Staff paper

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IASB® Meeting

Date	**February 2023**
Project	**Business Combinations—Disclosures, Goodwill and Impairment**
Topic	**The management approach**
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Purpose and structure

1. As Agenda Paper 18 explains, applying the tentative decisions, an entity would be required to disclose information about the subsequent performance of business combinations applying a 'management approach'—that is, the information an entity would be required to disclose is the information the entity's management uses in assessing the subsequent performance of business combinations.

2. This paper analyses, and includes our recommendations, on whether and how the International Accounting Standards Board (IASB) should define management in the management approach.

3. The structure of this paper is as follows:
   (a) Summary of staff recommendations (paragraph 4);
   (b) Background (paragraphs 5–17); and
   (c) Staff analysis and recommendations (paragraphs 18–35).

Summary of staff recommendations

4. We recommend the IASB:

   (a) specify a level of management within an entity to identify the information the entity is required to disclose about the subsequent performance of business combinations; and

   (b) describe that level of management as the key management personnel (KMP) of an entity as defined in IAS 24 *Related Party Disclosures*.

Background

The IASB's preliminary views

5. The Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment* sets out the IASB's preliminary views on the management approach. Applying those preliminary views (see paragraph 2.36 of the Discussion Paper), an entity would be required to disclose information only for those business combinations reviewed by an entity's chief operating decision maker (CODM), as described in paragraph 7 of IFRS 8 *Operating Segments*. For those business combinations, an entity would be required to disclose the objectives the CODM has set for the business combination and the information the CODM uses to review the achievement of those objectives. If the CODM does not review the performance of a business combination in the way described in the Discussion paper, the entity would be required to disclose that fact.

6. Paragraph 2.38 of the Discussion Paper explains:

   (a) Basing the information disclosed on what the CODM uses to monitor a business combination may help minimise the costs of preparing the information by focussing on the most important information about the most important business combinations.

   (b) Stakeholders will be familiar with this approach from applying IFRS 8.

(c) The IASB would not need to provide further guidance on ‘management’ and ‘monitors’. ‘Monitors’ would mean the same as the role the CODM plays in assessing performance described in IFRS 8, based on the information the CODM reviews for this purpose.

Feedback

7. The IASB received mixed feedback on whether the CODM is the right level of management to determine the business combinations an entity is required to disclose information about and what information an entity should disclose. Many respondents said using the CODM as the threshold is a practical approach that provides a reasonable cost-benefit balance.

8. However, some said that the CODM reviews information about few large business combinations that are strategically important and that using the CODM might result in users of financial statements (users) not receiving all material information. They said detailed monitoring of business combinations is performed by a lower level of management—for example by the head of individual segments (business units) into which the business combination is integrated.

9. A few users expressed concern about the use of the CODM—they said their experience of segment disclosures has been disappointing and are therefore concerned that using the CODM to identify information may not provide useful information.

10. Feedback from our fieldwork suggests that the amount and frequency of information about business combinations reviewed by the CODM differs by entity.

11. All participants in the fieldwork said that there is an approval process for undertaking business combinations. Approval from the CODM is typically needed for only particularly large business combinations. As part of the approval process, the CODM is provided with information on the business combinations. The content and amount of information provided varies by entity but can include a valuation of the target

business as a stand-alone entity, an estimate of potential synergies and a future business plan.

12. The CODM might not review actual performance of the business combination in subsequent periods using information that is prepared on the same basis as was used to approve the business combination, if for example:

    (a) some of the targets identified during the business combination are not followed up; or

    (b) after the business combination the CODM reviews information about the budget of the organisation as a whole rather than following up directly on information included in any business plan prepared for approving the business combination.

13. The budget for the current year might be updated to reflect the assumptions in the business plan prepared for approving the business combination if the business combination is particularly large. However, in other cases the budget might not be updated—any variance from budget might be explained as the effect of a business combination but that effect analysis, at least at the CODM level, might not capture whether the business combination is performing to plan. Only if there is a significant variance between the unadjusted budget and actual performance would the CODM be provided with additional information. Such additional information may be available at a level lower than the CODM.

14. Some fieldwork participants said a 'post-acquisition review' process might take place one to two years after a business combination. The entity reviews assumptions made in the business plan prepared as part of the business combination and compares those assumptions with actual outcomes. The purpose of this review is to identify learnings from the acquisition process that can be applied to future business combinations. In some entities the report from this review is provided to the CODM.

15. Respondents, and fieldwork participants, said that if the IASB decides to use the CODM as the filter for identifying the information to be disclosed, the IASB should

specify the type of information reviewed by the CODM that needs to be disclosed—for example, whether an entity would be required to disclose only information provided to the CODM as part of regular performance monitoring, or also information provided on an ad-hoc basis such as information provided in the 'post-acquisition review'.

