IFRS Accounting

Staff paper

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Project	**Business Combinations—Disclosures, Goodwill and Impairment**
Topic	**Auditability and audit expectation gap**
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Introduction

1. As Agenda Paper 18 for this meeting explains, this paper provides the International Accounting Standards Board (IASB) with our initial analysis of feedback relating to auditability of performance and expected synergy information and a possible audit expectation gap.[1]

2. This paper provides only a high-level initial analysis and sets out our planned next steps (for example, matters we will consult on). This agenda paper does not ask the IASB to make any decisions. We will analyse the auditability of (and a possible audit expectation gap related to) each item of performance and expected synergy information when the IASB redeliberates those items at future IASB meetings.

3. The paper is structured as follows:

   (a) background (paragraphs 4–5);

   (b) feedback summary (paragraphs 6–14);

   (c) staff analysis (paragraphs 15–44); and

[1] Respondents also raise concerns relating to auditability of other proposals, which we will consider when analysing those proposals. For example, paragraphs 7–12 of Agenda Paper 18B of the IASB's June 2025 meeting consider feedback about the auditability of the exemption.

(d) summary of staff initial views and next steps (paragraphs 45–50).

Background

4. The Exposure Draft *Business Combinations—Disclosures, Goodwill and Impairment* (Exposure Draft) proposed to require an entity to disclose information about:

   (a) the performance of a strategic business combination (performance information) including:

      (i) an entity's acquisition-date key objectives and related targets (KOTs); and

      (ii) the extent to which those KOTs are being met in subsequent periods (subsequent performance information); and

   (b) quantitative information about synergies expected from combining the operations of an acquiree and an acquirer (expected synergy information) including a description of expected synergies by category and for each category of synergies:

      (i) the estimated amounts or range of amounts of the expected synergies;

      (ii) the estimated costs or range of costs to achieve these synergies; and

      (iii) the time from which the benefits from the synergies are expected to start and how long they are expected to last.

5. Paragraphs BC144–BC145 of the Basis for Conclusions on the Exposure Draft (Basis for Conclusions) outline the IASB's considerations for the auditability of performance information. These paragraphs state:

> BC144 In the IASB's view, the [performance] information the IASB's proposals would require an entity to disclose is auditable. In the IASB's outreach, preparers said they prepare significant documentation in determining the amount to pay for a business

> combination and many auditors said they expect to be able to audit that information.
>
> BC145 The IASB expects auditors and regulators will be able to verify:
>
> (a) whether the [performance] information disclosed is the information an entity's key management personnel receive to review a business combination.
>
> (b) whether there is adequate explanation and appropriate evidence supporting the [performance] information.
>
> (c) whether the [performance] information disclosed faithfully represents what it purports to represent. For example, by requiring the disclosure of information for only strategic business combinations it is more likely that the performance of a combined business…is reflective of the performance of the business acquired because strategic business combinations are those that have a more visible effect on the entity's business.

Feedback summary

6. As paragraphs 23–31 of Agenda Paper 18B of the IASB's December 2024 meeting (December agenda paper) note, many respondents raised concerns around the auditability of, and a possible audit expectation gap for, performance and expected synergy information. Some respondents suggested collaborating with the International Auditing and Assurance Standards Board (IAASB) to develop a solution for the auditing the information.

Audit expectation gap

7. Accounting firms agreed they would be able to verify whether the information disclosed by an entity is information management received to review a business

combination. Respondents confirmed it would be difficult to verify the reasonableness of the information (including the appropriateness and achievability of KOTs and expected synergies).

8. However, some respondents, including many audit firms, accounting bodies and standard setters, highlighted a possible audit expectation gap that could arise as a consequence of requiring this information in financial statements. Some of these respondents acknowledged the IASB is not expecting auditors to verify the reasonableness of the information. However, they said users of financial statements (users) might misunderstand the audit work done and conclude that auditors have audited the reasonableness of the information. They said users might place undue weight on the reasonableness of such information when that information is included in the audited financial statements.

9. One Interpretations Committee member said the audit expectation gap would be pronounced when it comes to information about an entity's actual performance in subsequent periods. In this respondent's view, users could understand that the acquisition-date disclosures reflect management's expectation at the time of the transaction. However, because information about actual performance in subsequent periods is historical information, a user would expect an auditor to verify the accuracy of this information. However, doing so could be challenging, particularly if the key objectives or targets are qualitative or are based on measures not defined in IFRS Accounting Standards.

