European Accounting Association (EAA) / EFRAG / International Accounting Standards Board Research (IASB) Workshop

Business Combinations—Disclosures, Goodwill and Impairment
30 April 2024
Business Combinations—Disclosures, Goodwill and Impairment

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Objective of this workshop

• Provide an overview of the Exposure Draft—*Business Combinations, Goodwill and Impairment*

• To gather academic input on:
  • the effects of pre- and post-acquisition disclosures about business combinations provided voluntarily by companies or pursuant to regulatory environments around the world, including for example the United States;
  • incentives and consequences of disclosures—for example, exemptions from requirements to disclose information that might be commercially sensitive; and
  • factors affecting pre- and post-acquisition disclosures, such as the nature or size of the business combination, and impact of the reporting environment on disclosures.
Agenda

- Background 5–8
- Improving disclosures about business combinations 9–15
Background
Summary of the Exposure Draft

Objective

- Improve information entities provide about their business combinations at a reasonable cost

Package of proposals

- A package of improved disclosure requirements in IFRS 3 Business Combinations
- Changes to the impairment test of cash-generating units containing goodwill in IAS 36 Impairment of Assets

Comment period

- Comments requested by 15 July 2024

Better information for better decisions
- increases transparency and usefulness of information
Why is the IASB publishing an Exposure Draft?

High value transactions

- Acquisitions—referred to as ‘business combinations’ in IFRS Standards— are often large transactions for the entities involved.
- These transactions play a central role in the global economy. For example, deals announced in 2023 totalled $3.2 trillion.

Information about acquisition’s performance

Investors receive insufficient information about an acquisition’s performance – investors sometimes use information from impairment test as a proxy to assess an acquisition’s success.

Preparers consider information about an acquisition’s performance to be commercially sensitive.

Impairment test

Impairment losses on goodwill sometimes recognised too late.

Impairment test complex and costly

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1 Looking Back at M&A in 2023: Who Wins in a Down Year? | Bain & Company
### Package of proposals

#### Proposed changes to IFRS 3

- Disclose information used by key management personnel about performance of **strategic business combinations**
  - Key objectives, targets in year of acquisition
  - Performance against key objectives, targets in subsequent periods
- Other improvements to existing disclosures, including disclosing quantitative information about expected synergies
- **Exempt** an entity from disclosing some information in specific circumstances

#### Proposed changes to IAS 36

- Clarify how an entity allocates goodwill to cash-generating units (CGU)
- Require entities to **disclose which reportable segment contains a CGU**
- Simplify value in use calculation
Improving disclosures about business combinations
Key disclosure proposals

- Performance of business combinations
- Quantitative information about expected synergies
- Exemption
Investors and Preparers

Acquisitions are a large and risky use of capital. Investors need better information to help assess:
• the price paid;
• why management paid that price; and
• subsequently, whether the acquisition is meeting management's expectations.

Some investors use impairment losses on goodwill as a signal of an unsuccessful acquisition but sometimes impairment losses are recognised too late.

Information about the performance of acquisitions and information about expected synergies could be commercially sensitive and forward-looking.

Companies should not be required to disclose this information in financial statements.
Performance of business combinations

Information to be disclosed

- **Key objectives** and targets
- **Performance** against key objectives and targets

Population of business combinations

- **Strategic** business combinations

Exemption

- Applied to some items of **commercially sensitive** information
Expected synergies

Information to be disclosed

In year of acquisition only, information aggregated by category about:
• Expected synergies
• Cost to achieve synergies
• Expected timeframe

Population of business combinations

• All ‘material’ business combinations

Exemption

• Applied to some items of commercially sensitive information
Exemption

**Principle**
An entity may be exempted from disclosing some information if doing so can be expected to prejudice seriously an entity’s objective for a business combination.

**Application guidance**
For example:
- disclosing the reason for applying the exemption for each item of information
- factors to consider in identifying the appropriate circumstances for applying the exemption

**Responds to preparer concerns**
In particular, concerns about commercial sensitivity and some concerns about forward-looking information.
Summary of key disclosure proposals

Disclosures for material business combinations

- Expected synergies
  - Exemption - YES

- Strategic rationale
  - Exemption - NO

Additional disclosures for strategic business combinations

- Key objectives and targets
  - Exemption - YES

Performance - actuals

- Exemption - NO

Performance – statement

- Exemption - YES
Business Combinations—Disclosures, Goodwill and Impairment

EFRAG Presentation

30 April 2024

Didrik Thrane-Nielsen and Ioanna Michailidi
DISCLAIMER

The views expressed in this presentation are those of the presenter, except where indicated otherwise. EFRAG positions, as approved by the EFRAG FRB, are published as comment letters, discussion or position papers, or in any other form considered appropriate in the circumstances.
OVERVIEW

