# STAFF PAPER

November 2021

**IASB® meeting**

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| **Project** | **Goodwill and Impairment** |
| Paper topic | Liabilities arising from financing activities and defined benefit pension liabilities |


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## Purpose and structure

1. The purpose of this paper is to:

   (a) provide the International Accounting Standards Board (Board) with our analysis of feedback on the Board's preliminary view to develop proposals to specify that liabilities arising from financing activities (financing liabilities) and defined benefit pension liabilities (pension liabilities) are major classes of liabilities; and

   (b) ask the Board whether it agrees with our recommendation to not proceed with its preliminary view but to instead propose amending:

      (i) paragraph B64(i) of IFRS 3 *Business Combinations* to remove the term 'major' from the requirement to disclose major classes of assets acquired and liabilities assumed; and

      (ii) paragraph IE72 of the Illustrative Examples accompanying IFRS 3 to illustrate financing and pension liabilities as material classes of liabilities assumed.

2. The paper is structured as follows:

   (a) background and feedback summary (paragraphs 3–9);

   (b) staff analysis (paragraphs 10–23);

   (c) staff recommendation (paragraph 24); and

(d) question for the Board.

## Background and feedback summary

3. Paragraph B64(i) of IFRS 3 requires an entity to disclose amounts recognised for each major class of assets acquired and liabilities assumed in a business combination. Some users of financial statements (users) said it would be useful to know the amount of financing and pension liabilities acquired as part of a business combination and that some entities do not disclose these liabilities separately for each business combination. These users said they need this information to calculate the total capital employed in a business combination—in their view, these liabilities form part of the total capital employed.

4. The Board's preliminary view is that it should develop proposals to specify that financing and pension liabilities are major classes of liabilities. As a result, an entity would be required to disclose the amount of such liabilities acquired for each business combination (if the information is material). That information would be useful and is likely to be readily available because these liabilities are required to be recognised and measured at the date of a business combination.

5. Almost all respondents to the Discussion Paper agreed with the Board's preliminary view for the reasons discussed in paragraph 4. This included accounting firms, accounting bodies, national standard-setters, regulators, preparers and users.

6. Some of those who agreed with the Board's preliminary view acknowledged 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 supported the Board's preliminary view.

7. Respondents who disagreed with the Board's preliminary view—a few accounting firms and national standard-setters—did so because, in their view, that information is already required if material, by IFRS 3 and/or 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 Standards 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. A few respondents said, applying this requirement, if financing or pension liabilities acquired in a business combination are material, an entity is required to disclose those 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 balance of the net defined benefit liability (asset).

8. One national standard setter who disagreed with the Board's preliminary view said the preliminary view would result in a specific requirement, which does not fit in with the principles-based approach generally used in IFRS Standards.

9. A few respondents—in particular some national standard-setters and individuals—suggested requiring separate disclosure of other items acquired in a business combination, which some users might consider similar to financing liabilities, 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.

## Staff analysis

10. We considered whether to:

(a) proceed with the Board's preliminary view (paragraphs 11–2222); and

(b) specifically require separate disclosure of items similar to financing liabilities (paragraph 2323).

### *Proceed with the Board's preliminary view?*

11. We acknowledge feedback from a few respondents who said the existing requirements in IFRS 3 and other IFRS Standards (see paragraph 7) should result in an entity disclosing information about financing and pension liabilities acquired in a business combination.

12. However, as noted in paragraph 4, users said they sometimes do not receive this information. Also, as noted in paragraph 2.70 of the Discussion Paper, whilst IAS 7 and IAS 19 require entities to provide the information noted in paragraphs 7(b) and 7(c) of this paper, those Standards do not require separate disclosure of the amounts for each acquisition. Accordingly, we think the Board should continue to consider whether and how to address this matter.

13. We think the Board could proceed with its preliminary view. This would provide users with information they need and as noted in paragraph 5 almost all respondents agreed with the preliminary view.

14. However:

    (a) we agree with the respondent who said the preliminary view would result in a specific requirement, which is inconsistent with the principles-based approach generally used in IFRS Standards (see paragraph 8).

    (b) paragraphs 38–39 of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* also use the phrase 'major classes of assets and liabilities'. Specifying that two specific types of liabilities are major classes of liabilities in IFRS 3 could have unintended consequences for the application of IFRS 5.

    (c) since the publication of the Discussion Paper in March 2020 the Board:

        (i) has published *Disclosure of Accounting Policies*, which amended IAS 1 *Presentation of Financial Statements*. That amendment replaced the phrase 'significant accounting policies' with 'material accounting policies'. Paragraph BC76L of IAS 1 explains that entities can have difficulty assessing whether an accounting policy is significant because significant is not defined in IFRS Standards. The Board also noted entities can have difficulty understanding the difference, if any, between ‘significant’ and ‘material’ accounting policies. A similar rationale could apply in relation to the use of ‘major’ in paragraph B64(i) of IFRS 3—it is not defined and there could be confusion as to what ‘major’ means.

