March 2024

Exposure Draft—Snapshot

IFRS® Accounting Standards

Business Combinations—Disclosures, Goodwill and Impairment

Objective of the proposals in the Exposure Draft

To improve the information companies provide to investors, at a reasonable cost, about the acquisitions those companies make. This information is intended to help investors better assess management's decision to make an acquisition and the performance of that acquisition.

Proposals in the Exposure Draft

The IASB proposes to amend IFRS 3 *Business Combinations* and IAS 36 *Impairment of Assets*:

- to require companies to disclose better information about their acquisitions; and
- to make targeted changes to the impairment test.

Next steps

The IASB will consider feedback on the Exposure Draft and decide whether to proceed with the proposals.

Comment deadline

15 July 2024

Introduction

Acquisitions—called ‘business combinations’ in IFRS Accounting Standards—are often significant transactions. These transactions play an important role in the global economy, with deals announced in 2023 totalling US$3.2 trillion.[1]

IFRS 3 sets out accounting requirements for these transactions. In the post-implementation review of IFRS 3 stakeholders raised concerns about:

- investors receiving insufficient information about the performance of acquisitions;
- impairment tests being costly and complex;
- impairment losses on goodwill sometimes being recognised too late; and
- amortisation of goodwill.

The IASB has been exploring these concerns in its project on Business Combinations—Disclosures, Goodwill and Impairment which has resulted in developing the proposals in the Exposure Draft.

The Exposure Draft sets out a package of proposals that in the IASB’s view would result in companies providing better information—at a reasonable cost—about acquisitions, thereby responding to stakeholder concerns.

The Exposure Draft contains proposed changes to IFRS 3 (pages 3–5) and IAS 36 (pages 6–8).

The proposed changes to IFRS 3 would:

- result in companies providing information to investors about the performance of an acquisition.
- allow investors to directly assess the performance of acquisitions, rather than using goodwill impairment as a proxy indicator. These proposed changes would therefore respond to concerns about impairment losses sometimes being recognised too late.

The proposed changes to IAS 36 would also respond to concerns about impairment losses sometimes being recognised too late and concerns about the cost and complexity of the impairment test.

Feedback requested

The IASB is requesting feedback about:

- whether its proposed changes to IFRS 3 appropriately balance the benefits of requiring a company to make the proposed disclosures and the costs of doing so; and
- whether its proposed changes to the impairment test in IAS 36 would improve the effectiveness of the impairment test and reduce the cost and complexity of applying the test.

1 Based on Bain & Company, ‘Looking Back at M&A in 2023: Who Wins in a Down Year?,’ Bain & Company, 2024, https://www.bain.com/insights/looking-back-m-and-a-report-2024/. Used with permission from Bain & Company.

Improving disclosure requirements

What is the problem?

When a company acquires another company, investors need to know management's objectives for the acquisition and whether the company meets those objectives in the subsequent years. Better information helps investors assess how effective a company's management is at acquiring and managing businesses—paying the right price, integrating the acquired business and realising benefits from the acquisition.

In the absence of direct information about the success of an acquisition, investors relying on information from the impairment test as a signal of an acquisition being unsuccessful contributes to concerns that impairment losses on goodwill are sometimes recognised too late.

Proposals in the Exposure Draft

The IASB is proposing amendments to IFRS 3 that are intended to improve the information companies disclose about acquisitions.

These proposals aim to balance investor needs with preparer concerns about disclosing information about the performance of acquisitions and the cost of providing that information.

This includes a proposal to require companies to disclose information about the performance of strategic acquisitions. This proposal would require a company to disclose:

- in the year of acquisition, information about management's acquisition-date key objectives and the related targets for the acquisition; and
- subsequently, the extent to which those acquisition-date key objectives and related targets are being met.

Using management information

The proposed disclosures about the performance of a strategic acquisition would be based on information management uses to review the strategic acquisition rather than a list of specified information because:

- management is assumed to review strategic acquisitions and be aware of how they are performing.
- objectives for an acquisition are typically company-specific. No single set of information specified by the IASB could provide useful information for all acquisitions.

The IASB proposes to require a company to disclose information used by its key management personnel, a term defined in IAS 24 *Related Party Disclosure*. The IASB expects key management personnel—a senior level of management—to typically review only the most important information about an acquisition. The IASB therefore expects this proposal to result in investors receiving the most useful information about the performance of an acquisition.

Generally, a company would be required to disclose information about the extent to which its acquisition-date key objectives and the related targets are being met for as long as the key management personnel review that information. If key management personnel do not review this information, a company would simply disclose that fact.

The proposed exemption

Many preparers expressed concern that the proposals might require them to disclose information that is so commercially sensitive that it should not be required in financial statements and that companies might be subjected to increased litigation risk by disclosing this information.

In response, the IASB is proposing to exempt companies from disclosing some information if doing so can be expected to prejudice seriously any of the company's acquisition-date key objectives.

The exemption would be available for information which the IASB identified as being of particular concern if disclosed—for example, information about the targets for an acquisition.

The IASB proposes to include application guidance to help companies identify the appropriate circumstances in which the exemption can be used and to help auditors and regulators assess a company's application of the exemption. The application guidance builds on requirements and guidance from regulators for similar exemptions.