• TIMELINE

• EFRAG’S PRELIMINARY VIEWS ON THE IASB’S PROPOSED DISCLOSURES IN IFRS 3 BUSINESS COMBINATIONS
  • Performance of a business combination
  • Strategic business combinations
  • Expected synergies
  • Exemption from disclosing information
  • Identifying information to be disclosed
TIMELINE

- **Q1 2020**
  - Discussion Paper published

- **Q2 2021 - Q3 2023**
  - Redeliberations

- **March 2024**
  - Exposure Draft published

- **Early May 2024**
  - EFRAG to publish its Draft Comment Letter

- **May-June 2024**
  - EFRAG to publish its Final Comment Letter

- **July 2024**
  - EFRAG DCL consultation period and outreaches

Consultation period. In Q1 2021, EFRAG issued its FCL.

Q2 2021 - Q3 2023
Performance of a business combination

**IASB PROPOSALS**

- Acquisition-date key objectives and targets and whether these are being met
- Actual performance and statement of whether actual performance meeting/met key objectives and targets
- Information only required for strategic business combinations, and subject to the exemption in specific circumstances (no exemption for actual performance)

**EFRAG PRELIMINARY VIEW**

- Welcomes the IASB’s proposals for better information on the performance of strategic business combinations as they respond to users' requests
- Appreciates the IASB’s efforts in reaching a compromise for preparers and users by requiring the information only for a subset of business combinations, and for exempting an entity from providing the information in specific circumstances

**FEEDBACK REQUIRED**

- Further feedback on potential scenarios where the exemption would not be applicable, and the disclosures would pose serious concerns to the entity
- Feedback on whether the information on actual performance would be useful in all cases, and the usefulness of integrated performance information to users
- Additional feedback on whether the information related to the performance of a business combination should be provided in the financial statements
Strategic business combinations

**IASB PROPOSALS**

- Identification of a strategic business combination using a closed-list of thresholds
  - quantitative thresholds—any one of revenue, operating profit and assets of the acquired business constitutes at least 10% of the acquirer’s corresponding amounts; or
  - qualitative thresholds—the acquisition results in a company entering a new major line of business or geographical location

**EFRAG PRELIMINARY VIEW**

- Supports the proposed thresholds since they are, in most cases, expected to capture the intended population of acquisition and is consistent with thresholds used in other IFRSs
- Notes concerns that the thresholds may capture immaterial acquisitions; however notes that the concept of materiality would still apply and recommends the IASB to elaborate on this in the Basis for Conclusions

**FEEDBACK REQUIRED**

- Additional feedback on the potential challenges in applying the proposed thresholds
- Seeks additional insight into whether open-list approach would be more appropriate
- Feedback on the appropriateness of the 10% measure
- Additional feedback on the usefulness of guidance in assessing whether a series of business combinations could be strategic on an aggregated basis
**Expected synergies**

**IASB PROPOSALS**
- Require the disclosure of expected synergies by category
- For each category, disclosure of the estimated cost to achieve the synergies and estimated timeframe
- Information subject to the exemption in specific circumstances

**EFRAG PRELIMINARY VIEW**
- Generally supportive of proposals, and considers that it would enhance the information on expected synergies that users currently receive under IFRS 3
- For cases where the disclosure of this information would be prejudicial to the entity, the exemption may be applied

**FEEDBACK REQUIRED**
- Additional feedback on whether the information of expected synergies should be provided in the financial statements
- Seeks input on whether to define ‘synergies’ or provide additional guidance on the types of synergies for which quantitative information should be provided
Exemption from disclosing information

IASB PROPOSALS

• Exemption to some items of information in specific circumstances
• Application guidance to support the identification of the circumstances where the exemption can be applied

EFRAG PRELIMINARY VIEW

• Welcomes the proposed exemption, as it would address some of the concerns expressed by constituents (e.g., on commercial sensitivity)
• Suggests including illustrative examples of ‘specific circumstances’ to support entities in its application, as these circumstances could be interpreted differently

FEEDBACK REQUIRED

• Seeks additional feedback on whether further application guidance and/or illustrative examples are needed to clarify the meaning of ‘specific circumstances’
Identifying information to be disclosed

• Provide the proposed disclosures about the performance of a strategic business combination based on information that the entity’s management uses to review and monitor the acquisition

• Appropriate level of management is set to be the entity’s Key Management Personnel (KMP)

• Supports proposals and considers that the KMP is the appropriate level
  • Entities would be familiar with the ‘KMP’ term, as it is defined in IAS 24 and used in other IFRSs (IFRS 10)

• Seeks additional feedback from constituents on whether KMP is the appropriate level

