March 2020

IFRS® Standards
Discussion Paper

Snapshot

Business Combinations—Disclosures, Goodwill and Impairment

This Snapshot provides an overview of the Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment* published by the International Accounting Standards Board (Board).

The Board's objective:	To improve the information companies provide to investors, at a reasonable cost, about the acquisitions those companies make. Better information should help investors more effectively hold a company's management to account for its acquisition decisions.
Project stage:	The Board has published a Discussion Paper that sets out its preliminary views. The Board is seeking comments on whether: • its suggested disclosure requirements for acquisitions would provide useful information and are feasible; and • stakeholders have new evidence or new arguments on how companies should account for goodwill.
Next steps:	The Board will consider comments received on the Discussion Paper before deciding whether to develop an exposure draft containing proposals to implement any or all of its preliminary views.
Comment deadline:	31 December 2020 (comment deadline changed from 15 September 2020 because of the covid-19 pandemic).

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Why is the Board undertaking this project?

Mergers and acquisitions—referred to as ‘business combinations’ in IFRS Standards—are often large transactions for the companies involved. These transactions play a central role in the global economy. For example, deals announced in 2019 totalled $4 trillion.[1]

IFRS 3 *Business Combinations* sets out the accounting requirements for these transactions. A few years after issuing IFRS 3, the Board asked stakeholders whether the Standard was working as intended. Such an assessment is called a Post-implementation Review.

Stakeholders raised concerns about some aspects of the accounting for acquisitions. The Board has been exploring these concerns in a research project called ‘Goodwill and Impairment’.

The Discussion Paper sets out the Board’s preliminary views on how to respond to the concerns raised by stakeholders.

Stakeholder concerns about the accounting for acquisitions included:

- Investors do not get enough information about acquisitions and their subsequent performance.
- The impairment test is complex and costly for companies.
- Impairment losses on goodwill are recognised too late.
- Goodwill should be amortised. It has been paid for and so, sooner or later, it should have an impact on profit or loss.
- It is difficult for companies to account for intangible assets such as customer relationships and brands separately from goodwill.

1993	2004	2013–2015	2015–present
IAS 22 *Business Combinations* Required amortisation of goodwill	IFRS 3 issued, replacing IAS 22 Introduced an impairment-only approach for goodwill	Post-implementation Review of IFRS 3	Goodwill and Impairment research project

1 JPMorgan, 2020 Global M&A Outlook, January 2020.

The Board's preliminary views

1 Improving disclosures about acquisitions	Require companies to provide information that would help investors better understand an acquisition and its subsequent performance, including: • management's objectives for the acquisition, disclosed in the year of acquisition; and • how the acquisition has performed against those objectives in subsequent periods. (see pages 4–6)
2 Improving the accounting for goodwill	Background—What is goodwill and how is it tested for impairment? (see pages 7–8)
	A Can the impairment test be made more effective? — Not significantly, and not at a reasonable cost. (see pages 9–10)
	B Should goodwill be amortised? — No, retain the impairment-only model. (see page 11)
	C Can the impairment test be simplified? — Yes, provide relief from the quantitative annual impairment test and simplify how value in use is estimated. (see page 12)
3 Other topics	• Require companies to present on their balance sheets the amount of total equity excluding goodwill. • Do not change the range of intangible assets recognised in a business combination. (see page 13)

1 Improving disclosures about acquisitions

What is the issue?

Investors want information about acquisitions at the time of the transaction and about how well they perform afterwards. Investors want to be able to assess how effective a company's management is at acquiring businesses—at identifying targets, paying the right price, integrating the acquired business and realising the benefits from the transaction. Such information enables investors to hold management to account for its acquisition decisions.

However, IFRS Standards do not specifically require companies to disclose information about the subsequent performance of acquisitions.

