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Purpose and structure

1. The purpose of this paper is to assist the International Accounting Standards Board (Board) in making a decision about reintroducing amortisation of goodwill and whether that decision is conditional on the feasibility of the Board's preliminary views to improve the disclosure requirements about business combinations.

2. This paper provides the Board with the staff's analysis of common matters raised by respondents relating to the Board's preliminary views to add to IFRS 3 *Business Combinations* additional disclosure objectives, requirements for an entity to disclose information about the subsequent performance of business combinations and requirements for an entity to provide quantitative information about expected synergies arising from a business combination. In particular, this paper analyses feedback on:

    (a) the practical challenges of providing these disclosures; and

    (b) the location of these disclosures—ie whether it is appropriate to disclose this information in financial statements.

3. This paper does not analyse other feedback regarding the Board's preliminary views.

4. For each of these matters, the paper summarises feedback, provides staff's analysis of that feedback, and presents possible ways forward. This paper does not include a staff recommendation and the Board will not be asked to make any decisions on these matters at this meeting.

5. The paper is structured as follows:

   (a) Background (paragraphs 6–11);

   (b) Staff analysis on:

      (i) practical challenges (paragraphs 14–71); and

      (ii) location of the information (paragraphs 72–91).

Background

Preliminary views

6. The Board's preliminary views were that it should develop proposals to:

   (a) add disclosure objectives to IFRS 3 that would require an entity to provide information to help users of financial statements (users) understand:

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

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

   (b) replace the requirement in IFRS 3 to disclose the primary reasons for a business combination with a requirement to disclose:

      (i) the strategic rationale for undertaking a business combination; and

      (ii) management's objectives for the business combination.

   (c) add a requirement to disclose:

      (i) in the year in which a business combination occurs, the metrics that management will use to monitor whether the objectives of the business combination are being met; and

      (ii) in subsequent periods, the extent to which management's objectives for the business combination are being met using those metrics, for as long as management monitors the business combination against its objectives.[1]

(d) require an entity to disclose in the year a business combination occurs:

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

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

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

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

Feedback on disclosure objectives

7. Most respondents agreed with the Board's preliminary view to add the proposed disclosure objectives (see paragraph 6(a)). However, some respondents disagreed and said:

(a) providing information about management's expectations and the extent to which an entity is meeting those expectations in financial statements would be inappropriate and the information should instead be provided in an entity's management commentary;

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

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

(d) the proposed disclosure objectives would require explaining the price paid in a business combination, which is negotiated between the buyer and seller and is not an exact science.

8. A few respondents said they agreed with the proposed disclosure objective to require an entity to explain the benefits an entity's management expected from a business combination when agreeing the price to acquire a business, but not with the disclosure

[1] Paragraphs 2.45(b)(iii)–2.45(b)(v) of the Discussion Paper include details about the disclosures an entity would be required to provide if management (the entity's Chief Operating Decision Maker as described in IFRS 8 *Operating Segments*) does not monitor or stops monitoring a business combination and if management changes the metrics it uses to monitor whether the objectives for a business combination are being met.

objective to disclose the extent to which management's objectives for a business combination are being met.

Feedback on subsequent performance of business combinations

9. Many respondents, including almost all users, agreed that an entity should provide information about the subsequent performance of business combinations and that the information provided should be based on information an entity's management reviews (see paragraphs 6(b) and 6(c)). However, many respondents said providing such information in financial statements would be inappropriate and the information should instead be provided in management commentary.

10. In addition, many respondents, including many preparers, raised concerns about the cost of providing this information and whether the benefits would outweigh the costs. Those costs arise from various practical challenges including that such information could be:

    (a) commercially sensitive;

    (b) forward-looking;

    (c) difficult to audit; and

    (d) costly and difficult to provide when an acquired business is integrated into an entity's existing business.

Feedback on expected synergies

11. The Board received mixed feedback on its preliminary view to require quantitative information on the synergies an entity expects at the time it enters into a business combination (see paragraph 6(d)). Many respondents, including most users, agreed with the Board's preliminary view. However, many disagreed and said quantitative information on synergies:

    (a) would be better provided in management commentary than in financial statements;

    (b) could be commercially sensitive;

    (c) could be difficult and costly to quantify and audit;

(d) could be forward-looking; and

(e) is already provided in other communication material.

Staff analysis

12. This paper covers two areas of feedback that are common across the Board's preliminary views described in paragraph 6 of this paper:

    (a) costs of providing the proposed disclosures (paragraphs 14–71); and

    (b) location of the proposed disclosures (paragraphs 72–91).

13. Many respondents said implementing the Board's preliminary views would be costly for preparers, and some stakeholders suggested providing information in management commentary rather than in financial statements. In the staff's view, concerns regarding cost can be addressed or mitigated through well drafted requirements, providing illustrative examples and application guidance or by adopting alternative approaches. For each of the topics discussed in this paper, the staff analysis includes some possible ways forward that the Board could consider.

Costs of providing the proposed disclosures

14. There was strong overall support for the objective of providing users with better information about business combinations. However, as noted in paragraphs 7–11, some respondents said the costs of the preliminary views on improving the disclosures about business combinations could outweigh the benefits. The staff have identified and analysed the following four main areas of practical challenges which, in respondents' views, could give rise to significant costs:

    (a) Commercial sensitivity (paragraphs 15–40);

    (b) Forward-looking information (paragraphs 41–59);

    (c) Auditability (paragraphs 60–67); and

    (d) Integration (paragraphs 68–71).

