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Exposure Draft

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Basis for Conclusions on Business Combinations—Disclosures, Goodwill and Impairment

Proposed amendments to IFRS 3 and IAS 36

Comments to be received by 15 July 2024

International Accounting Standards Board

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Basis for Conclusions on Exposure Draft *Business Combinations—Disclosures, Goodwill and Impairment*

This Basis for Conclusions accompanies, but is not part of, Exposure Draft Business Combinations—Disclosures, Goodwill and Impairment. *It summarises the considerations of the International Accounting Standards Board (IASB) when developing the Exposure Draft. Individual IASB members gave greater weight to some factors than to others.*

Introduction

BC1 The Exposure Draft sets out proposals to amend IFRS 3 *Business Combinations* and IAS 36 *Impairment of Assets*. The proposals cover the disclosure requirements in IFRS 3 and the requirements for the impairment test of cash-generating units (CGUs) containing goodwill in IAS 36. This package of proposals is expected to provide users of financial statements (users) with more useful information, at a reasonable cost, about an entity's business combinations. In particular:

(a) the proposed new disclosure requirements in IFRS 3 would require an entity to disclose information to allow users to make a better assessment of the success of a business combination; and

(b) the proposed amendments to IAS 36 are intended to improve the effectiveness of the impairment test of CGUs containing goodwill and to reduce the cost and complexity of its application.

BC2 The Exposure Draft also sets out related proposed amendments to:

(a) forthcoming IFRS X *Subsidiaries without Public Accountability: Disclosures*; and

(b) IFRS Practice Statement 2 *Making Materiality Judgements*.

BC3 These proposals result from the IASB's project Business Combinations—Disclosures, Goodwill and Impairment. The project was added to the IASB's work plan in response to some concerns raised in the post-implementation review (PIR) of IFRS 3. The objective of this project is to explore whether entities can, at a reasonable cost, provide users with more useful information about business combinations.

BC4 Providing users with such information would help them make better decisions by allowing them to better assess:

(a) the performance of an entity's business combinations; and

(b) how efficiently and effectively the entity's management has used the entity's economic resources to acquire businesses.

Background

BC5 The IASB issued IFRS 3 in 2004 and revised it in 2008. In 2013–2014 the IASB carried out a PIR of IFRS 3 to assess whether that IFRS Accounting Standard was working as intended. The findings were summarised in the Report and Feedback Statement *Post-implementation Review of IFRS 3* Business Combinations published in 2015.

BC6 In the project Business Combinations—Disclosures, Goodwill and Impairment, the IASB considered some of the areas of focus identified in the PIR of IFRS 3. In particular:

(a) information about the performance of a business combination;

(b) the effectiveness and complexity of the impairment test of CGUs containing goodwill (impairment test);

(c) subsequent accounting for goodwill—that is, retaining the impairment-only approach or reintroducing an amortisation and impairment approach (an amortisation-based model); and

(d) the identification and fair value measurement of intangible assets such as customer relationships and brand names.

The Discussion Paper

BC7 In March 2020 the IASB published the Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment*. The Discussion Paper set out the IASB's preliminary views on how to respond to the areas of focus described in paragraph BC6. The IASB's preliminary views were that it:

(a) should improve the disclosure requirements in IFRS 3;

(b) could not design a different impairment test that would be significantly more effective than the impairment test in IAS 36 at recognising impairment losses on goodwill on a timely basis and at a reasonable cost;

(c) should not reintroduce amortisation of goodwill;

(d) should develop proposals intended to reduce the cost and complexity of performing the impairment test;

(e) should develop a proposal to require an entity to present on its statement of financial position the amount of total equity excluding goodwill; and

(f) should not change the range of identifiable intangible assets recognised separately from goodwill in a business combination.

BC8 The IASB received 193 comment letters in response to the Discussion Paper. The IASB also met with various stakeholders to gather feedback on topics included in the Discussion Paper. This process included fieldwork with preparers to understand what information is reviewed within entities about the performance of business combinations and to understand concerns

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preparers might have with disclosing that information in financial statements.

BC9 Overall, stakeholder feedback on the Discussion Paper indicated:

(a) general agreement that users need better information about business combinations. However, many respondents said there would be practical challenges if the preliminary views on improving the disclosure requirements in IFRS 3 were implemented. In particular, almost all preparers said some of the information described in the preliminary views would be so commercially sensitive that its disclosure in financial statements should not be required. Many respondents also questioned whether the information should be required in an entity's financial statements or whether the information would be better suited to another document such as management commentary.

(b) general agreement that it is not feasible to design a different impairment test that would be significantly more effective than the impairment test in IAS 36 at a reasonable cost. However, many respondents suggested improvements to the impairment test in IAS 36.

(c) mixed views about whether to retain the impairment-only approach for the subsequent accounting of goodwill or to reintroduce amortisation of goodwill.

(d) mixed views about the preliminary views to reduce the cost and complexity of the impairment test. There was general agreement with developing proposals to simplify and improve how entities calculate value in use. However, respondents generally disagreed with removing the requirement to perform the impairment test annually.

(e) general disagreement with requiring an entity to present on its statement of financial position the amount of total equity excluding goodwill.

(f) mixed views on the usefulness of information provided by the range of intangible assets recognised separately from goodwill in a business combination. However, respondents generally agreed that this matter should not be considered further as part of the Business Combinations —Disclosures, Goodwill and Impairment project.

Summary of proposals

BC10 Following feedback on its preliminary views in the Discussion Paper, the IASB further engaged with stakeholders to investigate:

(a) preparers' concerns about the information an entity would be required to disclose if the preliminary views were implemented. Staff of the IASB developed and tested some examples of those disclosures with both preparers and users. During this work, participants were asked about ways the preliminary views could be amended to better balance users' needs and preparers' concerns.

(b) the feasibility of estimating the useful life of goodwill and the pattern in which it diminishes.

(c) suggestions from respondents to the Discussion Paper for changes to the impairment test that could improve its effectiveness.

BC11 The IASB subsequently redeliberated its preliminary views and formed the proposals included in this Exposure Draft. The IASB expects the benefits of the proposals (for example, the usefulness of information to users) to outweigh the costs of implementing the proposals (for example, those that arise for preparers from having to disclose the information).

BC12 There are two main aspects to the IASB's proposals:

(a) disclosures about business combinations (paragraphs BC17–BC183); and

(b) changes to the impairment test (paragraphs BC184–BC251).

BC13 The IASB proposes to amend IFRS 3 by:

(a) adding disclosure objectives (paragraphs BC23–BC28);

(b) adding disclosure requirements, including:

(i) requiring an entity to disclose information about the entity's acquisition-date key objectives and the related targets for a strategic business combination and the extent to which those key objectives and targets are met in subsequent periods (information about the performance of a business combination) (paragraphs BC29–BC147);

(ii) requiring an entity to disclose quantitative information about synergies expected to arise from a business combination (paragraphs BC148–BC163); and

(iii) exempting, in specific circumstances, an entity from disclosing some of the information in paragraphs (b)(i)–(ii); and

(c) changing some disclosure requirements in IFRS 3 (paragraphs BC164–BC183).

BC14 The IASB proposes to amend IAS 36 by:

(a) clarifying how an entity allocates goodwill to CGUs (paragraphs BC194–BC201);

(b) requiring an entity to disclose in which reportable segment a CGU or group of CGUs containing goodwill is included (paragraph BC202); and

(c) changing how an entity calculates value in use (paragraphs BC203–BC222).

BC15 Related to the proposed amendments to IFRS 3 and IAS 36, the IASB proposes changes to the forthcoming IFRS X *Subsidiaries without Public Accountability: Disclosures* (see paragraphs BC252–BC256).

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BC16 After considering feedback on its preliminary views, the IASB decided not to explore further, as part of this project:

(a) whether to reintroduce amortisation of goodwill (see paragraphs BC228–BC251);

(b) whether to require an entity to present on its statement of financial position an amount representing total equity excluding goodwill; and

(c) changing the range of identifiable intangible assets recognised separately from goodwill in a business combination.

Proposed amendments to IFRS 3 *Business Combinations*

BC17 The IASB proposes to amend the disclosure requirements in IFRS 3 by:

(a) adding disclosure objectives (paragraphs BC23–BC28);

(b) adding requirements for an entity to disclose:

  (i) information about the performance of a business combination (paragraphs BC29–BC147); and

  (ii) quantitative information about the synergies expected from combining the operations of an acquiree and an acquirer (expected synergies) (paragraphs BC148–BC163); and

(c) making targeted changes to disclosure requirements including:

  (i) amending the requirement to disclose the strategic rationale for a business combination (paragraphs BC164–BC165);

  (ii) amending the requirements on the contribution of an acquired business (paragraphs BC166–BC177);

  (iii) amending the requirement to disclose information relating to classes of assets acquired and liabilities assumed (paragraphs BC178–BC181); and

  (iv) deleting some requirements (paragraphs BC182–BC183).

Need for better information about business combinations

BC18 Acquiring a business often requires an entity to use a significant amount of economic resources. In feedback to the IASB, users said they want to understand whether the price paid for a business combination was reasonable and whether the business combination has been successful. Users said:

(a) entities typically do not provide sufficient information about business combinations; and

(b) they need information about a business combination's performance to help them assess management's stewardship of an entity's economic resources used in the business combination.

BC19 Feedback suggested some users use information provided by the IAS 36 impairment test of CGUs containing goodwill as a proxy for assessing the success of a business combination. Some users said they view an entity's recognition of an impairment loss on goodwill as a confirmatory signal that the related business combination was unsuccessful. However, some stakeholders said that impairment losses on goodwill are sometimes recognised too late (that is, there appears to be a delay between an impairment occurring and an impairment loss being recognised in financial statements). Therefore, users do not get a timely signal of the failure of the related business combination.

BC20 The objective of the IASB's proposed amendments is to require entities to provide users with better information about the performance of a business combination at a reasonable cost. In doing so, the IASB seeks to respond to users' need for better information to enable users to understand whether the acquisition price for a business combination was reasonable and whether the subsequent performance of the business combination has been successful, while balancing that with the cost for preparers of disclosing this information.

BC21 The IASB's proposals for improving the disclosure requirements in IFRS 3 would also partly respond to concerns about impairment losses on goodwill sometimes being recognised too late. The proposed disclosure requirements would provide more direct information on the success of a business combination than the impairment test. With this information, users would be better able to assess management's decision to acquire a business.

Stakeholder concerns

BC22 Many respondents to the Discussion Paper raised practical concerns about the information that would be required to be disclosed if the preliminary views were implemented. These concerns relate to:

(a) *location of information*—respondents asked whether the information should be included in financial statements. Many of these respondents said the information is better suited to an entity's management commentary (see paragraphs BC132–BC143).

(b) *commercially sensitive information*—many preparers said some of the information would be so commercially sensitive that its disclosure in financial statements should not be required (see paragraphs BC74–BC78).

(c) *forward-looking information*—respondents said the information could be forward-looking (see paragraphs BC138–BC142). Disclosing such information could increase the entity's risk of litigation (see paragraphs BC82–BC85).

(d) *auditability*—some respondents, particularly preparers and national standard-setters, said it could be difficult and costly to audit the information (see paragraphs BC144–BC145).

(e) *integration*—some respondents said it could be difficult to disclose the information if an acquired business is integrated with an existing business of the entity soon after a business combination is completed (see paragraphs BC146–BC147).

Adding new disclosure objectives to IFRS 3

BC23 Feedback indicated that entities frequently apply the current IFRS 3 disclosure requirements as a checklist. Even though the information required is extensive, the resulting disclosures can often be 'boilerplate' and fail to provide sufficiently useful information for users.

BC24 Developing disclosure objectives that are more specific could enable preparers to understand better why users need a particular item of information and help entities disclose information that better meets the needs of users.

BC25 The IASB proposes adding two new disclosure objectives to IFRS 3 to respond to users' need for better information about business combinations (see paragraphs BC18–BC21). These disclosure objectives would require an entity to disclose information that helps users evaluate:

(a) the benefits an entity expects from a business combination when agreeing on the price to acquire a business; and

(b) for a strategic business combination, the extent to which the benefits an entity expects from the business combination are being obtained.

BC26 The proposed disclosure objectives have been developed in response to feedback from users about what information about business combinations, which is not currently required to be disclosed, would allow them to assess those business combinations more effectively.

BC27 In developing these disclosure objectives, the IASB considered the *Guidance for Developing and Drafting Disclosure Requirements in IFRS Accounting Standards* (Guidance) published on the IASB's website in March 2023. The proposed disclosure objectives for IFRS 3 are not directly equivalent to overall or specific disclosure objectives as described in the Guidance but are designed to follow the structure of the disclosure requirements in IFRS 3 (that is, one type of disclosure objective supported by specific requirements).

BC28 The IASB's proposed new requirements and targeted changes to the disclosure requirements are designed to support an entity in disclosing information to meet the proposed disclosure objectives. Some of the current disclosure requirements in IFRS 3 would also result in an entity disclosing information that would meet the proposed disclosure objectives.

Information about the performance of a business combination

BC29 In developing its proposals, the IASB considered:

(a) what type of information to require an entity to disclose (paragraphs BC30–BC44);

(b) what business combinations the information should be required for (paragraphs BC45–BC73);

(c) whether, and if so when, to exempt an entity from disclosing any of the information (paragraphs BC74–BC107);

(d) how an entity should identify the information required to be disclosed (paragraphs BC108–BC130); and

(e) other concerns (paragraphs BC131–BC147).

What type of information to require an entity to disclose

BC30 To help an entity meet the proposed disclosure objectives (see paragraphs BC23–BC28), the IASB proposes to require an entity to disclose:

(a) in the year of acquisition, information about the acquisition-date key objectives and the related targets for a business combination (paragraphs BC31–BC39); and

(b) in the year of acquisition and in subsequent reporting periods, information about the extent to which the acquisition-date key objectives and the related targets are being met (paragraphs BC40–BC44).

Acquisition-date key objectives and the related targets for a business combination

BC31 The IASB proposes to require an entity to disclose in the year of acquisition its key objectives and related targets for a strategic business combination (see paragraphs BC45–BC73). That information would be based on the entity's acquisition-date assumptions for the business combination.