10. Some respondents provided suggestions to manage the audit expectation gap (see paragraph 14).

Auditability concerns

11. Many respondents raised concerns about the cost to audit the performance and expected synergy information. Respondents said the information required by these disclosures can be highly subjective, requiring audit firms to perform extensive audit procedures, leading to significant increases to audit costs. Respondents also said

entities might need to incur significant costs to establish new systems or controls that can be audited.

12. A few respondents said paragraph BC145 of the Basis for Conclusions (see paragraph 5) is unclear on whether the IASB expects an audit to cover the reasonableness of the information. A few said management's targets for a business combination might often be aspirational and therefore not represent management's reasonable expectations. These respondents suggest not including the IASB's observation in paragraph BC145(c) of the Basis for Conclusions about auditors being able to verify whether the information disclosed faithfully represents what it purports to represent in any final amendments.

13. On the other hand, some preparers said an audit that merely confirms management's review of the information—without assessing its reasonableness or appropriateness—might not be beneficial to users.

Suggestions

14. To manage the audit expectation gap:

    (a) some respondents suggested requiring an entity to explicitly state in the financial statements that the disclosed KOTs and expected synergy information are:

        (i) solely based on information used and prepared by management based on their acquisition-date best estimates; and

        (ii) those expectations might not be realised in the future and might not be comparable to similar measures provided by other entities;

    (b) a few respondents suggested requiring an entity to disclose the basis of preparation for any targets based on measures not defined in IFRS Accounting Standards; and

    (c) a few respondents suggested providing further guidance and illustrative examples to assist preparers and auditors.

Staff analysis

15. Our analysis considers concerns about auditability and a possible audit expectation gap separately for:

    (a) KOTs (set out in paragraph 4(a)(i))—see paragraphs 18–28;

    (b) subsequent performance information (set out in paragraph 4(a)(ii))—see paragraphs 29–37; and

    (c) expected synergy information (set out in paragraph 4(b))—see paragraphs 38–41.

16. In addition, paragraphs 42–44 discuss other feedback related to auditability.

17. Our analysis reflects only our understanding and initial view of what auditors would be required to verify in the context of the audit of financial statements and how to mitigate any possible audit expectation gap. The IASB does not set auditing standards and cannot tell auditors how to verify a specific disclosure in the context of the audit of financial statements. The IASB can only set out its understanding and expectations (as it has done in paragraphs BC144 and 145 of the Basis for Conclusions).

KOTs

18. We acknowledge respondents' concerns—noted in paragraph 8—that it would be difficult to verify the reasonableness of KOTs. However, as paragraph 19–25 explains, our understanding is that an auditor would not be required to verify the reasonableness of KOTs.

19. The objective of disclosing KOTs is set out in proposed paragraph 62A(a) of IFRS 3 *Business Combinations* in the Exposure Draft. This paragraph states:

    > The acquirer shall disclose information that enables users of its financial statements to evaluate:
    >
    > (a) the benefits an entity expects from a business combination when agreeing on the price to acquire a business; and

...

20. As paragraph BC108 of the Basis for Conclusions notes '…The entity would disclose information that its management uses to assess the performance of a business combination.'

21. In other words, the disclosure of KOTs is intended to help users understand, from management's perspective, why the entity paid the price it did for the business combination (and how that business combination performs subsequently). This disclosure would allow users to use that information to make their own assessment of how effectively and efficiently management have invested the entity's resources. The disclosure was not designed to directly inform users whether the business combination was a 'good' or 'bad' deal for the entity and whether the price management paid for a business combination was reasonable.

22. Based on the design of the disclosure requirements and related disclosure objective and our understanding of audit requirements, we think an auditor would:

    (a) be required to verify whether the disclosed KOTs are what key management personnel (KMPs) receive to review the business combination; and

    (b) not be required to verify the reasonableness of the KOTs.

23. It is not uncommon for IFRS Accounting Standards to require an entity to disclose information viewed from management's perspective. Our understanding is that while auditors—as part of their audit of the entity's financial statements—are required to verify whether that information reflects management perspective they are not required to verify the reasonableness of that perspective. For example:

    (a) IFRS 18 *Presentation and Disclosures in Financial Statements* requires an entity to disclose management-defined performance measures (MPMs) which reflects management's view of an aspect of the financial performance of the entity as a whole. Paragraph BC358(a) of the Basis for Conclusions on IFRS 18 notes that an MPM 'needs to faithfully represent the aspect of an entity's financial performance it purports to represent'. Paragraph BC360 of the Basis for Conclusions on IFRS 18 notes that faithful representation does not provide information about whether a measure is a 'good' or 'bad' measure. It is our understanding that in auditing financial statements that include MPMs, an auditor is not expected to verify whether an MPM is a 'good' or 'bad' MPM.