The IASB's September 2022 decisions

16. In September 2022 the IASB tentatively decided to require an entity to disclose information about the subsequent performance of a business combination (see paragraph 5 of Agenda Paper 18) for 'strategically important' business combinations, rather than for business combinations reviewed by the CODM.

17. The IASB tentatively decided that a 'strategically important' business combination would be a business combination for which not meeting the objectives would seriously put at risk the entity achieving its overall business strategy. To identify such business combinations, the IASB tentatively decided to propose using a closed list of thresholds—a business combination that meets any one of those thresholds would be 'strategically important'.

Staff analysis and recommendation

18. In the light of feedback on the use of the CODM to determine the information an entity would be required to disclose about the subsequent performance of a business combination, we consider:

    (a) whether the IASB should specify a level of management to help identify the information an entity should disclose (paragraphs 19–23); and

    (b) if so, what that level of management should be (paragraphs 24–34).

Specifying a level of management

Staff analysis

19. The IASB could decide not to specify a level of management when identifying the information an entity would be required to disclose about the subsequent performance of a business combination. Doing so would:

    (a) Respond to concerns from a few stakeholders about possible structuring opportunities. For example, if the requirements generically refer to 'management' rather than specifying that an entity be required to disclose information the CODM (or another specified level of management) is reviewing, it would mean an entity would not be able to avoid disclosing information by restructuring its internal reporting.

    (b) Result in an entity disclosing information about the subsequent performance of a business combination no matter what level of management reviews that information. Some might argue that information about how a business combination's performance compared to the objectives for that business combination is more useful than a statement that an entity's CODM (or another specified level of management) is not reviewing the performance of the business combination.

    (c) Be less rules-based.

20. It is not uncommon for IFRS Accounting Standards to refer to information reviewed or used by management, without specifying the exact level of management. For example:

    (a) paragraph 54 of IFRS 15 *Revenue from Contracts with Customers* states that the information that an entity uses to estimate the amount of variable consideration would typically be similar to the information that the entity's management uses during the bid-and-proposal process and in establishing prices for promised goods or services;

(b) paragraph 122 of IAS 1 *Presentation of Financial Statements* states that an entity shall disclose judgements management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements; and

(c) paragraph 33(b) of IAS 36 *Impairment of Assets* states that when measuring value in use, an entity shall base cash flow projections on the most recent financial budgets or forecasts approved by management.

21. However, there could be benefits to specifying a level of management, in particular a senior level of management, because:

(a) Doing so may better help hold management to account for 'strategically important' business combinations than not specifying a level of management. Applying the IASB's preliminary view, if the CODM was not reviewing the performance of a business combination, an entity would be required to disclose that fact. Some users said this statement would be useful because it gives information about management's stewardship of the entity's resources. If the IASB does not link the information required to be disclosed to the information reviewed by an entity's senior management, users might not be informed of this fact. This may happen, for example, if the performance of a 'strategically important' business combination is reviewed only by an entity's junior management but not by its senior management.

(b) If the IASB decided not to prescribe the level of management there may be greater pressure to accurately define 'monitoring' the performance of a business combination in a way that distinguishes the information an entity would disclose about the business combination from information the entity uses to monitor the performance of the business as a whole.

(c) Doing so may help emphasise that the information about business combinations entities would be required to disclose is information about the key objectives for a business combination (and the related metrics, targets and subsequent performance information). In other words, specifying a level of management could help identify the most important information about a business combination. This emphasis would be particularly helpful when different levels of management within an entity monitor the performance of a business combination using information with differing levels of detail.

Staff recommendation

22. In our view, the IASB should define a level of management, in particular, a senior level of management, when identifying the information an entity would be required to disclose about the subsequent performance of a business combination. We find the arguments in paragraph 21 to be more persuasive than the arguments in paragraph 19. In particular, we think requiring an entity disclose the information used by a senior level of management to assess the subsequent performance of a business combination is:

   (a) easier than defining 'monitoring' in such a way that clearly distinguishes between the management of an entity reviewing the performance of a business combination from reviewing the business as a whole; and

   (b) more likely to identify the information that is most relevant for users (including whether a senior level of management is monitoring a 'strategically important' business combination).

23. We think there are other ways to address concerns that users might not receive sufficient information if an entity discloses only that its management stopped monitoring the performance of a 'strategically important' business combination and no other information—we describe a possible amendment to the preliminary views to address that feedback in paragraphs 22–27 of Agenda Paper 18B.

