IFRS

STAFF PAPER

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IASB® Meeting

Project	**Goodwill and Impairment research project**		
Paper topic	Identifying better disclosures for business combinations, goodwill and impairment		
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Purpose

1. The purpose of this paper is to ask the Board to confirm the further work to be performed to achieve the research objective of identifying better disclosures that would enable investors to assess whether a business combination is a good investment decision and whether the acquired business is performing after the business combination as expected.

Structure of the paper

2. The paper is structured as follows:
   (a) background and introduction (paragraphs 3–12);
   (b) summary of the recent feedback from the ASAF (paragraphs 13–23);
   (c) further work to be performed to identify better disclosures (paragraphs 24–39);
   (d) next steps (paragraph 40); and
   (e) questions for the Board.

Background and introduction

3. During and after the Post-implementation Review (PIR) of IFRS 3 *Business Combinations*, investors gave mixed feedback about the information provided by entities on business combinations, goodwill and impairment.

   (a) Some said the information currently provided by applying the requirements in IAS 36 *Impairment of Assets* is relevant because it has confirmatory value for users of financial statements by informing them about the performance of the acquired business after the acquisition and provides an insight into the stewardship by management of the reporting entity's economic resources.

   (b) Some said the information currently provided has limitations for one or more of the following main reasons:

      (i) impairment losses are recognised too late;

      (ii) estimates of recoverable amount are inherently very judgemental and the assumptions used in the calculations are subjective;

      (iii) disclosures are not sufficient to enable users to assess whether the main inputs/assumptions are reasonable. However, some investors said that some of the current disclosures are useful; these included discount rates used, long-term growth rates, profit and capital expenditure assumptions and sensitivities; and

      (iv) insufficient information is provided to help users understand the subsequent performance of the acquired business and whether the main targets and expected synergies of the acquisition are being achieved.

   (c) Some investors focus more on the timing of the impairment write-down and its overall magnitude than on the specific amount of impairment loss recognised.

   (d) Some said that the disclosures provided by entities applying the requirements in IFRS 3 do not provide sufficient information for investors to properly understand the effect of the acquisition on the reporting entity. For example, they said that:

(i) the qualitative description of the factors that make up the acquired goodwill is often generic and tends not to provide useful information;

(ii) it is often difficult to ascertain the total cost of an acquisition. For them it is critical to calculate the total cost including cash paid, cash acquired, debt and pension obligations assumed, fees and restructuring costs, shares and notes issued to the vendor together with any deferred consideration; and

(iii) for their trend analysis, they require clear information on the operating performance of the acquired business, specifically, revenue and operating profit over preceding periods and pro-forma prior year comparative information for the combined entity.

4. Investors appear to be particularly interested in understanding (a) the key drivers that justified the consideration paid for a business combination (and hence the amount of goodwill) and (b) whether the acquisition has been successful.

5. Preparers generally think that the existing disclosure requirements about goodwill and impairment are excessive.

6. Although disclosures were not initially included in the scope of the research on goodwill and impairment, as a result of feedback from investors during and after the PIR, the Board directed the staff to consider how information about the subsequent performance of the acquired business could be provided.

7. In past Board meetings, the staff analysed possible improvements in requirements for disclosure about business combinations, goodwill and impairment. These are summarised in the following table along with the Board's initial preference on whether to pursue the possible improvement.

Objective	***Possible changes***	***The Board's initial preference***

Objective	*Possible changes*	*The Board's initial preference*
Additional disclosures (Agenda Paper 18F for the December 2017 Board meeting)	Each year, information about the headroom[1] in a cash-generating unit (or groups of units) to which goodwill has been allocated for impairment testing	Yes
	Each year, a breakdown of goodwill by past business combination, explaining why the carrying amount of goodwill is recoverable	Yes
	In the year in which a business combination occurs, the reasons for paying a premium above the value of the net identifiable assets acquired in a business combination, together with the key assumptions or targets supporting the purchase consideration; and subsequently each year, a comparison between the actual performance and those assumptions or targets	Yes
	Disclosure of the payback period of an investment in a business combination	No
	A measure of total assets and total liabilities for each reportable segment	No
	Reviewing current disclosure requirements in IFRS 3 to determine whether the drafting of those requirements could be improved	No
	Reviewing current disclosure requirements in IAS 36 to determine whether the drafting of those requirements could be improved	No preference indicated

8. During the research project, the staff performed extensive work to understand the causes of ineffectiveness in the IAS 36 impairment testing model and to investigate ways to make the impairment test more effective at the timely recognition of impairments of goodwill.

9. Making the recognition of impairment of goodwill timelier would address some of the limitations of the information provided by the impairment test noted in paragraph 3(b).

10. In exploring whether it was feasible to make the impairment test more effective, the staff developed the headroom approach, which the Board discussed in the

[1] Any reference in this paper to disclosure of headroom should be read as disclosure of headroom in a unit (group of units) that include(s) goodwill or indefinite-lived intangible assets.