(b) IFRS 8 *Operating Segments* requires an entity to identify and disclose information about its reportable segments using a management approach. We understand that in auditing financial statements that include segment-related disclosures required by IFRS 8, an auditor would verify whether the information disclosed reflects how management has organised its business but is not expected to verify whether that is a reasonable way to organise the business.

24. We also think the IASB's observations in paragraphs BC145(b) and BC145(c) of the Basis for Conclusions in respect of KOTs (reproduced in paragraph 5) remain valid. In particular:

(a) paragraph BC145(b) of the Basis for Conclusions refers to the IASB's observation about auditors and regulators being able to verify whether there is adequate explanation and appropriate evidence supporting the information. This refers to evidence and explanation that would support the fact that the KOTs disclosed reflect the information an entity's KMPs use to review a business combination (as required by paragraph B67A of the Exposure Draft).

(b) paragraph BC145(c) of the Basis for Conclusions refers to the IASB's observation about auditors and regulators being able to verify whether the information disclosed faithfully representing what it purports to represent. In the context of KOTs, we think this means that KOTs should faithfully represent—in a manner that is complete, neutral and free from error[2]—the key objectives and targets *that management expected* from the business

[2] Paragraph 2.13 of the Conceptual Framework states 'To be a perfectly faithful representation, a depiction would have three characteristics. It would be complete, neutral and free from error…The [IASB's] objective is to maximise those qualities to the extent possible.

combination when it acquired the business. It does not imply that those key objectives and targets themselves are necessarily 'good' or 'bad'. We think verifying faithful representation would involve verifying only whether the disclosed KOTs reflect management's expectations—at the date of the acquisition—from the business combination.

25. As paragraph 7 notes, accounting firms confirmed they would be able to verify whether the KOTs disclosed reflect the information management uses to review a business combination. This is in line with what we would expect auditors to verify in the context of their audit of the entity's financial statements (explained in paragraph 22). We will consider clarifying the explanation about an auditor verifying the faithful representation of KOTs (included in paragraph BC145(c) of the Basis for Conclusions) to avoid any misunderstanding.

26. We acknowledge concerns about a possible audit expectation gap that might arise in the context of KOTs particularly because, as paragraph 18 explains, we understand that auditors would not be required to verify the reasonableness of KOTs. We accept that by requiring entities to disclose KOTs in financial statements that are subject to audit, users might misunderstand the audit work done and conclude that auditors have verified the reasonableness of the information, resulting in an audit expectation gap.

27. However, respondents have said concerns about a possible audit expectation gap can be mitigated using some of the suggestions set out in paragraph 14 of this paper. In particular, we plan to explore further the following suggestions by respondents:

    (a) including a requirement similar to the suggestion in paragraph 14(a) of this paper (for example, requiring an entity to explicitly state that KOTs reflect only management's expectations at the time of the acquisition); and

    (b) requiring an entity to disclose the basis of preparation for targets based on metrics not defined in IFRS Accounting Standards.

28. We plan to liaise with audit professionals to:

    (a) confirm our understanding of auditability concerns and the possible audit expectations gap set out above; and

    (b) assess if the suggestions discussed in paragraph 27 would mitigate the concerns raised.

Subsequent performance information

29. As paragraph 4(a)(ii) notes, the Exposure Draft proposed requiring an entity to disclose the extent to which the KOTs are being met in subsequent periods.

30. The objective of disclosing subsequent performance against KOTs is set out in proposed paragraph 62A(b) of IFRS 3 *Business Combinations* in the Exposure Draft. This paragraph states:

> The acquirer shall disclose information that enables users of its financial statements to evaluate:
>
> …
>
> (b) for a strategic business combination…, the extent to which the benefits an entity expects from the business combination are being obtained.

31. As paragraph BC108 of the Basis for Conclusions notes '…The entity would disclose information that its management uses to assess the performance of a business combination.'