The Board's preliminary view

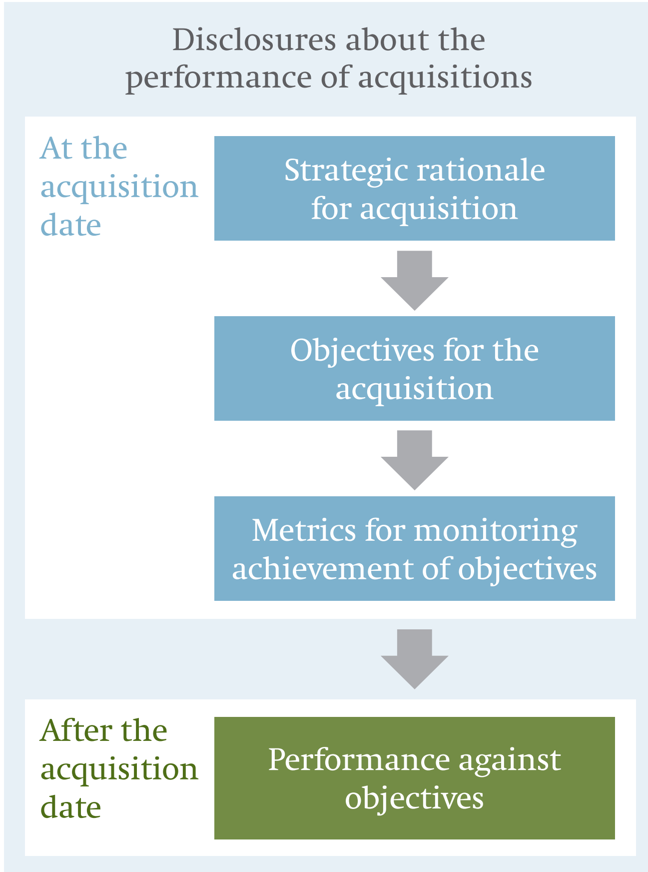
To provide investors with the information they need, companies should be required to disclose management's objectives for acquisitions and how acquisitions have performed against those objectives.

That information should be based on the information management uses to monitor acquisitions rather than on metrics specified by the Board because:

- the Board presumes that management monitors acquisitions internally and is aware of how well they are performing.
- objectives for acquisitions are company-specific. Therefore, no single set of metrics specified by the Board could provide useful information for all acquisitions.

> Companies would disclose information management uses internally to monitor acquisitions. Companies would not need to create information solely for external reporting.

Companies would be required to disclose information about acquisitions used by their chief operating decision maker, a term that is described in IFRS 8 *Operating Segments*. The Board is interested in stakeholders' views on whether such an approach would provide the information investors need.



For how long do investors need information about the performance of acquisitions?

Stakeholders have said information about the subsequent performance of an acquisition becomes less relevant after a relatively short time, as the acquired business becomes indistinguishable from the rest of the acquirer's business.

Nevertheless, management is likely to be aware of how well an acquisition is performing in the first few years after acquisition, even if the acquired business is integrated.

Therefore, in the Board's preliminary view, a company should continue to provide information about an acquisition for as long as its chief operating decision maker continues to monitor the acquisition against its objectives.

If the chief operating decision maker does not monitor an acquisition or stops monitoring it shortly after the acquisition occurred, the company would be required to disclose this fact and explain why.

Reporting performance of an acquisition

At acquisition date

if monitored by chief operating decision maker	if not monitored
disclose objectives	disclose reason for not monitoring

Within 2 years[2]

if monitoring continues	if monitoring ceases
disclose performance against objectives	disclose reason for ceasing to monitor

After 2 years[2]

if monitoring continues	if monitoring ceases
disclose performance against objectives	no further disclosure needed

Further improvements to the disclosure requirements in IFRS 3

Stakeholders have said companies sometimes do not provide enough useful information about acquisitions. The Board is exploring targeted improvements to disclosures companies provide in the year of acquisition, including those on:

- **Expected synergies**
  Companies would be required to describe synergies management expected from an acquisition and disclose the estimated amount of synergies, or range of amounts. This information would help investors to better understand the factors that contributed to the acquisition price.
- **Defined benefit pension and debt liabilities of the acquired business**
  Companies would be required to disclose the amount of defined benefit pension and debt liabilities taken over in the acquired business, separately from other classes of liabilities. This information would help investors assess companies' return on capital employed.

2 Two full years after the year of acquisition.

Q&A—Disclosures about acquisitions and how well they perform

Q1 Would information about objectives be forward-looking information?

No. In the Board's view, such information reflects management's views and targets at the time of the acquisition. This information is not a forecast of the outcome of the acquisition at the time the company prepares its financial statements.

Q2 What happens if management changes the metrics it uses?