BC32 Information about acquisition-date key objectives and the related targets meets both of the IASB's proposed new disclosure objectives because that information:

(a) explains the expected benefits of a business combination—in particular, information about acquisition-date key objectives and the related targets would help users:

   (i) to understand why an entity entered into a business combination and the nature of the assets acquired and liabilities assumed; and

   (ii) to assess an entity's economic resources and claims against the entity, as well as the entity's ability to generate future net cash inflows, enabling users to form their own opinions about whether the acquisition price was reasonable; and

(b) provides a base against which to compare a business combination's future performance to assess whether that business combination has been successful.

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BC33 The IASB proposes that the information an entity is required to disclose about acquisition-date key objectives and the related targets reflects the information the entity's management uses to review and measure the success of a business combination (management approach). Paragraphs BC108–BC130 explain the IASB's rationale for the management approach.

BC34 Most respondents to the Discussion Paper agreed with the preliminary view to require an entity to apply a management approach. The IASB expects that applying the management approach would:

(a) result in an entity disclosing the most useful information about business combinations. Information that is used by the entity's management for decision-making will probably also be relevant to users.

(b) minimise the cost of disclosing the information because the information is already being used by an entity.

BC35 An objective for a business combination is a specific aim an entity's management has for the business combination. An example of an objective is 'to increase sales of Entity A's (the acquirer) own Product W in new Territory Y using the acquired sales channels of Entity B (the acquiree)'.

BC36 An entity's management might have multiple objectives for a business combination. Some preparers were concerned that requiring an entity to disclose information about all of its objectives and related targets for a business combination could be onerous and could result in material information being obscured. However, the proposals would not require an entity to disclose detailed information about all objectives and their related targets. Instead, an entity would be required to disclose only the key objectives —those that are critical to the success of the business combination.

BC37 An acquisition-date target for a business combination describes the level of performance that will show whether an objective for a business combination has been met. It reflects the entity's acquisition-date assumptions for the business combination. An acquisition-date target might not be the same as management's current expectation of the future performance of the business combination at the reporting date.

BC38 Targets need to be specific enough for it to be possible to verify whether the objectives are being met. A target could be measured using a metric denominated in currency units or another unit of measurement. Examples of a target could include 'additional revenue of CU100 million of Product V in Territory W in 202X compared to 202Y' or 'increasing the number of customers for Product Z by 5,000 by 202X compared to 202Y'.

BC39 In response to the Discussion Paper, many preparers said that in determining the price an entity pays for a business combination, assumptions and targets are often estimated as a range rather than as specific amounts. These preparers asked whether an entity could disclose targets as a range. The IASB agreed and proposes to allow an entity to disclose targets as a range rather than as a point estimate.

Performance of a business combination after acquisition

BC40 The IASB proposes to require an entity to disclose in the year of acquisition and in subsequent reporting periods:

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

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

BC41 This information is designed to meet the second of the IASB's proposed disclosure objectives described in paragraph BC25. That is, this information helps users assess the extent to which acquisition-date key objectives and the related targets are being met or have been met.

BC42 In some circumstances, information about the actual performance might not be enough to convey whether a business combination has been successful. Therefore, the IASB decided to propose that an entity be required to disclose a qualitative statement about whether that performance is meeting or has met the acquisition-date key objectives and the related targets. For example, this statement might be particularly useful if an entity has applied the proposed exemption (see paragraphs BC74–BC107) to information about an acquisition-date key objective or related target. In these circumstances, users would be unable to assess the performance of a business combination using only the information about its actual performance; users also need the contextual information provided by either the acquisition-date key objective and the related targets, or a qualitative statement about actual performance.

BC43 The intention of the qualitative statement would be for an entity to disclose only whether it is meeting or has met its key objectives and targets. The IASB's proposals would not require an entity to disclose an explanation of differences between the actual performance and the key objective.

BC44 In the view of some IASB members, the IASB should not require an entity to disclose a qualitative statement about actual performance because those IASB members were concerned that an entity would find it difficult to disclose only a statement of whether actual performance is meeting or has met the acquisition-date key objectives and the related targets. These IASB members think users will ask the entity to provide further analysis or explanations of how far the actual performance was from meeting the key objective. Some IASB members consider such an analysis to be commercially sensitive because it could indirectly require the entity to disclose information about an acquisition-date key objective or related target even though that information was exempt. Other IASB members think the entity is likely to apply the exemption to the qualitative statement about actual performance. These IASB members therefore question how useful a requirement to disclose this information would be—users are unlikely to receive the context needed if the entity applies the exemption to a qualitative statement about actual performance.

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What business combinations the information should be required for

The preliminary views in the Discussion Paper and feedback on them

BC45 IFRS 3 requires an entity to disclose information for each business combination that occurs during the reporting period. The entity is required to disclose information separately for each material business combination and to disclose information in aggregate for individually immaterial business combinations.

BC46 Some stakeholders expressed concerns about requiring an entity to disclose information about the performance of a business combination for all material business combinations. Stakeholders said that some entities frequently acquire businesses. These stakeholders said that if an entity is required to disclose information about acquisition-date key objectives and the related targets and subsequent performance separately for each material business combination, the volume of disclosures could be onerous and could obscure material information.

BC47 Some users said they need information about the performance of a business combination only for 'major' or 'fundamental' business combinations.

BC48 Responding to these concerns, the preliminary view in the Discussion Paper was to require an entity to disclose information about the performance of a business combination for only a subset of material business combinations. This subset of business combinations would be those that are monitored by the entity's chief operating decision maker (CODM) as described in IFRS 8 *Operating Segments*.

BC49 In the IASB's preliminary view, requiring an entity to disclose this information for only the subset of business combinations monitored by the entity's CODM would result in the entity disclosing the most important information about the most important business combinations, while also addressing stakeholder concerns about the volume of disclosures being costly and onerous.

BC50 Respondents to the Discussion Paper generally agreed with the need to identify a subset of material business combinations. However, there were mixed views about using an entity's CODM to do so. For example, because:

(a) CODMs in different entities review the performance of different types of business combination. As such, some respondents said requiring information to be disclosed for business combinations reviewed by the CODM could result in an entity disclosing information about too few business combinations (and therefore result in users not receiving the information they need) or too many business combinations (and therefore implementing the preliminary views would make the resulting requirements too costly for entities).

(b) the experience of a few users regarding segment disclosures made by entities applying IFRS 8 indicated that using the CODM might not provide users with the most useful information about business combinations.

BC51 Some stakeholders disagreed with requiring an entity to disclose information for only a subset of business combinations; they expressed concern about how such requirements would interact with the concept of materiality.

The IASB's response

BC52 After considering feedback on the Discussion Paper, the IASB decided to propose that information about the acquisition-date key objectives, related targets and subsequent performance of business combinations should be required for only a subset of material business combinations. Such a requirement would help balance users' need for information with the costs of disclosing that information.

BC53 The IASB's proposals do not attempt to define or explain how an entity makes materiality judgements. The IASB's intention is to identify a population of business combinations for which an entity would be required to disclose particular information. An entity would still assess whether each item of information it is required to disclose in applying the proposals is material, as it does for any other item of information disclosed in financial statements.

BC54 After considering feedback (see paragraph BC50), the IASB decided against proposing to use an entity's CODM to identify the business combinations for which an entity would be required to disclose some information. Instead, the IASB proposes to require information to be disclosed for a population of business combinations that the IASB terms 'strategic' business combinations. A strategic business combination would be one for which failure to meet any one of an entity's acquisition-date key objectives would put the entity at serious risk of failing to achieve its overall business strategy.

BC55 In the IASB's view, strategic business combinations would capture business combinations of significant strategic value to an entity. An entity's overall business strategy could be put at serious risk if, for example, the entity:

(a) committed a large amount of capital to a business combination that subsequently failed to meet the entity's expectations; or

(b) failed to enter major new lines of business or geographies that are essential to the entity's overall business strategy through the business combination.

Identifying strategic business combinations

BC56 The IASB considered two ways to identify strategic business combinations:

(a) by applying an open list of factors (open-list approach); or

(b) by applying a closed list of thresholds (closed-list approach).

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BC57 The open-list approach would involve the IASB adding to IFRS 3 a description of a strategic business combination (see paragraph BC54) and supplementing that description with an open list of factors an entity would consider when assessing whether a business combination meets that description. The factors would be neither individually determinative nor exhaustive.

BC58 This approach would be similar to the requirements in IAS 21 *The Effects of Changes in Foreign Exchange Rates* on functional currency. IAS 21 defines a functional currency and provides a list of factors an entity is required to consider when determining its functional currency.

BC59 The closed-list approach would involve the IASB specifying what constitutes a strategic business combination by setting specific thresholds. An entity would be required to disclose information about a business combination if the business combination met at least one of the thresholds. An example of a closed-list approach is the identification of reportable segments applying paragraph 13 of IFRS 8.

BC60 The open-list approach is more principle-based and, if implemented correctly, could offer users valuable insights by capturing business combinations entered into for different strategic needs. However, the open-list approach might have practical challenges, in particular:

(a) it might be difficult to devise a list of factors that are distinguishable from factors that an entity would consider when making materiality judgements. An open list of factors might be viewed by stakeholders as guidance for entities to apply in identifying material business combinations rather than strategic business combinations.

(b) it might also be difficult to apply, audit and enforce, leading to higher costs. The application of this approach would require an entity to exercise its judgement, and in some cases there might not be enough objective evidence to determine whether a business combination is strategic.

BC61 As noted in paragraph BC49, one purpose of requiring an entity to disclose information for only a subset of material business combinations is to reduce the cost of the proposed disclosure requirements. A closed-list approach better aligns with that objective than an open-list approach. Accordingly, the IASB proposes a closed-list approach.

BC62 The IASB proposes thresholds in the closed-list approach that are:

(a) quantitative (paragraphs BC63–BC67); and

(b) qualitative (paragraphs BC68–BC70).

Quantitative thresholds

BC63 Regulations in some jurisdictions require an entity to provide information about business combinations that meet specific quantitative thresholds. The quantitative thresholds used by those local regulations often include criteria based on primary financial statement measures (for example, total assets and

profit) and criteria based on other measures (for example, market capitalisation).

BC64 The IASB proposes to base its quantitative thresholds on measures defined in IFRS Accounting Standards that are commonly used in regulations. This proposal would allow the IASB to leverage the definitions in IFRS Accounting Standards and avoid having to define new criteria (for example, one based on the value of an entity). It would also help avoid situations in which a quantitative threshold might not be applicable to all entities applying IFRS Accounting Standards (for example, a threshold based on market capitalisation would not be applicable for non-listed entities).

BC65 Consequently, the IASB is proposing quantitative thresholds based on revenue, total assets and operating profit. Using three different measures, including those based on the statement of financial position and the statement of financial performance, takes into account different motives for entering into a business combination.

BC66 Although the IASB decided against using a threshold based on the value of an entity, it has designed the threshold based on total assets to function in a similar way to one based on the value of the entity. The IASB has done so by proposing to require an entity to use the value of all assets recognised by the acquirer as a result of a business combination, including goodwill, instead of using total assets recognised by the acquired business before the acquisition.

BC67 The IASB observed that the quantitative threshold in local regulations for additional disclosure is usually set between 5% and 30%. Although the IASB acknowledges that any quantitative threshold would to some extent be arbitrary, the IASB proposes to set the percentage at 10% because:

(a) the IASB's research suggests the number of business combinations captured by regulators' thresholds is fewer than the number of business combinations for which entities disclose information separately in financial statements.

(b) limited feedback from outreach suggested a 5% threshold might be too low and would capture too many business combinations.

(c) IFRS 8 uses a 10% threshold to identify the operating segments about which an entity is required to disclose information separately. IFRS 8 uses thresholds to identify segments that are large enough to require information to be disclosed about, which is similar to what the IASB is proposing.

Qualitative thresholds

BC68 The IASB's objective in setting qualitative thresholds is to capture business combinations that would not meet the quantitative thresholds in proposed paragraph B67C of IFRS 3 but are nonetheless strategic because they would represent a strategic shift for an entity. These business combinations include those that would result in the entity entering a new major line of business or geographical area of operations.

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BC69 These thresholds are based on the thresholds in paragraph 32 of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* used to identify discontinued operations. The thresholds have been adapted to reflect the purchase of a business instead of the discontinuance of an operation.

BC70 The IASB considered whether to include other qualitative thresholds. The IASB decided to propose only a limited number of thresholds to reduce the cost of applying the proposed requirements—one of the main reasons for requiring entities to disclose information about only strategic business combinations. Other qualitative thresholds considered by the IASB include whether local regulations require an entity to provide additional information about a business combination. However, the IASB concluded that it was unnecessary to include such a threshold because the thresholds regulators use are often designed to capture large business combinations which would already be captured by the proposed quantitative thresholds.

Series of business combinations

BC71 In feedback, a few users said they need information about a series of business combinations entered into to achieve the same strategic objective(s), and raised concerns that these business combinations would not, individually, be captured by the proposed thresholds.

BC72 The IASB was unable to develop a method for identifying a series of business combinations entered into to achieve the same strategic objective. The IASB proposes a management approach to disclosing information (see paragraph BC33) and any requirements set by the IASB might not group business combinations in the same way that an entity's management would. If the IASB were to prescribe the way that business combinations should be grouped, an entity that groups business combinations in a different way would disclose only that its management is not reviewing the series of business combinations because they are reviewed in a different way from how the IASB envisaged. This situation might not provide users with useful information.

BC73 However, the IASB's qualitative thresholds might at least help an entity to identify the first in a series of business combinations entered into to achieve the same strategic objective. For example, the first in a series of business combinations could result in an entity entering into a new line of business or geographical area, enabling the acquisition of other businesses in future.

Exemption from some disclosure requirements

BC74 When the IASB developed its preliminary views in the Discussion Paper, many stakeholders, particularly preparers, expressed concerns that some of the information an entity would be required to disclose if the preliminary views were implemented would be so commercially sensitive that its disclosure in financial statements should not be required. IFRS Accounting Standards do not normally exempt an entity from disclosing information that might be commercially sensitive. In reaching its preliminary views, the IASB decided concerns about commercial sensitivity were not enough of a reason to prevent the disclosure of information that users need.

BC75 Respondents to the Discussion Paper highlighted various concerns with the preliminary views. Commercial sensitivity was the most commonly cited concern, particularly by preparers. Some respondents provided examples of information that in their view would be so commercially sensitive that its disclosure in financial statements should not be required, including:

(a) *targets*—respondents said disclosing targets for a business combination could reveal information about how an entity prices deals. The entity's competitors could use this information to outbid the entity in future deals. Respondents said this would be particularly problematic if the entity was entering into a series of strategically linked acquisitions.