32. The disclosure of subsequent performance information is intended to help users understand how a business combination performs subsequent to acquisition in relation to the KOTs set by management. This disclosure would allow users to use that information to make their own assessment, in periods subsequent to an acquisition, of how effectively and efficiently management have invested the entity's resources. The disclosure was not designed to directly inform users whether the business combination

was a 'good' or 'bad' deal for the entity and whether the price management paid for a business combination was reasonable.

33. We understand that in the context of their audit of an entity's financial statements, auditors would be required to verify whether subsequent performance information disclosed faithfully represents (as noted in paragraph BC145(c) of the Basis for Conclusions) information about the actual performance of the business that management uses to assess performance against its acquisition-date KOTs. We think doing so would involve verifying whether the subsequent performance information disclosed:

(a) is the information an entity's KMPs receive to review performance against acquisition-date KOTs; and

(b) reflects actual performance.

34. We think—as paragraph BC145(a) of the Basis for Conclusions notes—auditors should be able to verify whether the subsequent performance information disclosed is the information an entity's KMPs receive to review a business combination.

35. We think the complexity of verifying whether the subsequent performance information disclosed reflects actual performance could vary depending on the nature of the metric used to determine the target for the business combination and consequently, the metric used to measure subsequent performance. In particular:

(a) if the target is based on metrics defined in IFRS Accounting Standards (for example, revenue or operating profit), we think auditors will be able to verify whether the subsequent performance information reflects actual performance. This would be similar to what auditors are required to do when verifying, for example, revenue for a particular reportable segment.

(b) if the metric is not defined in IFRS Accounting Standards (for example, market share), we accept it will be more difficult for auditors to verify whether the subsequent performance information disclosed reflects actual performance. This is because auditors would not have a framework against which to verify the disclosure. If the IASB requires entities to disclose the basis of preparation for targets based on metrics not defined in IFRS Accounting Standards (explained in paragraph 27(b)), auditors would be able to verify whether disclosed subsequent performance information reflects actual performance based on that basis.

36. Based on our analysis in paragraph 35, we think auditors would be able to verify whether disclosed subsequent performance information reflects actual performance. We therefore think there would not be an audit expectation gap between what users expect and what the auditors would be able to do.

37. We plan to liaise with audit professionals to:

(a) confirm our understanding of auditability concerns and the possible audit expectations gap set out above; and

(b) assess if the suggestions discussed in paragraph 35(b) would mitigate the concerns raised.

Expected synergy information

38. Paragraph B64(e) of IFRS 3 *Business Combinations* requires an entity to disclose 'a qualitative description of the factors that make up the goodwill recognised, such as expected synergies…'. Feedback suggested entities often only provide generic description for these expected synergies and users told us that they wanted information on the nature, timing and amount of expected synergies[3]. Consequently, the Exposure Draft proposed expanding the requirement in paragraph B64(e) of IFRS 3 *Business Combinations*, to require an entity to disclose quantitative information about expected synergies (see paragraph 4(b)). Because the proposed requirement to disclose expected synergy information was an extension of the existing requirement in

[3] See paragraphs 2.62 and 2.63 of *Discussion Paper Business Combinations—Disclosures, Goodwill and Impairment*.

paragraph B64(e) of the Exposure Draft, the IASB did not expect the proposal to result in significant audit challenges.

39. However, as Agenda Paper 18E to the IASB's December 2024 meeting notes, most respondents to the Exposure Draft (including almost all preparers and preparer groups and accounting firms) disagreed with the proposal to require an entity to disclose expected synergy information. As paragraphs 16–19 of that agenda paper note, stakeholders said expected synergy information might not be readily available and that it would be difficult to estimate or quantify the because of the estimation challenges involved. Auditors also highlighted difficulties in verifying the reasonableness of the information in the context of their audit of an entity's financial statements (see paragraph 7 of this paper).

40. We think there are differing views of how the proposal to disclose expected synergy information should be applied, for example:

(a) an entity would be required to disclose expected synergy information only if KMPs receive that information to review the business combination. Such information would—similar to KOTs—reflect only management's expectations of expected synergies. This view reflects our intention when developing the proposal. Applying this view, any challenges regarding auditability and a possible audit expectation gap would be similar to, and can be resolved in a manner similar to, what we have discussed for KOTs (see paragraphs 26–27).

