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

Business Combinations—Disclosures, Goodwill and Impairment
30 April 2024

IFRS® Accounting

# Business Combinations—Disclosures, Goodwill and Impairment

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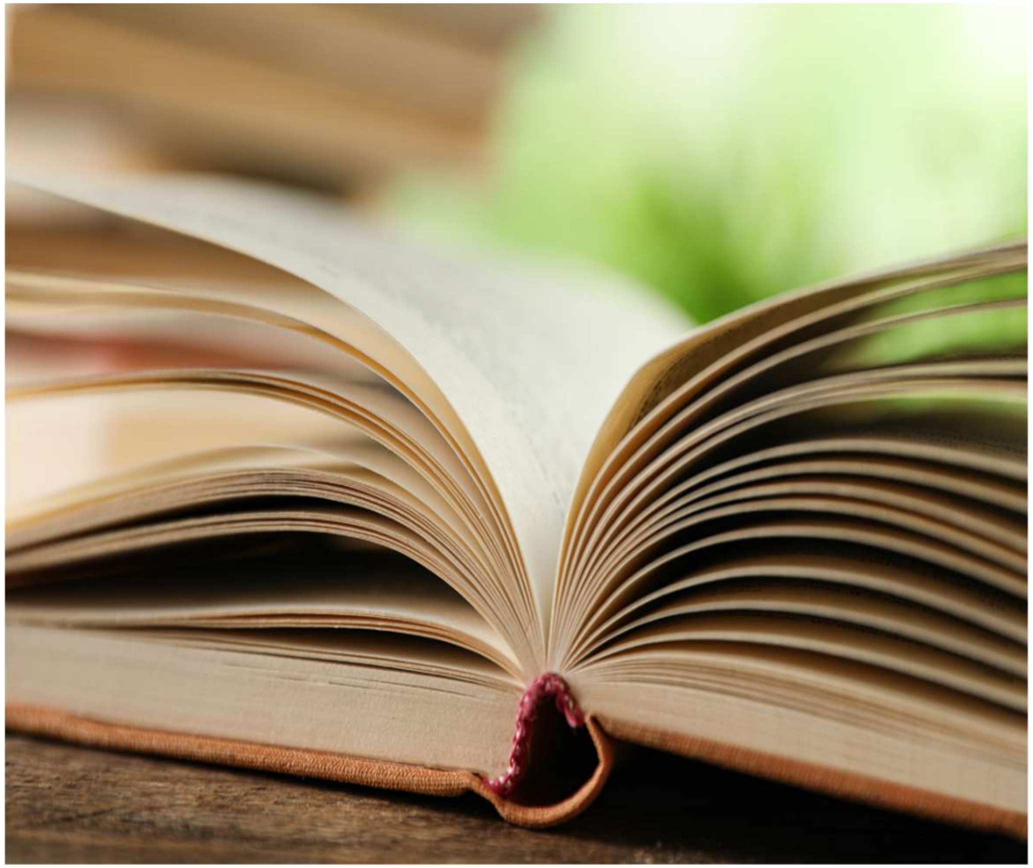
IFRS Accounting

# 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

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# 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[1]

**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

[1] Looking Back at M&A in 2023: Who Wins in a Down Year? | Bain & Company

IFRS Accounting

# 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

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# Improving disclosures about business combinations

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# Key disclosure proposals

Performance of business combinations

Quantitative information about expected synergies

Exemption

# Stakeholder feedback leading to proposals

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

Investors

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

Companies should not be required to disclose this information in financial statements.

Preparers

## 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 | Additional disclosures for strategic business combinations |
|---|---|---|
| **As at acquisition date** | **Expected synergies**<br>• Exemption - YES<br><br>**Strategic rationale**<br>• Exemption - NO | **Key objectives and targets**<br>• Exemption - YES |
| **After acquisition date** | | **Performance - actuals**<br>• Exemption - NO<br><br>**Performance – statement**<br>• Exemption - YES |

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# Business Combinations—Disclosures, Goodwill and Impairment

EFRAG Presentation

30 April 2024

Didrik Thrane-Nielsen and Ioanna Michailidi

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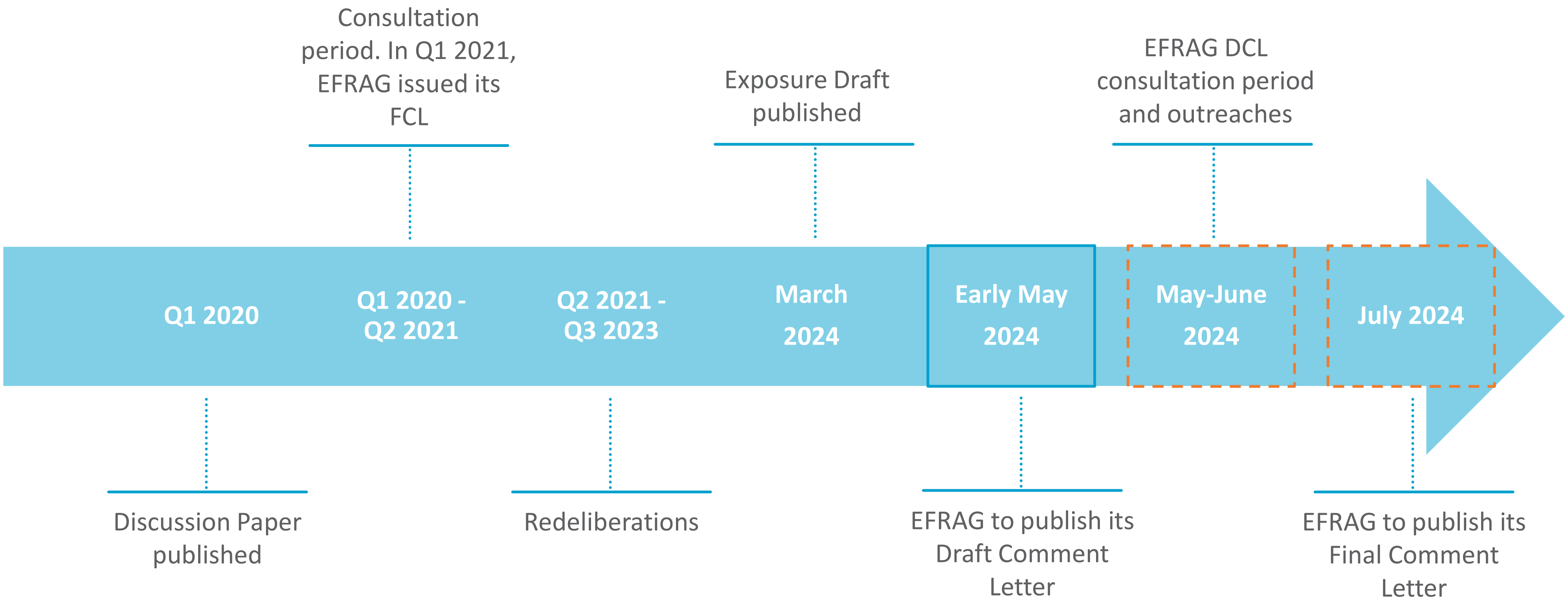
The views expressed in this presentation are those of the presenter, except where indicated otherwise. EFRAG positions, as approved by the EFRAG FRB, are published as comment letters, discussion or position papers, or in any other form considered appropriate in the circumstances