(b) *cost-based targets*—respondents said disclosing cost-based targets could reveal an entity's internal cost structure. An entity's competitors could use such information to outbid the entity in future tenders and customers could ask for some of the cost savings to be passed on to them.

(c) *employee-related information*—respondents said disclosing information relating to employees (for example, redundancy information) could demotivate employees or pre-empt some jurisdictions' legal requirements to inform employees or trade unions first about potential redundancies.

BC76 The IASB investigated these concerns with preparers to obtain a better understanding. The IASB also discussed with users to understand what information about business combinations users need. The IASB brought together both groups of stakeholders to find solutions that would balance users' need for information and respond to some preparer concerns.

BC77 Following these discussions, the IASB decided to propose exempting an entity from the requirement to disclose some information (exemption). In making this decision, the IASB considered but rejected other alternatives, such as:

(a) *requiring an entity to disclose only qualitative information in the year of acquisition*—this alternative would fail to adequately resolve all preparers' concerns about information being commercially sensitive. It could also result in users receiving insufficient information to allow them to understand the benefits expected from a business combination and the extent to which the objectives for a business combination are being met.

(b) *specifying the metrics an entity is required to disclose information about rather than following a management approach*—the IASB concluded it would not be feasible to specify metrics that would be relevant for all business combinations because business combinations are entered into for different reasons.

BC78 In the IASB's view, the exemption would respond to some concerns about commercial sensitivity, while ensuring the disclosure of as much useful information for users as possible. In designing the exemption, the IASB considered:

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(a) the principle underpinning the exemption (paragraphs BC79–BC80);

(b) which practical concerns the exemption should aim to resolve (paragraphs BC81–BC85);

(c) which items of information the exemption would be available for (paragraphs BC86–BC89); and

(d) what application guidance, if any, to provide (paragraphs BC90–BC107).

Principle underpinning the exemption

BC79 The IASB developed a principle underpinning the exemption—that an entity be exempted from disclosing specified information that it would be required to make if such a disclosure can be expected to prejudice seriously the achievement of any of the entity's acquisition-date key objectives for the business combination.

BC80 The IASB proposes this principle because:

(a) linking the exemption to acquisition-date key objectives for a business combination provides a direct link to the outcome of the business combination to which the information relates, without needing to define specific situations.

(b) this approach is similar to the exemption in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.[1] Feedback suggested that the exemption in IAS 37 works well in practice.

(c) the principle could also address some stakeholder concerns about having to disclose what they regard as forward-looking information in financial statements (see paragraphs BC82–BC85).

Which practical concerns to address

BC81 The IASB designed the exemption primarily to respond to preparers' concerns about commercial sensitivity. An item of information might qualify for the exemption, and therefore the entity may elect not to disclose that item of information if, for example:

(a) the entity's competitors can be expected to use the information (to which they would not otherwise have access) to prevent the entity from meeting any of its acquisition-date key objectives for the business combination; or

(b) legal obligations prevent the entity from disclosing a particular item of information, and the breach of those obligations can be expected to result in consequences that would prevent the entity from achieving any of its acquisition-date key objectives for the business combination.

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1 Paragraph 92 of IAS 37 exempts an entity from disclosing some or all information that would be required by paragraphs 84–89 of IAS 37 if doing so can be expected to prejudice seriously the position of the entity in a dispute with other parties on the subject matter of the provision, contingent liability or contingent asset that the information relates to.

BC82 The IASB considered whether to allow the exemption to apply if an entity might be exposed to litigation risks that arise from disclosing what some stakeholders regard as forward-looking information (see paragraphs BC138–BC142). If an entity failed to meet its objectives for a business combination and an investor relied on that information but subsequently suffers a loss, the entity might be sued. An entity might fail to meet its objectives for a business combination because:

(a) disclosing the information resulted in the entity being unable to meet the objectives of the business combination;

(b) there were factors outside the entity's control; or

(c) management did not efficiently or effectively discharge its responsibilities.

BC83 In the IASB's view, litigation risk arising from an entity failing to meet its acquisition-date key objectives for a business combination because it disclosed the information (paragraph BC82(a)) would be addressed by the exemption.

BC84 On the other hand, litigation risk arising from the factors described in paragraphs BC82(b) and BC82(c) results from an entity failing to meet its acquisition-date key objectives for a business combination for reasons other than the disclosure of the information. In other words, it is not the disclosure of information that causes the entity to fail to achieve its acquisition-date key objectives. This risk is no different from litigation risk that arises from disclosing forward-looking information required by other IFRS Accounting Standards. For example, such a risk could arise from the measurement and disclosure of expected credit losses in accordance with IFRS 9 *Financial Instruments*, or from the disclosure of assumptions used in the impairment test required by IAS 36.

BC85 The IASB sees no justification for an exemption that addresses litigation risks arising from the factors described in paragraphs BC82(b) and BC82(c) when other IFRS Accounting Standards do not exempt an entity from disclosing information affected by those factors. Consequently, the IASB decided not to propose an exemption to address litigation risk arising from the factors described in paragraphs BC82(b) and BC82(c).

What information to exempt

BC86 Research by the IASB (see paragraph BC76) indicates that not all the items of information that would be required when applying the proposals in this Exposure Draft would be so commercially sensitive that it should not be required in financial statements.

BC87 The IASB has therefore proposed to permit the application of the exemption only to the disclosure of:

(a) the acquisition-date key objectives and the related targets for a business combination;

(b) a qualitative statement of whether actual performance is meeting or has met the objectives and targets for a business combination; and

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(c) quantitative information about expected synergies (see paragraphs BC148–BC163).

BC88 The IASB proposes not to exempt an entity from disclosing information about:

(a) the strategic rationale for a business combination (see paragraphs BC164–BC165); and

(b) the actual performance being reviewed to determine whether acquisition-date key objectives and the related targets are being met.

BC89 Feedback on the Discussion Paper and subsequent outreach identified that stakeholders do not expect the items of information described in paragraph BC88 to be so commercially sensitive that they should be exempt from being disclosed. Furthermore, users said they need at least some qualitative information about a business combination. In the IASB's view, information about the strategic rationale for the business combination provides this qualitative information.

Application guidance for the exemption

BC90 To ensure the proposed exemption is operational and enforceable, the IASB decided to propose application guidance. The application guidance would require an entity:

(a) to disclose, for each item of information to which an entity has applied the exemption, that it has applied the exemption and the reason for doing so (paragraphs BC93–BC95).

(b) to consider whether, instead of applying the exemption, it is possible to disclose information in a different way—for example, at a sufficiently aggregated level—without prejudicing seriously the entity's acquisition-date key objectives for a business combination (paragraphs BC96–BC98).

(c) to consider factors such as the effect of disclosing the information and the public availability of the information in determining whether the exemption is applicable (paragraphs BC99–BC102).

(d) to reassess in each reporting period whether the item of information still qualifies for the exemption. If it is no longer appropriate to apply the exemption, the entity would be required to disclose the item of information previously exempted (paragraphs BC103–BC107).

BC91 The IASB considered including a probability assessment in the application guidance—that is, allowing an entity to use the exemption only if the likelihood of harm resulting from disclosing the information is, for example, more likely than not. However, the exemption already requires an entity to assess the likelihood because the prejudicial outcome must be 'expected'. In the IASB's view, an additional probability assessment is unnecessary.

BC92 The IASB also considered specifying how often it expects entities to apply the exemption—for example, whether it expects the application of the exemption to be extremely rare, similar to the requirement in paragraph 92 of IAS 37. The IASB decided against doing so. Instead, the IASB decided to focus on

identifying the appropriate circumstances in which an entity could apply the exemption, and developed application guidance designed to ensure that the exemption is applied only in those circumstances.

Disclosing the reason for applying the exemption

BC93 An entity applying the proposed exemption to an item of information would be required to disclose in its financial statements both the fact it applied the exemption and the reason it has not disclosed the item of information. This requirement is similar to the requirement in paragraph 92 of IAS 37.

BC94 Disclosing that the entity has applied the exemption and the reason for doing so would be required for each item of information to which the entity has applied the exemption. For example, if an entity has three acquisition-date key objectives for a business combination with related targets and the entity determines it could apply the exemption to any of those objectives or targets, the entity would be required to disclose the reason for applying the exemption for each acquisition-date key objective and each target to which it applied the exemption.

BC95 Some IASB members think this requirement will make the application of the exemption more robust by improving the auditability and enforceability of the exemption.

Disclosing information in a different way

BC96 In response to the Discussion Paper and in subsequent outreach, some preparers said the degree to which information is commercially sensitive depends on how detailed it is. For example, information about an important new product might be more commercially sensitive than information about an operating segment into which the acquired business has been integrated.

BC97 Accordingly, the IASB proposes to require an entity to consider whether, instead of applying the exemption, it is possible for the entity to disclose information in a different way—for example, at a sufficiently aggregated level—such that the proposed new disclosure objectives could be met without prejudicing seriously the acquisition-date key objectives for the business combination.

BC98 The IASB also proposes a specific requirement in relation to the application of the exemption to disclosure of information about expected synergies. As explained in paragraph BC155, the IASB proposes to require an entity to disclose information about the total amount of expected synergies at a total level, rather than totals by category if disclosing the information by category could result in a need to apply the exemption. The IASB developed this requirement to respond to feedback that, in some cases, information about expected synergies by category might be commercially sensitive but information about the total amount of expected synergies would not be.

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Factors to consider in determining whether to apply the exemption

BC99 The IASB considered regulatory requirements in some jurisdictions that include exemptions from disclosing commercially sensitive information—for example, Regulatory Guide RG 247 published by the Australian Securities & Investments Commission and Guideline EBA/GL/2014/14 published by the European Banking Authority. Those regulatory requirements list situations in which an entity is not allowed to use the exemptions. In particular:

(a) the disclosure of information already contained in continuous disclosure notices, investor presentations, briefings to analysts or other publicly available documents is unlikely to give rise to unreasonable prejudice to an entity.

(b) a general risk of a potential weakening of competitiveness due to disclosure is not, on its own, seen as enough of a reason for an entity to avoid disclosure. Specific reasoning should be available and be based on an analysis of the incidence of disclosure of proprietary information.

(c) in assessing the usefulness of information to competitors, an entity is required to consider whether competitors are already likely to have access to the information from public or non-public documents or other sources, as well as the ability of competitors to act on the information to the significant detriment of the entity.

BC100 The IASB considered whether to prescribe circumstances in which an entity would not be allowed to apply the proposed exemption. However, the IASB decided against doing so because it would not be feasible for the IASB to come up with a complete list of circumstances.

BC101 Instead, the IASB decided to propose a list of non-exhaustive factors for an entity to consider in assessing whether the exemption is applicable. This list is designed to help entities, auditors and regulators identify the circumstances in which application of the exemption would be appropriate.

BC102 In drafting the list of factors, the IASB considered:

(a) whether to explicitly require an entity to assess the ability of competitors to act on the information. Proposed paragraph B67D(a) of IFRS 3 would require an entity to identify a specific reason for not disclosing the information, including identifying the seriously prejudicial effect of disclosing the information. Therefore, if the entity's concern relates to competitors being able to act on information disclosed, the entity would already be required to consider what actions a competitor could take to prevent the entity meeting its key objectives.

(b) how an entity would be able to assess what information its competitors have access to. The factor in proposed paragraph B67D(b) of IFRS 3 focuses on identifying information the entity has made public.

Reassessment in subsequent periods

BC103 The IASB observed that the circumstances resulting in an entity applying the proposed exemption could arise for only a limited period of time. For example, if an acquisition-date key objective of a business combination is for an entity to develop and launch a new product, disclosing that key objective might result in the entity being unable to launch the product successfully and therefore could prejudice seriously the achievement of that key objective. However, after the new product is launched, disclosing information about the product would no longer harm the achievement of the key objective.

BC104 Regulatory disclosure requirements that include specific exemptions often require an entity to reassess its eligibility for the exemption. Some jurisdictions impose so-called continuous disclosure obligations that require an entity to assess the need to apply an exemption on a continuous basis. For example, listing rules in one jurisdiction stipulate that an entity could be exempt from disclosing some information if it is commercially sensitive. But if the information later ceases to be commercially sensitive, the entity is required immediately to disclose that information.

BC105 The IASB decided to propose a similar approach by including in its application guidance a requirement for an entity to reassess at the end of each reporting period whether the item of information still qualifies for the exemption. If it is no longer appropriate to apply the exemption, the entity would be required to disclose that information. For example, if an entity applies the exemption to a target in the year of acquisition, but in the following year the reason for applying the exemption no longer exists, the entity would be required to disclose in the second year what that target was.

BC106 The IASB proposes to require reassessment only for as long as an entity would otherwise be required to disclose information about the performance of a business combination. In the IASB's view, a time limit is needed to avoid requiring an entity to disclose information about a business combination a significant time after the transaction, when that information might no longer be relevant.

BC107 The IASB considered an alternative approach whereby an entity would be required to disclose, on initial application of the exemption, for how long the entity expects to use the exemption. At the end of that period the entity would need either to disclose the item of information to which the exemption was applied or justify why the exemption is still necessary. The IASB decided not to follow this approach because:

- (a) it might not be feasible for an entity's management to estimate, at the acquisition date, for how long the exemption is needed; and
- (b) such an approach could result in an entity:
  - (i) disclosing that it would apply the exemption for a longer period of time than necessary; or
  - (ii) continuing to apply the exemption until the end of the stated period, even if the circumstances that resulted in the exemption no longer exist before the end of that stated period.

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Identifying the information to be disclosed

BC108 Applying the IASB's proposals, an entity would be required to disclose information about the acquisition-date key objectives, related targets and subsequent performance of a strategic business combination by following a management approach. The entity would disclose information that its management uses to assess the performance of a business combination. Most respondents to the Discussion Paper agreed that the management approach would be the most effective method for an entity to identify the information to be disclosed.

BC109 In designing the management approach, the IASB considered:

(a) whether, and if so how, to define management (paragraphs BC110–BC114);

(b) how long an entity would be required to disclose information (paragraphs BC115–BC123); and

(c) what happens if an entity updates the key objectives or targets for a business combination (paragraphs BC124–BC130).