Commercial sensitivity

Feedback

15. Commercial sensitivity was the most common practical challenge cited by respondents, especially preparers, to providing the information required by applying the Board's preliminary views. Some of those respondents said concerns over commercial sensitivity is a sufficient reason to not proceed with these preliminary views. However, others suggested exploring ways to address concerns about commercial sensitivity and to make the disclosure requirements more practical. Examples of commercially sensitive information provided by respondents included:

    (a) management targets—such information could reveal how the entity prices deals. Competitors could use this information to outbid the entity in future deals. Respondents said this is a particular concern if an entity is undertaking a series of strategically linked acquisitions.

    (b) information about cost-based targets—such information could reveal an entity's cost structure. Competitors could use such information to outbid the entity in future tenders for sales contracts and customers could request some of the cost savings be passed on to them.

    (c) information related to employees (for example cost synergies)—disclosing such information could demotivate employees. In addition, disclosing details about expected cost synergies in the financial statements could pre-empt some jurisdictions' legal requirements to inform employees or trade unions about potential redundancies before any other party.

16. Some respondents, particularly in Europe, expressed concern about a 'level playing field' and said being required to disclose information about the performance of business combinations could put entities applying IFRS Standards at a disadvantage compared to other entities—particularly if that information would be commercially sensitive.

17. In addition, at the June 2021 meeting of the Accounting Standards Advisory Forum (ASAF), the staff asked ASAF members about the importance of convergence with US generally accepted accounting principles and whether convergence on disclosure requirements for business combinations was important. ASAF members had different

views on the importance of convergence, but a few ASAF members said convergence should cover not only the subsequent accounting of goodwill but also disclosures about business combinations.

18. On the other hand, some respondents, including many users, did not view commercial sensitivity as a valid basis for not providing useful information about business combinations. These respondents said:

    (a) commercial sensitivity is often used as an excuse for not disclosing useful information;

    (b) information about management's objectives for a business combination and progress in meeting those objectives need not be so detailed as to be commercially sensitive; and

    (c) the strategic objective of a business combination is rarely kept secret in a competitive market from those likely to be affected by the transaction (such as competitors and employees).

Analysis

19. The Board considered commercial sensitivity in developing its preliminary views. Paragraphs 2.27–2.28 and paragraph 2.67 of the Discussion Paper state:

> 2.27 Some stakeholders, mainly preparers, have expressed concerns that detailed disclosure of a company's post-acquisition intentions together with precise targets could be commercially sensitive. However, some investors suggest that the information they need to understand management's objectives and to hold management to account against those objectives may not need to be as detailed and precise as other stakeholders initially thought. Thus, companies may be able to provide useful information in a way that limits the disclosure of commercially sensitive information.
>
> 2.28 Nevertheless, if concerns over commercial sensitivity remained, in the Board's view, this is not a sufficient reason to prevent disclosure of information that investors need.
>
> …

> 2.67 Stakeholders have also said that disclosures about expected synergies could be commercially sensitive. However, the Board does not intend to require companies to disclose detailed plans on how they intend to realise the synergies. Therefore, the Board expects the information it would require a company to disclose to have limited commercial sensitivity. The information on expected synergies could also be considered to be forward-looking in some jurisdictions. As discussed in paragraphs 2.29–2.32, the Board considers that the information would reflect management's targets at the time of the acquisition and would not be forward-looking information.

20. Some respondents might have understood the Board's preliminary views as requiring a significant level of detail and specificity, possibly more than the Board intended. Based on outreach, the staff understand that commercial sensitivity increases with the level of detail and specificity of the information. Although the staff agree that detailed information can sometimes be commercially sensitive, in the staff's view, entities should generally be able to provide useful information at a level of detail that is not commercially sensitive.

21. The staff agree with respondents who said information about expected synergies, management's objectives for a business combination and progress in meeting those objectives could be provided at a high enough level so as to not be commercially sensitive. This was demonstrated in the staff's fieldwork during which one participant identified synergies as a key performance indictor monitored by management for a business combination. That participant said disclosing detailed quantitative information about where synergies were expected to arise (for example, cost synergies from better bargaining power with suppliers and cost synergies resulting from staffing changes) could be commercially sensitive, but disclosing the total amount of expected cost synergies would not be commercially sensitive.

22. The staff also note that information about management's overall strategy for a business combination, as well as expected synergies from the acquisition, is often provided in documents such as press releases at the time of the acquisition.

23. In addition, without the Board's preliminary views on disclosures for business combinations, entities may not include the same level of detail in their disclosures.

Specifically requiring these disclosures would set a level playing field for entities in jurisdictions that apply IFRS Standards. Regarding the concern that requiring entities applying IFRS Standards to disclose this information would disadvantage those entities, some users said that if the Board develops disclosure requirements similar to those included in the Discussion Paper, users in other jurisdictions will likely request similar disclosures.

24. Notwithstanding the analysis above, the staff considered whether it is possible to address concerns about commercial sensitivity. Paragraphs 25–40 discuss possible ways forward.