# 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



Consultation period. In Q1 2021, EFRAG issued its FCL
Exposure Draft published
EFRAG DCL consultation period and outreaches
Q1 2020
Q1 2020 - Q2 2021
Q2 2021 - Q3 2023
March 2024
Early May 2024
May-June 2024
July 2024
Discussion Paper published
Redeliberations
EFRAG to publish its Draft Comment Letter
EFRAG to publish its Final Comment Letter

# 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

IASB PROPOSALS

- 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)

EFRAG PRELIMINARY VIEW

- 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)

FEEDBACK REQUIRED

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

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# THANK YOU

EFRAG
Financial reporting

Otto Beisheim School of Management

# The IASB's Exposure Draft *Business Combinations – Disclosures, Goodwill and Impairment* – Academic perspective

EAA–IASB Virtual Research Workshop
30 April 2024

Excellence in
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# The IASB‘s Business Combinations Project – Background, Process

# The IASB's Business Combinations Project – Background, Process

- 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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- **2018, FASB goodwill accounting project**
  **Dec. 2020, FASB tentatively decides to reintroduce amortisation**

## The IASB‘s Business Combinations Project – Background, Process

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Otto Beisheim School of Management

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  - no re-introduction of amortization
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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**

# The IASB's Business Combinations Project – Background, Process

**- -  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

# 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

  - - 2017, Discussion Paper “Principles of Disclosure”

  - - 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 (***<u>see next part</u>***) 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
    e.g., Aboody JAR 1996, Davis-Friday et al. TAR 1999, Espahbodi et al. JAE 2002, Barth et al. JAR 2003, Ahmed et al. TAR 2006, Jifri & Citron EAR 2009, Yu TAR 2013, Bratten et al. TAR 2013, Israeli RAST 2015, Müller et al TAR 2015 Michels JAR 2017
  - - Experimental studies
    e.g., Hirst & Hopkins 1998, Hodge et al. TAR 2004, Hirst et al. TAR 2004, Gaynor AOS 2011, Chlor-Proell & Maines JAR 2014, Leitter et al. SSRN 2023

# 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
  - \- - Managerial compensation, e.g., Lo JAE 2003, Craighead et al. CAR 2004, Robinson et al. TAR 2011, Frantz et al. JBFA 2013, Jiang et al JAAF 2018, Wang et al. JAAF 2020, Gipper JAE 2021

University of Glasgow

Adam Smith Business School

# Business Combinations—Disclosures, Goodwill and Impairment Proposed amendments to IFRS 3 and IAS 36

EAA-IASB Visual Workshop, 30 April 2024,

Yannis Tsalavoutas


AACSB ACCREDITED

ASSOCIATION OF MBAS ACCREDITED

EQUIS ACCREDITED

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# 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*

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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

PS, 2023, p.4.

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.12.

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# Key takeaways in the Project Summary and Feedback Statement regarding *Exposure Draft Disclosure Requirements in IFRS Standards—A Pilot Approach*

IASB's response to feedback & way forward

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

**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.

- 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

# Making Materiality Judgements PS2

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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).

- The 10% threshold arguably contradicts these
- The justification for a threshold in BC67 arguably contradicts these
- IFRS 8 precedes the PS

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.*

- 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

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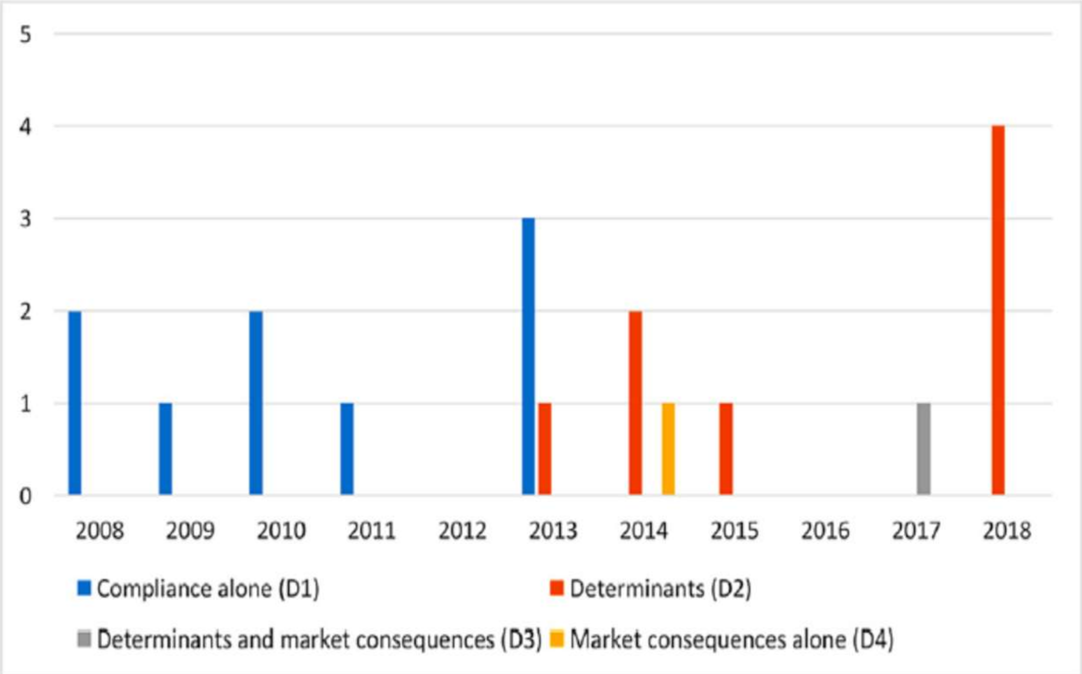


**Fig. 6.** Number of studies focusing on *Goodwill and goodwill impairment testing* (E2) by research question and publication year.

