IFRS Accounting

Staff paper

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IASB® meeting

Date	**September 2022**
Project	**Goodwill and Impairment**
Topic	**Background and alternatives to consider**
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Purpose and structure

1. At its April 2022 meeting, the International Accounting Standards Board (IASB) discussed possible ways forward for its preliminary views to require entities to disclose information about the subsequent performance of business combinations and quantitative information about synergies expected from a business combination. The purpose of this paper is to summarise feedback on those possible ways forward and to help the IASB narrow down the options for further consideration.

2. This paper is structured as follows:

   (a) Background (paragraphs 3–19);

   (b) Staff analysis (paragraphs 20–37); and

   (c) Staff recommendation (paragraph 38).

Background

The IASB's preliminary views

3. During the post-implementation review of IFRS 3 *Business Combinations*, stakeholders said entities often apply the disclosure requirements of IFRS 3 mechanically as a checklist. The resulting disclosures can be 'boilerplate' and despite being extensive, provide insufficient information. Users of financial statements (users) said they need better information to help them understand a business combination and its subsequent performance. Information about management's objectives for a business combination and whether those objectives are being met would be useful and would help users assess:

   (a) management's ability to realise expected benefits from a business combination.

   (b) whether management paid a reasonable price for the acquired business. Such information would allow users to assess performance and more effectively hold management to account for its decision to acquire a business.

4. In response, the IASB considered possible improvements to the disclosure requirements in IFRS 3. The Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment* set out the IASB's preliminary views on this matter, including:

   (a) more specific disclosure objectives (paragraphs 5–6);

   (b) requirements to disclose information about the subsequent performance of a business combination (paragraphs 7–12); and

(c) requiring additional quantitative information about expected synergies from a business combination (paragraphs 13–14).

Disclosure objectives

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

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

6. For reasons noted in paragraph 3, the IASB's preliminary view is to add disclosure objectives that would require an entity to provide information to help users understand:

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

   (b) the extent to which a business combination is meeting management's objectives.

Subsequent performance of business combinations

7. Paragraph B64(d) of IFRS 3 requires an entity to disclose, among other things, the primary reason for a business combination. Paragraph 2.9 of the Discussion Paper notes that this requirement may result in entities providing some information about management's objectives, but that information is unlikely to be specific enough to help users assess the subsequent performance of a business combination.

8. For this reason, the IASB's preliminary view is that it should:

   (a) replace that requirement with a requirement to disclose:

      (i) the strategic rationale for 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 business combination's objectives are being met and the targets associated with those metrics;[1] and

[1] The preliminary view (paragraph 2.25 of the Discussion Paper) states that if the acquired business is integrated with the acquirer's business, information about the subsequent performance of the acquisition used by management may be based on the combined business.

(ii) in subsequent periods, the extent to which management's objectives for that business combination are being met using those metrics for as long as management monitors the business combination against those objectives.[2] For simplicity, we refer to this as information about 'actual performance' in Agenda Papers 18A–18D.

9. The phrases used in the Discussion Paper were described as:

(a) Strategic rationale—a description of the strategic rationale is likely to be broad (for example, 'to expand the company's geographical presence in Region Z by acquiring Company B, which trades in Territory Y in Region Z') and this would link to the company's overall business strategy (paragraph 2.11(a) of the Discussion Paper).

(b) Objectives—management's objectives would be more specific financial or non-financial aims for a business combination (for example, 'to achieve additional sales of the company's own Product W in new Territory Y using the acquired sales channels of Company B') (paragraph 2.11(b) of the Discussion Paper). Management's objectives are the objectives that management considers must be achieved for the acquisition to be a success and would form the basis of the information to help investors assess the subsequent performance of the acquisition (paragraph 2.12 of the Discussion Paper).

(c) Metrics—how targets are to be measured. The metrics are the metrics management uses to monitor a business combination's performance and subsequent progress. These metrics could be financial—for example, amounts of synergies, profit measures, returns on capital—or non-financial—for example, market share, retention of staff, product launches—or both (paragraphs 2.11(b), 2.16(b) and 2.16(d) of the Discussion Paper).

(d) Targets—the targets are how management will determine whether the objectives of a business combination have been met. An example of a target and metric is 'additional revenue of CU100 million of Product W in Territory Y in 202X' (paragraph 2.11(b) of the Discussion Paper).

10. As paragraph 2.30 of the Discussion Paper explains, in the IASB's view, information about the objectives, metrics and related targets for a business combination reflects information at the time of the business combination and is not a forecast of the expected outcome at the time the entity prepares its financial statements.

11. The preliminary view would require information to be disclosed only for those business combinations monitored by an entity's chief operating decision maker (CODM). The information provided for those acquisitions would be the objectives the CODM has set for the acquisition and the information the CODM uses to monitor whether those objectives are being met (paragraph 2.36 of the Discussion Paper). Basing the information on what the CODM uses to monitor an acquisition may help minimise the costs of preparing the information, focusing on the most important information about the most important business combinations (paragraph 2.38(b) of the Discussion Paper).