Possible ways forward

25. The Board could:

(a) proceed with its preliminary views with clarifications (paragraphs 26–28);

(b) adopt a comply or explain approach (paragraphs 29–34);

(c) permit qualitative disclosures (paragraphs 35–36); or

(d) prescribe specific metrics (paragraphs 37–40).

Proceed with preliminary views with clarifications

26. Stakeholders have raised commercial sensitivity as a concern about changes to accounting requirements previously proposed by the Board on other occasions[2]. Examples include:

(a) disclosure of revenue contribution by major customer (IFRS 8 *Operating Segments*) which might give key customers an upper hand in negotiations with the entity;

(b) descriptions of capitalised intangible assets (IAS 38 *Intangible Assets*) which might reveal details about an entity's research and development plans that would allow competitors to step in; and

[2] Slides 14 to 18 of *Agenda Paper 3—Disclosure of sensitive information*, presented to IFRS Advisory Council in March 2019 provide more details.

(c) descriptions of uncertainties relating to an entity's ability to continue as a going concern (IAS 1 *Presentation of Financial Statements*) which may result in a negative impact for an entity's financial position.

27. Generally, IFRS Standards do not allow entities to avoid disclosing information due to concerns about commercial sensitivity. Because of the unique circumstances surrounding each business combination, it might be difficult for the Board to list all the possible scenarios in which information is commercially sensitive. Therefore, it might not be feasible for the Board to devise a mechanism to identify all disclosures considered sensitive. The Board may therefore wish to proceed with its preliminary views without any exceptions or exemptions on the grounds of commercial sensitivity.

28. However, even if the Board decides to proceed without any exceptions or exemptions, the Board can still undertake some steps to address concerns about commercial sensitivity. For example, the Board could develop some examples illustrating the level at which the Board expects entities to provide information about business combinations. The staff thinks the Board could develop illustrative examples using the fieldwork the staff undertook. The Board could test these examples with the Board's preparer and user consultative groups or it could ask the staff to undertake additional fieldwork to further develop the illustrative examples.

Comply or explain approach

29. The Board could adopt a comply or explain approach. Applying this approach, entities would provide disclosures based on the Board's preliminary view. However, to the extent any of the required information would be commercially sensitive, an entity would be permitted not to disclose that information and would instead be required to explain the reason why that information is commercially sensitive.

30. The Board adopted a similar approach in IAS 37 *Provisions, Contingent Liabilities and Contingent Asset*, which permits entities to not disclose information about contingent liabilities if doing so may prejudice seriously the entity's position in a legal dispute. Paragraph 92 of IAS 37 states that such situations are expected to be extremely rare. Respondents suggesting the Board consider this approach report that the exemption in IAS 37 is not often used in practice, and therefore the risk of applying such an approach might be limited.

31. In 2019, the staff discussed more generally the disclosure of commercially sensitive information with the IFRS Foundation Advisory Council and at the joint Capital Markets Advisory Committee (CMAC) and Global Preparers Forum (GPF) meeting. Some participants said a comply or explain approach could be a practical way to balance the need to provide users with better information and preparers' concern about commercial sensitivity. Such an approach could create an incentive for an entity to provide the disclosure if the cost is acceptable because the entity may risk being penalised by the market if its explanation for not providing disclosure is deemed unsatisfactory. Some respondents to the Discussion Paper also shared similar views.

32. However, some other participants highlighted concerns about a comply or explain approach, which include:

    (a) the option to avoid disclosing specific information may be subject to abuse by some entities;

    (b) the approach could be difficult to apply consistently, particularly when the entities operate in different markets and regulatory environments; and

    (c) entities may incur costs debating with regulators and auditors on whether information is commercially sensitive.

33. In order to apply a comply or explain approach, the Board would need to develop a framework or provide guidance to help entities determine what kind of information could be commercially sensitive. For example, IAS 37 links the exemption to information that may prejudice seriously the entity's position in a legal dispute. However, because of the unique circumstances surrounding each business combination, it might be difficult for the Board to develop a framework or list all possible scenarios in which information could be commercially sensitive.

34. Some jurisdictions have developed frameworks for considering whether information is commercially sensitive which could inform the Board's work. For example, the Australian Securities and Investment Commission published Regulatory Guide 247 in 2019 which states that if an entity has disclosed the information in another document, that information will not be considered commercially sensitive.

Permit qualitative disclosures

35. Another option could be for the Board to use an approach that permits but does not explicitly mandate the disclosure of specific quantitative information. The Board could, for example, not propose specific disclosure requirements but instead decide to propose only a clear disclosure objective that would help entities identify and disclose the necessary information. Management would then determine, based on the disclosure objective, the best approach to meet that objective. The information provided could be qualitative or quantitative in nature, or a mix of qualitative and quantitative information. Most respondents who were concerned about commercial sensitivity indicated that quantitative information is generally more commercially sensitive than qualitative information.

36. However, permitting entities to disclose only qualitative information may result in entities providing boiler plate information that may not fully meet users' information needs. Paragraph B64(e) of IFRS 3 requires an entity to provide 'a qualitative description of the factors that made up the goodwill recognised, such as expected synergies from combining operations of the acquiree and the acquirer...'. During outreach, users said the disclosures provided applying paragraph B64(e) are often boiler plate and not useful. Auditing and enforcing the requirements could also be difficult if entities provide only qualitative information.