*I. Tsalavoutas, F. Tsoligkas and L. Evans / Journal of International Accounting, Auditing and Taxation 40 (2020) 100338*

- 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)

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# 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[a].

| Paragraph | Sub-paragraph | # Firms applicable (*N*) | % Firms that comply |
|---|---|---|---|
| *68 (before revision) – B65 (after revision)* For individually immaterial business combinations occurring during the reporting period that are material collectively, the acquirer shall disclose in aggregate the information required by paragraph B64(e)–(q). | | | |
| | *68-f (before revision) – B65-i (after revision)* the amounts recognised as of the acquisition date for each major class of assets acquired and liabilities assumed. | 537 | 65.4 |
| | *68-h (before revision)* a description of the factors that contributed to a cost that results in the recognition of goodwill – a description of each intangible asset that was not recognised separately from goodwill and an explanation of why the intangible asset's fair value could not be measured reliably | 270 | 9.1 |
| | *B65-e (after revision)* 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 | 251 | 51.8 |

Mazzi, F., André, P., Dionysiou, D., & Tsalavoutas, I. (2017). Compliance with goodwill-related mandatory disclosure requirements and the cost of equity capital. Accounting and Business Research, 47(3), 268-312.

**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**

| IFRS 3 |
|---|
| B64 (sub d) – mean compliance 55% |
| The primary reasons for business combination and a description of how the acquirer obtained control of the acquiree. |
| B64 (sub e) – mean compliance 78% |
| 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. |
| B64 (sub h) – mean compliance 36% |
| For acquired receivables: (i) the fair value of the receivables; (ii) the gross contractual amounts receivable; and (iii) the best estimate at the acquisition date of the contractual cash flows not expected to be collected. The disclosures shall be provided by major class of receivable, such as loans, direct finance leases and any other class of receivables. |
| B64 (sub q) – mean compliance 71% |
| The following information: (i) the amounts of revenue and profit or loss of the acquiree since the acquisition date included in the consolidated statement of comprehensive income for the reporting period; and (ii) the revenue and profit or loss of the combined entity for the current reporting period as though the acquisition date for all business combinations that occurred during the year had been as of the beginning of the annual reporting period. |
| B65/B64 (referring to individually immaterial business combinations occurring during the reporting period that are material collectively)(subh) – mean compliance 41% |
| For acquired receivables: (i) the fair value of the receivables; (ii) the gross contractual amounts receivable; and (iii) the best estimate at the acquisition date of the contractual cash flows not expected to be collected. The disclosures shall be provided by major class of receivable, such as loans, direct finance leases and any other class of receivables. |

Tsalavoutas, I., André, P., & Dionysiou, D. (2014). Worldwide application of IFRS 3, IAS 38 and IAS 36, related disclosures, and determinants of non-compliance. ACCA research report, 134.

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

B64 ~~To meet the objective in paragraph 59, the~~ 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.

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

## Strategic business combinations

*Newly introduced requirements*

B67A The acquirer shall disclose the information described in this paragraph for each strategic business combination (see paragraph B67C). The information to be disclosed is the information reviewed by the acquirer's key management personnel (as defined in IAS 24 *Related Party Disclosures*). The acquirer shall disclose:

(a) in the year of acquisition, the acquisition-date *key objectives* and the related *targets*. Targets can be disclosed as a range or as a point estimate.

(b) in the year of acquisition and in each subsequent reporting period, the extent to which the acquisition-date key objectives and the related targets are being met. This information shall include:

(i) information about actual performance being reviewed to determine whether acquisition-date key objectives and the related targets are being met; and

(ii) a statement of whether actual performance is meeting or has met the acquisition-date key objectives and related targets.

*Deal synergies are typically uncertain, difficult to forecast, and re... detailed ... of the... ker's merger with Compaq).*
Dasgupta et al., (2024 p. 522)

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.

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

| Paragraph | Sub-paragraph | # Firms applicable (N) | % Firms that comply |
|---|---|---|---|
| *134* An entity shall disclose the information required by (a)–(f) for each CGU (group of units) for which the carrying amount of goodwill or intangible assets with indefinite useful lives allocated to that unit (group of units) is significant in comparison with the entity's total carrying amount of goodwill or intangible assets with indefinite useful lives | *134-d* if the unit's (group of units') recoverable amount is based on value in use | | |
| | *134-d-ii* a description of management's approach to determining the value(s) assigned to each key assumption, whether those value(s) reflect past experience or, if appropriate, are consistent with external sources of information, and, if not, how and why they differ from past experience or external sources of information | 771 | 61.4 |
| | *134-d-i* a description of each key assumption on which management has based its cash flow projections for the period covered by the most recent budgets/forecasts. Key assumptions are those to which the unit's (group of units') recoverable amount is most sensitive | 771 | 71.2 |

Food for thought: *Is "management" the same as "key management personnel"?*

Mazzi, F., André, P., Dionysiou, D., & Tsalavoutas, I. (2017). Compliance with goodwill-related mandatory disclosure requirements and the cost of equity capital. Accounting and Business Research, 47(3), 268-312.

