IFRS

STAFF PAPER

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Project	**Goodwill and Impairment**
Paper topic	Conceptual considerations for location of disclosures

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Objective

1. The purpose of this paper is to set out our analysis and recommendation on whether, based on the *Conceptual Framework for Financial Reporting* (*Conceptual Framework*), information entities would disclose about business combinations applying the International Accounting Standards Board's (the Board's) preliminary views in its Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment* can be required in financial statements.

2. This paper does not analyse practical concerns about including the information in financial statements. Agenda Paper 18B to this meeting includes further analysis of those practical concerns.

3. We conclude that, based on the *Conceptual Framework*, information about the benefits expected from a business combination and the extent to which management's objectives for a business combination are met can be required in financial statements.

4. If the Board agrees with our conclusion, the Board could still decide at a future meeting not to require entities to disclose some or all of this information in financial statements for other reasons such as practical considerations.

Structure of the paper

5. The paper is structured as follows:

   (a) background (paragraphs 6–11);

   (b) staff analysis (paragraphs 12–35); and

(c) staff recommendation (paragraphs 36–37).

Background

The Board's preliminary views

6. In the Discussion Paper, the Board's preliminary views were that it should develop proposals to:

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

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

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

7. The additional disclosure objectives were supported by the Board's preliminary views that it should develop proposals to:

   (a) 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.

   (b) add a requirement to disclose:

      (i) in the year in which a business combination occurs, the metrics 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]

(c) 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 location of information

8. Many respondents said the Board should not require disclosure of information about the benefits an entity's management expect from a business combination and the extent to which management's objectives are being met 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.

9. 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 (see Agenda Paper 18B to this meeting); and

(c) to avoid duplicating information.

[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.

Conceptual reasons

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

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

11. Some respondents commented on requiring disclosures about the metrics management intends to use to monitor whether a business combination has been a success—they said some of those metrics might be non-financial and, in their view, this information in particular should not be included in financial statements.

Staff Analysis

12. Respondents' feedback discussed in paragraphs 8–11 of this paper referred to the Board's preliminary views to add additional disclosure objectives to IFRS 3, information about the subsequent performance of business combinations, and

quantitative information about expected synergies arising from a business combination (see paragraphs 6–7). The Board's preliminary views on requiring entities to disclose information about the subsequent performance of business combinations, and quantitative information about expected synergies are linked to the Board's preliminary views to add additional disclosure objectives to IFRS 3 (see paragraph 6)—that is, those disclosures would help satisfy the disclosure objectives. Our analysis and conclusions in this section, while applying to all aspects of the Board's preliminary views, generally focusses on whether, applying the *Conceptual Framework*, the information required to satisfy the disclosure objectives described in the Discussion Paper can be required in financial statements. This is because the Board could decide in future meetings to allow entities to provide the information required to meet those objectives differently from that described in the Board's preliminary views.

13. Our analysis considers:

    (a) the relationship between the proposed information and elements in financial statements (paragraphs 15–19);

    (b) whether, based on the *Conceptual Framework,* the information described by the Board's preliminary views are forward-looking (paragraphs 20–31); and

    (c) whether information about metrics could be non-financial and therefore, not required in financial statements (paragraphs 32–35).

14. Much of our analysis repeats the analysis in Agenda Paper 18A to the Board's July 2021 meeting.

Relationship with elements in financial statements

15. As explained in paragraph 10, some respondents said the proposed information is not directly related to the elements in 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

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.

16. To identify how much an entity is willing to pay to acquire a business, almost all fieldwork participants said the entity's management (a) considers the strategic rationale and objectives for the business combination; and (b) estimates the amount or range of amounts of synergies expected to arise as a result of a business combination. The price the entity pays is then reflected in the financial statements through the recognition of assets and liabilities acquired in the business combination. Accordingly, we think information about management's objectives and targets, and quantitative information about expected 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 between the information and the assets and liabilities acquired could be less direct if management uses non-financial metrics to monitor a business combination. However, even in this situation, information about the success of a 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.

17. Similarly, information about the subsequent performance of business combinations can help users understand an entity's financial performance—for example some of the income and expenses recognised. As described in paragraphs 38–40 of Agenda Paper 18A to the Board's June 2021 meeting, we think such information can also address some aspects of the problem identified by the Board on the timeliness of the recognition of impairment losses.

18. In addition, paragraph 1.3 of the *Conceptual Framework* states 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.

