IFRS

STAFF PAPER

October 2021

IASB® meeting

Project	Goodwill and Impairment		
Paper topic	Practical Challenges—forward-looking information		
CONTACT(S)	Dehao Fang	fdehao@ifrs.org	+44 (0)20 7246 6416

Objective and structure

1. Agenda Paper 18A to this meeting includes our analysis of conceptual concerns raised by respondents to the International Accounting Standards Board's (the Board's) Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment* relating to requiring disclosures of additional information about business combinations in financial statements. This paper includes our analysis of *practical concerns* raised by respondents on this matter. In particular, this paper provides the Board with additional research and analysis on practical concerns about requiring entities to disclose information that might be considered forward-looking in some jurisdictions.

2. This paper does not include a staff recommendation and the Board will not be asked to make any decisions at this meeting.

3. This paper is structured as follows:
   (a) Background (paragraphs 4–7);
   (b) Plan to address practical challenges (paragraphs 8–10);
   (c) Forward looking information (paragraphs 11–42);
   (d) Next steps (paragraph 43–44); and
   (e) Question for the Board.

Background

Preliminary views

4. 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.

   (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 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]

[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.

(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 location of information

5. Many respondents to the Discussion Paper suggested not requiring entities to disclose information about management's strategy, targets, the progress in meeting those targets and expected synergies in financial statements. Many of these respondents said entities should instead provide this information in management commentary, and that the Board could consider this as part of its Management Commentary project.

6. 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 (see Agenda Paper 18A to this meeting);

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

   (c) to avoid duplicating information, such as the strategic rationale and objectives for a business combination, which a few respondents said is already provided in management commentary.

Practical reasons

7. Most respondents who said information about expected synergies arising from a business combination should be disclosed 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:

(a) allow entities to benefit from 'safe-harbour' protections[2]. 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. These respondents said that in most jurisdictions, information in management commentary is typically either not audited or not subject to similar level of assurance as information in financial statements.

Plan to address practical challenges

8. Paragraph 14 of Agenda Paper 18A of the Board's July 2021 meeting describes four areas of practical challenges raised by respondents and discusses possible alternatives to address those concerns:

   (a) commercial sensitivity (see paragraphs 25–40 of that paper)

   (b) forward-looking information (see paragraphs 57–59 of that paper);

   (c) auditability (see paragraphs 65–67 of that paper); and

   (d) integration (see paragraph 71 of that paper).

9. As noted in paragraphs 11–13 of Agenda Paper 18 to the Board's September 2021 meeting, we also plan to develop staff examples illustrating our expectation of what an entity would disclose applying the Board's preliminary views. We plan to test these examples with preparers, users, auditors and regulators. Feedback on these examples could assist the Board in deciding whether to proceed with its preliminary views. This work is ongoing and we will provide the Board with the feedback at a future meeting.

10. Paragraphs 11–16 of this paper provide the Board with an update on our research into the practical concern regarding information that would be disclosed applying the

[2] We 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.

Board's preliminary view potentially being forward-looking in some jurisdictions. Paragraphs 17–42 explore possible ways to address or mitigate that concern.

Forward-looking information

Practical concern identified

11. Paragraphs 41–59 of Agenda Paper 18A of the Board's July 2021 meeting set out our analysis of concerns about the information that would be disclosed applying the Board's preliminary views being forward-looking. Agenda Paper 18A to this meeting analyses concerns about the information being forward-looking from the perspective of the *Conceptual Framework for Financial Reporting* (Conceptual Framework). As noted in that paper, applying the *Conceptual Framework*, we think the information that would be disclosed applying the Board's preliminary view can be required in financial statements.

12. However, practical concerns about that information being included in financial statements could result from potential differences in the definitions of forward-looking information in jurisdictional requirements and in the *Conceptual Framework*. In particular, we understand that in some jurisdictions, entities are entitled to 'safe harbour' provisions which provide entities with protection from legal action in respect of forward-looking information disclosed in documents other than financial statements.

13. Respondents raised particular concern about the ability of entities registered in the United States to access the 'safe harbour' provisions provided by the US *Private Securities Litigation Reform* Act (the act). The act protects such entities in respect of litigation from investors resulting from the disclosure of forward-looking information. This protection does not extend to forward-looking information disclosed in financial statements.

14. We undertook additional outreach with some stakeholders, including a US securities lawyer. From these discussions, we understand a decision on whether a piece of information is forward-looking in the context of US regulations could be a matter for the appropriate court to decide. Feedback from the additional outreach indicates that

applying the definition of forward-looking statements in US regulations, a court might conclude that quantitative information about management's objectives and synergies expected to arise as a result of a business combination are forward-looking.

15. Therefore, an entity may be subject to additional litigation risk and incur significant additional costs if they make a forward-looking statement in the financial statements that is not protected by the 'safe harbour' provisions when compared to making such a statement outside the financial statements that is protected by the 'safe harbour' provisions. Those costs would arise as a result of an entity being required to defend, settle or pay compensation in potential litigation. Litigation risk relating to additional disclosures about business combinations may be more pronounced than for other transaction types because business combinations often involve large amounts of capital and attract greater attention.