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# 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[a].

| Paragraph | Sub-paragraph | # Firms applicable (N) | % Firms that comply |
|---|---|---|---|
| *129* An entity that reports segment information in accordance with IFRS 8 shall disclose the following for each reportable segment | *129-a* the amount of impairment losses recognised in profit or loss and in other comprehensive income during the period | 248 | 70.8 |
| *131* An entity shall disclose the following information for the aggregate impairment losses recognised during the period for which no information is disclosed in accordance with paragraph 130 | *131-b* the main events and circumstances that led to the recognition of these impairment losses | 177 | 39.0 |
| *134* An entity shall disclose the information required by (a)–(f) for each CGU (group of units) for which the carrying amount of goodwill or intangible assets with indefinite useful lives allocated to that unit (group of units) is significant in comparison with the entity's total carrying amount of goodwill or intangible assets with indefinite useful lives | *134-e* if the unit's (group of units') recoverable amount is based on fair value less costs to sell, the methodology used to determine fair value less costs to sell. If fair value less costs to sell is not determined using an observable market price for the unit (group of units), the following information shall also be disclosed: | | |
| | *134-e-ii* a description of management's approach to determining the value (or values) assigned to each key assumption, whether those values reflect past experience or, if appropriate, are consistent with external sources of information, and, if not, how and why they differ from past experience or external sources of information | 133 | 58.3 |

Mazzi, F., André, P., Dionysiou, D., & Tsalavoutas, I. (2017). Compliance with goodwill-related mandatory disclosure requirements and the cost of equity capital. Accounting and Business Research, 47(3), 268-312.

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## 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?

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# 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 valu-ation?

•Share price effect?

•Financial state-ment 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:**

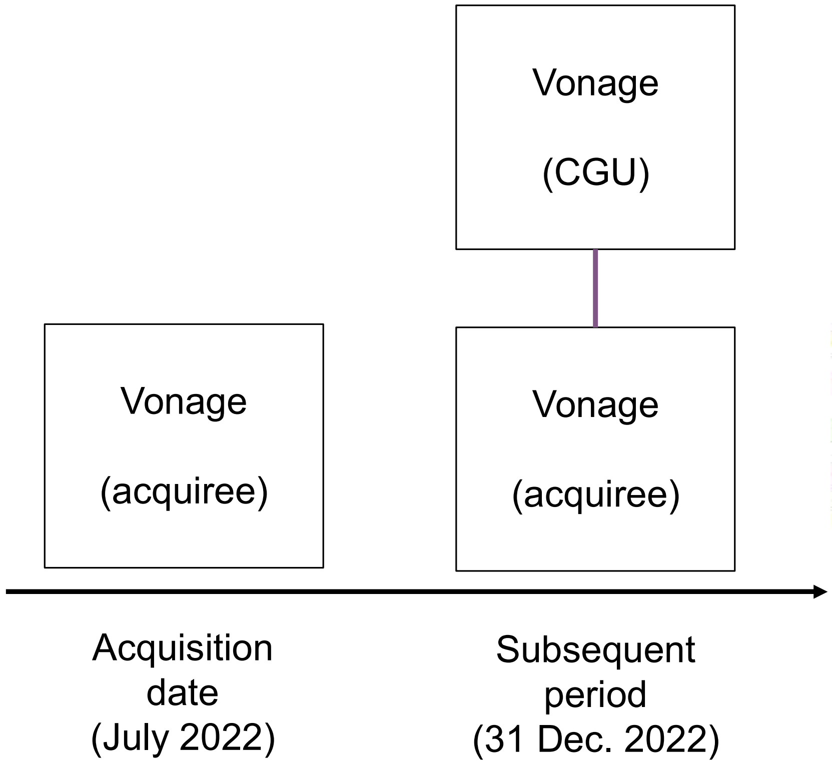
  **-Networks** [SEK 28.5 (25.8) billion],

  **-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)




- The acquiree and the CGU are the same.
- The impairment test will serve the purpose of evaluating the success of the acquisition.

<u>Goodwill impairment test</u>

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.

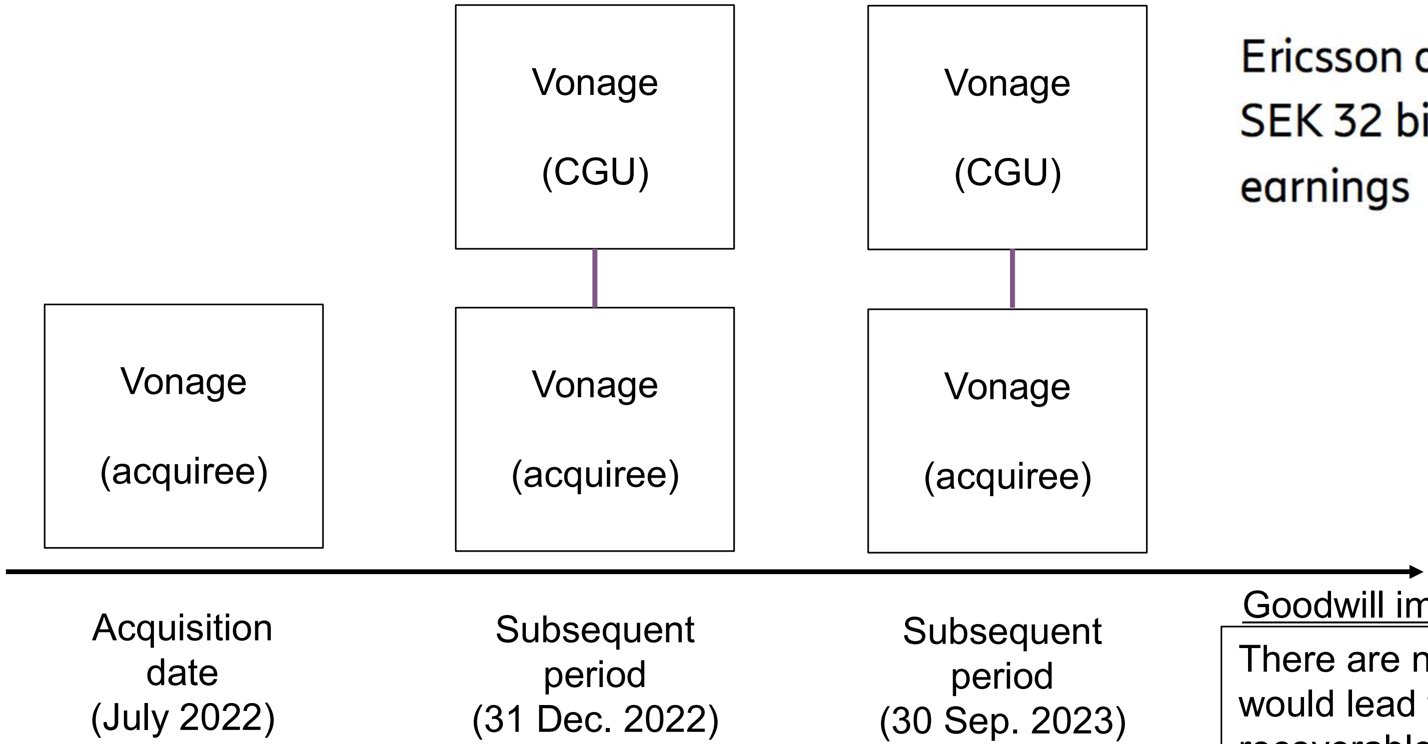
The growth rates after the forecast period have increased this year as a result of the increase in risk-free rates. All CGUs use a nominal annual growth rate of 2.0% (1.5%) per year after the forecast period, except Vonage which uses a rate of 3.5%. The higher rate for Vonage is due to the higher risk-free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