Prescribe specific metrics

37. The Board could also prescribe specific metrics that entities would be required to disclose in respect of their business combinations. If management are concerned that the metrics used by management to monitor a business combination are commercially sensitive, the Board prescribing some metrics could allow management to avoid providing information that they deem sensitive while still providing users with some information about the subsequent performance of the business combination. The Board could either:

    (a) replace its preliminary view of requiring entities to disclose information on the basis of the information reviewed by management with the specified metrics; or

(b) require entities to disclose information based on the management approach but to the extent the information required by the management approach would be commercially sensitive, allow entities to disclose specified metrics on a ‘comply or explain’ basis (see paragraphs 29–34).

38. Examples of metrics suggested by some respondents include:

(a) revenue growth;

(b) operating margin;

(c) a split between organic revenue growth and revenue growth resulting from the acquisition;

(d) return on investment or return on capital employed;

(e) estimated payback period for the investment; and

(f) information about the expected profits from, and expected cost to, integrate the acquired business.

39. The Board considered prescribing specific metrics when developing its preliminary views. The Board rejected this approach because in its view, it is not feasible to prescribe a set of metrics that would be applicable for all business combinations. In addition, prescribing specific metrics might require entities to produce information they do not already have solely for financial reporting, thereby increasing costs for preparers.

40. Although prescribing specific metrics might reduce stakeholders’ concerns about commercially sensitivity, it might exacerbate other practical concerns. For example, management might use particular metrics to monitor the integration of an acquired business into the entity’s legacy business. Requiring disclosure of a different metric may not be practical or meaningful in this situation.

Forward-looking information

Feedback

41. When developing its preliminary views, the Board considered the information that would be required not to be forward-looking. Paragraphs 2.30–2.31 of the Discussion Paper state:

2.30 In the Board's view, information about the strategic rationale, objectives and related targets for an acquisition is not forward-looking information. The information reflects management's target at the time of the acquisition. It is not a forecast of the expected outcome at the time the company prepares its financial statements.

2.31 Management uses the metrics to monitor how actual performance in subsequent years compares with that historical view, to assess to what extent the original acquisition objective has been met. However, for a full understanding of whether the objective is being met, management and investors are likely to need further information about whether the original objective is still expected to be met. The Board expects companies can provide this information in a way that does not constitute forward-looking information—for example, by providing a qualitative statement.

42. Many preparers and national standard-setters disagreed and said the information would, in their view, meet the definition of forward-looking information in:

(a) IFRS Practice Statement 1 *Management Commentary* which defines forward-looking information as 'information about the future. It includes information about the future (for example, information about prospects and plans) that may later be presented as historical information (as results). It is subjective and its preparation requires the exercise of professional judgement.'

(b) Regulation or legislation in various jurisdictions, including:

(i) Canadian securities regulation, which defines future-oriented financial information as 'forward-looking information about prospective financial performance, financial position or cash flows, based on assumptions about future economic conditions and courses of action, and presented in the format of a historical statement of financial position, statement of comprehensive income or statement of cash flows'.

(ii) Private Securities Litigation Reform Act of 1995 in the US which defines forward-looking information as:

> (A) a statement containing a projection of revenues, income (including income loss), earnings (including earnings loss) per share, capital expenditures, dividends, capital structure, or other financial items;
>
> (B) a statement of the plans and objectives of management for future operations, including plans or objectives relating to the products or services of the issuer;
>
> (C) a statement of future economic performance, including any such statement contained in a discussion and analysis of financial condition by the management or in the results of operations included pursuant to the rules and regulations of the Commission;
>
> (D) any statement of the assumptions underlying or relating to any statement described in subparagraph (A), (B), or (C);
>
> (E) any report issued by an outside reviewer retained by an issuer, to the extent that the report assesses a forward-looking statement made by the issuer; or
>
> (F) a statement containing a projection or estimate of such other items as may be specified by rule or regulation of the Commission.

43. Respondents who said the information is forward-looking said providing such information in financial statements might result in increased litigation or regulatory risk if management's targets are not subsequently met. Some respondents said including forward-looking information in financial statements would not allow them to benefit from 'safe harbour' protections in some jurisdictions[3]. These respondents suggested including the information in management commentary instead.

[3] The staff understand that some jurisdictions have statutory 'safe harbour' provisions that protect entities from litigation risks that may arise from forward-looking statements. Generally, entities would need to include those forward-looking statements, accompanied with cautionary statements, in management commentary in order to benefit from such 'safe harbour' provisions.

Analysis

44. Paragraph 3.6 of the *Conceptual Framework for Financial Reporting* (Conceptual Framework) says:

> Information about possible future transactions and other possible future events (forward-looking information) is included in financial statements if it:
>
> (a) relates to the entity's assets or liabilities—including unrecognised assets or liabilities—or equity that existed at the end of the reporting period, or during the reporting period, or to income or expenses for the reporting period; and
>
> (b) is useful to users of financial statements.
>
> For example, if an asset or liability is measured by estimating future cash flows, information about those estimated future cash flows may help users of financial statements to understand the reported measures. Financial statements do not typically provide other types of forward-looking information, for example, explanatory material about management's expectations and strategies for the reporting entity.

45. In the light of paragraph 3.6, the staff considered:

    (a) whether the information that would be required would be forward-looking (paragraphs 46–51); and

    (b) if the information would be forward-looking, whether it should be disclosed in financial statements (paragraphs 52–56).