In such cases, a company would need to disclose the new metrics and the reasons for the change. A company would not be required to continue disclosing metrics the chief operating decision maker no longer uses internally.

Q3 Why do the Board's suggested requirements refer to the chief operating decision maker?

Monitoring the performance of an acquisition and deciding to allocate resources to acquire a business is likely to be part of the chief operating decision maker's role.

The Board believes that referring to the chief operating decision maker helps to focus the disclosures on the most important information about the most important acquisitions. Using this approach, the Board aims to provide investors with useful information but avoid excessive disclosures that may unnecessarily burden preparers.

The chief operating decision maker should be a familiar concept for companies applying IFRS 8.

Q4 What happens if the acquired business is integrated after acquisition?

Applying the Board's preliminary view, a company would disclose the information the chief operating decision maker uses to monitor the acquisition, which could be about the combined business.

In such cases, the chief operating decision maker may obtain further explanation of what the information about the combined business signals about the performance of the acquisition. If so, the company would also need to disclose such information if investors need it to understand whether the objectives of the acquisition are being met.

Q5 Would the information about the performance of acquisitions be too subjective to verify?

The Board expects that it would be possible to verify objectively whether such information:

- is indeed used by management for monitoring;
- has a clear basis for preparation; and
- faithfully represents the performance of the acquisition.

❷ Improving the accounting for goodwill

What are the issues?

Stakeholders have reported concerns that:

- impairment losses on goodwill are often recognised too late, long after the events that caused those losses; and
- the impairment test can be costly and complex to perform.

In view of these issues, the Board considered:

A. whether the impairment test could be made more effective (see pages 9–10);

B. whether goodwill should be amortised (see page 11); and

C. whether the impairment test could be simplified (see page 12).

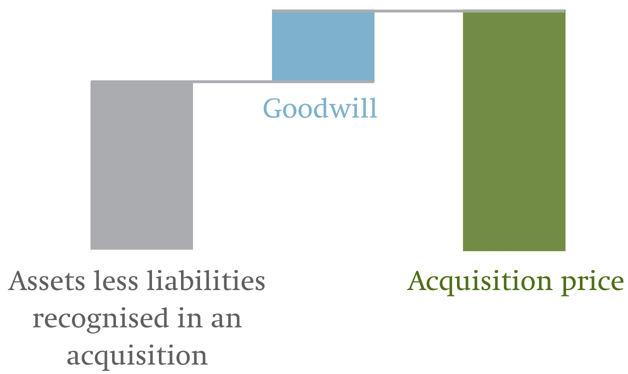
What is goodwill and how do companies account for it?

When a company buys a business, the company reports on its balance sheet the assets and liabilities acquired and, in most cases, an asset called goodwill.

At the date of the acquisition, the company measures goodwill as the amount by which the price paid for the business exceeds the fair values of the individual assets and liabilities recognised in an acquisition.

An acquirer pays this excess because it expects to achieve benefits from the acquisition, such as future synergies, that are not reported on the balance sheet separately as identifiable assets.

Before the Board issued IFRS 3 in 2004, companies were required to amortise goodwill—that is, goodwill was gradually written down over a fixed period (its ‘useful life’). In 2004 the Board introduced a requirement to carry out an annual impairment test of goodwill and prohibited the amortisation of goodwill.



How does an impairment test work?

Applying IAS 36 *Impairment of Assets*, an impairment test assesses whether the value of an asset is lower than the amount recorded for it on the balance sheet (carrying amount).

A company estimates the value of an asset (recoverable amount) as the higher of:

- the amount of cash flows it expects to generate by continuing to use the asset (value in use); and
- the amount for which the company could sell the asset (fair value less costs of disposal).

If the value of an asset is lower than its carrying amount, the company would recognise an impairment loss. The impairment loss would reduce the amount on the balance sheet to the value of the asset. This impairment loss is recognised as an expense in profit or loss for that period.