30 April 2024 - EAA Reporting Standards Workshop on BC DGI - www.efrag.org
EFRAG is co-funded by the European Union through the Single Market Programme in which the EEA-EFTA countries (Norway, Iceland and Liechtenstein), as well as Kosovo participate. Any views and opinions expressed are however those of the presenter only and do not necessarily reflect those of the European Union, the European Commission or of countries that participate in the Single Market Programme. Neither the European Union, the European Commission nor countries participating in the Single market Programme can be held responsible for them.
The IASB’s Exposure Draft *Business Combinations – Disclosures, Goodwill and Impairment* – Academic perspective

EAA–IASB Virtual Research Workshop
30 April 2024
The IASB’s Business Combinations Project – Background, Process
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- 2004, introduction of IFRS 3
- 2013/14, Post-Implementation Review of IFRS 3 (IASB 2015)
- March 2020, Discussion Paper
  main preliminary views:
  - no re-introduction of amortization
  - no substantial changes to impairment testing (headroom approach, etc.)
  - improved disclosure requirements

- November 2022, IASB votes to retain the impairment-only approach
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  Dec. 2020, FASB tentatively decides to reintroduce amortisation
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  - improved disclosure requirements
- 2018, FASB goodwill accounting project
  Dec. 2020, FASB tentatively decides to reintroduce amortisation
- June 2022, FASB removes goodwill project from agenda
- November 2022, IASB votes to retain the impairment-only approach
- - interdependency of FASB, IASB decision-making
  comparability, convergence – also: timing of events!

- - path dependency
  changing an existing standard vs. developing new standard
  (see IASB ED Business Combinations, para. BC 232 and 233)
Disclosures – Academic research

- Different definitions of *disclose, disclosure*
  1. making any type of information publicly available (also: ESG/CSR)
  2. making financial statements publicly available
  3. providing information in notes to financial statements
Disclosures – Academic research

- Different definitions of disclose, disclosure
  (1) making any type of information publicly available (also: ESG/CSR)
  (2) making financial statements publicly available
  (3) providing information in notes to financial statements

- Literature reviews on financial disclosure, (1) and (2)
  Verrechia JAE 2001; Healy & Palepu JAE 2001; Botosan ABR 2006; Beyer et al. JAE 2010;
  Bertomeu & Cheynel Abacus 2016; Leuz & Wysocki JAR 2016; Goldstein & Yang ARFE 2017;
  Roychowdhury et al. JAE 2019; Blankespoor et al. JAE 2020
Mandatory disclosures

- **Mandatory disclosures** (in notes to financial statements)
  - Schipper TAR 2007
**Mandatory disclosures**

- **Mandatory disclosures** (in notes to financial statements)
  - Schipper TAR 2007
  - since 2013, IASB Disclosure Initiative
  - 2018, IASB Guidance for developing and drafting disclosure requirements
  - 2021, ED Disclosure requirements in IFRS standards,
    A Pilot Approach, IFRS 13 and IAS 19
  - 2023, Project Summary, Targeted Standards-level Review of Disclosures

also see:

- 2012, EFRAG, Towards a Disclosure Framework for the Notes
- 2018, FASB Statement of Financial Accounting Concepts No. 8,
  Notes to Financial Statements

also see: https://www.sec.gov/corpfin/cfdisclosure
Disclosures – Lines of research

- Determinants
- Compliance with mandatory disclosures
- Recognition vs. disclosure
- Effects of Disclosures
Disclosures – Lines of research

- **Determinants**
  - refers mainly to voluntary disclosure and compliance

- **Compliance with mandatory disclosures**
  - associated with differences in level of enforcement, governance, firm-level and managerial incentives
  - literature reviews: Hellman et al. AccEu 2018, Tsalavoutas et al. JIAAT 2020
  - many studies on compliance with M&A and goodwill accounting (see next part) other areas, e.g., financial instruments, pensions, executive compensation, employee stock options, CSR/ESG
  - non-compliance not only for IFRS, Europe, Asia, etc., also US companies e.g., Shalev TAR 2009, Ettredge et al. RAST 2011, Robinson et al. TAR 2011, Ayers et al. TAR 2015, Caskey et al. RAST 2023
  - also see literature review, Choudhary et al. Man & Dec Econ 2013
Disclosures – Lines of research

- Determinants

- Compliance with mandatory disclosures

- Recognition vs. disclosure
  - Managerial/preparer perception, reliability
    e.g., Wiedman & Wier 1999 JAAF 1999; Choudary JAE 2011; Chlor-Proell & Maines JAR 2014
  - Value relevance, reliability and information processing costs
  - Experimental studies
Disclosures – Lines of research

- Determinants

- Compliance with mandatory disclosures

- Recognition vs. disclosure

- Effects of Disclosure
  - CSR/ESG disclosures
  - SEC risk factors, e.g., Campbell et al. RAST 2014, Hope et al. RAST 2016, Chiu et al. CAR 2017, Beattie et al. CAR 2018, Cazier et al. TAR 2021
Business Combinations—Disclosures, Goodwill and Impairment Proposed amendments to IFRS 3 and IAS 36

