few respondents said that disclosing expected synergies at the time of the business combination may increase an entity's regulatory or legal risk if those synergies are not eventually realised. Academic literature suggests that entities are

less likely to disclose synergy estimates when the synergy information is uncertain and there are litigation concerns.

34. Academic literature provides evidence of compliance levels, in various jurisdictions, with the disclosure requirements in IFRS 3 and IAS 36 *Impairment of Assets*. The academic literature identified that non-compliance was associated with entities unwillingness to disclose commercially sensitive information and information that revealed managers' judgement and expectations. However, academic studies on voluntary disclosure of expected synergies from business combinations in US entities found no evidence that entities refrained from disclosing such information to avoid sharing commercially sensitive information with competitors.

35. A few preparers said that information on expected synergies will not be commercially sensitive if provided at a high enough level. For example, one participant in the staff's fieldwork identified synergies as the key performance indicator that the entity's Chief Operating Decision Maker (CODM) uses to monitor the success of a business combination. The CODM allocated a target for synergies at a detailed level, for example:

    (a) revenue synergies from cross selling products and increasing overall prices; and

    (b) cost synergies from better purchasing power from suppliers, technology sharing and improved working practices.

36. The fieldwork participant said that disclosing total expected revenue synergies and total expected cost synergies would not be commercially sensitive but disclosing the detailed breakdown from where those synergies are expected to arise would be because it could affect the attainment of those synergies.

37. This view is also supported by some national standard-setters who said that disclosing the total amount of expected synergies would not require an entity to describe in detail how those synergies will be achieved.

38. Respondents made some suggestions for the Board to consider in order to address concerns about the commercial sensitivity of information on expected synergies. Many of these suggestions are similar to those discussed in Agenda Paper 18C. They include:

(a) performing field testing with preparers to understand what information may be considered commercially sensitive.

(b) developing illustrative examples to demonstrate that the disclosure of the amount or range of amounts of synergies is only required at a high level. Some respondents said that illustrative examples might also help in explaining the definition of synergies (see paragraph 53–58 of this paper).

(c) information about synergies should be qualitative if quantitative information is expected to be commercially sensitive.

(d) a ‘comply or explain’ approach where an entity is permitted not to disclose quantitative information about expected synergies but is instead required to explain why that information is sensitive.

Difficult to quantify and audit

39. Many respondents said that information about expected synergies is difficult and costly to estimate. Cost arises both in the time it takes for the entity to estimate the amount of synergies and the cost and difficulty of auditing those estimates.

40. Some respondents said that they expect an entity to have estimated the amount or range of amounts of synergies expected from an business combination as part of the acquisition process and that disclosing this information in financial statements would not be costly. Those respondents said that sometimes an entity will disclose the estimated amount of any expected synergies in a press release at the time of the business combination. At the joint meeting of the Capital Markets Advisory Committee (CMAC) and Global Preparers Forum (GPF) in October 2020, some CMAC members said that information about expected synergies is in management presentations made at the time of the business combination, but this information can disappear over time.

41. An academic study of voluntary disclosure of expected synergies by US entities found that information is more likely to be disclosed on business combinations for which more precise information related to synergies was available (for example business combinations of entities in the same industry) than when information might be uncertain (for example in cross-border deals).

42. Some GPF members said that cost synergies are easier to estimate, but other GPF members said that revenue synergies are easier to estimate.

43. Many participants in the fieldwork said that the acquisition process typically involves determining the price the entity is willing to pay for a potential target. Such determinations will often involve valuing the business on a stand-alone basis and then estimating the value of any synergies the entity expects to arise as a result of the business combination.

44. In addition, at the joint meeting of the CMAC and GPF in October 2020 most GPF members said that they estimate the amount of synergies to justify the price paid when making business combinations, especially larger ones. Some GPF members said that they estimate synergies only for some business combinations. Some GPF members would not estimate synergies where the strategic rationale of the business combination is to obtain particular assets and synergies are not expected.