Is the information forward-looking?

46. The staff thinks some aspects of the information proposed in the Discussion Paper might be forward-looking. In particular, information about the strategic rationale for undertaking a business combination could be forward-looking. Paragraph 3.6 of the *Conceptual Framework* implies information about management's expectations and strategies for the reporting entity is forward-looking. Although the proposed information would be about the strategy for a particular business combination and not for the entire reporting entity, it could nonetheless be forward-looking.

47. However, the staff continue to think that information about the synergies management expected at the time of a business combination, management's objectives for the business combination and the metrics management intend to use to monitor the performance of the business combination are not forward-looking. The staff thinks this information does not describe possible future transactions and other possible future events but instead describes historical information—assumptions made at the time of the business combination which underpinned the price the acquiring entity's management were willing to pay for the business. The Board's preliminary view was that an entity should disclose the assumptions made at the time of the business combination, and not the expectations for the future performance of the business combination as at the reporting date, or when the financial statements are issued. Such information could be disclosed for example, as follows:

    (a) 'in determining the price management were willing to pay to acquire [acquiree], at the time of the acquisition management expected the business combination to result in increased sales of product X of 5% in the first three years after the acquisition'; or

    (b) 'when the entity acquired [acquiree], management expected the acquisition to result in potential cost synergies of between CU1m and CU1.5m. Management have put in place a plan to realise those synergies in the two years after the acquisition date'.

48. When an entity discloses the performance of the business combination in a subsequent period based on the metrics set at the acquisition date, it compares historical information (performance of the business combination in the subsequent period) against those initial assumptions and such information is not forward-looking.

49. After acquiring a business, management may revise their expectations of what the business combination will achieve. The Board's preliminary view does not require an entity to disclose updated expectations for a business combination. However, paragraph 2.31 of the Discussion Paper states that for the information to be useful, management may need to provide further information about whether it still expects the acquisition date objectives to be met. The Board's preliminary views do not include detailed requirements on how entities should provide such information in the

financial statements. The staff think an entity could disclose this information in a way that it is not forward-looking.

50. This information should not be confused with the Board's preliminary view that when management changes the metric it uses to monitor whether the acquisition date objectives of the business combinations are being met, entities should disclose the updated metric and the reason for the change. An entity may need to update the metric it uses to monitor the performance of a business combination if it is no longer feasible to do so using the original metric, for example because of an internal reorganisation. In the staff's view, information about the updated metric and the reasons for the change is not forward-looking because the change has already occurred.

51. Most respondents who expressed concerns over the information being forward-looking said disclosing such information in financial statements would result in losing 'safe harbour' provisions (see paragraph 43). The staff's assessment in paragraphs 46–50 is based on the definition of forward-looking information in the Board's *Conceptual Framework*. Entities might reach a different conclusion based on the definition of forward-looking information in regulation or legislation applicable in specific jurisdictions. While assessing whether the proposed information could constitute forward-looking from a regulatory or legal standpoint for each jurisdiction applying IFRS Standards would not be practical, the staff nonetheless reviewed responses to the Discussion Paper from IOSCO and individual regulators:

(a) Most regulators said they either did not view the Board's preliminary views as requiring entities to disclose forward-looking information or were not aware of any potential conflict between the Board's preliminary view and local regulations. Those regulators agree disclosure of acquisition-date objectives and estimates are not forward-looking.

(b) Some regulators said the Board's preliminary view could require entities to disclose information that would be considered forward-looking in their jurisdictions. Some of those regulators said including these disclosures in financial statements could trigger additional disclosures under local requirements.

Should the information be provided in financial statements?

52. As analysed in paragraphs 46–50, the staff think the only piece of information proposed by the Board that could be forward-looking is the acquisition date strategic rationale for a business combination. The staff understands that some stakeholders may view some of the other proposed information, such as synergies expected from a business combination, to also be forward looking because, in their view, such information could also relate to future transactions or events. However, in the staff's view, this would not preclude the Board from requiring disclosure of such information in financial statements.

53. It is not uncommon for IFRS Standards to require entities to disclose expected or possible future transactions or events based on information available as at the reporting date (or in some cases the date when the financial statements are authorised for issue). Examples include:

    (a) paragraph 21A of IFRS 7 *Financial Instruments: Disclosures* which requires entities to disclose information about risk exposures for which an entity hedges and applies hedge accounting, which according to paragraph 6.3.1 of IFRS 9 *Financial Instruments*, could include forecast transactions; and

    (b) paragraphs 25–26 of IAS 1 *Preparation of Financial Statements* which requires an entity to disclose all available information about the future that may cast significant doubt upon the entity's ability to continue as a going concern.

54. Paragraph 3.6 of the *Conceptual Framework* provides two conditions for forward-looking information to be included in financial statements, that the information is:

    (a) related to the entity's assets or liabilities—including unrecognised assets or liabilities—or equity that existed at the end of the reporting period, or during the reporting period, or to income or expenses for the reporting period; and

    (b) useful to users.