EAA-IASB Visual Workshop, 30 April 2024, Yannis Tsalavoutas
Presentation structure

- Context 1: Exposure Draft Disclosure Requirements in IFRS Standards—A Pilot Approach
- Context 2: Making Materiality Judgements PS2 (IAS 1 & 8 amendments).
- Brief overview of compliance with IFRS Mandatory disclosures around BC & Goodwill
- Comments on specific suggestions in the ED, while reflecting on related literature.
- Conclusions
Key takeaways in the Project Summary and Feedback Statement regarding *Exposure Draft Disclosure Requirements in IFRS Standards—A Pilot Approach*

Aspects of the IFRS Accounting Standards that could be contributing to the disclosure problem

- Lack of specific disclosure objectives
- Use of prescriptive language such as ‘shall’ or ‘as a minimum’
- Voluminous prescriptive requirements

IASB’s response to feedback & way forward

Overall disclosure objectives
- provide Accounting Standard-specific context of the overall user information needs to enable an entity to make materiality judgements and apply the requirements about specific disclosure objectives and items of information.

Specific disclosure objectives
- describe the detailed information needs of users of financial statements;
- use the prescriptive language ‘shall’ to require an entity to comply with those disclosure objectives; and
- are accompanied by explanations of the user assessments that rely on the information preparers disclose when applying the specific disclosure objectives.

Items of information that satisfy specific disclosure objectives
- describe the information needed to satisfy disclosure objectives in most cases, but additional information may be needed in some cases; and
- use the prescriptive language ‘shall’ to require an entity to disclose the information.

PS, 2023, p.4.

PS, 2023, p.12.
Key takeaways in the Project Summary and Feedback Statement regarding *Exposure Draft Disclosure Requirements in IFRS Standards—A Pilot Approach*

**Overall disclosure objectives**
- provide Accounting Standard-specific context of the overall user information needs to enable an entity to make materiality judgements and apply the requirements about specific disclosure objectives and items of information.

**Specific disclosure objectives**
- describe the detailed information needs of users of financial statements;
- use the prescriptive language ‘shall’ to require an entity to comply with those disclosure objectives; and
- are accompanied by explanations of the user assessments that rely on the information preparers disclose when applying the specific disclosure objectives.

**Items of information that satisfy specific disclosure objectives**
- describe the information needed to satisfy disclosure objectives in most cases, but additional information may be needed in some cases; and
- use the prescriptive language ‘shall’ to require an entity to disclose the information.

IASB’s proposals in the ED on Business Combinations (IFRS 3)

- 1 new objective
- “The prescriptive language “shall” is maintained
- A new, pre-defined, type of business combinations is introduced - based on a specific threshold
- More disclosure items are introduced
Para 41: It would not be appropriate for the entity to rely on purely numerical guidelines or to apply a uniform quantitative threshold for materiality (see paragraphs 53–55).

Para 53: Quantitative assessment alone is not always sufficient to conclude that an item of information is not material. The entity should further assess the presence of qualitative factors.

Example F—impact of an entity’s press release on materiality judgements

An entity undertook a business combination in the reporting period. The acquisition doubled the size of the entity’s operations in one of its main markets.

- The 10% threshold arguably contradicts these
- The justification for a threshold in BC67 arguably contradicts these
- IFRS 8 precedes the PS
- Strategy refers to the future
- What if this one – which does not meet B67C c - does not meet the threshold? Isn’t it “strategic”? Or is this captured by para 63 in the ED?
Brief overview of compliance with IFRS Mandatory disclosures around BC & Goodwill

- Compliance with disclosure requirements relating to Goodwill and goodwill impairment testing is, on average, low, but with significant improvement over time.
- The most recent evidence relates to the financial years 2015 for German firms and 2012 for Malaysian firms.
- The majority of studies focus on European countries, Australia, and Malaysia.
- The evidence highlights significant country differences in compliance levels.
- With a few exceptions, the studies examine large firms.
- Firm size and being audited by a Big 4 auditor are factors that contribute to higher levels of compliance.
- Very limited evidence on the role of governance (exception Bepari & Mollik, 2015).
- Only two studies explore market consequences arising from the varying levels of explicitly goodwill related disclosures (Baboukardos & Rimmel, 2014; Mazzi et al., 2017)
Comments on specific suggestions in the ED, while reflecting on related literature.


Table 5.5: Summary of paragraphs in IFRS 3, IAS 36 and IAS 38 for which high non-compliance (less than 80% compliance) is observed

Comments on specific suggestions in the ED, while reflecting on related literature.