(b) an entity would be required to estimate and quantify the amount of expected synergies included in goodwill regardless of whether KMPs receive such information to review the business combination. This was not our intention when developing the proposal in the Exposure Draft but we acknowledge that the wording of the proposal (see proposed paragraph B64(ea) of IFRS 3 in the Exposure Draft) may lead to stakeholders interpreting the proposals this way. Feedback suggests such a reading could lead to a conclusion that auditors would be required to assess the reasonableness of expected synergy information and respondents to the Exposure Draft said it could be difficult to do so.

41. We plan to assess how the IASB's proposed disclosure requirement for expected synergy information should be applied (and how to clarify the requirements if required) when the IASB redeliberates the proposals for expected synergies at a future IASB meeting. We will also consider the implications on the auditability and audit expectation gap for expected synergy information at that time.

Other feedback—Effect on internal controls, processes and related costs

42. Some respondents said entities might not have appropriate systems and controls in place to produce performance and expected synergy information that would stand up to the scrutiny of an audit. They said although the information might be internally available, entities would be required to establish new systems and controls to formalise the process which could involve significant costs. However, one preparer said the proposal could help the finance department take back control over the preparation of performance and expected synergy information which could enhance the reliability of the information.

43. We understand that some entities may not have robust systems and controls in place to prepare and disclose performance and expected synergy information. We acknowledge an entity might incur additional costs to implement or update processes and internal controls to apply the proposed requirements.

44. We note that it is not uncommon for entities to implement or update processes and controls following amendments to IFRS Accounting Standards to facilitate financial reporting and audit. As feedback in paragraph 42 notes, there could also be some benefits to implementing or updating controls and processes. Nonetheless, we will consider costs of implementing or updating processes and controls as part of our analysis of the cost-benefit trade-off when we analyse each of the disclosure proposals.

Summary of staff initial views and next steps

45. As paragraph 2 explains, this paper provides an initial analysis of concerns raised by respondents relating to auditability of performance information (including KOTs and subsequent performance information) and expected synergy information and the possible audit expectation gap. We will analyse the auditability and possible audit expectation gap relating to each item of performance and expected synergy information when the IASB redeliberates those items at future IASB meetings.

KOTs and subsequent performance information

46. For KOTs:

(a) we think in the context of the audit of an entity's financial statements, an auditor:

(i) would be required to verify whether the disclosed KOTs are what KMPs receive to review the business combination.

(ii) would not be required to verify the reasonableness of the KOTs (paragraphs 18–25).

(b) we acknowledge concerns about a possible audit expectation gap (paragraph 26), but think those concerns can be mitigated using some of respondent's suggestions—for example, disclosing the basis of preparation for targets based on metrics not defined in IFRS Accounting Standards (paragraph 27).

47. For subsequent performance information:

(a) we think in the context of the audit of an entity's financial statements, an auditor would be required to verify whether the subsequent performance information disclosed:

(i) is the information an entity's KMPs receive to review performance against KOTs; and

(ii) reflects actual performance (paragraphs 29–34).

(b) we acknowledge it could be difficult to verify whether the subsequent performance information disclosed reflects actual performance if the metric is not defined in IFRS Accounting Standards (paragraph 35). However, the suggestion to disclose the basis of preparation for any targets based on metrics not defined in IFRS Accounting Standards could mitigate this concern (paragraph 35(b)).

48. For KOTs and subsequent performance information, we plan to liaise with audit professionals to:

(a) confirm our understanding of auditability concerns and the possible audit expectations gap; and

(b) assess if the suggestions would mitigate the concerns raised.

Expected synergy information

49. We think there are different possible views of how the IASB's proposal to disclose expected synergy information should be applied. Feedback suggests it might be difficult to verify the reasonableness of expected synergy information (paragraphs 38–41). At a future IASB meeting, we plan to assess how the IASB's proposed requirement relating to expected synergy information should be applied, including the implications on the auditability and audit expectation gap for expected synergy information (paragraph 41).

Other feedback

50. We acknowledge an entity might incur costs to implement or update processes and internal controls to apply the proposed requirements. We will consider costs of implementing or updating processes and controls as part of our analysis of the cost-benefit trade-off when we analyse each of the disclosure proposals (paragraphs 43–44).

Question for the IASB
Do IASB members have any questions or comments on the analysis in this agenda paper? Specifically: (a) do IASB members have any comments or questions on the analysis in this paper or the initial staff views summarised in paragraphs 45–50? (b) is there anything IASB members would like us to research, consult on or analyse further, apart from matters identified in this paper?