Whether and how to define management

BC110 In the Discussion Paper the preliminary view was to require an entity to disclose information reviewed by the entity's CODM. CODM is a term that stakeholders are familiar with and the IASB viewed the use of the CODM as an effective method of identifying the most important information about the most important business combinations. As discussed in paragraph BC50, the IASB received mixed feedback on that preliminary view.

BC111 After considering feedback, the IASB concluded it would be beneficial to specify the level of management to be used in identifying the information required to be disclosed and that the level of management be at a senior level because:

(a) requiring an entity to disclose information reviewed by senior management would help identify the most important information about a business combination. Specifying senior management in this requirement would be helpful when different levels of management within an entity review the performance of a business combination using information with varying levels of detail.

(b) as noted in paragraphs BC121–BC123, if an entity's management is not reviewing or has stopped reviewing the performance of an acquisition-date key objective and the related targets, the entity would be required to disclose that fact. In the IASB's view, specifying a senior level of management would help users better assess management's stewardship of resources used for strategic business combinations. Being made aware that senior management is not reviewing or has stopped reviewing the performance of an acquisition-date key objective and the related targets could provide more useful information to users than receiving information about the performance of a strategic

business combination that is reviewed only by a more junior level of management.

(c) defining the level of management could help distinguish the information an entity would disclose about a business combination from information the entity uses to review the performance of the business as a whole, and therefore could help identify when an entity stops disclosing information. The IASB concluded that defining management is an easier way to make this distinction than defining in detail what reviewing a business combination's performance means.

BC112 In defining a senior level of management, the IASB considered whether to continue using an entity's CODM or whether to refer instead to an entity's key management personnel, as defined in IAS 24 *Related Party Disclosures*.

BC113 Analysing feedback on the Discussion Paper, the IASB identified two main drawbacks with continuing to use an entity's CODM to identify information. In particular:

(a) the entity's CODM is linked with the information the entity is required to disclose in accordance with IFRS 8. Although the preliminary view, if implemented, would not preclude the entity from reporting information about a reportable segment when assessing the performance of a business combination, entities might not always assess performance at a reportable segment level. Some stakeholders expressed confusion about how information about the performance of a business combination would differ from the information disclosed applying IFRS 8.

(b) there is diversity in the application of CODM in different entities—feedback on the Discussion Paper indicated that there is diversity in the role the CODM plays in reviewing the performance of business combinations. Therefore, continuing to use CODM to identify information might not result in consistent application of the proposed requirements by entities.

BC114 The IASB proposes to specify management as an entity's key management personnel. In the IASB's view:

(a) using key management personnel has similar benefits to using CODM because:

(i) it would utilise terminology within IFRS Accounting Standards; and

(ii) disclosing that key management personnel—a senior level of management—do not start reviewing or stop reviewing the performance of a key objective for a strategic business combination is likely to be useful information (see paragraph BC111(b)).

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(b) an entity's key management personnel are not linked with segment reporting. The confusion noted in paragraph BC113(a) regarding the relationship between the proposed disclosure requirements and disclosure requirements in IFRS 8 would therefore be avoided.

(c) other IFRS Accounting Standards use key management personnel to identify information to be disclosed by an entity—for example, paragraph 34(a) of IFRS 7 *Financial Instruments: Disclosures*. The IASB is not aware of concerns about the use of key management personnel in these IFRS Accounting Standards.

How long an entity would be required to disclose information

BC115 In the Discussion Paper, the preliminary view was to require an entity to disclose:

(a) information about the subsequent performance of a business combination for a core time period—that is, for as long as an entity's management continues to review whether the objectives for a business combination are being met (paragraphs BC119–BC120); and

(b) that an entity's management is not reviewing or has stopped reviewing whether its objectives for the business combination are being met (paragraphs BC121–BC123). In particular:

   (i) if management does not review whether an acquisition-date key objective and the related targets for the business combination are being met, the entity shall disclose that fact and the reasons for not doing so; or

   (ii) if management stops reviewing whether an acquisition-date key objective and the related targets for the business combination are met before the end of the second annual reporting period after the year of acquisition, the entity shall disclose that fact and the reasons for doing so.

BC116 Some respondents to the Discussion Paper agreed with requiring an entity to disclose information for a core time period. However, a few respondents suggested requiring disclosure for a specified time period.

BC117 Most respondents agreed with the preliminary view that would require an entity to disclose that it is not reviewing or has stopped reviewing the performance of an acquisition-date key objective and the related targets. However, a few respondents said the time period for this proposed requirement is arbitrary and either too short or too long.

BC118 Feedback on the Discussion Paper and other outreach with preparers highlighted concerns about how the preliminary views, if implemented, would be applied in specific circumstances. These concerns relate to:

(a) *interaction with the annual budgeting process*—some respondents said an entity's management reviews the performance of a business combination against the business plan developed during the acquisition process only for up to one year after the business

combination. After that, the business combination is reviewed as part of the entity's annual budgeting process whereby the CODM reviews the performance of the business as a whole against an updated business plan instead of against the assumptions made at the time the business combination occurs. These respondents said that, in this circumstance, if the preliminary views were implemented, an entity would disclose performance against its acquisition-date key objectives and the related targets for up to a year after the business combination occurs. However, when the next annual budgeting cycle starts, the entity would disclose that it has stopped reviewing the performance of an acquisition-date key objective and the related targets because it is no longer reviewing performance against its acquisition-date objectives and the related targets.

(b) *post-acquisition reviews*—some respondents said information is sometimes reported to an entity's management as part of a post-acquisition review, instead of on a regular basis. This post-acquisition review is a one-off review that might take place a few years after a business combination occurs. An entity reviews assumptions made in the business plan prepared as part of the business combination and compares those assumptions against actual outcomes.

Core time period

BC119 The IASB proposes to proceed with specifying the core time period for disclosure as being for as long as an entity's management reviews whether the acquisition-date key objectives and the related targets for a business combination are being met. To help distinguish between management reviewing the business combination and management reviewing the business as a whole, the IASB decided to clarify that management is regarded as reviewing whether the acquisition-date key objectives and the related targets of the business combination are being met if management compares actual performance in subsequent periods with the acquisition-date key objectives and the related targets for the business combination.

BC120 In the IASB's view, specifying a fixed time period for disclosure could be viewed as arbitrary whereas specifying the core time period is better because it:

(a) would require an entity to disclose information based on what is used internally by the entity's management. This information would be less costly because it already exists. On the other hand, specifying a fixed time period could result in the entity being required to develop information specifically to meet disclosure requirements.

(b) takes into account the fact that the management of different entities review the performance of business combinations differently. If an entity's management reviews information internally, that information is also likely to be useful to users.

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(c) would capture ad hoc information reviewed by an entity's management—for example, from 'post-acquisition reviews' described in paragraph BC118(b).

Management is not reviewing or has stopped reviewing the performance of an acquisition-date key objective and the related targets

BC121 The IASB decided to propose that an entity be required to disclose if its management does not start reviewing or has stopped reviewing the performance of an acquisition-date key objective and the related targets before the end of the second annual reporting period after the year of acquisition. This information would be required for each acquisition-date key objective and related targets for the business combination. For example, an entity's management might review the performance of one acquisition-date key objective and related targets but not another. The entity would be required to disclose information about the acquisition-date key objective and the related targets that its management is reviewing and also disclose that it is not reviewing whether the other key objective and related targets are being met and explain why. Although the time period is arbitrary, in the IASB's view, this time frame is an appropriate balance between requiring an entity to disclose relevant information and the risk of imposing a time frame that is too long and onerous for preparers.

BC122 In the IASB's view, this information is useful because users said knowing that an entity's management is not reviewing or has stopped reviewing the performance of an acquisition-date key objective and the related targets helps them assess management's stewardship of the entity's resources.

BC123 The IASB acknowledged the concern raised by respondents as described in paragraph BC118(a). The IASB agreed that in those circumstances a user might not receive useful information if the preliminary view was implemented. In response the IASB proposes to add a requirement that would apply if an entity's management stops reviewing the achievement of an acquisition-date key objective and the related targets before the end of the second annual reporting period after the year of acquisition. This proposal would require an entity to disclose information about actual performance using the metric set out in the year of acquisition if (and only if) information about the business combination's subsequent performance measured using that metric is still being received by the entity's management in a different context.

Can an entity change the way it reviews performance?

BC124 The Discussion Paper described situations in which an entity changes the metrics used to measure the performance of a business combination.

BC125 The preliminary view was not to require an entity to continue disclosing information about performance using a metric it no longer uses internally. Instead, if the entity makes such a change, the entity would be required to disclose that fact, the reason for the change, and information about performance using the revised metrics.

BC126 The preliminary view to require an entity to disclose information about changed metrics would have applied in limited circumstances—that is, the requirement would apply only if disclosing information about the original metric were impracticable. Such a situation could arise, for example, if a CGU that is the basis of measuring a target, is merged into another CGU because of a reorganisation. It was not the intention of the preliminary view to require an entity to disclose an updated key objective or target for a business combination that reflects updated expectations for the business combination.

BC127 The preliminary view on changing metrics would also not apply in instances in which an entity's management refines its target. For example, if in a subsequent period an entity's management narrows the range for its target, this would not be regarded as a change in target or metric.

BC128 Responses to the Discussion Paper indicated mixed views on this preliminary view. Many respondents agreed with the preliminary view. However, some respondents said requiring entities to disclose information about changed metrics would:

(a) reduce comparability of the financial statements over time; and

(b) allow entities to hide poor performance by disclosing information using a changed metric that suggests a better performance than the metric it replaced.

BC129 The IASB decided against proceeding with its preliminary view to require an entity to disclose information about a change in metrics because:

(a) a changed metric would not provide information about the acquisition price—a key reason for the IASB proposing to require an entity disclose information about the performance of business combinations in financial statements (see paragraphs BC132–BC143).

(b) this requirement would apply in limited circumstances, as explained in paragraph BC126.

(c) users would still receive information about a change in metric if an entity makes that change before the end of the second annual reporting period after the year of acquisition. This circumstance would be captured by the IASB's proposal to require an entity to disclose that its management has stopped reviewing an acquisition-date key objective and the related targets during that period. A user would therefore receive information that the entity has stopped reviewing against its acquisition-date objectives and targets and the reason why (that is, it has changed the basis of measurement).

(d) the IASB was concerned that proposing many additions to the core time period described in paragraph BC115(a) could add undue complexity to the proposed requirements and cause confusion. After considering feedback on the Discussion Paper, the IASB's view is that applying its proposal to require the disclosure of information about performance using a particular metric, if it is still being received by management in a different context (see paragraph BC123), would

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provide information that is more useful than information about a change in metrics.

(e) the IASB noted that it might be difficult to identify whether an entity's management had stopped reviewing the performance of the business combination if the entity changed its key objectives and related targets after the acquisition. For example, it might be difficult to distinguish between reviewing changed key objectives and related targets for the business combination and reviewing the performance of a combined business as part of management's review of the entity as a whole.

BC130 Some IASB members disagreed with the IASB's decision in this respect. These IASB members would have preferred to proceed with the preliminary view because:

(a) not requiring an entity to disclose changed metrics it uses to measure performance, even in limited circumstances, allows an entity to avoid disclosing information about the performance of a business combination. These IASB members think that information about performance measured on a new basis is more useful than a statement that the entity has stopped reviewing that performance because the entity's key management personnel changed the basis of measurement of the key objectives and related targets for the business combination.

(b) the preliminary view was supported by many respondents, which indicates that such information would be useful.

Other concerns

BC131 Many respondents to the Discussion Paper raised other practical concerns about the preliminary views, including about:

(a) the location of information (paragraphs BC132–BC143);

(b) auditability of information (paragraphs BC144–BC145); and

(c) integration (paragraphs BC146–BC147).

Location of information

BC132 Most respondents to the Discussion Paper agreed that the IASB should explore how an entity could provide more useful information about business combinations. However, many respondents said the IASB should not require an entity to disclose information about the performance of a business combination in financial statements. These respondents said an entity should provide this information in management commentary and suggested the IASB consider this as part of its Management Commentary project. Some respondents provided similar feedback about requiring an entity to disclose in its financial statements information about expected synergies (see paragraphs BC148–BC163).

BC133 Most respondents who disagreed with the preliminary view to require an entity to disclose this information in financial statements said this was because the information:

(a) does not directly relate to an entity's assets, liabilities, equity, income and expenses. In the view of these respondents, disclosing such information does not meet the objective of financial statements as described in paragraphs 3.2–3.3 of the *Conceptual Framework for Financial Reporting* (Conceptual Framework); and

(b) includes forward-looking information, which closely resembles information typically included in management commentary.

BC134 The IASB considered this feedback but, for the reasons discussed below, concluded that it can require the information to be disclosed in financial statements.

Does the information meet the objective of financial statements?

BC135 Paragraph 3.2 of the Conceptual Framework and paragraph 9 of IAS 1 *Presentation of Financial Statements* state that the objective of financial statements is to provide financial information about an entity's assets, liabilities, equity, income and expenses that is useful in assessing the prospects for future net cash inflows to the entity and in assessing management's stewardship of the entity's economic resources.

BC136 The description of the notes to the financial statements the IASB developed in its Primary Financial Statements project explains that the role of the notes is to provide material financial information necessary:

(a) to enable users to understand the line items presented in the primary financial statements; and

(b) to supplement the primary financial statements with additional financial information to achieve the objective of financial statements.

BC137 Information about an entity's acquisition-date key objectives and the related targets for a business combination and expected synergies provides information about the acquisition price for the business combination. The IASB observes that the acquisition price is reflected in the financial statements through the recognition of assets acquired and liabilities assumed in the business combination, including goodwill.

Forward-looking information

BC138 The IASB acknowledges that some aspects of its proposals—particularly in relation to information about the strategic rationale for a business combination (see paragraphs BC164–BC165)—could require the disclosure of forward-looking information.

BC139 However, some IASB members think other information (such as information about acquisition-date key objectives, related targets and expected synergies) is not forward-looking in the context of the Conceptual Framework because the information relates to assumptions made at the time a business combination occurs. The information does not represent the expectations of an entity's management about the future performance of the business combination as at the reporting date or when the financial statements are issued. Instead, the information relates to assumptions for a historic transaction. These

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assumptions are then reflected in the acquisition price and the assets and liabilities recognised as a result of the business combination. Information about management's acquisition-date key objectives, their related targets and expected synergies are fixed at the date of acquisition.