To meet the objective in paragraph 59, the acquirer shall disclose the following information for each business combination that occurs during the reporting period:

... (d) the strategic rationale primary reasons for the business combination and a description of how the acquirer obtained control of the acquiree.

(e) a qualitative description of the factors that make up the goodwill recognised, such as expected synergies from combining operations of the acquiree and the acquirer, intangible assets that do not qualify for separate recognition or other factors.

(ea) additional information about expected synergies from combining operations of the acquiree and the acquirer. The acquirer shall disclose a description of the expected synergies that specifies each category of expected synergies (for example, revenue synergies, cost synergies and each other type of synergy). For each category of expected synergies, the acquirer shall disclose:

(i) the estimated amounts or range of amounts of the expected synergies.
(ii) the estimated cost or range of costs to achieve these synergies.
(iii) the time from which the benefits from the synergies are expected to start and for how long they are expected to last. This disclosure would require the acquirer to specify whether the benefits from the synergies are expected to be finite or indefinite.
Comments on specific suggestions in the ED, while reflecting on related literature.

Deal synergies are typically uncertain, difficult to forecast, and realized only over the longer term. Providing detailed synergy forecasts exposes management to legal risk: investors can sue the management for misleading synergy disclosure and may even ask managers to disclose the basis of their synergy estimates in court (e.g., Hewlett-Packard’s merger with Compaq).

Food for thought: Should IAS 36 then have additional disclosure requirements for the impairment testing of strategic business combinations?

Bernile and Bauguess (2011) and Dutordoir et al., (2014): only about 20% of all deals are accompanied by a management forecast of synergy, and only 2% actually provide an NPV number.

And, see: Ismail et al, (2019), Ismail & Mavis (2022), Ismail (2011)
Comments on specific suggestions in the ED, while reflecting on related literature.

Food for thought: Is “management” the same as “key management personnel”?

Comments on specific suggestions in the ED, while reflecting on related literature.

Table 3. Paragraphs in IFRS 3 and IAS 36 for which high non-compliance is observed.

<table>
<thead>
<tr>
<th>Paragraph</th>
</tr>
</thead>
<tbody>
<tr>
<td>129</td>
</tr>
<tr>
<td>131</td>
</tr>
<tr>
<td>134</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Sub-paragraph</th>
<th># Firms applicable (N)</th>
<th>% Firms that comply</th>
</tr>
</thead>
<tbody>
<tr>
<td>An entity that reports segment information in accordance with IFRS 8 shall disclose the following for each reportable</td>
<td>248</td>
<td>70.8</td>
</tr>
<tr>
<td>segment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>An entity shall disclose the following information for the aggregate impairment losses recognised during the period for</td>
<td>177</td>
<td>39.0</td>
</tr>
<tr>
<td>which no information is disclosed in accordance with paragraph 130</td>
<td></td>
<td></td>
</tr>
<tr>
<td>An entity shall disclose the information required by (a)–(f) for each CGU (group of units) for which the carrying amount of</td>
<td></td>
<td></td>
</tr>
<tr>
<td>goodwill or intangible assets with indefinite useful lives allocated to that unit (group of units) is significant in</td>
<td>133</td>
<td>58.3</td>
</tr>
<tr>
<td>comparison with the entity’s total carrying amount of goodwill or intangible assets with indefinite useful lives</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Concluding remarks:

- Changes in the right direction.
- Scope for more suggestions to align IFRS 3 and IAS 36?
- Probability of effectiveness of the proposed disclosure requirements, if they go ahead?
- Risks for the IASB?
Thank you for attending!
BUSINESS COMBINATIONS – GOODWILL, DISCLOSURES AND IMPAIRMENT

Virtual Research Workshop
April 30, 2024

Niclas Hellman, Stockholm School of Economics
ARE M&AS SUCCESSFUL?

On the basis of a review of 93 published studies, King et al. (2004, Strategic Management Journal) conclude (emphasis added):

‘We find robust results indicating that, on average and across the most commonly studied variables, acquiring firms' performance does not positively change as a function of their acquisition activity, and is negatively affected to a modest extent.’

In a more recent review, King et al. (2019, Mergers and Acquisitions: A Research Overview. Routledge) state (emphasis added):

‘Still, research consistently examines the effectiveness of M&A using financial or other measures of M&A outcomes. While [methodological] progress has been made through reviews (...) and meta-analysis of prior research (...), observed failure rates of M&A have not improved over the recent decades…’
THREE ASPECTS TO CONSIDER

Corporate strategy
• Does our strategy for increased/maintained growth & profitability require acquisitions?

Financial consequences
• Attractive valuation?
• Share price effect?
• Financial statement effects?