| Post-tax discount rates (%) | |
|---|---|
| CGU | 2022 |
| Vonage | 9.5 |

- The preparer provides adequate disclosures that users can use to evaluate the success of the acquisition.

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.

# AN ACQUISITION EXAMPLE (3)




- 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.

Contents lists available at ScienceDirect

Journal of International Accounting, Auditing and Taxation

# The goodwill impairment test under IFRS: Objective, effectiveness and alternative approaches

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Available online 8 July 2023



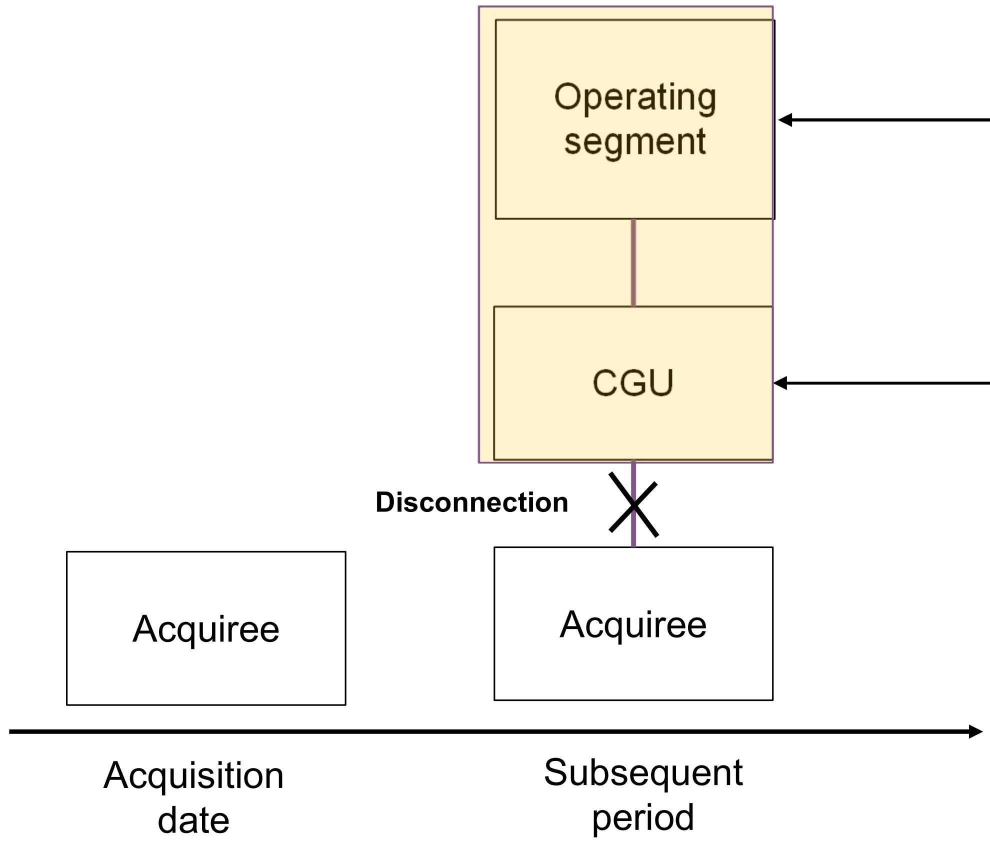
A R T I C L E  I N F O

*Keywords:*
Goodwill
Acquisition
Impairment
Impairment-test effectiveness
Pre-acquisition headroom
IFRS