BC140 The IASB considered whether the information about acquisition-date key objectives, related targets and expected synergies can be required in financial statements in accordance with the Conceptual Framework. Paragraph 3.6 of the Conceptual Framework supports the disclosure of forward-looking information in financial statements if that information:

(a) relates to an entity's assets or liabilities—including unrecognised assets or liabilities—or equity that existed at the end of the reporting period, or during the reporting period, or to income or expenses for the reporting period; and

(b) is useful to users.

BC141 In the IASB's view, the information it proposes requiring an entity to disclose relates to assets the entity has acquired and liabilities it has assumed in a business combination (see paragraph BC137) and is useful to users (see paragraphs BC18–BC21).

BC142 Although some IASB members think this information is not forward-looking, the IASB acknowledges that other stakeholders regard the information to be forward-looking, possibly because of different definitions of forward-looking in local regulations. The definition of forward-looking information in those regulations might result in additional litigation risk for an entity disclosing the information. The IASB considered this feedback in developing the exemption (see paragraphs BC82–BC85).

Other considerations

BC143 The IASB observed that not all entities produce a management commentary, and when an entity does so, this commentary might not be as readily available as financial statements. Requiring the information to be disclosed in financial statements would ensure all entities disclose this information in a consistent manner.

Auditability

BC144 In the IASB's view, the information the IASB's proposals would require an entity to disclose is auditable. In the IASB's outreach, preparers said they prepare significant documentation in determining the amount to pay for a business combination and many auditors said they expect to be able to audit that information.

BC145 The IASB expects auditors and regulators will be able to verify:

(a) whether the information disclosed is the information an entity's key management personnel receive to review a business combination.

(b) whether there is adequate explanation and appropriate evidence supporting the information.

(c) whether the information disclosed faithfully represents what it purports to represent. For example, by requiring the disclosure of information for only strategic business combinations it is more likely that the performance of a combined business (see paragraphs BC146–BC147) is reflective of the performance of the business acquired because strategic business combinations are those that have a more visible effect on the entity's business.

Integration

BC146 The preliminary views in the Discussion Paper took into account situations in which an acquired business is integrated. The IASB decided to follow the same approach in developing its proposals in this Exposure Draft. In particular, the IASB expects that, for a strategic business combination, even if management's intention is to quickly integrate the acquired business into an entity's existing business, the entity's key management personnel are likely to be reviewing some information to assess the performance of the business combination—for example by using information about the combined business.

BC147 The IASB's proposals:

(a) follow a management approach—if an entity's management intends to review information about a combined business to assess the performance of the business combination, then this information is what an entity would be required to disclose.

(b) would not require an entity to create information about the acquired business in isolation if its management assesses the performance of a business combination in a different way. If an entity does not review the performance of the business combination because of integration, it would be required to disclose that fact.

Quantitative information about expected synergies

Background and feedback on preliminary views

BC148 Throughout the Business Combinations—Disclosures, Goodwill and Impairment project users said information on the nature, timing and amount of expected synergies from a business combination is important because it gives them a better understanding of why an entity paid the price it did for the business combination. Paragraph B64(e) of IFRS 3 requires an entity to disclose a qualitative description of the factors that make up the goodwill recognised, which could include expected synergies from combining the operations of the acquiree and the acquirer.

BC149 In response to users' need for better information about expected synergies, the preliminary view in the Discussion Paper was to expand the requirement in paragraph B64(e) of IFRS 3 by requiring an entity to disclose:

(a) a description of expected synergies;

(b) when the synergies are expected to be realised;

(c) the estimated amount or range of amounts of the synergies; and

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(d) the estimated cost or range of costs to achieve the synergies.

BC150 The IASB received mixed feedback on its preliminary view. Most users who commented on the preliminary view agreed and said the information is useful. However, many respondents, including some who agreed the information is useful, disagreed with the preliminary view. They said the information would be so commercially sensitive that its disclosure in financial statements should not be required or could be regarded as forward-looking in their jurisdiction and expose the entity to litigation risk.

BC151 The IASB decided to proceed with its preliminary view, subject to some amendments, and to propose that an entity be required to disclose additional information about expected synergies at the acquisition date. The IASB considered:

(a) whether to specify the level at which to disclose information about expected synergies and concerns about commercial sensitivity (paragraphs BC152–BC156);

(b) the duration of expected synergies (paragraphs BC157–BC158);

(c) whether to define expected synergies (paragraphs BC159–BC160); and

(d) how the IASB's proposal for disclosing information about expected synergies interacts with its proposals for disclosing information relating to the performance of a business combination (paragraphs BC161–BC163).

Level at which to disclose expected synergies and concerns about commercial sensitivity

BC152 Taking into account feedback from respondents that information about expected synergies might be commercially sensitive, the IASB considered the level of aggregation at which an entity could disclose this information. In particular:

(a) some users suggested disaggregating cost and revenue synergies and said they would analyse information about cost synergies differently from information about revenue synergies;

(b) some preparers who expressed concerns about the commercially sensitive nature of the information acknowledged the information would not be commercially sensitive if disclosed at a sufficiently aggregated level; and

(c) many entities that provide quantitative information about expected synergies outside financial statements do so at a level that disaggregates synergies into different categories—notably cost and revenue synergies.

BC153 Accordingly, the IASB proposes to require an entity to disclose information about expected synergies by category—for example, total revenue synergies, total cost synergies and totals for each other type of synergy (such as tax synergies).

BC154 In the IASB's view, disclosing information about expected synergies by category would, in most cases, respond to concerns that expected synergy information could be commercially sensitive. However, the IASB acknowledges that there might be instances in which disclosing quantitative information about expected synergies could be commercially sensitive, even if disclosed only by category. The IASB therefore proposes allowing an entity to apply the proposed exemption described in paragraphs BC74–BC107 to information about expected synergies.

BC155 As part of the IASB's proposals about the exemption from the proposed requirement to disclose information about expected synergies, an entity would be required to consider whether, instead of applying the exemption, disclosing the total amount of expected synergies could resolve concerns about commercial sensitivity. The IASB expects information at a total synergies level would not be as sensitive as information specified by category (see paragraph BC98). This proposed requirement is intended to preserve as much quantitative information as possible, while allowing for circumstances in which information about expected synergies by category would be so commercially sensitive that its disclosure in financial statements should not be required.

BC156 The IASB also decided to clarify its preliminary view to require an entity to disclose the nature of expected synergies. An entity would disclose the nature of expected synergies by disclosing each category of expected synergies—for example, whether the category represents revenue, cost or other types of synergies.

Duration of expected synergies

BC157 Some respondents to the Discussion Paper suggested defining when synergies are expected to be 'realised' (see paragraph BC149(b)). The IASB identified two possible understandings of when synergies are 'realised':

(a) when an entity has taken steps to benefit from expected synergies; or

(b) the duration of the benefit resulting from expected synergies.

BC158 In the IASB's view, both types of information would be useful and help users develop their cash flow forecasts for an entity. Therefore, the IASB decided to propose requiring an entity to disclose the time from which the synergies are expected to start and how long they are expected to last. In applying this requirement, the entity would have to identify whether the synergies are expected to be finite or indefinite.

Definition of expected synergies

BC159 Some respondents to the Discussion Paper suggested defining expected synergies. These respondents said a lack of definition might lead to diversity in how entities identify and quantify expected synergies. In their view, such diversity could result in users receiving varied and potentially misleading information.

BC160 The IASB considered providing a definition of expected synergies but decided against doing so. The IASB observed that:

(a) the term appears to be widely understood. Most of the dictionaries the IASB consulted define 'synergies' as arising from a combination of two or more items, and resulting in a combined performance or value greater than the sum of the items when considered separately. The IASB concluded there would be limited benefit in including this definition in IFRS 3.

(b) paragraph B64(e) of IFRS 3 requires an entity to disclose qualitative information about expected synergies. Feedback did not suggest entities fail to identify expected synergies appropriately.

Interaction with proposed disclosure requirements about the performance of a business combination

BC161 The IASB observed some confusion among stakeholders about the link between its proposals to require an entity to disclose information about expected synergies and its proposals to require an entity to disclose information about the performance of a business combination. Some stakeholders said it might be impossible to track whether synergies have been achieved in periods after the business combination occurs.

BC162 These two proposals are separate. The proposed requirement for an entity to disclose information about expected synergies would apply only in the year of acquisition. It would not require an entity to disclose information subsequently about whether those synergies have been achieved.

BC163 The IASB notes that the proposed management approach to disclosing information about the performance of a business combination does not specify which acquisition-date key objectives and related targets an entity is required to disclose information about. Instead, it requires the entity to disclose the information its key management personnel review to determine the extent to which an acquisition-date key objective and the related targets are being met. The entity's key management personnel might assess whether expected synergies have been achieved in reviewing the performance of the business combination. If this is the case, the proposals on disclosing information about the performance of a business combination would require the entity to disclose the information about synergies being reviewed by the entity's key management personnel.

Strategic rationale

BC164 Paragraph B64(d) of IFRS 3 requires an entity to disclose its primary reasons for a business combination. The IASB proposes to replace that requirement with a requirement for an entity to disclose the strategic rationale for the business combination. The description of the strategic rationale is likely to be broad (for example, 'to expand the entity's geographical presence in Region Z by acquiring Entity B, which trades in Region Z').

BC165 The intention of the proposal is to provide a clearer link between the objectives for a business combination and an entity's overall business strategy.

Contribution from acquired businesses

BC166 Paragraph B64(q) of IFRS 3 requires an entity to disclose to the extent practicable:

(a) 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

(b) 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 (combined entity information).

BC167 The IASB received mixed views on the usefulness and cost of disclosing this information. In response to this feedback, the IASB proposes:

(a) to retain the requirement in paragraph B64(q) of IFRS 3 (paragraphs BC168–BC169);

(b) to replace the term 'profit or loss' in paragraph B64(q) of IFRS 3 with the term 'operating profit or loss' (paragraphs BC170–BC172);

(c) not to require an entity to disclose information about cash flows arising from operating activities (paragraphs BC173–BC174); and

(d) to explain the objective of the requirement in paragraph B64(q)(ii) of IFRS 3 to disclose combined entity information and to specify that the basis on which an entity prepares that information is an accounting policy (paragraphs BC175–BC177).

Retaining the requirement in paragraph B64(q) of IFRS 3

BC168 Many preparers said the information required by paragraph B64(q) of IFRS 3 is complex and costly to prepare. Preparers also highlighted diversity in how entities prepare the information and said the information is therefore not comparable. However, almost all users who commented on the topic said they need this information because it helps them determine a baseline performance against which they can compare future performance.

BC169 On balance, the IASB decided to retain the requirement in paragraph B64(q) of IFRS 3.

Replacing the requirement to disclose profit or loss with a requirement to disclose operating profit or loss

BC170 The preliminary view in the Discussion Paper was to replace the term 'profit or loss' in paragraph B64(q) of IFRS 3 with the term 'operating profit or loss before deducting acquisition-related costs and integration costs'. 'Operating profit or loss' would be defined in the IASB's Primary Financial Statements project. This would:

(a) provide users with more useful information about the operating performance of a business combination to help with trend analysis;

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(b) reduce diversity in what measure of profit or loss entities disclose by requiring entities to disclose a consistent measure of profit or loss; and

(c) avoid the need for entities to make subjective allocations of finance costs and tax expenses as if a business combination had been as of the beginning of the annual reporting period, and therefore reduce the cost of preparing combined entity information.

BC171 Most respondents to the Discussion Paper agreed with the preliminary view that entities should disclose information about operating profit or loss. The IASB decided to propose a measure based on operating profit or loss for the reasons explained in paragraph BC170.

BC172 However, the IASB decided to amend its preliminary view and not to propose that amount be 'before deducting acquisition-related costs and integration costs'. The IASB observed that:

(a) an entity is already required to disclose information about acquisition-related costs in accordance with paragraph B64(m) of IFRS 3; and

(b) an entity might incur integration costs not only in the year of acquisition but also in the years after the business combination. Operating profit or loss before deducting acquisition-related costs and integration costs might not provide useful information to allow users to forecast operating profit or loss for the first few years after the acquisition.

Whether to add a requirement to disclose cash flows from operating activities

BC173 The preliminary view in the Discussion Paper was to add a requirement to paragraph B64(q) of IFRS 3 to disclose information about the cash flows arising from operating activities. The IASB expected this information would help users who use cash flow measures in their analysis.

BC174 However, after considering feedback, the IASB decided against proposing such a requirement. Many respondents, including almost all preparers, said it would be costly to prepare this information. Respondents also said the usefulness of the information would be limited without incremental information.

Application guidance for the requirement in paragraph B64(q)(ii) of IFRS 3

BC175 Many respondents to the Discussion Paper suggested that the IASB should provide guidance on how to prepare combined entity information. These respondents said application guidance is needed on, for example:

(a) circumstances in which an acquirer's and acquiree's accounting policies differed before a business combination;

(b) upstream and downstream transactions; and

(c) whether to include cost or revenue synergies.

BC176 The IASB decided against proposing application guidance because it would be difficult to provide guidance that would be applicable for all business combinations and would answer all application questions.

BC177 Instead, the IASB proposes:

(a) to describe the objective of disclosing combined entity information. The IASB expects that explaining this objective will help entities develop accounting policies for calculating combined entity information and reduce diversity in how entities prepare the information.

(b) to specify that the basis on which an entity prepares combined entity information is an accounting policy. Paragraph 117 of IAS 1 requires an entity to disclose material accounting policy information. Specifying that this is an accounting policy will result in entities disclosing information about the basis of preparation of combined entity information to the extent that information is material.

Classes of assets acquired and liabilities assumed

BC178 Some users said they need to know the amount of liabilities arising from financing activities and defined benefit pension liabilities assumed as part of a business combination. However, some entities do not disclose this information separately for each business combination. These users view such liabilities as part of the total capital employed in the business combination.

BC179 Paragraph B64(i) of IFRS 3 requires an entity to disclose the amounts recognised for each major class of assets acquired and liabilities assumed in a business combination. In the Discussion Paper, the preliminary view was to develop proposals to specify that liabilities arising from financing activities and defined benefit pension liabilities are major classes of liabilities.