Integration
• Can the synergies be attained in practice at a reasonable cost?
AN ACQUISITION EXAMPLE (1)

• Ericsson completed the acquisition of the US-based firm Vonage on 21 July 2022 for about SEK 53 billion (about EUR 5 billion).

• At the end of 2022, Ericsson provides the following information in its annual report:

• The total goodwill for Ericsson is SEK 84.6 (38.2) billion and is allocated to the operating segments:
  - Networks [SEK 28.5 (25.8) billion],
  - Cloud Software and Services [SEK 3.6 (3.2) billion],
  - Enterprise [SEK 52.5 (9.2) billion] of which Vonage SEK 42.0 billion.

• Goodwill from the Vonage acquisition during the year has been allocated to the Vonage CGU within segment Enterprise.
AN ACQUISITION EXAMPLE (2)

Goodwill impairment test
The forecasted cash flows are based on a five-year business plan. The CGUs Vonage and Cradlepoint have assumed a forecasted growth above 20% per year over the next five years followed by a gradual decline in growth rates. The assumptions reflect the expected high growth market conditions in which both CGUs are present. Market maturity and market growth at long term sustainable levels (nominal rates described below) are not expected to be reached until after ten years. It is noted that it is more difficult to estimate market conditions the further into the future they are forecasted.

The growth rates after the forecast period have increased this year as a result of the increase in risk-free rates. All CGUs use a nominal annual growth rate of 2.0% (1.5%) per year after the forecast period, except Vonage which uses a rate of 3.5%. The higher rate for Vonage is due to the higher risk-free rate implied by USD treasury bonds, which are used as the cash flows are forecasted in USD.

<table>
<thead>
<tr>
<th>Post-tax discount rates (%)</th>
<th>2022</th>
</tr>
</thead>
<tbody>
<tr>
<td>CGU</td>
<td></td>
</tr>
<tr>
<td>Vonage</td>
<td>9.5</td>
</tr>
</tbody>
</table>

Projections over extended time periods where the estimated cash flow growth exceeds that of the market in which the Company operates are inherently uncertain. The recoverable amount for CGU Vonage would equal the carrying value, if the expected sales growth per year is reduced by circa 3% until assuming steady state, or if a 4% decrease in the long term EBIT margin would be applied. Likewise, an increase in the applied WACC for Vonage by 1.5% would give the same outcome.

- The acquiree and the CGU are the same.
- The impairment test will serve the purpose of evaluating the success of the acquisition.
- The preparer provides adequate disclosures that users can use to evaluate the success of the acquisition.
**AN ACQUISITION EXAMPLE (3)**

- **Acquisition date** (July 2022)
- **Vonage (CGU)**
- **Vonage (acquiree)**

**Subsequent period** (31 Dec. 2022)

- **Vonage (acquiree)**
- **Vonage (CGU)**

**Subsequent period** (30 Sep. 2023)

- **Vonage (acquiree)**
- **Vonage (CGU)**

- **The acquiree and the CGU are the same.**
- **The impairment test will serve the purpose of evaluating the success of the acquisition, but even when the acquiree and the CGU are the same, the design of the impairment test creates headroom.**

**PRESS RELEASE**

October 11, 2023

Ericsson announces impairment charge of SEK 32 billion and provides update on Q3 earnings

‘The impairment is a consequence of the significant drop in the market capitalization of Vonage’s publicly traded peers, increased interest rates and overall slowdown in Vonage’s core markets.’

Goodwill impairment test 31 Dec. 2023

There are no reasonably possible changes that would lead to the carrying value not being recoverable for any CGU, except for Vonage. The recoverable amount of CGU Vonage exceeds the carrying amount by SEK 1.1 billion. This CGU was written down to its recoverable amount in Q3 2023. The current head room comes mainly from the amortization of intangible assets since the write-down.
The goodwill impairment test under IFRS: Objective, effectiveness and alternative approaches

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IFRS

ABSTRACT

Stakeholders have questioned the effectiveness of the goodwill impairment-only approach, which was widely adopted in the early 2000s. Much empirical work has been conducted on the matter, but there is a need for more conceptual work. This paper applies goodwill-components theory to derive the theoretical objective of the goodwill impairment test and to define impairment effectiveness – a concept previously undefined but often referenced in the debate. Goodwill-components theory allows us to address the various components of goodwill instead of viewing accounting goodwill as homogeneous. Adopting this framework, we compare the current International Financial Reporting Standards (IFRS) model to two alternative impairment-only models, the pre-acquisition headroom (PH) model and the fair value (FV) model. We conclude that the PH model results in more effective impairment testing than the current IFRS model. Compared to the FV model, the PH model is more effective in the short run and less effective in the long run. Our analysis further identifies situations where the PH model is “over-effective”. The framework is also used to illustrate the effectiveness of the current IFRS model compared to a goodwill amortization model.
A COMMON SITUATION

- Entities may be aggregated so that operating segments become the CGUs (or group of CGUs) subject to impairment tests.