45. Some GPF members said that a non-finance team may make the estimates of expected synergies, perhaps using less robust information than would normally be used to prepare financial statements. Those GPF members said that estimates may therefore be harder to audit.

46. To address concerns about the difficulty of estimating the amount or range of amounts of synergies some respondents suggested the Board consider:

    (a) performing field testing with preparers to understand what information is available internally.

    (b) requiring quantitative information about expected synergies only if the entity has estimated the amount of synergies during the acquisition process or that information can be estimated reliably.

    (c) requiring an entity to disclose the basis of preparation for any quantitative estimates of the amount or range of amounts of synergies so that users are able to assess for themselves the reliability of the estimates.

47. Some respondents questioned whether the information about expected synergies would be auditable. They said that synergies represent management's expectations for the future and questioned whether it is possible to audit management's estimates for the future performance of a business.

48. A few national standard-setters said that they expect the amount of synergies to be auditable if the Board makes requirements specific enough. One accounting firm noted that it might be difficult to audit information about expected synergies if an entity does not have that information readily available.

Forward-looking

49. Some respondents said that quantitative information about expected synergies arising from a business combination is likely to be understood as forward-looking information. In particular, some preparers said that including a quantified amount or range of amounts of expected synergies in audited financial statements might lead users to misunderstand the estimate as a forecasted amount.

50. In addition, the potential forward-looking nature of the information might contribute to any difficulties in auditing that information.

Management Commentary

51. Some respondents suggested that information on expected synergies should be included in an entity's management commentary rather than be required to be disclosed in the entity's financial statements. Respondents provided similar reasons for requiring quantitative information of synergies in management commentary as they did for information about the subsequent performance of business combinations. In particular, respondents said that information on expected synergies should be provided in management commentary because of:

    (a) practical reasons—the most common reason respondents said quantified information on expected synergies should be provided in management commentary were practical reasons. In particular, many respondents that suggested this said such information is forward-looking and therefore better placed in management commentary. An accounting firm said that quantified information on expected synergies may be difficult to audit and therefore should be placed in management commentary.

    (b) conceptual reasons—some respondents said that information on expected synergies is related to management's strategy and therefore is more similar in nature to information disclosed in management commentary rather than financial statements.

(c) duplication of information—some respondents, notably banking entities, said that they already provide information about expected synergies in their management commentary and requiring this information in financial statements would result in unnecessary duplication.

Other comments

52. Some respondents raised other comments in connection with the Board's preliminary views on requiring additional, quantified information on synergies:

(a) definition of synergies (paragraphs 53–58);

(b) definition of 'realised' (paragraphs 59–62);

(c) other components of goodwill (paragraphs 63–64);

(d) future attainment of synergies (paragraphs 65–67);

(e) materiality (paragraphs 68).

Definition of synergies

53. Some respondents said that if the Board is to require information on synergies then it should define synergies. There are many different types of synergies and they arise in different ways. Those respondents said the Board should define synergies to prevent diversity in practice arising in relation to how an entity identifies synergies.

54. Some respondents said the Board should distinguish between cost and revenue synergies. When the staff discussed this matter with the CMAC and GPF in October 2020, CMAC and GPF members distinguished cost from revenue synergies. There were mixed views in relation to whether cost or revenue synergies are more reliable.

55. Academic evidence found that users viewed cost savings but not revenue projections as credible. To validate the credibility of the cost savings projections, the researchers documented that management's cost savings estimates were correlated with the changes in the combined post-acquisition operating performance. The researchers, however, could not rule out competing explanations for the latter result.

56. Some CMAC members said they often get more information about cost synergies than about revenue synergies.

57. A few respondents said that they would like information on other types of synergies beyond revenue and cost synergies, for example tax synergies.

58. Related to requiring a definition of synergies, some respondents said that the Board should specify whether the quantified amount of synergies relates to synergies in total or to a total expected amount of each type of synergy.

Definition of 'realised'

59. A few respondents asked what the Board meant by when synergies are expected to be 'realised'. In other words, does 'realised' mean when steps have been taken to benefit from the synergies or when the benefit actually arises from the synergies?