19. Accordingly, we think information about the benefits an entity's management expects from a business combination and the extent to which management's objectives are being met—that is, information required to meet the additional disclosure objective described in paragraph 6—relates to elements recognised in financial statements and therefore, can be required in financial statements.

Forward-looking information

20. Paragraph 3.6 of the *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.

21. In the light of paragraph 3.6, we considered:

   (a) whether the information that would be required would be forward-looking (paragraphs 22–27); and

   (b) if the information would be forward-looking, whether it can be required in financial statements (paragraphs 28–31).

Is the information forward-looking?

22. Paragraph 3.6 of the *Conceptual Framework* implies information about management's expectations and strategies for a reporting entity is forward-looking. Accordingly, we

think some aspects of the information proposed in the Discussion Paper—particularly information about the strategic rationale for undertaking a business combination—might be 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.

23. However, based on paragraph 3.6 of the *Conceptual Framework*, we continue to think information about the synergies management expected at the time of a business combination, management's objectives for a business combination and the metrics management intend to use to monitor the performance of a business combination are not forward-looking. We think 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'.

24. When an entity discloses the performance of the business combination in a subsequent period based on 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.

25. After acquiring a business, management may revise their expectations of what a business combination will achieve. The Board's preliminary view does not

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

26. This information should not be confused with the Board's preliminary view that when management changes a 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 our view, information about the updated metric and the reason(s) for the change is not forward-looking because the change has already occurred.

27. 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. The staff's assessment in paragraphs 22–26 is based on the definition of forward-looking information in the *Conceptual Framework*. There may be different definitions of forward-looking information in jurisdiction specific regulation or legislation and entities might reach a different conclusion based on those definitions. Agenda Paper 18B to this meeting further discusses this practical concern.

Can information be required in financial statements?

28. As analysed in paragraphs 22–26, we 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. We understand 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 provide information about future transactions or events. However, in our view, this would not preclude the Board from requiring disclosure of such information in financial statements.

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

    (a) paragraph 21A of IFRS 7 *Financial Instruments: Disclosures* which requires an entity to disclose information about risk exposures for which the 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 require 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.

30. 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.

31. Requiring disclosure of the strategic rationale for a business combination would simply clarify paragraph B64(d) of IFRS 3, which already requires an entity to disclose the primary reasons for a business combination. We think 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 (see also paragraphs 15–19). Feedback from users also suggested that the information would be useful. Therefore, we think, based on the *Conceptual Framework*, the proposed information can be required in financial statements.

Non-financial information

32. Paragraph 2.11(b) of the Discussion Paper acknowledges the objectives and metrics management uses to monitor the performance of a business combination could be non-financial.

33. An entity's management is likely to pursue several objectives when acquiring a business and use several metrics for measuring progress towards those objectives. Paragraph 2.13 of the Discussion Paper explains that information about the metrics management uses to monitor a business combination is likely to be more relevant to users in assessing the performance of a business combination than if the Board were to specify a single metric.

34. In our view, there is no reason for the Board to limit the metrics an entity discloses in financial statements to financial metrics. We think non-financial metrics can provide as relevant information to users about the assets and liabilities recognised by an entity as a result of a business combination as that provided by financial metrics. As explained in paragraphs 17–18 of this paper, we also note that information about the subsequent performance of business combinations (whether monitored using financial or non-financial metrics) would:
    - (a) be related to elements in the financial statements;
    - (b) address some aspects of problem identified by the Board on the timeliness of the recognition of impairment losses; and
    - (c) provide information to allow users to assess management's stewardship of the entity.

35. Therefore, in our view, using non-financial metrics to measure the performance of a business combination should not preclude an entity from including the information required by the Board's preliminary views in financial statements.

Staff recommendation

36. We think, based on the *Conceptual Framework* information about the benefits an entity's management expect from a business combination and the extent to which management's objectives are being met—such as information about the subsequent performance of business combinations, and quantitative information about expected

synergies—can be required in financial statements. Accordingly, we recommend that the Board confirm that such information can be required in financial statements.

37. We plan to provide the Board with further analysis of practical concerns respondents raised. If the Board agrees with the recommendation in this paper, the Board could still decide at a future meeting not to require entities to disclose some or all of this information in financial statements for other reasons such as practical considerations.

Question for the Board
Does the Board agree with our recommendation in paragraph 36 that, based on the *Conceptual Framework*, information about the benefits an entity's management expect from a business combination and the extent to which management's objectives are being met—such as information about the subsequent performance of business combinations, and quantitative information about expected synergies—can be required in financial statements?