- The acquiree is integrated into one or more CGUs with pre-existing internally generated goodwill (pre-acquisition headroom).

- Users want to learn about whether the acquisition of the acquiree was successful, but financial information is not provided at the acquiree level.

- The valuation of the CGU according to the impairment test is disconnected from the subsequent value of the acquiree (different units, current condition).
A MANAGEMENT APPROACH

• The suggested solution in the ED to deal with the disconnection between the acquired entity and entity tested for impairment is to ask management to disclose information about business combinations based on the acquiree view rather than the CGU view (i.e. maintaining the link to the goodwill recognized for the acquired entity at the acquisition date).

• At the acquisition date, disclosures shall pertain to the strategic rationale and expected synergies for material business combinations and key objectives and targets for strategic business combinations.

• During the post-acquisition period, management shall report on performance (statement and actuals).
A high-level principle

Some specific requirements

Disclosure

20 An entity shall disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates.

Information about profit or loss, assets and liabilities

23 An entity shall report a measure of profit or loss for each reportable segment. An entity shall report a measure of total assets and liabilities for each reportable segment if such amounts are regularly provided to the chief operating decision maker. An entity shall also disclose the following about each reportable segment if the specified amounts are included in the measure of segment profit or loss reviewed by the chief operating decision maker or are otherwise regularly provided to the chief operating decision maker, even if not included in that measure of segment profit or loss:

(a) revenues from external customers;
(b) revenues from transactions with other operating segments of the same entity;
(c) interest revenue;
(d) interest expense;
(e) depreciation and amortisation;
(f) material items of income and expense disclosed in accordance with paragraph 97 of IAS 1 Presentation of Financial Statements (as revised in 2007);
(g) the entity’s interest in the profit or loss of associates and joint ventures accounted for by the equity method;
(h) income tax expense or income; and
(i) material non-cash items other than depreciation and amortisation.

Source: IFRS 8, Operating Segments

MANAGEMENT APPROACH APPLIED IN IFRS 8
SOME IFRS 8–RELATED OBSERVATIONS

• Many users were concerned about the objectivity and reliability of the reported information under the management approach (Aboud & Roberts, 2018; Berger & Hann, 2003; Crawford et al., 2012). Additionally, several issues under this approach are blurry, such as aggregation guidelines, reconciliation, the CODM identification, and the use of non-IFRS measures.

• The major observed changes in segmental reporting practices following IFRS 8 are the increase in the disaggregation of geographical information and the reduction in the number of items disclosed (André et al., 2016; Crawford et al., 2012; Leung & Verriest, 2015; Nichols et al., 2013).

• Results reported by Aboud and Roberts (2018) indicate that firms with greater proprietary costs provide lower-quality segment disclosure under IFRS 8.

André et al. (2016) find that under IFRS 8, more discretion can be exercised over the quality than the quantity of disclosures and that incentives played an important role in the sense that managers with proprietary concerns tended to solve this by (p. 443, emphasis added): ‘…either deviating from the suggested line-item disclosure in the standard, or, if following standard guidance, by decreasing segment reporting quality.’

These results suggest that when management is given much flexibility in relation to disclosure in combination with low enforceability, there will be high variation in disclosure quantity and quality in practice, to some extent related to the incentive patterns of management.

<table>
<thead>
<tr>
<th>Panel B: Distribution of sample into groups based on SRQI and SRQt</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
<tr>
<td>-------------------</td>
</tr>
<tr>
<td>SRQI</td>
</tr>
<tr>
<td>HighQI</td>
</tr>
<tr>
<td>AvgQI</td>
</tr>
<tr>
<td>LowQI</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>

This table presents the sample distribution into groups of SRQt, i.e., Over-disclosers, Box-tickers, and Under-disclosers against SRQI, i.e., High, Avg, and LowQI (percent of total sample in brackets). The sample contains 270 firm observations. Companies are split into groups based on whether their values for SRQI and SRQt are in the bottom, upper, and two middle quartiles. See variable definitions in Appendix A.
IFRS 8 AND SOME ANALYST FINDINGS (1)

• Prior studies suggest that segment-based forecasts outperform consolidated forecasts and that the average forecast error decreased after analysts began using segment information (Cereola et al., 2018; Roberts, 1989).

• Segment information is likely to be more beneficial to analysts when business segments are comparable with the industry sectors and are more disaggregated (Berger & Hann, 2003; Heo & Doo, 2018; Hussain, 1997; Kou & Hussain, 2007).

• However, using a sample from Australia, He et al. (2016) documented that analysts’ earnings forecasts did not improve significantly after the adoption of the Australian Accounting Standards Board’s AASB 8, suggesting that the benefits associated with the management approach did not materialize when Australia moved to the management approach.