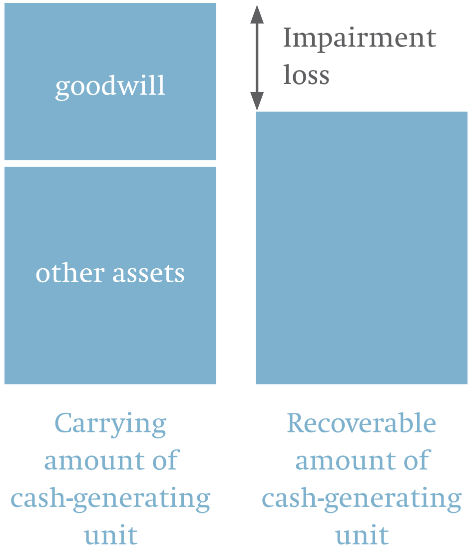
How is goodwill tested for impairment?

Many assets—for example, a building or a brand—can create value for a company only by working together with other assets to generate cash for the company from the goods they produce or services they provide.

Companies test these assets together for impairment as a group. Such groups of assets are called cash-generating units.

Goodwill is one such asset that can only be tested for impairment together with other assets.

When a company concludes that a group of assets is impaired, the impairment loss first reduces the carrying amount of any goodwill in the group, before reducing the carrying amount of any other asset. As a result, the impairment test cannot directly assess goodwill for impairment.



2 A Can the impairment test be made more effective?

What is the issue?

Some stakeholders have told the Board that the impairment test does not identify impairment of goodwill on a timely basis. This delay may occur because:

- management's estimates of future cash flows may be too optimistic (see page 10); or
- goodwill is 'shielded' from impairment by, for example, the headroom of a business with which an acquired business is integrated.

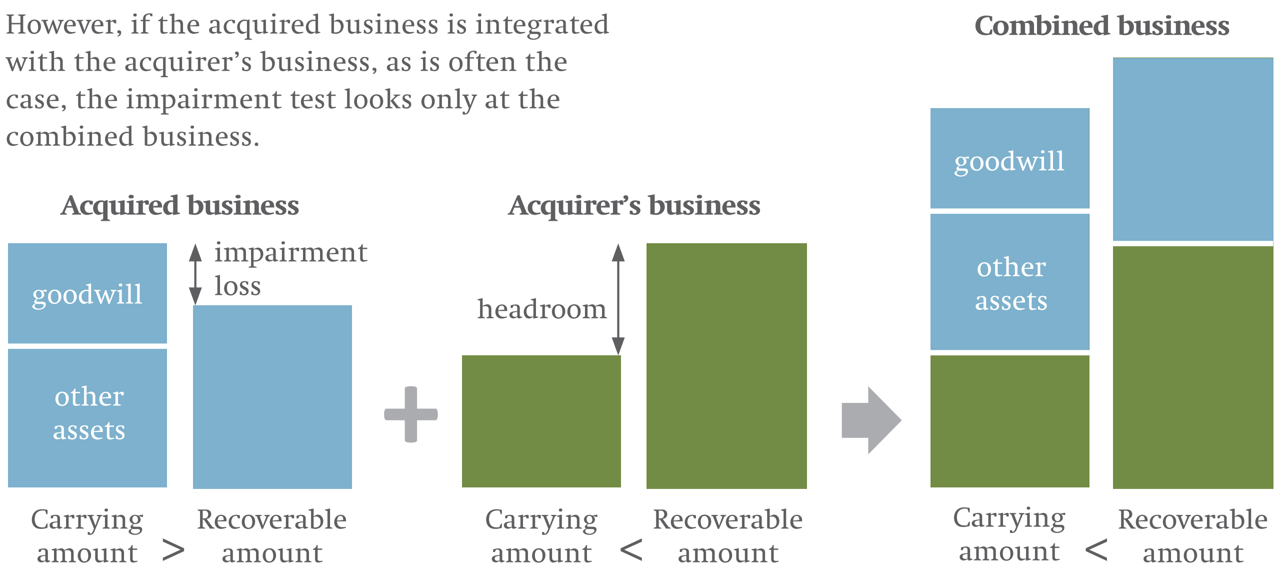
Headroom largely arises because not all of the value of a business is recognised on a company's balance sheet. For example, a company's balance sheet does not include some intangible assets that the company generates internally.

Shielding—illustration

In this example, the acquired business is not performing as well as expected. If the acquired business were run independently of the acquirer and tested for impairment separately, an impairment loss on goodwill would be recognised because the value (recoverable amount) of the acquired business is lower than its carrying amount.

However, if the acquired business is integrated with the acquirer's business, as is often the case, the impairment test looks only at the combined business.