55. Requiring disclosure of the strategic rationale for a business combination would simply be a clarification of paragraph B64(d) of IFRS 3, which requires an entity to

disclose the primary reasons for a business combination. The staff thinks such information provides context for, and is therefore related to, the assets and liabilities, including goodwill, recognised as a result of the business combination. Similarly, other proposed information, such as synergies expected from a business combination, also relate to the entity's recognised assets, liabilities, income or expenses. Feedback from users also suggested that the information would be useful. Therefore, the staff think that, based on the *Conceptual Framework*, it is appropriate to require the proposed information to be disclosed in financial statements.

56. Some respondents suggested including this information in management commentary instead of financial statements for reasons other than that the information is forward-looking. Paragraphs 77–84 analyse those other arguments.

Possible way forward

57. Notwithstanding the analysis above, the staff considered whether it is possible to address concerns about forward looking information, particularly about the potential litigation risk.

58. The staff thinks a first step in doing so might be to develop illustrative examples of the information that would be disclosed applying the Board's preliminary view. Such illustrative examples could:

   (a) help entities identify the type of information required by the Board's preliminary view; and

   (b) illustrate how entities can provide the information in a factual and historical way.

59. The Board could use the illustrative examples to consult with regulators on whether concerns about the information being forward-looking remain. If such concerns remain, the Board could consider:

   (a) providing an exemption in the disclosure requirements that allows an entity to not disclose the information on a 'comply or explain' basis (see paragraphs 29–34 for further discussion about such an approach). Applying this exemption, entities may choose not to disclose the information to the extent doing so would be forward-looking in the respective jurisdiction and would significantly increase the entity's risk of litigation; or

(b) requiring an entity to provide information about specific financial reporting metrics in subsequent years, for example operating profit of the acquired business (see paragraphs 37–40 for further discussion about such an approach). Applying this approach, entities would provide information about the specified metrics only on a historical basis in subsequent years and would not be required to disclose what some may perceive as an expectation for the future performance.

Auditability

Feedback

60. Many respondents expressed concerns about the auditability of the proposed disclosures about management's objectives for, and subsequent performance of, business combinations, as well as expected synergies from business combinations. Their concerns include:

(a) It may be difficult for an auditor to confirm the objective and targets for a business combination because the Chief Operating Decision Maker (CODM) might have many objectives and targets. An entity might selectively disclose only some objectives and targets.

(b) Targets and metrics are likely to be subjective and non-GAAP in nature Accordingly, it might be difficult for an auditor to confirm those targets are appropriate and realistic.

(c) Some respondents said the concern is less about whether the information can be audited and more about the cost of auditing the information. The costs include preparing supporting documentation in a way that is auditable and the cost of the audit itself.

61. A few accounting firms said:

(a) There could be an 'expectation gap' where users might expect that management's targets included in audited financial statements are reasonable and appropriate and that the entity will be able meet those targets in the future because they have been audited.

(b) It may be difficult to audit qualitative information about the progress towards meeting a target—for example, it would be difficult to determine if an entity is 'on track' to achieving a market share of 25% for a product 3 years after the acquisition date if the entity obtained a market share of 23% at the end of the first year.

Analysis

62. In the staff's view, the information that would be required—information about assumptions and estimates that support the price paid for a business combination—is not subjective or unverifiable because management are likely to have documented this information. That documentation could serve as the basis for verification and may come in the form of board meeting minutes, public announcements, investor presentation materials or application to regulatory bodies for approval of the business combination. Based on observations from fieldwork, we think most entities are likely to have documented their strategic rationale and management's objectives at the time of the acquisition, at least for major business combinations.

63. We also note that:

(a) most accounting firms and auditing bodies who submitted comment letters did not comment on the auditability of the information that would be produced applying the Board's preliminary views. A few participants in our outreach with accounting firms said they expect the information to be auditable, but at a cost.

(b) in its comment letter, the International Auditing and Assurance Standards Board (IAASB) said disclosures relating to expected synergies, strategic rationale and management objectives of a business combination, as well as subsequent performance of business combinations may be difficult to audit. The IAASB suggested developing robust requirements and providing guidance for entities on how to disclose such information in financial statements. In the IAASB's view, such requirements and guidance would help auditors understand, and then audit the type of information the Board expects entities to provide.

64. The staff agree that the Board's preliminary views, if implemented, could also increase the cost of an audit. However, the staff think the benefit of better accountability for management's decisions, as well as potential reduction in the cost of equity for preparers resulting from better meeting users' information needs would outweigh those costs.

Possible ways forward

65. In the staff's view, the Board can address auditability concerns through well drafted disclosure requirements. The staff think that the Board could:

    (a) clarify that the information required would not be subjective by highlighting the link between that information and the transaction price;

    (b) clarify that the information is not unverifiable because entities are expected to have documented the strategic rationale and management's objectives for, as well as expected synergies from, major business combinations; and

    (c) explore with relevant stakeholders whether and how the auditability of the proposed disclosures could be improved.

66. Some respondents to the Discussion Paper suggested requiring an entity to disclose the basis of preparation for any 'non-GAAP' metric related to a business combination[4]. They said disclosing the basis of preparation might help address auditability concerns because such disclosure would allow users to understand how the metrics are calculated.

67. Although the staff agree that requiring an entity to disclose the basis of preparation of 'non-GAAP' measures could help users understand the metrics, the staff think disclosing the basis would not necessarily improve auditability of the disclosed metrics. Auditors would generally already have access to the basis of preparation of a metric and disclosing this information would not provide auditors with additional tools to assist in auditing the information.