IFRS 8 AND SOME ANALYST FINDINGS (2)

• Cereola et al. (2018) find that geographic sales disclosures by companies located in countries with high and moderate enforcement regimes improve the predictive accuracy of geographic sales.

• Aboud and Helfaya (2021) find that common-law countries, higher country-level legal enforcement, and investor protection are positively related to higher quantity of segment disclosure (and disaggregation of geographical information), while both country-level conservatism and closeness between national GAAP and IFRS are negatively related to the quantity of segment disclosure (and disaggregation of geographical information).

A controversial aspect of IFRS 8 allows firms to define their segment profit (or loss) on a different basis than IFRS measurement and recognition principles, but whether these non-IFRS segment data are useful is in large part unexplored.

Using hand-collected segment data on a sample of European multi-segment firms, we find empirical evidence that non-IFRS segment data lead to less accurate analyst forecasts. Additionally, we find that non-IFRS segment data are associated with higher forecast dispersion, higher uncertainty in analysts’ forecasts, and a lower precision of analysts’ public information set.

Collectively, our findings suggest that non-IFRS segment data impair analysts’ information environment, which casts doubt on their usefulness.

What about new acquiree-centred disclosures on targets and performance – Will they refer to non-IFRS numbers?
WHO IS MANAGEMENT? WHO MONITORS PERFORMANCE?

Acquiree

Acquisition date

Subsequent period

Chief Operating Decision Maker (IFRS 8)
The CODM identifies a function, not necessarily a manager with a specific title. That function is to **allocate resources to and assess the performance** of the operating segments of an entity.

‘Management’ (IAS 36)
Throughout the *Conceptual Framework*, the term ‘management’ refers to management and the governing board of an entity unless specifically indicated otherwise.

Key Management Personnel (ED proposal, IAS 24)
Those 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.

How will users be able to tell the difference between these categories of management? Does it matter for the disclosures provided?
IDENTITY OF THE CODM

The identity of the CODM varies considerably. The identity of the CODM affects the level of segmental disclosures significantly (the 'level' is measured by applying a disclosure index for IFRS 8 comprising 18 mandatory items and 5 voluntary items).

The 32 observations where firms do not disclose the identity of the CODM has the lowest level of segment reporting (41.2%).

Table 7
CODM identity and level of segmental information reporting (N = 425) Years covered: 2013-2017

<table>
<thead>
<tr>
<th>CODM identity</th>
<th>No. of observations</th>
<th>Mean level of SIR (%)</th>
<th>Rank (by Mean)</th>
<th>SD</th>
</tr>
</thead>
<tbody>
<tr>
<td>NP</td>
<td>36</td>
<td>41.2</td>
<td>7</td>
<td>0.171</td>
</tr>
<tr>
<td>MGT</td>
<td>55</td>
<td>56.3</td>
<td>6</td>
<td>0.121</td>
</tr>
<tr>
<td>CEO</td>
<td>70</td>
<td>60.0</td>
<td>5</td>
<td>0.183</td>
</tr>
<tr>
<td>OC</td>
<td>10</td>
<td>62.5</td>
<td>4</td>
<td>0.064</td>
</tr>
<tr>
<td>EC</td>
<td>108</td>
<td>73.0</td>
<td>1</td>
<td>0.171</td>
</tr>
<tr>
<td>BoD</td>
<td>130</td>
<td>67.5</td>
<td>3</td>
<td>0.132</td>
</tr>
<tr>
<td>BoD &amp; CEO</td>
<td>16</td>
<td>71.3</td>
<td>2</td>
<td>0.091</td>
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<tr>
<td>Hypothesis Status</td>
<td>H3 (Accepted)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

This table illustrates the CODM identity of FTSE-100. NP refers to Not Provided; MGT refers to Management; CEO refers to Chief Executive Officer; OC refers to Operating Committee; EC refers to Executive Committee; BoD refers to Board of Directors.

CHALLENGES WITH THE ED AND THE SUGGESTED MANAGEMENT APPROACH

• Users are likely to make connections between the business combination disclosures related to the acquired entity (acquiree) and the goodwill impairment tests for corresponding CGUs. The acquiree-centred disclosures may become leading indicators for future goodwill impairments. Management may hesitate to provide information about negative acquisition-related performance.

• There is lack of clarity for users (and perhaps also for preparers) as regards the identity and overlap across KMP, CODM and ‘management’.

• There is a risk that the flexibility offered by the management approach may result in a significant group of poor disclosers. Prior research related to IFRS 8 provides some support in this direction.
Thank you!

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DO COMPANIES FOLLOW UP ACQUIRED FIRMS AT THE ACQUIREE LEVEL?

• Stylized example from a listed company’s acquisition of a relatively small acquiree.