60. For example, consider an entity that expects cost synergies from moving to one IT system, which is expected to save CU 10 million annually. The question is whether the synergies have been realised when the entity moves to one IT system and therefore is obtaining the CU 10 million benefit on an annual basis or whether realised refers to when the benefits will be obtained, which may be an indefinite period since the entity does not expect to return to multiple IT systems in the future.

61. This question is also evident in the suggestions a few respondents made to connect the disclosure about synergies with some of the Board's other preliminary views. For example, a few respondents suggested aligning the period for disclosing information about the subsequent performance of business combinations with the period over which synergies will be realised as a proxy for when integration is expected to be complete. This suggests those respondents view 'realised' to mean the time in which the entity will start to benefit from synergies.

62. A few other respondents said that the period over which synergies are realised could be used as an amortisation period for goodwill. This suggests those respondents understand 'realised' to mean the period over which the entity will benefit from synergies.

Other components of goodwill

63. Some respondents said that synergies are not the only reason for an entity to enter into a business combination. Those respondents said that information about other components of goodwill would be equally of interest to users. A few of those respondents said that if the Board does not expand the information required beyond

synergies then it should set a materiality threshold for the disclosure of quantitative information about synergies that would provide information about other components of goodwill.

64. A few respondents said that focusing on synergies implies that the Board expects there to be material synergies in all business combinations and questioned whether disclosing the expected amount or range of amount of synergies in business combinations where material synergies are not expected provides useful information.

Future attainment of synergies

65. The Board's preliminary view is to require an entity to disclose quantitative information about synergies only in the year of the business combination. However, a few preparers disagreed with the Board's preliminary views because they were concerned that users might ask for information on the achievement of synergies in future years.

66. A few academics, accounting bodies, regulators and users suggested the Board consider whether it should require an entity to provide an update on the attainment of synergies in future years.

67. Some respondents, including a few accounting firms and national standard-setters and some preparers, said that entities do not track the achievement of synergies in the years following a business combination. A few respondents said they disagree with the Board's preliminary view because tracking the achievement of synergies is costly, subjective and difficult to audit. In particular, because assessing the achievement of synergies requires the comparison of actual performance against a hypothetical performance estimated if the entity hadn't taken particular steps.

Materiality

68. A few respondents said that the Board should consider the level of materiality for which information on expected synergies is provided. In particular, a few respondents said that the Board should consider whether to apply the same level of materiality to the disclosure of expected synergies as it does to the disclosure of the subsequent performance of business combinations. In other words, the Board should require the disclosure of amounts of expected synergies only for business combinations that are monitored by the entity's CODM.

Liabilities arising from financing activities and defined benefit pension liabilities

Summary of the Board's preliminary views

69. Paragraph B64(i) of IFRS 3 requires an entity to disclose amounts recognised for each major class of assets acquired and of liabilities assumed in a business combination. Some users said they would like to know the amount of debt and pension liabilities acquired as part of the acquired business and that some entities do not disclose these liabilities separately. For these users, this information is needed to calculate the total capital employed because they view these liabilities as part of the total capital employed in the transaction by the entity.

70. The Board's preliminary view is that it should develop proposals to specify that liabilities arising from financing activities and defined benefit pension liabilities are major classes of liabilities. As a result, an entity would need to disclose separately the amount of such liabilities acquired as part of the acquired business for each business combination, if the information is material. That information would be useful for users and is likely to be readily available to an entity because these items are required to be recognised and measured at the date of the business combination.

Questions asked in the Discussion Paper

71. Question 4 in the Discussion Paper asked:

> Paragraphs … 2.69–2.71 [of the Discussion Paper] explain the Board's preliminary view that it should develop proposals:
>
> …
>
> · to specify that liabilities arising from financing activities and defined benefit pension liabilities are major classes of liabilities.
>
> Do you agree with the Board's preliminary view? Why or why not?