(ii) has been redeliberating its proposals in Exposure Draft *General Presentation and Disclosures* in relation to clarifying the principles of aggregation and disaggregation and their application in primary financial statements and the notes. We think clarifying those principles could improve the application of the disaggregation requirements in the context of entities applying paragraph B64(i) of IFRS 3.

15. Accordingly, we considered whether the Board could take a more principles-based approach to addressing this matter.

16. We think an alternative approach the Board could consider is to remove the word ‘major’ in paragraph B64(i) of IFRS 3. Accordingly, entities would be required to disclose ‘the amounts recognised as of the acquisition date for each class of assets acquired and liabilities assumed’. In applying this requirement, entities would consider the general materiality and disaggregation requirements in IAS 1.

17. Requiring an entity to assess materiality when applying paragraph B64(i) of IFRS 3 would, in our view, be appropriate—paragraph 7 of IAS 1 states ‘materiality depends on the nature or magnitude of information, or both’[1]. We think the materiality of the class of assets acquired and liabilities assumed required to be disclosed applying paragraph B64(i) is based not only on its amount, but also on its nature and therefore its potential role in users’ analysis.

18. Paragraph IE72 of the Illustrative Examples accompanying IFRS 3 illustrates the application of paragraph B64(i). We think it would be helpful to also amend paragraph IE72 to illustrate pension and debt liabilities as material classes of liabilities assumed.

[1] The Exposure Draft *General Presentation and Disclosures* proposed moving unchanged the definition of material from IAS 1 to IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

19. We think this approach would address the concern described in paragraph 3. In particular:

    (a) it would remove confusion about what 'major' means. As noted in paragraph BC76M of IAS 1, 'material' is defined in IFRS Standards and is well understood by stakeholders;

    (b) it could also result in useful information for users by requiring entities to disclose information about all material classes of assets acquired and liabilities assumed (which would include information about pension and debt liabilities acquired if these liabilities are material). This information would help users better understand the benefits that a company's management expected from an acquisition when agreeing the price to acquire a business.

20. The proposed amendment would also be consistent with the Board's recent decisions in the Primary Financial Statements project. Paragraph 25 of Exposure Draft *General Presentation and Disclosures* proposed requiring entities to present or disclose the '…amount of each material class of assets, liabilities, income or expense, equity or cash flow'. In September 2021 the Board tentatively decided to remove the reference to 'material' in the requirement. The resulting phrase 'amount of each class of assets, liabilities…' would be similar to our recommended amendment to paragraph B64(i) of IFRS 3 (see paragraph 16). In drafting the proposed amendment, we will ensure consistency with the related decisions and drafting in the Primary Financial Statements project.

21. We acknowledge the term 'major' is also used in other instances in IFRS Standards. However, we think it is unnecessary to also replace 'major' in those other instances—the Board has identified a concern related to the application of paragraph B64(i) and not in relation to those other instances. We think amending 'major' in those other instances would go beyond the scope of this project.

*Conclusion*

22. Based on our analysis, we think the Board should not proceed with its preliminary view but should instead propose amending:

(a) paragraph B64(i) of IFRS 3 to remove the term ‘major’ from the requirement to disclose major classes of assets acquired and liabilities assumed; and

(b) paragraph IE72 of the Illustrative Examples accompanying IFRS 3 to illustrate financing and pension liabilities as material classes of liabilities assumed.

### *Specifically require separate disclosure of other items*

23. If the Board disagrees with our conclusion in paragraph 22 and instead decides to proceed with its preliminary view—that is, to specify that financing and pension liabilities are major classes of liabilities—we think it would be unnecessary to also specifically require separate disclosure of other items some might consider similar to financing liabilities (such as those identified in paragraph 9) because:

(a) users did not identify these as items for which they need, but do not receive, information about following a business combination; and

(b) IFRS 3 already requires entities to disclose information about some or all of the items noted in paragraph 9. For example:

(i) paragraph B64(o) of IFRS 3 requires an entity to disclose the amount of the non-controlling interest in an acquiree recognised at the acquisition date and the measurement basis for that amount; and

(ii) paragraph B64(f) of IFRS 3 requires an entity to disclose the acquisition-date fair value of the total consideration transferred and the acquisition-date fair value of each major class of consideration, which includes equity instruments issued in a business combination.

## Staff recommendation

24. We recommend that the Board not proceed with its preliminary view but instead propose amending:

    (a) paragraph B64(i) of IFRS 3 to remove the term ‘major’ from the requirement to disclose major classes of assets acquired and liabilities assumed; and

    (b) paragraph IE72 of the Illustrative Examples accompanying IFRS 3 to illustrate financing and pension liabilities as material classes of liabilities assumed.

| **Questions for the Board** |
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| 1. Does the Board agree with our recommendation in paragraph 24? |
| 2. If the Board does not agree with our recommendation and instead decides to proceed with its preliminary view—that is, to specify that financing and pension liabilities are major classes of liabilities—does the Board agree to not specifically require separate disclosure of other items some might consider similar to financing liabilities? |