A B S T R A C T

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

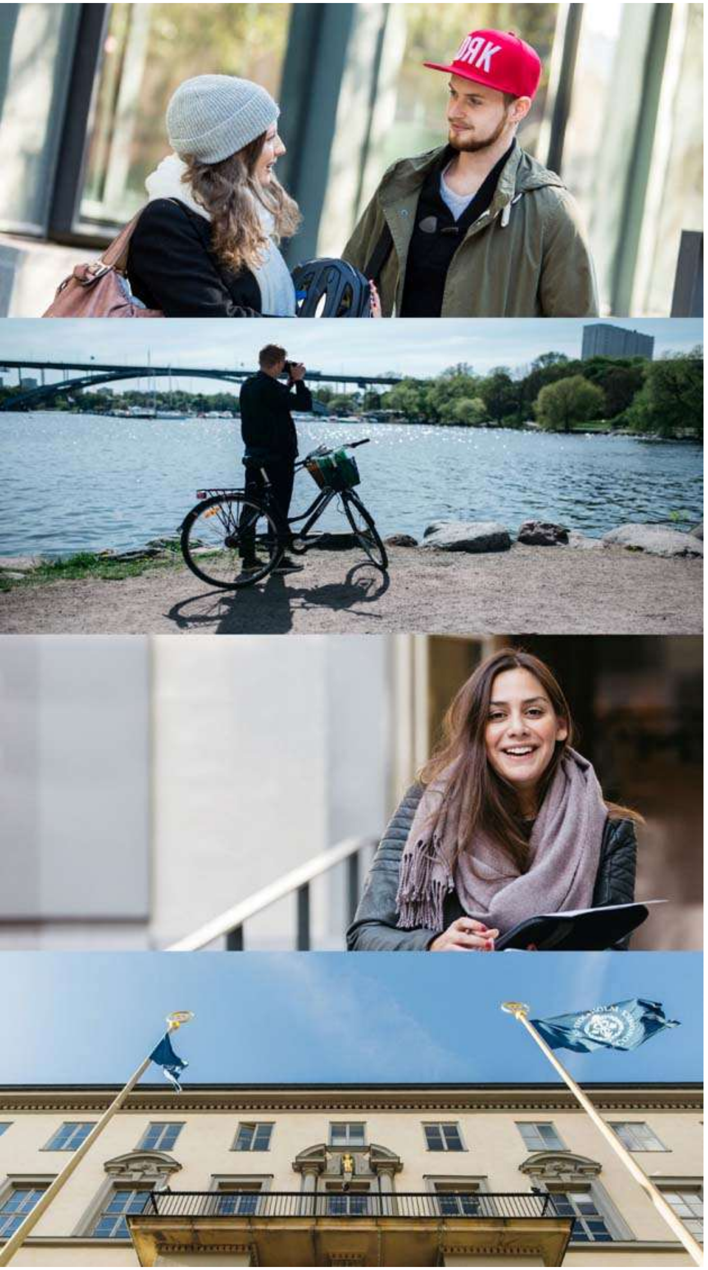



Entities may be aggregated so that operating segments become the CGUs (or group of CGUs) subject to impairment tests

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).

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IFRS 8

Operating Segments

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**.

Main source: Aboud, A. (2023) Segmental reporting, accounting enforcement, and analyst dispersion in the European Union. *Journal of International Accounting, Auditing and Taxation*, 53, 1-10

The International Journal of Accounting 51 (2016) 443–461

# Segment Disclosure Quantity and Quality under IFRS 8: Determinants and the Effect on Financial Analysts' Earnings Forecast Errors☆

Paul André[a], Andrei Filip[b], Rucsandra Moldovan[c,*]

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.

270 multi-segment European firms applying IFRS 8 that report non-geographical segments

**Table 2**

Panel B: Distribution of sample into groups based on *SRQl* and *SRQt*

| | | *SRQt* | | | |
|---|---|---|---|---|---|
| | | *Over-disclosers* | *Box-tickers* | *Under-disclosers* | **Total** |
| *SRQl* | *HighQl* | 22 (8.15%) | 31 (11.48%) | 15 (5.56%) | **68 (25.19%)** |
| | *AvgQl* | 39 (14.44%) | 66 (24.44%) | 30 (11.11%) | **135 (50.00%)** |
| | *LowQl* | 14 (5.19%) | 35 (12.96%) | 18 (6.67%) | **67 (24.81%)** |
| | **Total** | **75 (27.78%)** | **132 (48.89%)** | **63 (23.33%)** | **270 (100%)** |

This table presents the sample distribution into groups of *SRQt*, i.e., *Over-disclosers*, *Box-tickers*, and *Under-disclosers* against *SRQl*, i.e., *High*, *Avg*, and *LowQl* (percent of total sample in brackets). The sample contains 270 firm observations. Companies are split into groups based on whether their values for *SRQt* and *SRQl* 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.

Main source: Aboud, A. (2023) Segmental reporting, accounting enforcement, and analyst dispersion in the European Union. *Journal of International Accounting, Auditing and Taxation*, 53, 1-10

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# 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).

Main source: Aboud, A. (2023) Segmental reporting, accounting enforcement, and analyst dispersion in the European Union. *Journal of International Accounting, Auditing and Taxation*, 53, 1-10

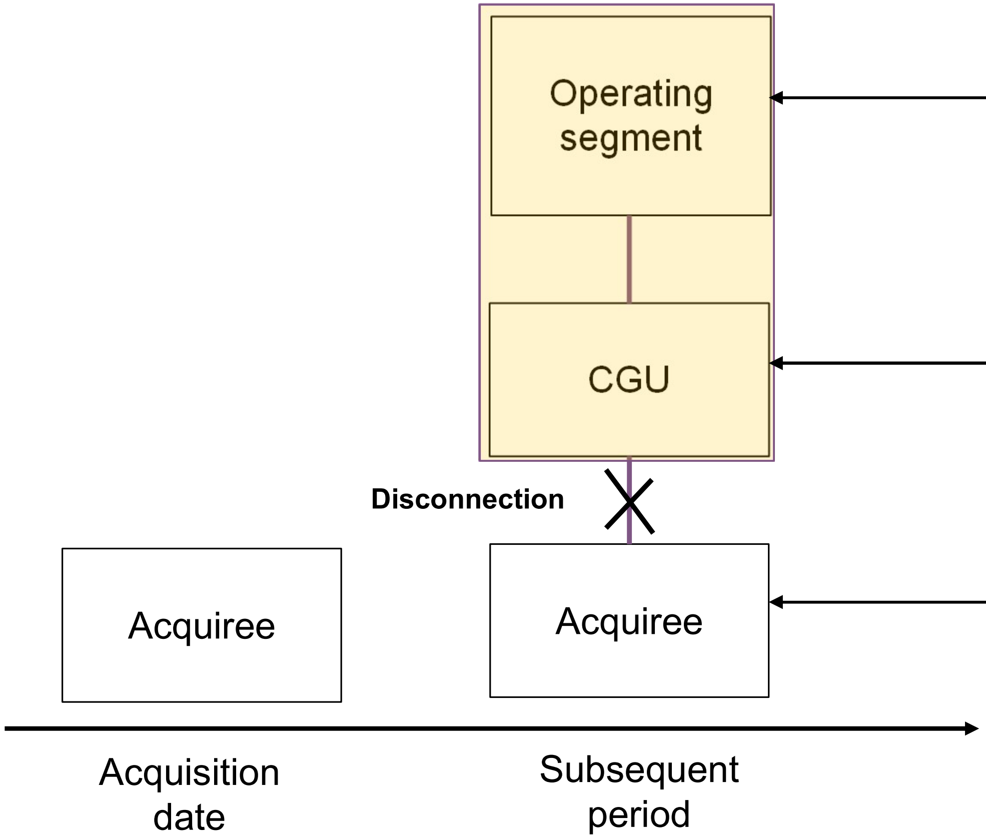
# IFRS 8–NON-IFRS NUMBERS

Source: Göttsche, M., Küster, S., & Steindl, T. (2021) The usefulness of non-IFRS segment data. *Journal of International Accounting, Auditing and Taxation*, 43, 1-21

- 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?