Feedback received

72. Almost all respondents to the Discussion Paper agreed with the Board's preliminary view to specify that liabilities arising from financing activities and defined benefit pension liabilities are major classes of liabilities. This included accounting firms, accounting bodies, national standard-setters, regulators, preparers and users. Those agreeing with the Board's preliminary view said that they expect the information will be useful for users and that they expect this information will already be available and therefore the information can be provided at low cost.

73. Some of those who agreed with the Board's preliminary view said that entities are already required to provide this information applying other IFRS Standards, notably IAS 7 *Statement of Cash Flows* and IAS 19 *Employee Benefits*. However, those respondents said it is useful to have all similar requirements in one location and therefore support the Board's preliminary view.

74. Respondents who disagreed with the Board's preliminary view, a few accounting firms and national standard-setters, did so because that information is required by other IFRS Standards. In particular:

    (a) paragraph 31 of IAS 1 *Presentation of Financial Statements* requires an entity to consider whether to provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance. Accordingly, a few respondents said that if debt or pension liabilities acquired in a business combination are material the entity is already required to disclose their amounts.

    (b) paragraph 44B(b) of IAS 7 requires an entity to disclose changes in liabilities arising from financing activities that arise from obtaining or losing control of subsidiaries or other businesses.

    (c) paragraph 141(h) of IAS 19 requires an entity to include 'the effects of business combinations and disposals' in a reconciliation of the opening and closing balances of the net defined benefit liability (asset).

75. A few respondents said the Board should consider requiring the separate presentation of other items at the time of the business combination, which some users might consider to be 'debt-like', including:

   (a) non-controlling interests;

   (b) liabilities recognised applying IFRS 16 *Leases*; and

   (c) other ways that deals are financed, for example through issuing additional shares.

Contribution of the acquired business

Summary of the Board's preliminary views

76. Paragraph B64(q) of IFRS 3 requires an entity to disclose, to the extent practicable:

   (a) the amounts of revenue and profit or loss of the acquired business since the acquisition date; and

   (b) the revenue and profit or loss of the combined entity for the current reporting period as though the acquisition date had been at the beginning of the annual reporting period (sometimes called pro forma information).

77. During the PIR of IFRS 3, stakeholders commenting on pro forma information said that:

   (a) the information is not useful because it is hypothetical;

   (b) there is a lack of guidance on how to prepare the information and therefore entities prepare the information in different ways; and

   (c) information about the revenue and profit of the acquired business before the business combination is not always readily available.

78. In response to this feedback, the Board's preliminary view is that it should:

   (a) replace the term 'profit or loss' in paragraph B64(q) of IFRS 3 with the term 'operating profit before deducting acquisition-related costs and integration costs'. Operating profit or loss would be defined as in the Exposure Draft *General Presentation and Disclosures*;

(b) add to paragraph B64(q) a requirement to disclose cash flows from operating activities; and

(c) after the revisions in (a) and (b), retain the requirement for the information to be disclosed for the combined entity as if the business combination had occurred at the start of the reporting period.

Questions asked in the Discussion Paper

79. Question 5 in the Discussion Paper asked:

> IFRS 3 *Business Combinations* requires companies to provide, in the year of acquisition, pro forma information that shows the revenue and profit or loss of the combined business for the current reporting period as though the acquisition date had been at the beginning of the annual reporting period.
>
> Paragraphs 2.82–2.87 explain the Board's preliminary view that it should retain the requirement for companies to prepare this pro forma information.
>
> (a) Do you agree with the Board's preliminary view? Why or why not?
>
> (b) Should the Board develop guidance for companies on how to prepare the pro forma information? Why or why not? If not, should the Board require companies to disclose how they prepared the pro forma information? Why or why not?
>
> IFRS 3 also requires companies to disclose the revenue and profit or loss of the acquired business after the acquisition date, for each acquisition that occurred during the reporting period.
>
> Paragraphs 2.78–2.81 explain the Board's preliminary view that it should develop proposals:
>
> • to replace the term 'profit or loss' with the term 'operating profit before acquisition-related transaction and integration costs' for both the pro forma information and information about the acquired business after the acquisition date. Operating profit or

loss would be defined as in the Exposure Draft *General Presentation and Disclosures*.