BC180 Almost all respondents to the Discussion Paper who commented on this topic agreed with the preliminary view. However, the IASB observes that since the development of the Discussion Paper it has:

(a) issued *Disclosure of Accounting Policies*, which amended IAS 1. These amendments included replacing the phrase ‘significant accounting policies’ with ‘material accounting policy information’. In these amendments the IASB noted that entities have difficulty in understanding the difference between ‘significant’ and ‘material’. This difficulty could also apply to ‘major’ as used in paragraph B64(i) of IFRS 3.

(b) developed principles of aggregation and disaggregation for the primary financial statements and the notes as part of the Primary Financial Statements project. Applying these principles to the requirement in paragraph B64(i) of IFRS 3 could help resolve issues with that requirement.

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BC181 The IASB concluded that the IAS 1 amendment and the principles it recently developed about aggregation and disaggregation are sufficient to help entities make better materiality judgements. Consequently, the IASB can now propose a more principles-based approach that relies on assessments about materiality. Therefore, the IASB is proposing:

(a) to remove the term 'major' in paragraph B64(i) of IFRS 3; and

(b) to amend paragraph IE72 of the Illustrative Examples accompanying IFRS 3 to illustrate an entity disclosing liabilities arising from financing activities and defined benefit pension liabilities as classes of liabilities assumed.

Deleting requirements

BC182 During the development of the Discussion Paper, preparers said the disclosure requirements in IFRS 3 are voluminous and costly to comply with. Stakeholders suggested removing some requirements in IFRS 3 to reduce the cost burden of applying the disclosure requirements in IFRS 3 without losing useful information.

BC183 After considering stakeholder suggestions, the IASB proposes to delete from IFRS 3:

(a) paragraph B64(h)—information about acquired receivables. This requirement was included in IFRS 3 while the IASB developed wider requirements for an entity to disclose information about the credit quality of its financial assets, including receivables. Subsequent to issuing IFRS 3, the IASB issued IFRS 7, which includes requirements for an entity to disclose such information. Information disclosed in accordance with paragraphs 35A–35M of IFRS 7 is at an aggregated level and not specific to each business combination. However, the IASB considers the information disclosed in accordance with IFRS 7 to be sufficient to meet user needs and that removing the requirement in IFRS 3 would reduce some costs for preparers.

(b) paragraph B67(d)(iii)—a line item in the required reconciliation between opening and closing goodwill balances that relates to changes resulting from the subsequent recognition of deferred tax assets. This requirement became redundant when the IASB amended IFRS 3 in 2008. Accordingly, although not reducing cost for preparers, the IASB decided to propose removing the requirement to avoid questions about why this requirement still exists.

(c) paragraph B67(e)—the amount and an explanation of any material gain or loss recognised in the current reporting period that relates to the identifiable assets acquired or liabilities assumed in a business combination that was affected in the current or previous reporting period. This paragraph is designed as a backstop that requires an entity to disclose any information about gains and losses relevant to the disclosure objective in paragraph 61 of IFRS 3. However, the IASB views this requirement as unnecessary because other requirements in IFRS

Accounting Standards require an entity to disclose this information. In particular, paragraph 97 of IAS 1 requires an entity to disclose separately the nature and amount of items of income or expense when they are material.

Proposed amendments to IAS 36 *Impairment of Assets*

BC184 IAS 36 requires an entity to test cash-generating units (CGUs) containing goodwill for impairment at least annually, even if there is no indication that the CGUs might be impaired. This requirement, introduced in 2004, replaced the requirement in IAS 22 *Business Combinations* to amortise goodwill over its useful life.

BC185 IAS 36 and its Basis for Conclusions explain that:

(a) goodwill is tested for impairment within the CGUs expected to benefit from the synergies of a business combination because goodwill does not generate cash flows independently. The impairment test assesses whether the combined recoverable amount of the assets of those CGUs, including the goodwill, is higher than their combined carrying amount. The impairment test therefore tests goodwill only indirectly.

(b) for the purpose of impairment testing, entities allocate goodwill to a CGU or group of CGUs at the lowest level at which the goodwill is monitored for internal management purposes. These groups shall not be larger than an operating segment, as defined by IFRS 8, before aggregation.

(c) the recoverable amount of each CGU or group of CGUs containing goodwill is the higher of fair value less costs of disposal and value in use. If a CGU or group of CGUs contains goodwill and the recoverable amount of that CGU or group exceeds its carrying amount, neither the CGU or group of CGUs nor the goodwill allocated to that CGU or group is impaired, and no impairment loss is recognised.

(d) if the recoverable amount is lower than the carrying amount, the CGU or group of CGUs is impaired and an entity recognises an impairment loss. This loss is allocated first to reduce the carrying amount of any goodwill allocated to the CGU or group of CGUs. Then, if the carrying amount of goodwill is zero, any remaining impairment loss reduces the carrying amounts of other assets of the CGU or group of CGUs within the scope of IAS 36.

BC186 In the Business Combinations—Disclosures, Goodwill and Impairment project the IASB considered how to respond to feedback from stakeholders in the PIR of IFRS 3 about:

(a) impairment losses sometimes being recognised too late;

(b) application of the impairment test being costly and complex; and

(c) reintroducing amortisation of goodwill.

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BC187 The IASB's deliberations focused on:

(a) improving the effectiveness of the impairment test, without significantly increasing cost and complexity (paragraphs BC188–BC202);

(b) reducing the cost and complexity of the impairment test, without significantly reducing the test's effectiveness (paragraphs BC203–BC227); and

(c) reintroducing amortisation of goodwill (paragraphs BC228–BC251).

Improving the effectiveness of the impairment test

BC188 The IASB identified two broad reasons for stakeholder concerns about possible delays in recognising impairment losses on goodwill:

(a) management over-optimism—some stakeholders said an entity's management might sometimes be overly optimistic in making assumptions about cash flow forecasts used in the impairment test.

(b) shielding—some stakeholders said goodwill can be shielded from impairment by, for example, the headroom of a business with which an acquired business is combined. Headroom is the amount by which a business's recoverable amount exceeds the carrying amount of its recognised net assets. This headroom can mask the impairment of acquired goodwill when an entity tests the combined business for impairment because any reduction in the recoverable amount of the combined business is first absorbed by that headroom.

BC189 In developing its preliminary views in the Discussion Paper, the IASB observed that:

(a) estimates of cash flows will be subject to management judgement but, if applied appropriately, the impairment test is expected to meet its objective of ensuring the combined assets, including goodwill, are carried at no more than their combined recoverable amount;

(b) IAS 36 contains requirements that reduce the risk of cash flow forecasts being too optimistic; and

(c) overly optimistic estimates of cash flows are best addressed by auditors and regulators, instead of by changing IFRS Accounting Standards.

BC190 To address shielding, the IASB considered whether it could design a different impairment test from the one in IAS 36 that would be significantly more effective at recognising impairment losses on goodwill at a reasonable cost. The IASB concluded it is not feasible to do so. In particular, the IASB considered a so-called headroom approach, in which at least a portion of any reduction in the recoverable amount would be attributed to the acquired goodwill, instead of allocating it first to the unrecognised headroom. However, after extensive work, the preliminary view set out in the Discussion Paper was not to propose a headroom approach because it:

(a) would reduce, but not eliminate, shielding;

(b) could result in recognising impairments that are, in some circumstances, difficult to understand; and

(c) would add cost and complexity to the test.

BC191 Most respondents to the Discussion Paper agreed with the preliminary view. However, some respondents disagreed and suggested alternative impairment tests or other methods to ensure CGUs containing goodwill are carried at no more than their recoverable amounts. The IASB considered these suggestions but decided against proposing any of them. The IASB concluded the suggested impairment tests would add cost, would reduce but not eliminate the shielding effect, would require an imperfect or arbitrary allocation of any resulting impairment losses to acquired goodwill, or result in a fundamental change to the underlying principles of IAS 36.

BC192 Many respondents suggested ways to improve the application and effectiveness of the impairment test in IAS 36. The Business Combinations—Disclosures, Goodwill and Impairment project was established to respond to feedback from the PIR of IFRS 3 and not to perform a comprehensive review of IAS 36. Hence, the IASB decided to explore only those suggestions that would respond to the feedback from the PIR and which could address concerns about the timeliness of impairment losses on goodwill.

BC193 The IASB focused on improvements to mitigate the two main reasons for these concerns (management over-optimism and shielding) that could be implemented at a reasonable cost. Following feedback from the IASB's consultative groups and the IFRS Interpretations Committee, the IASB decided:

(a) to provide additional guidance on how to allocate goodwill to CGUs (paragraphs BC194–BC201); and

(b) to require an entity to disclose in which reportable segment a CGU containing goodwill is included (paragraph BC202).

Additional guidance on how to allocate goodwill to CGUs

BC194 Paragraph 80 of IAS 36 contains requirements for allocating goodwill to CGUs or groups of CGUs for impairment testing. In particular, it requires each unit or group of units to which the goodwill is allocated:

(a) to represent the lowest level within an entity at which the goodwill is monitored for internal management purposes; and

(b) not to be larger than an operating segment as defined by paragraph 5 of IFRS 8 before aggregation.

BC195 As paragraph BC140 of the Basis for Conclusions on IAS 36 explains, there should be a link between the level at which goodwill is tested for impairment and the level of internal reporting that reflects the way an entity manages its operations. Paragraph BC146 of the Basis for Conclusions on IAS 36 explains that if a business combination enhances the value of all the acquirer's pre-existing CGUs, it would be wrong to conclude that goodwill can be tested only at the entity level.

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BC196 In developing its preliminary views in the Discussion Paper, the IASB concluded it would be difficult to provide additional guidance on allocating goodwill to CGUs for the purpose of impairment testing that could apply to all entities. This difficulty arises because the allocation of goodwill should reflect an entity's organisational structure and its internal reporting systems, but entities are organised in many different ways.

BC197 However, feedback on the Discussion Paper indicated entities might not always apply paragraph 80 of IAS 36 as the IASB intended when developing the impairment test. For example, feedback suggested entities might allocate goodwill for impairment testing purposes to operating segments as a default and that management might not specifically monitor goodwill.

BC198 Although the IASB continues to think it would not be possible to provide comprehensive guidance on allocating goodwill to CGUs, it acknowledges that some targeted changes to paragraph 80 of IAS 36 could improve the application and enforcement of those requirements, which in turn could help reduce shielding.

BC199 In particular, the IASB proposes:

(a) to replace the phrase 'goodwill is monitored' in paragraph 80(a) of IAS 36 with 'business associated with the goodwill is monitored':

(i) to describe better the activity that an entity's management performs;

(ii) to maintain the link between how goodwill is tested for impairment and how an entity is organised for internal reporting purposes; and

(iii) to avoid an entity allocating goodwill at the operating segment level by default because the entity concludes its management does not monitor goodwill.

(b) to clarify that an entity is required first to apply paragraph 80(a) of IAS 36 and determine the lowest level at which the business associated with the goodwill is monitored for internal management purposes and only then apply paragraph 80(b) of IAS 36, which acts as a ceiling to the level that the entity determines applying paragraph 80(a). This clarification would help to avoid an entity applying paragraph 80(b) as a default.

(c) to provide limited guidance on what is meant by monitoring the business associated with the goodwill (see proposed paragraph 80A of IAS 36). This guidance would help an entity allocate goodwill to a level consistent with how it reports internally and manages its operations, which is the intent of IAS 36.

(d) to clarify that IAS 36 requires an entity to allocate goodwill to groups of CGUs (if goodwill cannot be allocated to individual CGUs on a non-arbitrary basis) because goodwill arises in a business combination and a business sometimes comprises groups of CGUs.

BC200 Some respondents to the Discussion Paper suggested linking the level at which CGUs or groups of CGUs containing goodwill are tested for impairment with the level at which a business combination is reviewed for the purpose of the proposed disclosures about the business combination's performance (see paragraphs BC110–BC114). However, the IASB concluded a direct link could result in an entity performing the impairment test at a different level from that intended by the requirements in paragraph 80 of IAS 36, or in further misunderstandings about how to apply that paragraph.

BC201 To avoid any potential confusion, the IASB decided to clarify that the level an entity determines in its application of paragraph 80(a) of IAS 36 might not correspond with the level of reviewing described in proposed paragraphs B67A–B67B of IFRS 3. The objectives of these requirements are different. As explained in paragraph BC111, the use of key management personnel for the proposed disclosure requirements in IFRS 3 is intended to identify the most important information by focusing on a senior level of management. However, the purpose of the impairment test is to allocate goodwill at the lowest level within an entity at which its management is monitoring the business associated with the goodwill.

Disclosing in which reportable segment a CGU containing goodwill is included

BC202 The IASB proposes to require an entity to disclose in which reportable segment a CGU (or group of CGUs) containing goodwill is included. The proposal has been developed because:

(a) in the IASB's view, this information would help users better assess the reasonableness of assumptions used in the impairment test and thereby help reduce management over-optimism. Users would be able to compare these assumptions with the information they receive about reportable segments and with their own assumptions about the future performance of those reportable segments.

(b) the IASB's research suggests that disclosing this information would not result in significant costs—entities are likely already to have this information. A few stakeholders said some entities already disclose this information.

(c) knowing to which reportable segment goodwill has been allocated would provide users with information that, together with other information disclosed in accordance with IFRS 3, could help them assess the decision of an entity's management to acquire a business and integrate it with the entity's other businesses. This outcome would align with the project's objective of providing better information about business combinations.

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Reducing the cost and complexity of the impairment test

Changing how an entity calculates value in use

BC203 The IASB proposes to amend how an entity calculates value in use. The changes to value in use are intended both to reduce the cost and complexity of the impairment test in IAS 36 and improve the information provided by the test, by bringing the calculation closer to the cash flow forecasts used by an entity's management. The IASB is proposing to amend value in use by removing:

(a) the constraint on including future restructuring and asset enhancement cash flows (paragraphs BC204–BC214); and

(b) the requirement to use pre-tax cash flows and pre-tax discount rates (paragraphs BC215–BC222).

Removing the constraint on future restructuring and asset enhancement cash flows

BC204 Paragraphs 44–48 of IAS 36 constrain the cash flows an entity is permitted to include in calculating value in use. An entity is not permitted to include estimated cash flows expected to arise from:

(a) a future restructuring to which the entity is not yet committed (future restructuring); or

(b) improving or enhancing an asset's performance (asset enhancement).