16. Although we have researched the concerns in a US context, we understand similar concerns could exist in other jurisdictions. In their responses to the Board's Discussion Paper, most regulators said they either did not view the Board's preliminary views as requiring entities to disclose forward-looking information or that they were not aware of any potential conflict between the Board's preliminary views and their local regulations. However, regulators in some jurisdictions said the information that would be disclosed applying the Board's preliminary views could be considered forward-looking in their jurisdictions—accordingly, disclosing such information in financial statements could subject an entity to additional litigation risk when compared to disclosing the same information in other documents.

Potential alternatives

17. Paragraphs 20–42 analyse potential alternatives that might help respond to the concerns identified in paragraphs 11–16. We have not included a staff recommendation and are not asking the Board to make any decisions at this meeting. We think it would be helpful for the Board to also understand the extent of this concern in jurisdictions outside the US. To this end, we plan to contact securities regulators to gather more information.

18. In our view, as noted in Agenda Paper 18A to this meeting, the information described by the Board's preliminary views can be required in financial statements based on the

Conceptual Framework. However, the Board could consider the following alternatives to address practical concerns with including forward-looking information in the financial statements:

(a) permit an entity to incorporate information disclosed elsewhere by cross-reference in the financial statements (paragraph 20–22);

(b) incorporate its preliminary views into Practice Statement 1 *Management Commentary* (paragraphs 23–25);

(c) not require quantitative disclosure of management's objectives (paragraph 26–31);

(d) exempt entities from disclosing particular information in financial statements in some circumstances (paragraph 32–37); or

(e) develop an objective-based approach (paragraph 38–42).

19. Although some of these approaches could also help to address or mitigate other practical concerns, such as commercial sensitivity and auditability of information, the analysis in this paper focuses on forward-looking information.

Permit an entity to incorporate information by cross-reference

20. IFRS 7 *Financial Instruments: Disclosures* permits an entity to incorporate into financial statements some information by cross-reference to the extent the entity has disclosed the required information elsewhere. Some respondents suggested the Board consider a similar approach.

21. As noted in paragraph BC35L of IFRS 7, the cross-reference approach was intended to address concerns about the duplication of information. This is because many financial institutions applying IFRS 7 already disclose some information required by IFRS 7 outside financial statements. Cross-referring to the information could address duplication concerns and make information more transparent and easier to understand by presenting all relevant information in one location.

22. However, information incorporated by cross-reference is an integral part of financial statements and is generally subject to the same auditing requirements as information included directly in financial statements. Adopting such an approach is unlikely to address concerns discussed in paragraphs 11–16 of this paper.

Incorporate preliminary views into the IFRS Practice Statement 1 Management Commentary

23. The Board could decide to require entities applying IFRS Practice Statement 1 *Management Commentary* (Practice Statement) to provide the information that would be required applying the Board's preliminary views in their management commentary. Many respondents suggested adopting such an approach for various reasons, including to address concerns about forward-looking information.

24. However, not all entities applying IFRS Standards are required to, or choose to, apply the Practice Statement. Therefore, this approach 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 post-implementation review of IFRS 3 about not receiving sufficient information about the subsequent performance of business combinations.

25. In addition, the Board's preliminary views include requirements that may be too detailed to incorporate 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 about disclosures in the Goodwill and Impairment project, on the other hand, cover only business combinations and include some specific disclosure requirements which may not fit well within the management commentary framework.

Not require quantitative disclosure of management's objectives and expected synergies

26. The Board's preliminary view would require an entity to provide, at the date of acquisition, quantitative information about management's key objectives and expected synergies for a business combination.

27. The Board could amend its preliminary view to require an entity to disclose, at the date of acquisition, qualitative information about management's key objectives for a business combination and the metric(s) management will use to monitor whether the objectives of the business combination are being met without disclosing quantitative target(s) for that metric(s). In subsequent periods, an entity would be required to disclose the actual result using the metric(s) disclosed in the year of acquisition.

28. For example, if management's key objective for a business combination is to increase revenue by CU100 million each reporting period, the entity would be required to disclose, at the acquisition date, only its objective of increasing revenue and that it will use revenue as the metric by which it will measure the success of the business combination—the entity would not be required to disclose its quantitative target of increasing revenue by CU100 million. In subsequent reporting periods, the entity will disclose the actual increase in revenue achieved for that period (say CU98 million).

29. A variation of this approach would require an entity to also disclose in subsequent periods whether the entity has achieved its target. So in the example discussed in paragraph 28 above, if the entity's revenue increases by CU98 million, the Board could require the entity to disclose that its revenue has increased by CU98 million and also that it has not achieved its target (the entity would still not be required to disclose its target of CU100 million). Although the quantitative target is not required to be disclosed (at the date of acquisition or subsequently), the entity will have internal documents that could support the target, and the statement of whether the entity has achieved its target will be audited.

30. In our view, this approach could reduce the litigation risk that might arise from disclose potentially forward-looking information in financial statements while providing users with information about the actual subsequent performance of a business combination.