Definition of management

Staff analysis

24. As noted in paragraph 22, we recommend specifying a senior level of management an entity would use to identify information about the subsequent performance of business combinations that would be disclosed. We identified two possible definitions of senior management, where the IASB could define management as either:

    (a) an entity's CODM (paragraph 25–26); or

    (b) the KMP of the reporting entity (paragraph 27–32).

CODM

25. As noted in paragraphs 5–6, the IASB's preliminary view was to use an entity's CODM to identify the information an entity would be required to disclose about the subsequent performance of business combinations. This approach has some benefits:

    (a) Stakeholders are familiar with the concept of CODM from applying IFRS 8; and

    (b) The IASB would not need to provide application guidance on 'management' and 'monitors' or 'review'. 'Monitors' or 'review' would carry the same meaning as the role the CODM plays in assessing performance described in IFRS 8, based on the information the CODM reviews for this purpose.

26. However, as noted in paragraphs 7–15, feedback on this preliminary view was mixed. Based on this feedback, we think there are two reasons for not using the CODM:

    (a) There is diversity in the information CODMs in different entities review. This could lead to different entities disclosing different information based only on the way the entity's internal controls are structured.

    (b) An entity's CODM is linked with the information an entity is required to disclose applying IFRS 8. Although the preliminary view does not preclude an entity from reporting the subsequent performance of a business combination at segment level if the acquired business is itself an operating segment or if the objectives (and targets) for the business combination are set at operating segment level, this may not always be the case. Some stakeholders expressed confusion as to how information about the subsequent performance of a business combination would differ from the information already disclosed applying IFRS 8. We think this is because of the use of CODM in the preliminary view.

Key management personnel

27. An alternative is to use an entity's KMP as defined in IAS 24. IAS 24 defines KMP as persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity.

28. Using KMP has the following benefits:

    (a) KMP are typically senior management within an entity and therefore, using KMP has some similar benefits to using CODM because using KMP:

        (i) utilises existing terminology within IFRS Accounting Standards that stakeholders would be familiar with; and

        (ii) could provide useful information regarding management's stewardship if this level of management does not monitor the performance of a 'strategically important' business combination.

    (b) Unlike an entity's CODM, KMP is not linked with segment reporting. This could avoid confusion regarding the relationship between the proposed disclosure requirements and disclosure requirements in IFRS 8.

29. It is not uncommon for IFRS Accounting Standards to require an entity to disclose information based on what is provided to/ reviewed by KMP. For example:

(a) paragraph 34(a) of IFRS 7 *Financial Instruments: Disclosures* requires an entity to disclose summary quantitative data about its risk exposures based on information provided internally to the entity's KMP;

(b) paragraph B4.1.1 of IFRS 9 *Financial Instruments* requires an entity to determine the classification of financial assets based on the entity's business model as determined by its KMP; and

(c) paragraph 135 of IAS 1 *Presentation of Financial Statements*, requires an entity to disclose information about its objectives, policies and processes for managing capital based on information provided internally to the entity's KMP.

30. The IASB did not hear concerns about the use of KMP in the classification and measurement requirements in IFRS 9 as part of the recent post-implementation review of those requirements.

31. The definition of KMP in IAS 24 and related requirements do not include or refer to monitoring and assessment of an entity's performance as part of a KMP's role within an entity. Therefore, it is possible that using KMP might result in stakeholders asking for additional guidance on 'monitoring'.

32. We think it would be unnecessary to define or provide application guidance on 'monitoring'. We think retaining the core concept of monitoring in the Discussion Paper—that is monitoring being an assessment of whether a business combination's actual performance is meeting the entity's objectives (and targets) for that business combination the entity established when entering into the business combination—would be sufficient.

Staff recommendation

33. As a result of the concerns about using CODM and questions about whether this approach would appropriately identify the information the IASB intended entities to disclose, we recommend the IASB amend its preliminary view to require an entity to

disclose subsequent performance information based on the information reviewed by an entity's KMP rather than information reviewed by the entity's CODM.

34. We think using KMP would retain the idea of identifying a senior level of management while avoiding some of the problems with using an entity's CODM. We think the use of an entity's KMP helps to identify the most important information about a business combination.

Summary of staff recommendations

35. As a result of our analysis in paragraphs 18–32 of this paper, we recommend the IASB:

(a) specify a level of management within an entity to identify the information the entity is required to disclose about the subsequent performance of business combinations; and

(b) describe that level of management as the key management personnel as defined in IAS 24.

Question 1— Amending definition of management
Does the IASB agree with our recommendation in paragraph 35?