BC205 The IASB proposes to remove that constraint. In the IASB's view, doing so would:

(a) reduce cost and complexity—removing the constraint would reduce the need to amend management's financial budgets or forecasts. Stakeholders said it can be challenging for management to distinguish maintenance capital expenditure from expansionary capital expenditure and identify which cash flows need to be excluded because they relate to expansionary capital expenditure.

(b) make the impairment test less prone to error because estimates of value in use would be based more closely on cash flow projections that are prepared, monitored and used internally for decision-making.

(c) make the impairment test easier to understand, perform, audit and enforce.

BC206 Although many respondents to the Discussion Paper agreed with this proposal, some disagreed. Many stakeholders, including those that agreed, said there was a need for further discipline in including these cash flows in value in use calculations. The main concerns were that removing the constraint:

(a) could increase the risk of management over-optimism (paragraphs BC207–BC210); and

(b) lacks a conceptual basis (paragraphs BC211–BC214).

Increased management over-optimism

BC207 Stakeholders said removing the constraint could increase the risk of management over-optimism in calculating value in use and that additional constraints would be required before such cash flows are included in calculating value in use, for example:

(a) introducing a probability threshold to determine when to include these cash flows;

(b) requiring these cash flows to be included only if authorised by an entity's management;

(c) providing additional guidance on when these cash flows can be included; and

(d) requiring additional disclosure about the assumptions underlying these cash flows.

BC208 The IASB decided against proposing additional constraints because in its view the constraints in IAS 36 are sufficient. In particular, the IASB noted the requirements in IAS 36:

(a) to base cash flow projections on reasonable and supportable assumptions (paragraph 33(a));

(b) to base cash flow projections on budgets/forecasts approved by an entity's management (paragraph 33(b));

(c) to assess assets in their current condition (paragraph 44); and

(d) to disclose key assumptions (paragraph 134(d)(i)).

BC209 Some IASB members observed that paragraph 46 of IAS 36 refers to requirements in IAS 37 to explain when an entity is committed to a restructuring. Paragraph 72 of IAS 37 states that an obligation to restructure arises only when an entity:

(a) has a detailed formal plan for the restructuring; and

(b) has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features.

BC210 These IASB members questioned whether all the criteria for recognising a restructuring provision in IAS 37 are needed in IAS 36 for the inclusion of cash flows in the impairment test. In their view, for the purpose of calculating value in use, an entity should be constrained only by whether it has a plan for the restructuring and not whether it has created a valid external expectation. Paragraph 33(b) of IAS 36 already requires an entity to base its cash flow projections on the most recent financial budgets/forecasts approved by the entity's management and these budgets/forecasts might include plans for restructuring.

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Conceptual basis

BC211 Stakeholders said allowing an entity to include cash flows from a future restructuring or asset enhancement in calculating value in use could be inconsistent with the principle in IAS 36 of calculating the value in use of an asset in its current condition (see paragraphs BC72–BC75 of the Basis for Conclusions on IAS 36).

BC212 The IASB is proposing no change to the requirement in paragraph 44 of IAS 36 to estimate cash flows for an asset in its current condition. In the IASB's view, this requirement is consistent with permitting cash flows from a future restructuring or asset enhancement if the asset contains the current potential to generate those cash flows, even if the asset is being used in a different way. The IASB proposes to add paragraph 44A of IAS 36 to explain this interaction.

BC213 Applying the proposals, the measurement of value in use would be more consistent with how fair value (and hence, fair value less costs of disposal) is determined if an asset, or CGU, contains potential to be restructured, improved or enhanced. Fair value reflects potential to be restructured, improved or enhanced if it is present and if market participants would pay for it. If the potential is available to an entity that currently controls the asset and were also to be included in value in use, the recoverable amount would equal the higher of the two different measures of the same asset. The IASB views this approach as being more logical than the recoverable amount being equal to the higher of measures of one asset including potential (fair value) and one asset excluding it (value in use).

BC214 However, some IASB members disagree with the proposal to remove the constraint from including cash flows arising from a future restructuring or asset enhancement in calculating value in use. In the view of these IASB members, including these cash flows would not represent a test of an asset in its current condition and might allow for indirect recognition of internally generated goodwill if a future restructuring or asset enhancement allows an entity to avoid recognition of an impairment. These IASB members were concerned that in proceeding with the proposal the IASB was failing to respond to feedback about impairment losses on goodwill sometimes being recognised too late.

Post-tax cash flows and discount rates

BC215 In calculating value in use, an entity is required by IAS 36 to use pre-tax cash flows and discount them using pre-tax discount rates.[2] The IASB proposes to remove that requirement.

BC216 As explained in paragraphs BCZ81–BCZ84 of the Basis for Conclusions on IAS 36, the International Accounting Standards Committee, the predecessor to the IASB, took the view that the requirement to use pre-tax cash flows and pre-tax discount rates would be less burdensome because if an entity estimates

2 Paragraph 50 of IAS 36 states that 'estimates of future cash flows shall not include … income tax receipts or payments'. Paragraph 55 of IAS 36 states that 'the discount rate (rates) shall be a pre-tax rate (rates) …'.

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post-tax future cash flows it would need to exclude the effect of future tax cash flows resulting from temporary differences to avoid double-counting.

BC217 However, in response to the Discussion Paper, stakeholders said determining pre-tax discount rates is costly and complex. They explained that a pre-tax discount rate is hard to understand, is not observable and fails to provide useful information because it is generally not used for valuation purposes. In practice, valuations of assets are usually performed on a post-tax basis.

BC218 Paragraph BC94 of the Basis for Conclusions on IAS 36 states that, conceptually, discounting post-tax cash flows at a post-tax discount rate and discounting pre-tax cash flows at a pre-tax discount rate would be expected to give the same result—as long as the pre-tax discount rate is the post-tax discount rate adjusted to reflect the specific amount and timing of future tax cash flows.

BC219 In the IASB's view, removing the requirement to use pre-tax cash flows and pre-tax discount rates would:

(a) make the impairment test easier to understand by aligning it with valuation practice.

(b) not require entities to calculate pre-tax discount rates solely to satisfy the disclosure requirements in IAS 36.

(c) provide users with more useful information.

(d) better align the value in use calculation in IAS 36 with fair value in IFRS 13 *Fair Value Measurement*. IFRS 13 does not specify whether an entity is required to use pre-tax or post-tax cash flows and discount rates to measure fair value using a present value technique. Instead, IFRS 13 requires an entity to use internally consistent assumptions about cash flows and discount rates.

BC220 Some stakeholders asked the IASB to provide further guidance and illustrative examples to help entities avoid the potential double-counting referred to in paragraph BC216. The IASB decided not to propose doing so because:

(a) stakeholders said entities already use post-tax cash flows and post-tax discount rates to estimate value in use;

(b) entities using pre-tax cash flows and pre-tax discount rates already have to make similar judgements about tax effects; and

(c) the proposal is consistent with a similar change the IASB made to IAS 41 *Agriculture* in *Annual Improvements to IFRS Standards 2018–2020*.

BC221 In the IASB's view, it is important instead to emphasise that the cash flow forecasts and discount rates used in impairment tests should be internally consistent.

BC222 Paragraph 134(d)(v) of IAS 36 requires an entity to disclose the discount rate(s) applied to cash flow projections in calculating value in use. Some IASB members said removing the requirement to use pre-tax cash flows and pre-tax discount rates might make it unclear as to whether the discount rate disclosed

is pre-tax or post-tax. Therefore, the IASB proposes to require an entity to disclose whether the discount rate used is pre-tax or post-tax.

Other suggestions to reduce cost and complexity

BC223 The preliminary view in the Discussion Paper was to develop proposals to remove the requirement in IAS 36 for an entity to perform a quantitative impairment test of CGUs containing goodwill each year. If this preliminary view was implemented, a quantitative impairment test would be required only if there is an indication of impairment.

BC224 In developing its preliminary view, the IASB accepted that removing this requirement could make the impairment test marginally less robust. However, the IASB judged that, in the absence of an indication of impairment, the benefits of requiring an entity to perform the test would be minimal and would not justify the cost of doing so.

BC225 However, many respondents to the Discussion Paper disagreed with the preliminary view and raised various concerns. After considering the feedback, the IASB decided not to propose removing the requirement to perform an impairment test each year. The IASB was persuaded by concerns about removing the requirement, in particular:

(a) the potential loss of information for users. For example, information about the assumptions used in calculating value in use as required by paragraph 134 of IAS 36.

(b) the extent of any resulting cost reduction. For example, some respondents said entities would continue to perform the impairment test each year as part of their internal governance processes or because doing so would be easier than assessing whether the impairment test is required.

(c) the effect on the robustness of the impairment test. For example, it would be more difficult for auditors and regulators to enforce the impairment test and assess the reasonableness of assumptions used if they have no information from impairment tests performed in previous years.

BC226 The IASB also considered alternatives to removing the requirement to perform a quantitative impairment test each year. For example, the IASB considered making a requirement aimed at reducing the cost and complexity of the impairment test—paragraph 99 of IAS 36[3]—easier to apply. However, the IASB

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3 Paragraph 99 of IAS 36 permits an entity to use the most recent detailed calculation made in a preceding period of the recoverable amount of a cash-generating unit to which goodwill has been allocated in the impairment test of that unit in the current period provided all of the following criteria are met: (a) the assets and liabilities making up the unit have not changed significantly since the most recent recoverable amount calculation; (b) the most recent recoverable amount calculation resulted in an amount that exceeded the carrying amount of the unit by a substantial margin; and (c) based on an analysis of events that have occurred and circumstances that have changed since the most recent recoverable amount calculation, the likelihood that a current recoverable amount determination would be less than the current carrying amount of the unit is remote.

decided not to propose any of the alternatives because of concerns that the alternatives could reduce the effectiveness of the impairment test.

BC227 In the Discussion Paper the IASB considered, but did not pursue, other suggestions to reduce the cost and complexity of the impairment test such as mandating only one method for estimating the recoverable amount of an asset (either value in use or fair value less costs of disposal). Respondents generally agreed with the preliminary view. Therefore, the IASB decided not to propose these other changes.

Reintroduction of amortisation of goodwill

BC228 In response to feedback from the PIR of IFRS 3, the IASB explored whether to reintroduce amortisation of goodwill. In particular, the IASB considered whether amortisation could:

(a) provide a simple mechanism that targets acquired goodwill directly. By reducing the carrying amount of goodwill, amortisation might help resolve stakeholder concerns that the carrying amount of goodwill can be overstated because of management over-optimism or because goodwill is not tested for impairment directly.

(b) alleviate some of the burden placed on the impairment test, making the test easier and less costly to apply.

BC229 The preliminary view in the Discussion Paper was to retain the impairment-only model to account for goodwill, although this preliminary view was reached by a narrow majority of IASB members.

BC230 In reaching the preliminary view, the IASB acknowledged that both models for goodwill—an impairment-only model and an amortisation-based model—have limitations. No impairment test has been identified that can test goodwill directly, and for amortisation it is difficult to estimate the useful life of goodwill and the pattern in which it diminishes.

BC231 The views of respondents to the Discussion Paper were mixed. Many stakeholders agreed with the preliminary view to retain the impairment-only model, but many others disagreed, and wanted amortisation of goodwill to be reintroduced.

BC232 The IASB considered reintroducing amortisation of goodwill in the context of the PIR of IFRS 3. Therefore, the question was whether the evidence gathered since IFRS 3 was issued provided a compelling case for changing the model to account for goodwill. It was not a question of which model is better, as would be the case if the IASB were introducing the requirements for the first time.

BC233 On balance, considering the extensive evidence collected, the IASB concluded it had no compelling case to justify reintroducing amortisation of goodwill and so decided to retain the impairment-only model for the subsequent accounting for goodwill. Almost all IASB members agreed with this decision. However, if they were asked which model they preferred, some of the IASB members who agreed with the decision would have supported reintroducing amortisation of goodwill.

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BC234 In reaching this decision, the IASB considered whether there was a compelling case that reintroducing amortisation of goodwill would:

(a) significantly improve the information users receive about business combinations (paragraphs BC235–BC243); or

(b) significantly reduce costs (paragraphs BC244–BC246).

Improving information

BC235 Feedback on the Discussion Paper provided evidence that stakeholders continue to hold strong and differing views about reintroducing amortisation of goodwill. The IASB observed that the key reason for this divergence was a difference in stakeholders' views of the nature of goodwill and whether it is predominantly a wasting asset or an asset with an indefinite life.

BC236 Stakeholders who view goodwill as a wasting asset said this was because the value of goodwill diminishes over time due to competition, technological factors, the realisation of the benefits of synergies, or an acquiree's skilled workforce leaving or retiring. They said the benefits represented by goodwill have a finite, determinable life, whereas the concept of an asset with an indefinite life or perpetual benefits assumes reinvestment and that this reinvestment is internally generated goodwill.

BC237 For these stakeholders, the objective of the subsequent accounting for goodwill is to reflect this steady decline in the value of goodwill and its consumption—that is, reflecting its wasting nature. An amortisation-based model would be most appropriate for meeting this objective. Allocating the cost of acquired goodwill over the periods in which it is consumed would match the cost with the related benefits.

BC238 Stakeholders who view goodwill as an asset with an indefinite life emphasised that there is no foreseeable limit to the period over which an entity expects to consume the benefits represented by goodwill. The value of goodwill is expected to be maintained over an indefinite period instead of declining systematically over a defined period. Components of goodwill such as the assembled workforce (including the knowledge and processes embedded in that workforce), the cost synergies expected to recur, going concern value and business reputation are considered by these stakeholders to have an indefinite life.

BC239 For these stakeholders, the objective of the subsequent accounting for goodwill is to reflect that goodwill does not lose its value like other assets—goodwill reduces in value because of events that occur inconsistently over time. An impairment-only model best meets this objective.

BC240 The IASB acknowledged that stakeholders provided evidence to support their differing views about goodwill and gave reasons why the models for the subsequent accounting for goodwill could provide useful information. However, that evidence did not clearly demonstrate that one view was 'more correct' than the other.

BC241 The IASB concluded these differing views persist because goodwill is a unique asset that cannot be measured directly and is consequently measured as a residual. The IASB concluded that these views are unlikely to be reconciled because part of the problem is that the nature of goodwill varies by transaction and goodwill can comprise both wasting and indefinite life components.