12. The IASB's preliminary view is that if an entity's management continues to monitor whether its objectives are being met an entity should be required to disclose information about the subsequent performance for as long as the information remains necessary for users to assess whether the original objectives of the business combination are being met (paragraph 2.44 of the Discussion Paper).

Expected synergies

13. Paragraph B64(e) of IFRS 3 requires an entity to disclose, in the year in which a business combination occurs, a qualitative description of the factors that make up the goodwill recognised, such as expected

[2] The preliminary view (paragraph 2.45 of the Discussion Paper) also included other requirements that would apply if management does not monitor whether its objectives for the business combination are being met, if it stops monitoring whether its objectives are being met or if it changes the metrics it uses to monitor whether its objectives are being met.

synergies from the business combination. Users said this requirement often results in entities providing an unhelpful generic description. Users said the information they want is not about goodwill itself, but information that helps them better understand why an entity paid the price it did for the acquired business.

14. For this reason, the IASB's preliminary view is that it should require an entity to disclose, in the year in which a business combination occurs:

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

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

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

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

Feedback

15. Almost all users agreed with the IASB's preliminary views to improve the information disclosed about business combinations. Most users said existing disclosure requirements do not provide them with sufficient useful information. Many users said they are particularly interested in information about the subsequent performance of business combinations and about expected synergies from business combinations to help them better understand the rationale of business combinations, and to hold management to account for those business combinations.

16. As noted in Agenda Paper 18A to the IASB's April 2022 meeting, feedback on the preliminary views identified four practical concerns about disclosing the information that would be required applying those preliminary views:

 (a) commercial sensitivity—the information could contain information that, if disclosed, could harm the entity;

 (b) forward-looking information—the information could be about the future and if disclosed, could increase litigation risk;

 (c) integration—an entity may not be able to disclose information that is representative of the performance of a business combination if the acquired business is integrated into the entity's existing operations; and

 (d) auditability—some information that would be required by preliminary views may be costly, or impossible, to audit.

Possible alternatives and feedback on those alternatives

17. In April 2022 the IASB discussed four alternatives to the preliminary views which could help respond to the practical concerns. The alternatives we considered are:

 (a) requiring an entity to disclose information that would be required by the preliminary views for a subset of business combinations;

 (b) exempt an entity from disclosing some information that would be required by the preliminary views in specific circumstances;

 (c) requiring only qualitative information in the year of acquisition rather than quantitative information; and

(d) specifying metrics an entity would disclose.

18. To help the IASB determine which, if any, of the four alternatives to proceed with, we:

(a) researched particular aspects of the alternatives following comments made by IASB members at the April 2022 meeting. Agenda Paper 18A of the IASB's July 2022 meeting reports the results of our analysis.

(b) sought advice from Capital Markets Advisory Committee (CMAC) and Global Preparers Forum (GPF) members at their joint meeting in June 2022, a summary of which was reported to the IASB at its July 2022 meeting (see meeting summary from that meeting).

(c) sought advice from Accounting Standards Advisory Forum (ASAF) members at their July 2022 meeting, a summary of which was reported to the IASB at its July 2022 meeting (see meeting summary from that meeting); and

(d) considered feedback from stakeholders in previous outreach (for example paragraphs 72–86 of Agenda Paper 18A to the IASB's April 2022 meeting).

19. Our analysis in this and the other agenda papers for this meeting incorporates relevant aspects of our research and feedback.

Staff analysis

Our approach to analysis in these Agenda Papers

20. In developing our recommendations for this IASB meeting, we:

(a) first considered which, if any, of the alternatives described in paragraph 17 the IASB should not consider further (this Agenda Paper).

(b) then considered whether and how the remaining alternatives could apply to each item of information (Agenda Papers 18B–18D).

(c) finally, considered whether the IASB should propose the amended package of disclosure objectives and requirements (Agenda Paper 18B).

Alternatives we recommend not considering further

21. In considering feedback and the results of our research on the four alternatives discussed in paragraph 17, we identified two alternatives that we think the IASB should not consider further:

(a) requiring only qualitative information in the year of acquisition rather than quantitative information (paragraphs 22–28); and

(b) specifying metrics an entity would disclose (paragraphs 29–33).

Requiring only qualitative information in the year of acquisition

22. Applying this alternative, an entity would be required to disclose, in the year of the business combination, qualitative information about management's key objectives for a business combination and the metrics management will use to monitor whether the objectives of the business combination are being met without disclosing any quantitative targets for the metrics. In subsequent periods, an entity would be required to disclose the actual performance using the metrics disclosed in the year of acquisition and a statement as to whether the target was met. An entity would also not be required to disclose quantitative information about expected synergies as described in paragraph 14.