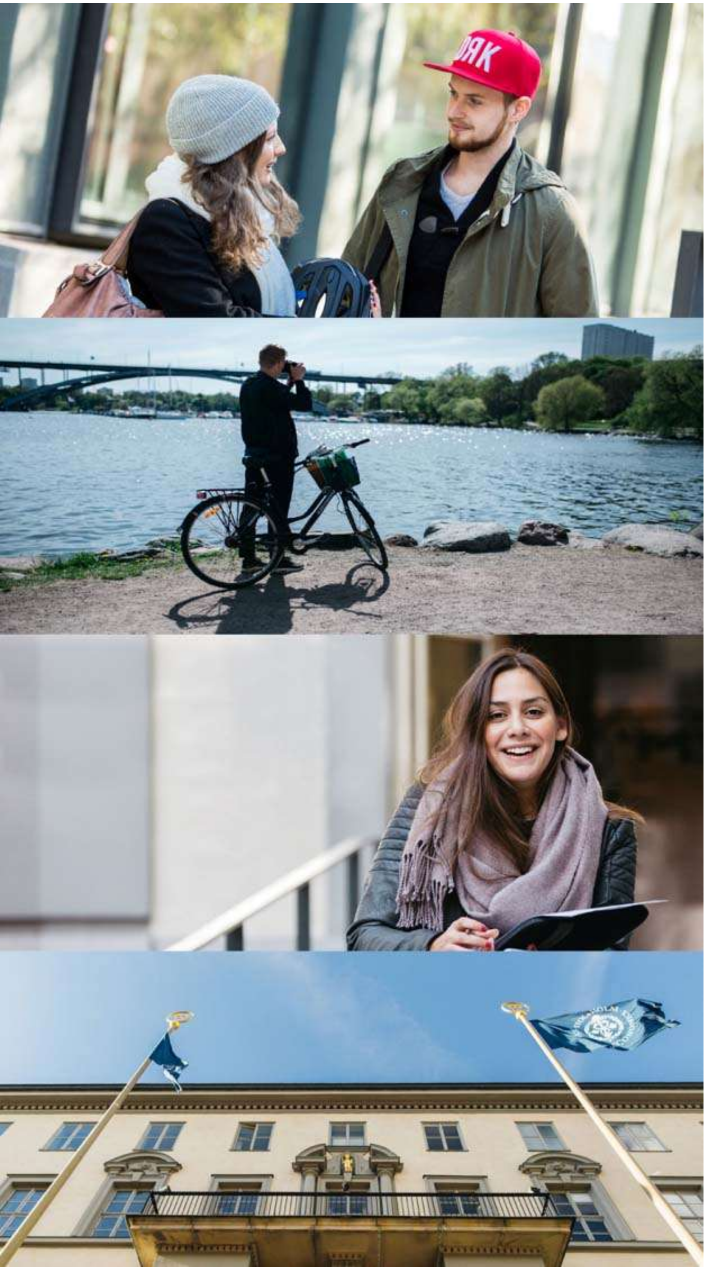



**Chief Operating Decision Maker** (IFRS 8)
The CODM identifies a function, not necessarily a manager with a specific title. That function is to **allocate resources to and assess the performance** of the operating segments of an entity.

**'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

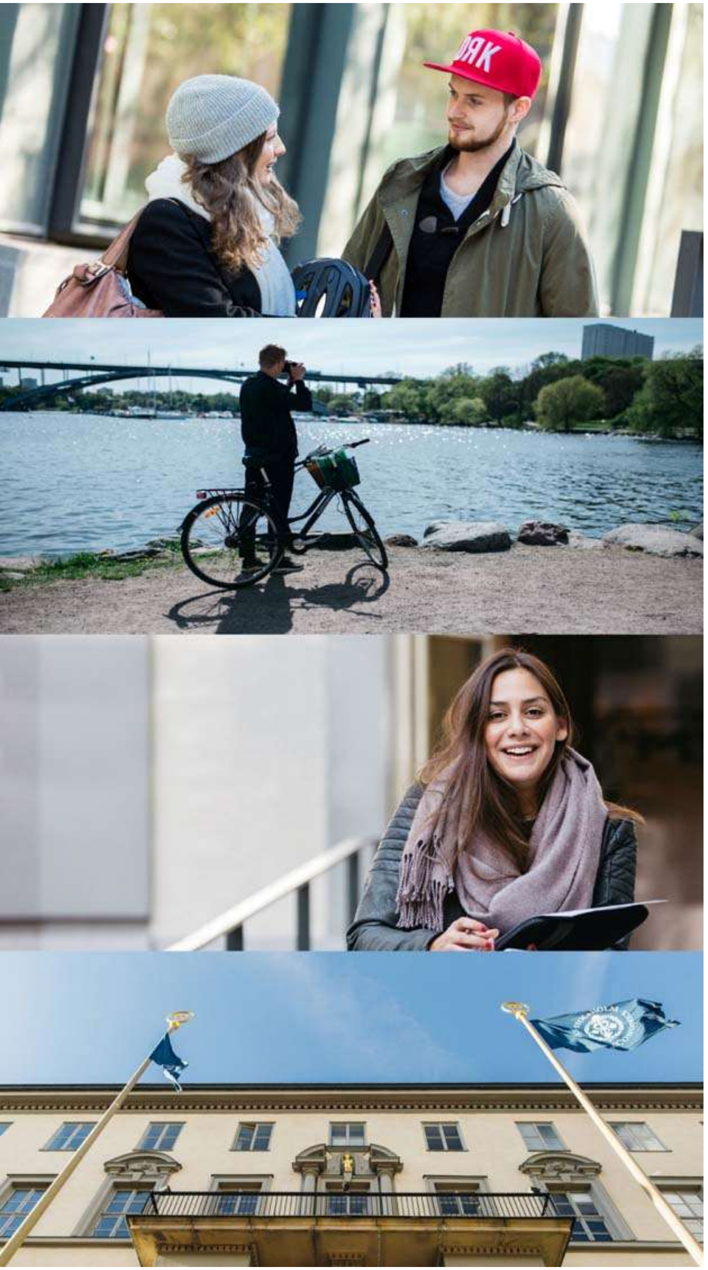
Source: Ammar, S. and Mardini, G. H. (2021) Enterprise resource planning enabling segmental information reporting practices of UK-FTSE 100. *Accounting and Finance*, 61, 1205-1237

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

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

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.