BC242 The IASB also concluded that whether amortisation of goodwill could provide useful information depends on whether it is feasible to estimate a useful life of goodwill and the pattern in which it diminishes that faithfully represents its decline in value. The IASB's research on whether this was feasible was inconclusive.

BC243 Many IASB members acknowledged the advantages and disadvantages of both models for the subsequent accounting for goodwill. Although an impairment-only model or an amortisation-based model can provide some information that would help meet user needs for information about business combinations (see paragraphs BC18–BC21), neither model can meet all those needs. These IASB members concluded that the proposed amendments to IFRS 3 to require an entity to disclose information about the performance of a business combination (see paragraphs BC29–BC147) are a better way to improve the information entities provide to users.

Reducing costs

BC244 Feedback on whether reintroducing amortisation of goodwill would reduce costs was mixed. The IASB obtained evidence during the Business Combinations—Disclosures, Goodwill and Impairment project—including from responses to the Discussion Paper and from researching the potential consequences of transitioning to an amortisation-based model. Feedback on the costs of such a transition was mixed, but the IASB found evidence that the costs could be significant for some entities in some jurisdictions and there could be costs for users because of the temporary disruption and confusion the change could cause.

BC245 In reaching their decision to retain the impairment-only model, many IASB members emphasised the importance of maintaining substantial convergence on this topic between IFRS Accounting Standards and US generally accepted accounting principles (US GAAP). Maintaining convergence with US GAAP on this topic would help reduce costs for users in assessing financial statements of entities around the world. The International Organization of Securities Commissions in a public statement made in February 2021 encouraged the IASB and the US Financial Accounting Standards Board (FASB) to work collaboratively and reach a converged outcome.[4]

BC246 Some IASB members were concerned the IASB would face similar difficulties to those encountered by the FASB when it recently explored reintroducing amortisation of goodwill. The FASB had on its technical agenda a project on similar topics to the IASB's Business Combinations—Disclosures, Goodwill and Impairment project. In June 2022 the FASB reviewed its package of leanings

4 See https://www.iosco.org/news/pdf/IOSCONEWS595.pdf.

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on a potential amortisation model, considered their effects on benefits and costs, and decided to deprioritise and remove the project from its technical agenda. Despite some of those leanings representing choices that would help make the amortisation model less costly (for example, a 10-year default amortisation period with the option to select another period subject to a cap of 25 years) some FASB members questioned the extent of the cost savings.

Other considerations

BC247 In reaching its decision to retain the impairment-only model, the IASB considered feedback that suggested the impairment test in IAS 36 is not working and that carrying amounts of goodwill are 'too high'.

BC248 In the IASB's view, this feedback could arise from a misunderstanding of what the impairment test is designed to achieve and could reflect an unrealistic expectation that the impairment test directly tests goodwill or can reflect consumption of that goodwill.

BC249 Goodwill is an asset that cannot be directly measured and does not generate cash inflows independently. It is therefore tested for impairment as part of a group of assets. Consequently, the impairment test will always have an element of shielding. The IASB was aware of that fact when it issued IFRS 3 (see paragraph BC135 of the Basis for Conclusions on IAS 36).

BC250 The objective of the impairment test is to ensure the carrying amounts of acquired goodwill—together with other assets within the CGUs containing goodwill—are recoverable from the cash flows jointly generated by these assets and the internally generated goodwill of the unit. The objective is not to test the acquired goodwill directly.

BC251 In the IASB's view, concerns that carrying amounts of goodwill are 'too high' were not compelling. Goodwill is not directly observable. Therefore, the IASB concluded it is difficult to determine whether 'high' goodwill balances are a significant issue and what conclusions to draw from quantitative evidence provided by stakeholders. The IASB observed there could be several reasons why goodwill balances might be high, including:

(a) low interest rates stimulating mergers and acquisitions;

(b) general growth in global economies; and

(c) more acquisitions involving entities with a high proportion of intangible assets.

Proposed amendments to the forthcoming IFRS X *Subsidiaries without Public Accountability: Disclosures*

BC252 The IASB expects to issue IFRS X *Subsidiaries without Public Accountability: Disclosures* (Subsidiaries Standard) in May 2024. The Subsidiaries Standard will permit an entity that qualifies as a 'subsidiary without public accountability' (eligible subsidiary) to apply the recognition, measurement and presentation requirements in IFRS Accounting Standards and reduced disclosure requirements in the Subsidiaries Standard. As part of maintaining the

Subsidiaries Standard, the IASB considered whether to propose amendments to that prospective IFRS Accounting Standard as a result of the proposed amendments in this Exposure Draft.

BC253 In deciding whether to amend the Subsidiaries Standard to reflect changes to the disclosure requirements in other IFRS Accounting Standards the IASB applies principles relating to:

(a) *short-term cash flows*—users are interested in information about an entity's ability to meet its obligations;

(b) *liquidity*—users are interested in information about an entity's ability to generate cash flows and continue as a going concern;

(c) *measurement uncertainty*—users need information about how amounts in an entity's financial statements are measured, including inputs (for example, significant judgements and estimates) used in those calculations;

(d) *disaggregation*—users want information about composition or details of movements of amounts in the financial statements; and

(e) *accounting policy choices*—users are interested in the accounting policies applied by an entity, particularly when an IFRS Accounting Standard offers more than one accounting policy option.

BC254 The IASB also assesses the Subsidiaries Standard to ensure the amended package of disclosure requirements for an eligible subsidiary meets a cost and benefit analysis.

BC255 After considering the process described in paragraphs BC253–BC254, the IASB proposes to amend the Subsidiaries Standard to require eligible subsidiaries to disclose:

(a) *quantitative information about synergies expected from combining operations of an acquiree and an acquirer*—this is because that information is typically about an entity's short-term cash flows. The exemption available to entities applying the proposed disclosure requirements in IFRS 3 in specific circumstances would also be available to eligible subsidiaries in those circumstances.

(b) *the strategic rationale for the business combination*—as noted in paragraph BC89, users said they need at least some qualitative information about a business combination, which the strategic rationale could provide. Information about the strategic rationale would provide relevant context for users to understand quantitative information about expected synergies. Providing the information is also not expected to be costly for a preparer.

(c) *information about the contribution of the acquired business*—in the IASB's view, this information would help users forecast an entity's short-term cash flows by allowing a better assessment of the entity's operating margin. Improved information about short-term cash flows could also arise because, for example, in the Primary Financial Statements

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project, the IASB tentatively decided to require an entity to use operating profit or loss as the starting point for the indirect method of reporting cash flows from operating activities. However, some IASB members disagreed with this proposal. In their view, this information might be costly to prepare and would outweigh the benefits of eligible subsidiaries disclosing it.

(d) *whether the discount rate used in an impairment test is pre-tax or post-tax*—the nature of the discount rate used would inform users about measurement uncertainty in the impairment test.

BC256 The IASB decided not to propose amending the Subsidiaries Standard to reflect the other changes to IFRS Accounting Standards proposed by the IASB in this Exposure Draft because the costs of requiring an eligible subsidiary to disclose information that would be required by those changes would outweigh the benefits.

Effective date and transition

Proposed amendments to IFRS 3

BC257 Proposed paragraph 64R of IFRS 3 would require an entity to apply the proposed amendments prospectively to a business combination on or after the effective date, with earlier application permitted. The IASB concluded that the costs of applying the amendments retrospectively would outweigh the benefits obtained from doing so because:

(a) requiring an entity to apply the proposed amendments retrospectively might not give the entity enough time to update its internal controls and processes. Some preparers said they intend to change how they review business combinations to improve the quality of information that would be disclosed applying the proposed requirements and to make that information easier to audit.

(b) some aspects of the proposed amendments might be difficult to apply without hindsight—for example, assessing which of an entity's objectives for a strategic business combination were key objectives as at the acquisition date.

(c) information about business combinations that occurred before and during the comparative period might sometimes be less useful. For example, the information could be less timely in helping users assess the price paid for a business combination.

BC258 The IASB decided not to propose relief for first-time adopters from any of the proposed amendments to IFRS 3 because:

(a) first-time adopters are expected to plan their transition to IFRS Accounting Standards with enough time. Consequently, concerns about the availability and cost of preparing the information similar to those described in paragraphs BC257(a) and BC257(b) for existing IFRS preparers do not exist for first-time adopters.

(b) this approach would be consistent with the approach the IASB has taken for other IFRS 3 disclosure requirements.

(c) although information about past business combinations might sometimes be less useful than information about business combinations in the first IFRS reporting period and subsequently (paragraph BC257(c)), that information is still useful.

BC259 However, some IASB members are concerned about the cost of not providing relief for first-time adopters, particularly from the proposed requirement for an entity to disclose information about the performance of a business combination (proposed paragraphs B67A–B67C of IFRS 3). These IASB members said not providing first-time adopters with relief from this proposed requirement would result in first-time adopters being required to assess, at the date of transition to IFRSs, whether the entity's key management personnel are reviewing the performance of all past business combinations, which could be costly.

Proposed amendments to IAS 36

BC260 Proposed paragraph 140O of IAS 36 would require an entity to apply the proposed amendments prospectively to impairment tests performed on or after the effective date, with earlier application permitted. The IASB concluded that the benefits of applying the amendments retrospectively would not justify the cost because:

(a) some of the information necessary to apply the proposed amendments retrospectively might not be available—for example, judgements and assumptions about future cash flows for impairment tests as at previous reporting dates.

(b) the recoverable amount of an asset would be unaffected by some of the proposed amendments and so the measurement of that asset would also be unaffected—for example, the proposed removal of the requirement to use a pre-tax discount rate in calculating value in use. Retrospective application would therefore provide no additional information.

BC261 The IASB considered whether to require an entity to perform an impairment test at the date of transition and recognise any changes in the carrying amount of the assets directly in equity. However, the IASB decided against doing so because, in the IASB's view, the cost of performing such a test would outweigh the benefit (that is, users would be able to tell whether an impairment loss results from an impairment event in the year, or simply from changes to how the impairment test is required to be performed). In addition, the IASB previously considered requiring an entity to perform an impairment test at the date of transition but decided not to do so (see paragraphs BC216–BC222 of the Basis for Conclusions on IAS 36).

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BC262 The IASB decided not to propose relief for first-time adopters from the proposed amendments to IAS 36 because a first-time adopter would be required to apply all other aspects of IAS 36 when applying IFRS 1 *First-time Adoption of International Financial Reporting Standards*.

Proposed amendments to the Subsidiaries Standard

BC263 Similar to its other proposals for transition requirements in this Exposure Draft, the IASB decided to propose requiring an eligible subsidiary to apply the proposed amendments prospectively. The IASB decided not to propose requiring an eligible subsidiary to restate comparative information when first applying the proposed amendments because, in its view, the costs would outweigh the benefits.

Effects

BC264 As noted in paragraph BC3, the objective of the Business Combinations—Disclosures, Goodwill and Impairment project is to explore whether entities can, at a reasonable cost, provide users with more useful information about business combinations. The proposals in this Exposure Draft aim to meet that objective by responding to feedback on the PIR of IFRS 3, in particular:

(a) feedback from users about the need for better information to help them understand the performance of a business combination; and

(b) concerns about the cost and effectiveness of testing CGUs containing goodwill for impairment.

BC265 The proposals in the Exposure Draft would affect any entity that enters into a business combination or performs an impairment test of CGUs containing goodwill (and, in some cases, an entity that performs any impairment test using value in use).

BC266 The IASB considered whether the expected benefits of the proposals would outweigh their cost, individually and in combination.

Benefits

BC267 The IASB expects the proposals to result in better information for users about business combinations. In particular:

(a) the proposals to require an entity to disclose information about the performance of a business combination would directly address feedback from users about deficiencies of information in this area.

(b) information about the performance of a business combination would also partially respond to feedback from the PIR of IFRS 3 about impairment losses on goodwill sometimes being recognised too late. Some users use information about impairment losses on goodwill as a proxy for assessing the success of the related business combination. For example, some users said they interpret the recognition of an impairment loss as confirmation that a business combination was unsuccessful. If information about an impairment loss on goodwill is

provided too late, users would not obtain that confirmation on a timely basis. Requiring an entity to disclose information about the performance of a business combination more directly responds to that user need.

(c) the IASB's proposals to improve the effectiveness of the impairment test would contribute to entities recognising impairments on goodwill on a timelier basis by responding to concerns about shielding and management over-optimism in the impairment test.

BC268 Academic evidence gathered by the IASB suggests the benefits of providing better information about business combinations to users are associated with a lower cost of capital for entities reporting that information.[5]

Costs

BC269 The IASB considered the economic effects on entities that could increase the cost of providing better information about business combinations, for both:

(a) the proposed amendments to IFRS 3 (paragraphs BC270–BC271); and

(b) the proposed amendments to IAS 36 (paragraphs BC272–BC273).

Proposed amendments to IFRS 3

BC270 As noted in paragraph BC22, stakeholders raised practical concerns about disclosing the information proposed by the IASB. The IASB responded to those concerns by proposing:

(a) to limit the number of business combinations for which an entity would be required to disclose some of the information (see paragraphs BC45–BC73); and

(b) to exempt an entity from disclosing some items of information in specific circumstances (see paragraphs BC74–BC107).

BC271 The IASB considers those responses to result in a set of proposed disclosure requirements for which the expected benefits would outweigh the costs.

Proposed amendments to IAS 36

BC272 The IASB considered costs associated with the impairment test in IAS 36 in relation:

(a) to improving the effectiveness of the impairment test in IAS 36. In considering how to improve the application of the impairment test in IAS 36, the IASB obtained feedback on whether potential improvements could be achieved at a reasonable cost. This feedback was taken into account by the IASB in developing its proposals (see paragraphs BC188–BC202).

5 F Mazzi, P André, D Dionysiou and I Tsalavoutas, 'Compliance with Goodwill-Related Mandatory Disclosure Requirements and the Cost of Equity Capital', *Accounting and Business Research*, vol 47, no 3, 2017, p. 268–312.

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(b) to reducing the cost and complexity of the impairment test in IAS 36. The main aim of this aspect of the IASB's work was to respond to feedback about the impairment test in IAS 36 being costly and complex by simplifying the application of the impairment test and bringing the calculation of value in use closer to the cash flow forecasts used by an entity's management (see paragraphs BC203–BC227).

BC273 As a result, the IASB expects that the expected benefits of the proposed changes to the impairment test in IAS 36 would outweigh the costs.

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