[4] The Board adopted a similar approach in its Exposure Draft *General Presentation and Disclosures*. Paragraph 106 of the Exposure Draft requires an entity to disclose the basis of preparation of its management performance measures.

Integration of acquired business with existing business

Feedback

68. Many preparers and a few accounting firms said integrating an acquired business with the existing business might prevent an entity from being able to provide useful information about the subsequent performance of the acquired business. Some national standard-setters also said this concern was common in their jurisdiction. The concerns raised by respondents are that:

(a) it may be costly or impracticable to provide information about the acquired business as a stand-alone entity if it is quickly integrated into the entity's existing business.

(b) information about the acquired business on a stand-alone basis may be misleading because it does not reflect the objective of the business combination.

69. A few participants in fieldwork said, in their view, the Discussion Paper focuses on requiring entities to provide information about the acquired business on a stand-alone basis.

Analysis

70. Staff think respondents' might have misunderstood the Board's preliminary views. The Board was not proposing to require entities to disclose information about an acquired business on a stand-alone basis in all situations. Paragraph 2.25 of the Discussion Paper states:

> …If management plans to integrate an acquired business, it is possible that management plans to monitor the subsequent performance of the [business combination] using information about the combined business. [Entities] would be required to disclose this combined information because management is using this combined information to understand how the [business combination] is performing.

Possible way forward

71. A few national standard-setters and preparers suggested clarifying that if management monitors the performance of the acquired business as part of an integrated unit, then

the entity would disclose information about the integrated unit rather than about the acquired business in isolation. The staff think the Board could, through illustrative examples or other means, ensure its view about how and in what situations disclosing information about the combined business would satisfy the disclosure requirements is clear.

Location of information

72. Many respondents said the Board should not require disclosure of information about management's strategy, targets, the progress in meeting those targets and expected synergies in financial statements. Instead, those respondents said entities should provide this information in management commentary, and the Board could consider this as part of its Management Commentary project.

73. Respondents suggested locating the information in management commentary for three reasons (see Agenda Paper 18C for the Board's April 2021 meeting):

    (a) conceptual reasons—the information is of a type that belongs in management commentary and not in financial statements;

    (b) practical reasons—placing information in management commentary could help resolve some of the practical challenges discussed earlier; and

    (c) to avoid duplicating information.

74. Most respondents who said information about the subsequent performance of business combinations should be provided in management commentary rather than in financial statements cited conceptual reasons as their primary arguments. Some respondents also highlighted conceptual reasons for including information about expected synergies in management commentary. These conceptual arguments included:

    (a) Information about management's strategy and the attainment of that strategy is not directly related to the entity's assets, liabilities, equity, income and expenses in financial statements. In those respondents' view, providing such information does not meet the objective of, and is not within, the scope of financial statements (see paragraphs 3.2 and 3.3 of the *Conceptual Framework*).

(b) Disclosures required by the Board's preliminary view include forward-looking information and paragraph 3.6 of the *Conceptual Framework* (see paragraph 44) sets a conceptual boundary between financial statements and management commentary, with forward-looking information typically being included in management commentary.

(c) Information about management's objectives for a business combination more closely resembles information that would be provided in management commentary, the purpose of which is to serve as a basis for understanding management's objectives and strategies for achieving those objectives.

75. Most respondents who said information about expected synergies arising from a business combination belongs in management commentary did so for practical reasons. Some respondents also provided practical reasons for including information about the subsequent performance of business combinations in management commentary rather than in financial statements. In those respondents' view, including such information in management commentary could help resolve some practical challenges entities face because doing so would:

(a) allow entities to benefit from 'safe-harbour' protections (see paragraph 43). Some respondents said these protections are important if information is forward looking.

(b) help resolve auditability concerns. Respondents particularly highlighted potential difficulties in auditing non-financial or non-GAAP information. Those respondents said information in management commentary is typically not audited or is not subject to similar levels of assurance as information in financial statements, except in some jurisdictions (for example Germany, where respondents said information in management commentary and in financial statements are subject to the same level of assurance).

76. A few respondents said some of the proposed information, such as the strategic rationale and objectives for a business combination, is already provided in management commentary and requiring that information to be disclosed in financial statements would result in duplication.

Analysis

Conceptual reasons

77. Some respondents said the proposed information is not directly related to the elements of financial statements. Paragraph 3.2 of the *Conceptual Framework*, paragraph 9 of IAS 1 *Presentation of Financial Statements* and paragraph 19 of the Board's Exposure *Draft General Presentation and Disclosures* state that the objective of financial statements is to provide financial information about the reporting entity's assets, liabilities, equity, income and expenses of financial statements that is useful in assessing the prospects for future net cash inflows to the reporting entity and in assessing management's stewardship of the entity's economic resources.

78. Almost all fieldwork participants said an entity's management estimates the amount or range of amounts of synergies expected to arise as a result of a business combination to identify how much the entity is willing to pay to acquire a business. The price the entity pays is then reflected in the financial statements through the recognition of the assets and liabilities acquired in the business combination. It could therefore be argued that information about management's objectives and targets, and the amount of synergies, is related to those assets acquired and liabilities assumed. Such information can help assess an entity's economic resources and claims against the entity, as well as the entity's ability to generate future net cash inflows. The relationship could be less direct if management uses non-financial metrics to monitor the business combination. However, even in this situation, the staff think information about the success of a major business combination will likely provide information about the recoverability of an entity's assets and the prospect of those assets generating future net cash inflows.