23. This alternative could help respond to concerns about commercial sensitivity and litigation risk that may arise from disclosing what some consider to be forward-looking information.

24. We received mixed feedback on this alternative. Some GPF members supported this alternative because it would avoid an entity being required to disclose quantitative information about management's targets for a business combination. Some CMAC members said this approach could be acceptable.

25. However, other CMAC and GPF members disagreed. Some preparers said qualitative information could still be commercially sensitive. Some users said without quantitative information about the targets for the business combination and expected synergies they would be unable to:

    (a) assess whether the price management paid for a business combination was reasonable, which is one of the disclosure objectives the IASB considered adding to IFRS 3 (paragraph 6); and

    (b) understand the context for the disclosure of actual performance in subsequent periods.

26. In addition, some stakeholders said this alternative would not solve integration and auditability concerns.

27. Reflecting on this feedback, we think the IASB should not consider this alternative further. We think this approach would not result in as significant an improvement to the information users obtain about business combinations compared to other alternatives. We think not requiring an entity to disclose quantitative information about the entity's targets and expected synergies would result in no entities disclosing this information in financial statements and is therefore effectively a blanket exemption for all entities, regardless of their circumstances. This would not respond to users' concerns.

28. In our view, other alternatives—for example, requiring entities to disclose the information but providing an exemption from disclosing that information in specific circumstances (analysed in Agenda Papers 18B and 18C to this meeting) could better respond to user requests and practical concerns. Exempting entities from disclosing information in particular circumstances could more effectively address situations in which the cost of providing information would exceed the benefits of doing so. It would also preserve as much information as possible in situations in which entities do not have significant practical concerns about providing that information.

Specifying metrics

29. Applying this alternative, the IASB would replace its preliminary view of requiring entities to disclose information about business combinations reviewed by management (a management approach) with a requirement for entities to disclose specific metrics for all business combinations. For example, paragraph B64(q) of IFRS 3 requires an entity to disclose information about the revenue and profit of an acquired business in the year of acquisition—the IASB could require an entity to continue to provide this information for a specified period of time after the acquisition.

30. As noted in paragraph 62 of Agenda Paper 18B to the IASB's April 2022 meeting, we think this alternative can respond to practical concerns about commercial sensitivity and forward-looking information because (a) information about specified metrics might not be linked to management's strategy; and (b) no information about management's targets would be provided. However, applying this alternative could exacerbate the practical concern about the integration of businesses because management might not be able to isolate the performance of the acquired business from that of its existing business once the acquired business is integrated.

31. As noted in paragraphs 81–82 of Agenda Paper 18C to the IASB's April 2021 meeting, most respondents to the Discussion Paper agreed with using a management approach. Only a few respondents said the IASB should specify metrics all entities would be required to disclose.

32. In addition, at their joint meeting in June 2022 CMAC and GPF members generally disagreed with this alternative. Those members said management should determine the metrics that best reflect the objective of the business combination rather than the IASB specifying metrics all entities would be required to disclose.

33. As a result of this feedback, we think the IASB should not consider this alternative further. We think it is questionable whether this alternative would provide useful information and requiring entities to track specific metrics for every business combination could be more costly than a management approach.

Other alternatives

34. Based on feedback received, we think the IASB should continue to explore further the alternatives to:

    (a) exempt an entity from disclosing some information that would be required by the IASB's preliminary views in specific circumstances (exemption alternative); and

    (b) require an entity disclose information that would be required by the IASB's preliminary views for a subset of business combinations (subset alternative).

35. Agenda Papers 18B–18D of this meeting explore these alternatives further.

36. Agenda Paper 18B contains our analysis and recommendations on whether the IASB should proceed with the exemption and subset alternatives. The paper also includes a summary of our recommendations on how the IASB could proceed with the exemption and subset alternatives should it decide to proceed with either or both of those alternatives.

37. Agenda Paper 18C and 18D analyse specific aspects of the exemption and subset alternatives in order to support our recommendations in Agenda Paper 18B on how the IASB could proceed with the exemption and subset alternatives. In particular:

    (a) Agenda Paper 18C discusses the exemption alternative and analyses:

        (i) how the IASB could design an exemption; and

        (ii) what application guidance the IASB could provide to help apply the exemption.

    (b) Agenda Paper 18D discusses the subset alternative and analyses how to:

        (i) describe the subset of business combinations; and

        (ii) identify that subset of business combinations.

Staff recommendation

38. Based on our analysis in this paper, we think the IASB should not consider further:

    (a) requiring entities to disclose only qualitative information in the year of acquisition rather than quantitative information; and

    (b) specifying metrics an entity would disclose.

Question for the IASB
Does the IASB agree with our recommendation not to consider further the alternatives to require only qualitative information in the year of acquisition and specifying metrics?