• to add a requirement that companies should disclose the cash flows from operating activities of the acquired business after the acquisition date, and of the combined business on a pro forma basis for the current reporting period.

(c) Do you agree with the Board's preliminary view? Why or why not?

Feedback received

80. Most respondents to the Discussion Paper agreed with the Board's preliminary view to retain the requirement for an entity to disclose information about the performance of the combined entity as if the business combination had occurred at the start of the reporting period.

81. Some respondents, including many preparers, disagreed with the Board's preliminary view. Those respondents repeated much of the feedback the Board received in the PIR of IFRS 3, notably that information about the performance of the combined entity as if the business combination had occurred at the start of the reporting period is:

    (a) costly to produce;

    (b) not useful for users because it is theoretical and judgemental. It therefore might not represent what the performance of the combined entity will be in the future;

    (c) difficult to audit—a few Japanese respondents said that such information is not audited in Japan, even when it forms part of financial statements.

82. Many of the respondents who commented on this topic agreed that the Board should develop guidance for companies on how to prepare the pro forma information. However, some accounting firms, preparers, and national standard-setters disagreed and said the Board does not need to develop guidance. Many respondents who said that additional guidance is not needed and some respondents who said that additional guidance is needed said that an entity should be required to disclose how the information was prepared.

83. Many respondents agreed with the Board's preliminary view to replace the term 'profit or loss' with the term 'operating profit before deducting acquisition-related costs and integration costs. Those respondents said the information will be useful to users.

84. Many respondents to the Discussion Paper disagreed with the Board's preliminary view to add a requirement to disclose cash flows from operating activities. This included some accounting firms, accounting bodies, national standard-setters, regulators and all preparers who commented. Those disagreeing with the Board's preliminary view said that information about cash flows from operating activities is costly and difficult to prepare and audit and may not be relevant for users.

85. The remainder of this paper discusses feedback on:

    (a) adding more guidance on how an entity should prepare pro forma information (paragraphs 86–93);

    (b) replacing the term 'profit or loss' with 'operating profit before acquisition-related transaction and integration costs' (paragraphs 94–97);

    (c) adding a requirement for an entity to disclose cash flows from operating activities of the acquired business after the acquisition date, and of the combined business on a pro forma basis for the current reporting period (paragraphs 98–101);

    (d) other comments (paragraph 102).

Guidance on how to prepare pro forma information

86. Many respondents recommend that the Board provide additional guidance on the way an entity prepares pro forma information. Respondents said that additional guidance is needed, for example, on how an entity should address:

    (a) circumstances where accounting policies between the acquirer and acquiree were different prior to the business combination;

    (b) upstream or downstream transactions;

    (c) the inclusion of cost or revenue synergies; and

    (d) the financing of the business combination.

87. A few respondents said that the Board could consider providing the objective of the disclosure rather than detailed guidance. Those respondents said describing the objective of pro forma information might assist entities in making judgements during the preparation of pro forma information.

88. Some national standard-setters and accounting firms said that providing guidance on how to prepare pro forma information should not be a priority for the Board because pro forma information is non-GAAP information. A few respondents said that in many jurisdictions, other organisations, like securities regulators, already provide guidance on the preparation of pro forma information.

89. A few respondents proposed the Board explore the possibility of permitting an entity to disclose in its financial statements pro forma information that it has already prepared for regulatory reasons to prevent undue cost arising from the duplication of information.

90. A few respondents said that additional guidance could reduce the flexibility for an entity to tailor such information to its facts and circumstances and therefore to provide users with more useful information.

91. Many of the respondents who said that additional guidance is not needed also said that the Board should require an entity to disclose the material judgements and estimates made in preparing the pro forma information. This would help users understand how the information was prepared and allow them to analyse the information for their own use. A few of those respondents said that such an approach might impair comparability across entities. However, they considered this to be a minor concern because comparability is less important than the predictive value of information.