31. However, the lack of quantitative information at the time of acquisition would mean:

    (a) users will not receive quantitative information in the year of an acquisition that might help them better understand the benefits an entity expected when entering the business combination.

    (b) not proceeding with the preliminary view of requiring entities to disclose quantitative information about expected synergies. This would mean not addressing feedback from users that qualitative information about synergies disclosed by entities applying IFRS 3 today not being useful.

Exempt entities from disclosing particular information in financial statements in some circumstances

32. The Board could provide a 'comply or explain' exemption similar to that in IAS 37 *Provisions, Contingent Liabilities and Contingent Asset*. IAS 37 permits entities to not disclose information about contingent liabilities if doing so may prejudice seriously the entity's position in a legal dispute.

33. The Board could consider an exemption based on particular criteria—for example, the Board could allow an entity to not disclose quantitative information about management's objectives and expected synergies in financial statements in the year of acquisition if:
    (a) the entity has already disclosed this information in another document that provides 'safe harbour' protections (or other similar mechanisms); or
    (b) providing that information in financial statements could result in significant additional litigation risk.

34. Alternatively, the Board could develop a combination of criteria an entity would need to meet to be able to use any exemption.

35. If an entity is exempted from providing the information in financial statements, the entity would need to explain:
    (a) the reason why that information is not provided in financial statements; and
    (b) whether that information is provided outside the financial statements, and if so, in which document.

36. We think requiring an entity to disclose in financial statements where particular information is disclosed does not make that information an integral part of the financial statements and is accordingly different from including that information in financial statements by cross reference (see paragraphs 20–22). If an entity used the exemption, it would not be required to disclose the information in financial statements, and therefore there is no information that would be part of financial statements. We could test this view in further discussions with regulators.

37. However, it may be difficult for the Board to draft requirements that are sufficiently robust to prevent abuse while still flexible enough to allow an entity to minimise its

litigation risk. For example, assessing whether disclosing a particular item of information in financial statements creates significant additional litigation risk could be subjective, costly to assess and difficult to audit.

Develop an objective-based approach

38. The Board could also develop an objective-based approach similar to that proposed in the Board's Exposure Draft *Disclosure Requirements in IFRS Standards—A Pilot Approach*. This approach would result in the Board using feedback obtained from users and other stakeholders to:

    (a) set out overall and specific disclosure objectives that explain investor needs in detail and require entities to apply judgement and disclose all material information that would enable those needs to be met; and

    (b) provide examples of information an entity may disclose to satisfy each disclosure objective. In most cases, these items of information would not be mandatory—instead, they would help entities determine how to meet the required objective.

39. This approach could provide an entity with flexibility to present information in a way that would minimise potential litigation risk while still meeting the disclosure objectives and providing useful information to users.

40. In developing such an approach, the Board could use its preliminary views and feedback on those preliminary views as a starting point. In particular, the Board could consider whether:

    (a) the disclosure objectives described in paragraph 4(a) of this paper could be used to develop overall and specific disclosure objectives; and

    (b) the more detailed potential requirements described in paragraphs 4(b)– 4(d) of this paper could be used as examples of information that would meet those objectives.

41. Some users said entities often disclose information outside financial statements that provide quantitative information about management's objectives for a business combination, but rarely disclose information regarding the achievement of those objectives in subsequent periods. The Board could explain that an entity can meet this

user need (a disclosure objective) by, for example, providing an update in subsequent periods on the information disclosed outside financial statements at the time of a business combination.

42. Following this approach could affect the project timeline because:

(a) IFRS 3 has some disclosure objectives and requirements that were developed before the approach proposed in the Exposure Draft *Disclosure Requirements in IFRS Standards—A Pilot Approach* was developed. In our view, if the Board were to use an objectives-based approach to address concerns about forward-looking information, it would need to consider whether to apply the same approach and be consistent across all disclosure requirements (existing and proposed) in IFRS 3. This could mean reconsidering existing disclosure requirements, which would widen the scope of the project.

(b) Exposure Draft: *Disclosure Requirements in IFRS Standards—A Pilot Approach* is open for comment till 12 January 2022. The Board may wish to consider feedback from that Exposure Draft before deciding whether to follow a similar approach for this project.

Next steps

43. At future meetings, we will provide the Board with feedback on the staff examples discussed in paragraph 9 and any additional information on forward-looking information requested by the Board. In particular, we plan to obtain feedback from regulators about:

(a) the existence of safe harbour requirements and concerns about disclosing forward looking information in financial statements outside the US (paragraph 17); and

(b) whether an exemption-based model could resolve concerns about forward-looking information that a cross reference approach could not (paragraph 36).

44. We will also provide the Board with our analysis of whether the Board should amend its preliminary views as a result of practical concerns about the location of the information described by the Board's preliminary views.

Questions for the Board
1. Do Board members have questions or comments on the additional outreach on forward-looking information or on the alternatives described in paragraphs 11–42? 2. Is there any additional information Board members would like to know before making a decision on the practical challenges for including the information that would be required by the Board's preliminary views in financial statements?