In that case, despite the poor performance of the acquired business, no impairment loss is recognised because the recoverable amount of the combined business is higher than its carrying amount. The headroom of the acquirer's business absorbs the decline in the recoverable amount of the acquired business, thus shielding the goodwill from impairment.



The Board’s preliminary view

The Board explored whether it could design an impairment test that reduces the effect of shielding, resulting in earlier recognition of impairment losses on acquired goodwill.

> After extensive work, the Board’s preliminary view is that significantly improving the effectiveness of the impairment test for goodwill at a reasonable cost to companies is not feasible.

The Board’s preliminary view is that it is not possible to eliminate shielding from the impairment test because goodwill has to be tested for impairment together with other assets and these groups of assets could contain headroom.

Therefore, the impairment test cannot always signal how well the acquired business is performing. The Board has developed the disclosures discussed on pages 4–5 to meet investors’ need for timely information about the performance of acquisitions.

If the impairment test is performed well, the test can be expected to achieve its objective of ensuring that the carrying amount of a group of assets containing goodwill as a whole is not higher than its recoverable amount.

The Board’s preliminary view is that if estimates of future cash flows are too optimistic (see page 9), this is best addressed by auditors and regulators, not by changing IFRS Standards. Companies are required by IAS 36 to use reasonable and supportable estimates when performing an impairment test.

✓ An impairment test seeks to assess

- whether a company’s assets are worth less than their carrying amounts; and
- for assets that are part of a cash-generating unit, whether the unit (or group of units) as a whole is worth less than its carrying amount.

✕ An impairment test

- cannot test goodwill directly.
- is not designed to signal whether an acquisition is succeeding or failing.
- cannot be performed without relying on management’s estimates of future cash flows. These estimates will always be subjective.

2 B Impairment-only vs amortisation

Having concluded that the impairment test cannot be significantly improved at a reasonable cost (see page 10), the Board explored whether to reintroduce amortisation of goodwill,[3] as some stakeholders had suggested.

The Board's preliminary view

There have always been strongly held and divergent views on whether goodwill should be amortised or should only be tested for impairment. Each approach has its limitations.

In the Board's preliminary view, the impairment-only model should be retained. In the view of the majority of Board members there is no compelling evidence that amortising goodwill would result in a significant improvement in financial reporting. The majority for this decision was small, so the Board is interested in stakeholders' views on this topic.

Stakeholders are invited to provide new arguments to help the Board decide how to move forward on this topic.

The Board has heard the following arguments from stakeholders who support either of the two approaches:

Amortising goodwill	Retaining the impairment-only model
some say ...	others say ...
Goodwill amounts on the balance sheet are overstated and, as a result, a company's management is not held to account. Amortisation provides a simple mechanism that targets acquired goodwill directly, which the impairment test cannot do.	The impairment-only model provides useful confirmatory information to investors. Although amortisation is simple, it leads to arbitrary outcomes that would be ignored by many investors and many companies would exclude it from performance measures they provide to investors.
Feedback suggests the impairment test is not working as well as the Board intended and does not always write goodwill down when it has lost value.	If applied well, the impairment test works as the Board intended, ensuring that, as a group, goodwill and other assets of a business are not overstated.
Goodwill is a wasting asset, which reduces as the benefits are consumed. Amortisation is the only way to show the consumption of goodwill.	The benefits of goodwill are maintained for an indefinite period, so goodwill is not a wasting asset.
Amortising goodwill would ultimately make the impairment test easier and less costly to apply because amortisation would reduce the carrying amount of goodwill, making an impairment less likely.	Amortising goodwill would not significantly reduce the cost of impairment testing, especially in the first few years.

3 Companies would still be required to perform impairment tests of goodwill, even if goodwill is amortised.

2 C Simplifying the impairment test

The Board is seeking to simplify the impairment test to address some of the concerns raised by stakeholders, without making the test significantly less robust.

Relief from an annual impairment test

IAS 36 requires companies to perform annual quantitative impairment tests even when they have no reason to suspect that an impairment might have occurred. Stakeholders have said that:

> The annual test adds cost for companies but provides little useful information to investors when there is no indication of impairment.

The Board's preliminary view is that it should no longer require a company to carry out an annual quantitative impairment test of cash-generating units containing goodwill if the company has no indication that an impairment has occurred. A company would still be required to assess whether any such indication exists.