December 2017 Board meeting. This approach uses the unrecognised headroom in a cash-generating unit (or groups of units) as an additional input in testing goodwill for impairment, with the objective of removing the shielding effect of internally generated goodwill.

11. Introducing the headroom approach would be a significant change. Having assessed the costs and benefits of applying the headroom approach and having discussed the headroom approach with some of the Board's consultative bodies, the Board became concerned that many stakeholders might not consider the headroom approach feasible.

12. In the July 2018 Board meeting, based on the findings from the research project, the Board decided to pursue disclosure requirements that would aim to provide investors with information that would enable them to assess more effectively whether a business combination was a good investment and whether the acquired business is performing after the combination as expected.

Summary of the recent feedback from the ASAF

13. The staff sought feedback from the ASAF at its July 2018 meeting about:

    (a) possible improvements to the current disclosure requirements that the Board had tentatively decided to consider, see paragraph 7; and

    (b) additional possible improvements to the current disclosure requirements for business combinations, goodwill and impairment the staff were considering as follows:

        (i) the amount of revenue and operating profit of the acquired business during the financial year in which the business combination occurred and the first two full financial years post business combination;

        (ii) information about debt assumed in the business combination;

        (iii) the effective tax rate on the underlying operating profit of the acquired business;

        (iv) disclosure of indicators that triggered the quantitative impairment test;

(v) improvements to the disclosure requirements in IFRS 8 *Operating Segments*; and

(vi) disclosure of total net assets, less goodwill.

14. In addition, ASAF members were asked for suggestions of other possible improvements to the current disclosure requirements for business combinations, goodwill and impairment.

15. Most ASAF members agreed with the need for improving disclosures about business combinations, goodwill and impairment although they expressed mixed views about the approaches that the Board tentatively decided to consider as set out in paragraph 7.

16. Several ASAF members were generally supportive of the disclosure of the reasons for payment of premium together with the key assumptions or targets supporting the purchase consideration and, subsequently, a comparison between the actual performance and those targets or assumptions. However, concerns were also expressed that:

(a) this information could be commercially sensitive, which may lead to entities providing only boilerplate information;

(b) tracking acquisitions would be difficult and costly if the acquired business has been integrated into the acquirer's other businesses; and

(c) verification of the information may be difficult.

17. One member commented that it is more appropriate to disclose such information in the management commentary rather than in the notes to the financial statements. Another member suggested that the objective of providing information on the acquisition and its subsequent performance could be met in a number of ways depending on the facts and circumstances of different acquisitions.

18. Most ASAF members generally did not support disclosing a breakdown of goodwill by past acquisition, expressing concerns on the ability of entities to track goodwill by past acquisition if the acquired businesses have been integrated with existing businesses, the costs involved and the usefulness of the information provided.

19. However, some ASAF members thought that this breakdown, along with information on the estimated payback period, could provide useful information.

20. Most ASAF members did not support disclosing headroom each year, mainly because it might mean disclosing the value of a segment or whole entity and they thought this information would be sensitive.

21. Of the additional possible improvements that the staff were considering, some ASAF members commented that:

    (a) disclosing the revenue and operating profit of the acquired business could be misleading if it ignored synergies achieved in other parts of the business and it may be difficult to obtain the information if the acquirer has integrated the acquired business;

    (b) the disclosure of total net assets less goodwill is not necessary because the information is readily available for investors; and

    (c) further work should be performed on providing the disclosures at operating segment level rather than at the level of individual acquisitions.

22. Possible improvements to disclosures suggested by members were as follows:

    (a) disclosure of the changes in the business environment or management strategy affecting management's estimates of value in use;

    (b) disclosure of the reason why an entity has chosen a particular assumption in determining recoverable amount, for example a growth rate or discount rate, as well as the assumption chosen;

    (c) a disclosure based on concepts similar to the subsequent cash flow test used in former UK Standard FRS 11 *Impairment of Fixed Assets and Goodwill*, which required that for five years following each impairment test for goodwill the actual cash flows achieved are compared with those forecasts;

    (d) disclosure of how an acquired business is to be integrated with the existing business; and

    (e) disclosure of the payback period of the acquisition.

23. The feedback from the ASAF will be incorporated into the staff's consideration of the possible improvements to disclosures and whether to develop any of the ideas in paragraph 13(b) further.

Further work to be performed to identify better disclosures

Disclosures about business combinations and their subsequent performance

24. As discussed in paragraph 12, the Board decided in the July 2018 Board meeting to explore improving disclosures that would enable investors to assess more effectively:

    (a) whether a business combination is a good investment decision; and

    (b) whether the acquired business is performing after the combination as expected.

25. The staff believe that the improvement identified in paragraph 24(a) can be achieved by meeting the existing disclosure objectives in IFRS 3 and making targeted improvements to the related disclosure requirements. The existing disclosure objectives in IFRS 3 are to provide information that enables users of the financial statements:

    (a) to evaluate the nature and financial effect of a business combination that occurs during the current reporting period or after the end of the reporting period but before the financial statements are authorised for issue (paragraph 59 of IFRS 3); and

    (b) to evaluate the financial effects of adjustments recognised in the current reporting period related to business combinations that occurred in the period or previous reporting periods (paragraph 61 of IFRS 3).