92. However, a few preparers said that, in their view, information about how an entity prepared pro forma information would not be useful for users.

93. A few respondents suggested the Board carries out field testing to understand what guidance would be most beneficial in practice.

‘Operating profit before acquisition-related transaction and integration costs’

94. Most respondents agreed with the Board’s preliminary view to replace the term ‘profit or loss’ with the term ‘operating profit before acquisition-related transaction and

integration costs' for the reasons set out in the Discussion Paper. Some respondents disagreed with the Board's preliminary view because:

(a) it would not address the feedback about the pro forma information the Board received in the PIR of IFRS 3.

(b) they disagreed with the Board's proposals in the Exposure Draft *General Presentation and Disclosures* about specifying presentation of an operating profit or loss amount.

(c) they disagreed with adjusting any amount defined in the Exposure Draft *General Presentation and Disclosures* for integration or acquisition costs. Those respondents said that having different definitions could be confusing.

(d) using profit or loss is a clearer and better understood term.

95. Some respondents, including those who agreed and disagreed with the Board's preliminary view, said that if the Board does proceed with its preliminary view, it should provide a clear definition of 'acquisition related transaction and integration costs' to help increase comparability and consistency. Some respondents said that 'acquisition costs' is already defined in paragraph 53 of IFRS 3 but 'integration cost' is not defined.

96. A few respondents said that an entity might incur significant integration costs after the year of the business combination. In that situation, the pro forma information relating to the year of business combination would lack predictive value.

97. A few respondents said the Board should require an entity to disclose any acquisition and integration costs separately from operating profit or loss. Those respondents said information about acquisition and integration costs is useful.

Add a requirement to disclose the cash flows from operating activities

98. Many respondents, including almost all preparers, said that it would be very costly to prepare information about the cash flows from operating activities of the acquired business after the acquisition date, and of the combined business on a pro forma basis for the current reporting period. Such costs arise because:

(a) depending on how the financial reporting function is organised, data may be available only in the form of profit or loss information, but not balance sheet and cash flow information.

(b) preparing cash flow information for individual businesses or sections of a group would involve significant additional effort and is likely to require configuration changes to systems and consolidation tools to gather this data separately and analyse it in a cash flow statement.

(c) entities preparing cash flow statements using the direct method applying paragraph 18 of IAS 7 may not track cash flows at this level of disaggregation. If the indirect method is applied for preparing the statement of cash flows, entities might have to prepare additional statements of financial position to be able to provide the information.

99. Some preparers said that they have concerns about an auditor’s ability to provide cost effective assurance on these calculations where they involve significant judgement.

100. Many respondents said that the usefulness of this information would be very limited. In particular, many financial services preparers who responded said that information about cash flows from operating activities is not relevant to those organisations. Some other respondents said that cash flows from operations can be heavily affected by cash collection policy in the period before the acquisition and information about operating cash flows might not provide useful trend information. Some also said that users would likely need incremental information for this cash flow measure to be considered useful—for example, information about the working capital balances of the acquired business at the beginning and end of the year.

101. A few respondents said that information about financing and investing cash flows would also be of interest to users.

Other comments

102. A few respondents made some other comments in relation to pro forma information:

(a) the Board should consider using an alternative term to ‘pro forma information’ because this is a term used in the context of prospectus issuances in the EU and may cause confusion for preparers and users.

(b) producing pro forma information when an entity applies IFRS 17 *Insurance Contracts* would be a highly complex and time-consuming exercise.

(c) the Board could consider using an alternative disclosure, drawing on a previous requirement in old UK Generally Accepted Accounting Principles (FRS 6), which requires disclosure of the actual revenue and profit of the acquired entity from the start of the financial period to the acquisition date and then what it has contributed to the combined group since the acquisition date.

Question for the Board
Does the Board have any comments or questions on the feedback discussed in this paper?