The change would reduce the cost of performing the impairment test.

The Board believes the change would not make the test significantly less robust because:

- when there is no indication of impairment it is unlikely that the quantitative test would identify large impairment losses; and
- performing the test every year cannot remove shielding (see page 9).

Simplifying value in use estimates

IAS 36 requires companies to estimate value in use (see page 8) on a pre-tax basis and to exclude from their forecasts cash flows from future uncommitted restructurings or asset enhancements. Stakeholders have said that:

> Working out which cash flows to exclude makes the test costly. Pre-tax discount rates are not observable; that is why the test is usually performed on a post-tax basis.

The Board's preliminary view is that it should:

- remove the restriction on including cash flows from uncommitted future restructurings or asset enhancements. The cash flow forecasts would still need to be reasonable and supportable.
- allow the use of post-tax discount rates and post-tax cash flows.

These changes would:

- reduce the cost and complexity of performing impairment tests by aligning cash flow estimates with companies' internal forecasts; and
- produce more useful and understandable information that is aligned with management estimates and industry practice.

❸ Other topics

Total equity excluding goodwill

The Board's preliminary view is that companies should present on the balance sheet the amount of total equity excluding goodwill.

Goodwill is different from other assets. It can only be measured indirectly—as part of a business valuation—and it cannot be sold separately.

Presenting the amount of total equity excluding goodwill on the balance sheet would make the amount more prominent and could draw investors' attention to companies whose goodwill constitutes a significant portion of their net assets.

The amount of total equity excluding goodwill may not fit easily into all balance sheet formats as a subtotal. However, there could be other ways a company could present the amount on the balance sheet. For example, the amount of total equity excluding goodwill could be presented on the balance sheet as a free-standing amount.

Recognising acquired intangible assets separately from goodwill

The Board's preliminary view is that it should retain the requirements in IFRS 3 and IAS 38 *Intangible Assets*.

When it issued IFRS 3, the Board broadened the range of acquired intangible assets recognised separately from goodwill, such as brands. Stakeholders' views on that approach differ. Companies' views on the cost of separate recognition also differed.

Because of the different views on how useful and costly this information is, the Board has no compelling evidence that it should change the range of intangible assets recognised in a business combination.

Considering whether to align the accounting treatments for acquired and internally generated intangible assets is beyond the scope of this project.

Separate recognition helps to explain what companies have bought. It also ensures that intangible assets with a finite useful life are recognised separately and amortised.

Separate recognition does not provide useful information, because:

- similar intangible assets are not recognised if they are generated internally; and
- some intangible assets are difficult to identify and value.

If stakeholders would like the Board to consider adding to its work plan a broader project on intangible assets, they can provide their inputs to the Board's 2020 Agenda Consultation.

Summary of the Board's preliminary views

In the Board's view, its package of preliminary views would achieve a balance between the following objectives:

- providing more useful information, allowing investors to hold management to account; and
- reducing costs for companies.

For each of the possible changes the Board considered, the table on the right summarises:

- whether the change would help to achieve the objectives, if implemented; and
- the Board's preliminary view on whether to make the change.

The Board also considered whether the impairment test could be made significantly more effective, at a reasonable cost to companies. Its preliminary view is that this is not feasible (see page 10).

	Possible changes the Board considered	Objectives		Board's preliminary view
		More useful information	Reduce cost	
1	Improve disclosures about acquisitions	✓	✗	Yes, change
2	Amortise goodwill	✗	✓	No, do not change
	Provide relief from mandatory annual impairment test	...	✓	Yes, change
	Amend how value in use is estimated	✓	✓	Yes, change
3	Present total equity excluding goodwill	✓	...	Yes, change
	Include some intangible assets in goodwill	✗	✓	No, do not change

✓ In line with objective ✗ In conflict with objective ... No significant impact

Further information

The deadline for comments on the Discussion Paper is 31 December 2020

The deadline has changed to 31 December 2020 because of the covid-19 pandemic; previously it was 15 September 2020.

Stakeholders are invited to respond to the questions in the Discussion Paper. The Board will welcome responses even if stakeholders do not comment on all questions.

To stay up to date with the latest developments in this project and to sign up for email alerts, please visit www.ifrs.org/projects/work-plan/goodwill-and-impairment/.

This document

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