26. The improvement identified in paragraph 24(b), providing information to help investors understand the subsequent performance of the acquired business, would require adding a new disclosure objective to IFRS 3.

27. The Board has already considered one possible new disclosure requirement that could contribute to meeting that objective, namely a requirement to disclose:

(a) in the year in which a business combination occurs, the reasons for paying a premium that exceeds the fair value of the net identifiable assets acquired in the business combination, together with the key assumptions or targets supporting the purchase consideration; and

(b) subsequently each year, a comparison between the actual performance and those assumptions or targets.

28. As noted in paragraph 16, ASAF members were generally supportive of this disclosure requirement although concerns were also expressed that the information could be commercially sensitive, difficult and costly to produce if the acquired business had been integrated into the acquirer's other businesses and difficult to verify.

29. The staff intend to:

(a) develop an additional disclosure objective to provide information to help investors understand the subsequent performance of the acquired business;

(b) develop additional disclosure requirements to meet that additional disclosure objective; and

(c) review the existing requirements of IFRS 3 in conjunction with the feedback from the PIR and recommend targeted improvements that contribute to achieving the research objective set at the July 2018 Board meeting to provide information to help investors assess whether a business combination is a good investment decision.

30. To make the changes highlighted in paragraph 29 the staff think the best approach would be to redraft the disclosure objectives and requirements in IFRS 3 to ensure, for example, that all new and existing disclosure requirements are linked to the revised disclosure objectives.

31. In developing the requirements identified in paragraph 29(b) the staff will consider the relative merits of two approaches:

(a) requiring an entity to meet specific disclosure requirements within the Standard; or

(b) requiring an entity to disclose the information that the entity's management uses to monitor and measure the success of an acquisition for internal reporting purposes.

32. The staff will consider whether these approaches may address some of the concerns raised by ASAF members and whether this would assist entities in providing information about acquisitions with different facts and circumstances.

33. The staff plan to conduct further research and outreach to help develop these new disclosure objectives and related disclosure requirements. For example, the staff plan to:

(a) conduct targeted outreach with selected preparers and auditors in October 2018 to obtain an understanding of the types of information an entity might feel it would need to disclose applying the new disclosure objective; and

(b) seek feedback on the staff's thinking from the November 2018 meetings of the Capital Market Advisory Committee and Global Preparers Forum.

34. At the December 2017 Board meeting, the Board tentatively decided not to review the existing disclosure requirements in IFRS 3 to determine whether the drafting of those requirements could be improved. However, as described in paragraph 29(c), following the decisions taken in the July 2018 Board meeting, the staff will review the feedback received during and after the PIR to identify improvements to the existing disclosure requirements in IFRS 3 that could help to address the research objective set in paragraph 12.

35. Based on past Board discussions, the staff will explore improvements to the disclosure objectives and requirements only to the extent needed to meet the research objective set in paragraph 12 rather than to perform a complete review of all the disclosure objectives and requirements of IFRS 3.

Disclosures about goodwill and impairment

36. At the December 2017 Board meeting, the Board tentatively decided to pursue disclosure of:

(a) headroom on an annual basis in a cash-generating unit (or group of units) to which goodwill has been allocated for impairment testing; and

(b) breakdown of goodwill by past business combination, explaining why the carrying amount of goodwill is recoverable.

37. The staff intend to review possible improvements to the disclosure requirements in IAS 36 that have already been discussed by the Board and also those possible improvements that the staff have developed in response to feedback and suggestions from stakeholders during and after the PIR of IFRS 3, to determine whether any of these possible improvements can help meet the research objective set in paragraph 12.

38. In addition, because the feedback from the PIR on IFRS 3 and subsequent outreach provided some evidence that the current disclosure requirements in IAS 36 may not always be properly applied in practice, the current disclosure requirements in IAS 36 could be reviewed to determine whether any of those requirements should be modified or removed.

39. Nevertheless, the research objective set in paragraph 12 does not include exploring whether to amend the disclosure requirements in IAS 36 to provide investors with additional information about the impairment test. Thus, the staff do not plan to analyse whether any changes beyond those identified in paragraph 37 should be made to the disclosure requirements in IAS 36.

Next steps

40. At a future meeting, the staff will present a more detailed analysis of possible improvements to the disclosure objectives and requirements of IFRS 3 and IAS 36 following the completion of the additional work outlined in this paper. See Agenda Paper 18A for further details.

Questions for the Board
1. Does the Board have any comments or suggestions on the additional work detailed in

paragraphs 29 to 30, 33 to 34 and 37 to be performed to achieve the objective of identifying better disclosures about business combinations, goodwill and impairment?

2. Does the Board agree not to expand the research objective to perform a complete review of the disclosure objectives and requirements of:

   a. IFRS 3; and

   b. IAS 36?