79. Similarly, information about the subsequent performance of business combinations can help explain some of the income and expenses recognised during the period. In addition, as described in paragraphs 38–40 of Agenda Paper 18A to the Board's June 2021 meeting, the staff thinks such information can also help address some aspects of problem identified by the Board on the timeliness of the recognition of impairment losses.

80. Paragraph 1.3 of the *Conceptual Framework* states that a key objective of financial reporting is to provide information to allow users to assess management's stewardship

of the entity. Users said information about the subsequent performance of business combinations is needed for assessing management stewardship. Although the *Conceptual Framework* does not specify that this information should be in financial statements, the Board would work towards meeting that objective by requiring the disclosure of such information.

81. Some respondents said the proposed information is forward-looking and therefore should not be included in financial statements (see paragraph 74(b)). The staff think concerns over forward-looking information is not a barrier for the Board to require the information to be disclosed in financial statements for the reasons provided in paragraphs 44–56.

Practical reasons

82. Some respondents provided practical reasons for including information in management commentary. In their view, including the information in management commentary would:

    (a) protect the entity from potential litigation through 'safe-harbour provisions' for forward-looking information; and

    (b) help resolve auditability concerns.

83. Paragraphs 41–67 of this paper include the staff's analysis on forward-looking information and auditability of the proposed information. The staff think these practical challenges should not prevent requiring entities to disclose the information in financial statements.

Duplication of information

84. A few preparers said that the Board's preliminary views would result in duplicating information provided in other documents published by the entity, such as management commentary. The staff observes that this concern is not as widespread as the conceptual and practical concerns. The staff think the potential cost to preparers in duplicating information would be limited, especially as more entities embrace digital reporting over time. Paragraph 88 discusses whether the Board could allow entities to incorporate the information in financial statements by cross-reference to the those other documents.

Possible ways forward

85. The staff think the Board could:

(a) proceed with its preliminary views (paragraphs 86–87);

(b) permit an entity to incorporate information disclosed elsewhere by cross-reference (paragraph 88);

(c) incorporate its preliminary views into *Practice Statement for Management Commentary* (paragraphs 89–90); or

(d) consider alternative ways to respond to feedback on the PIR of IFRS 3 (paragraph 91).

Proceed with preliminary views

86. The Board could proceed with requiring entities to disclose the information in financial statements. Paragraphs 52–56 analyse whether the information can be included in financial statements.

87. In addition, not all companies that prepare financial statements applying IFRS Standards are required to, or choose to, apply IFRS Practice Statement 1 *Management Commentary* (Practice Statement). Therefore, including the Board's preliminary views in the Practice Statement may not provide users with better information unless those preliminary views are also included in local regulatory requirements. This could hinder the Board's ability to respond to concerns users raised in the PIR of IFRS 3 that they do not receive sufficient information about the subsequent performance of business combinations.

Permitting an entity to refer to information by cross-reference

88. IFRS 7 *Financial Instruments: Disclosures* permits an entity to incorporate into financial statements some risk disclosures by cross-reference to the extent the entity has already disclosed this information elsewhere. If the Board confirms its preliminary view of requiring disclosure in financial statements, the Board could consider a similar approach to that used in IFRS 7 to address concerns about the duplication of information. Although a cross reference might resolve concerns about duplication, it is unlikely to resolve conceptual or practical concerns. Information included in financial statements by cross-reference is still part of the financial

statements and is generally subject to the same auditing requirement as information included directly in financial statements.

Incorporate preliminary views into the Practice Statement for Management Commentary

89. The Board could decide to require entities applying the Practice Statement to provide information about the subsequent performance of business combinations or synergies expected from combining the operations of the acquired business with the entity's business in management commentary for the reasons described in paragraphs 74–76. However, as noted in paragraph 87, including such requirements in the Practice Statement might not allow the Board to effectively respond to the feedback in the PIR of IFRS 3 because not all entities are required to apply the Practice Statement.

90. In addition, the Board's preliminary views include requirements that may be too detailed to be incorporated into the Practice Statement. The Practice statement is an objective-based framework and does not include requirements and guidance for reporting specific types of transactions, such as business combinations. The Board's preliminary views for disclosures in the Goodwill and Impairment project, on the other hand, cover only business combinations and include some specific proposals which may not fit well within the management commentary framework.

Considering alternative ways to respond to feedback received in the PIR of IFRS 3

91. In this paper, the staff have identified various alternative ways to provide users with better information about business combinations. Adopting these alternatives could help address concerns some stakeholders have over the location of the information. For example:

    (a) instead of requiring entities to disclose information management uses to monitor the performance of a business combination, the Board could prescribe specific metrics about business combinations that all entities should disclose (see paragraphs 37–40 for details); and

    (b) instead of requiring entities to provide quantitative information, the Board could permit entities to decide the best approach to provide information that would satisfy the Board's disclosure objectives, for example by permitting entities to disclose qualitative rather than quantitative information (see paragraphs 35–36 for details).

Question for the Board
Do the Board have any questions or comments on the staff analysis contained in this paper? Are there areas on which the Board would like additional analysis to support its decision on the subsequent accounting for goodwill?