- 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%).



## 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.

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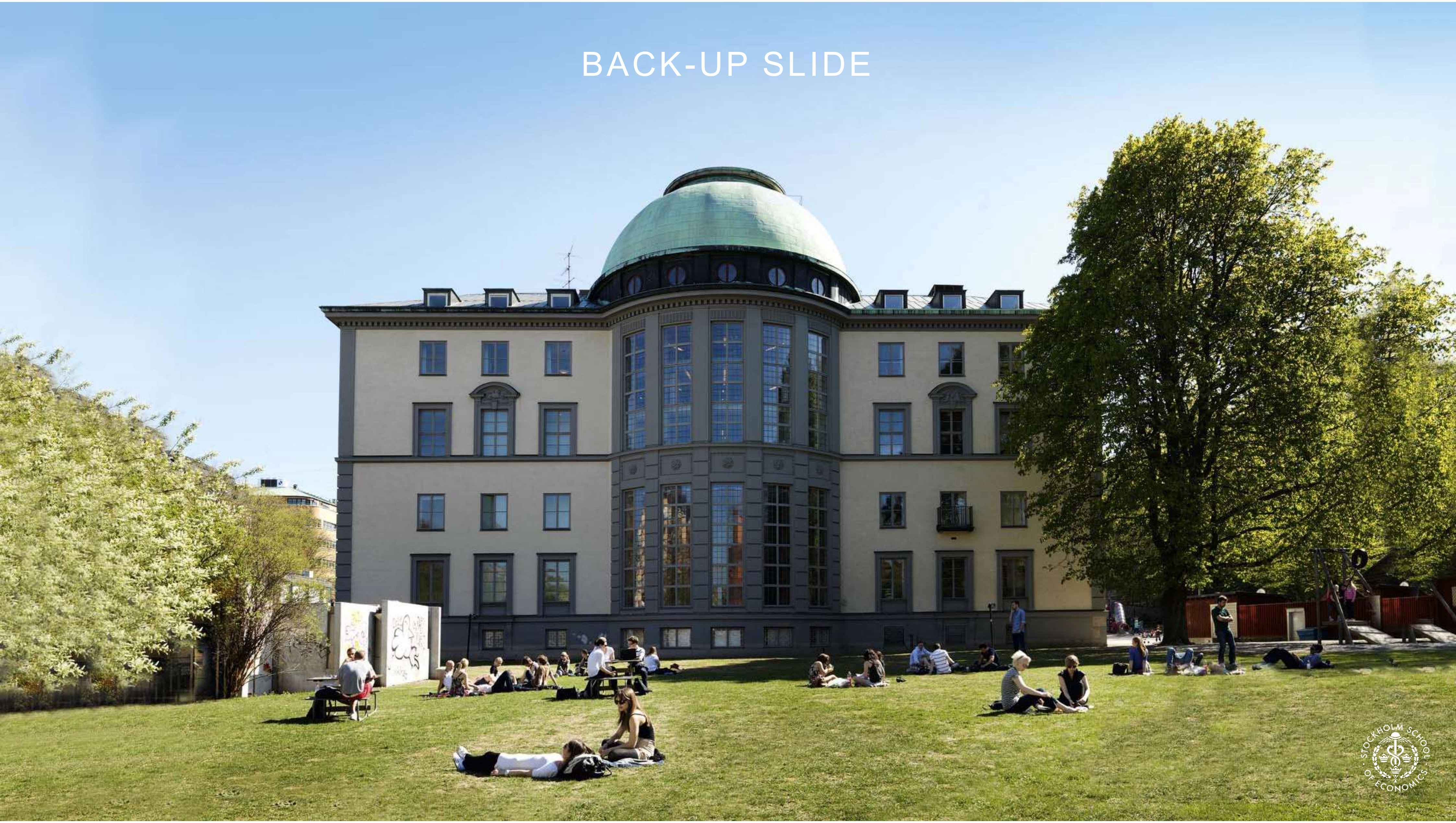
BACK-UP SLIDE
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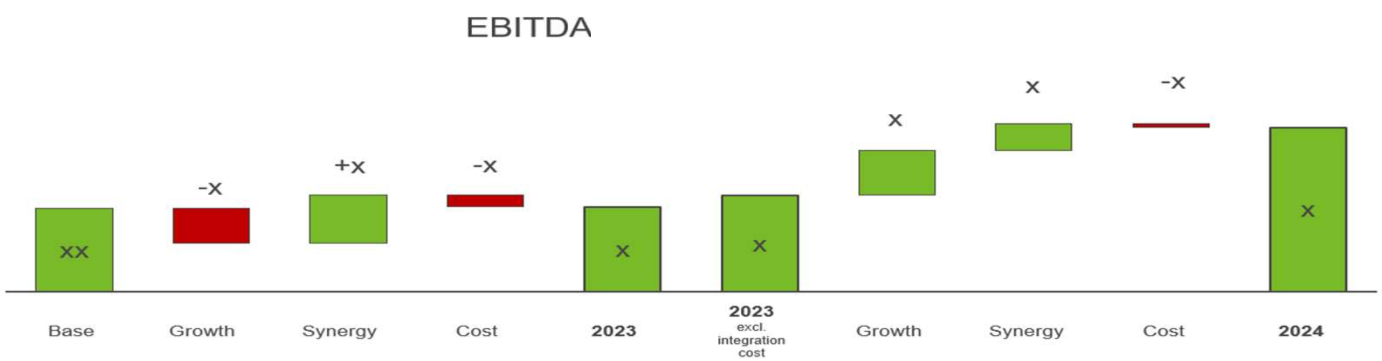
# DO COMPANIES FOLLOW UP ACQUIRED FIRMS AT THE ACQUIREE LEVEL?

- Stylized example from a listed company's acquisition of a relatively small acquiree.

## Integration on track with the business case




| | Growth | Synergy | Cost | 2023 | 2023 excl. integration cost | Growth | Synergy | Cost | 2024 |
|---|---|---|---|---|---|---|---|---|---|
| Business Case | +x | +x | -x | **x** | x | +x | +x | -x | **x** |
| Actual / LE (annualized) | -x | +x | -x | **x** | x | +x | +x | -x | **x** |
| Difference | -x | +x | +x | **-x** | -x | +x | +x | +x | **-x** |