Disclosing information for only strategic acquisitions

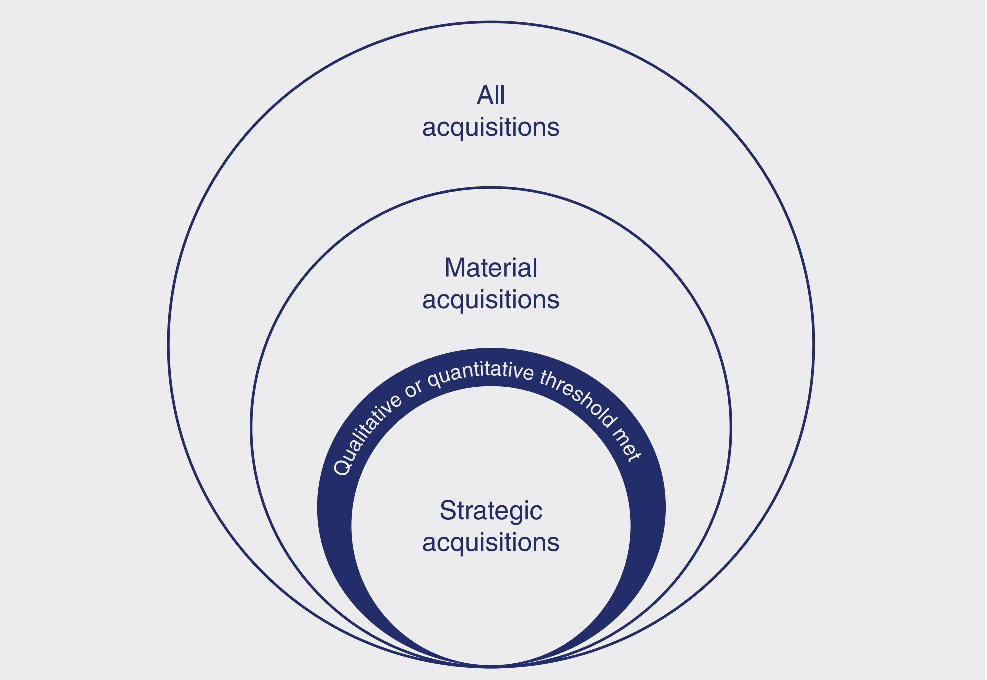
The IASB decided to propose requiring a company to disclose information about the performance of acquisitions for only strategic acquisitions. This proposal aims to respond to stakeholder feedback that disclosing information about the performance of too many acquisitions could result in 'disclosure overload'.

The IASB proposes that acquisitions that meet any one of these thresholds would be strategic acquisitions:

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

These thresholds build on other requirements, for example how regulators identify particularly important acquisitions.

Figure 1—Populations of acquisitions



Other proposed changes

The IASB also proposes other amendments to IFRS 3. For example, to require companies to disclose quantitative information about expected synergies in the year of acquisition, subject to the exemption.

Location of information

Information about the performance of an acquisition and expected synergies is directly linked to the price paid for it. The price is reflected in the financial statements in the measurement of the assets and liabilities recognised from the acquisition, including goodwill. Therefore, the IASB decided to require a company to disclose information about the performance of acquisitions in financial statements.

Would the information required by the proposals be auditable?

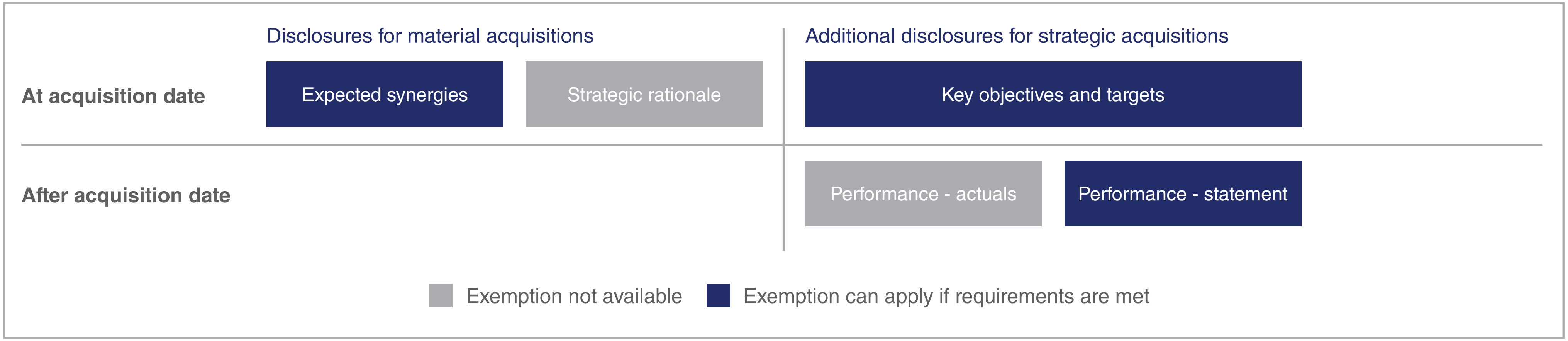
Most auditors said the information would be auditable at additional cost. The IASB expects that an auditor would be able to verify whether the information disclosed is the information management reviews about the acquisition.

What if the acquired business is integrated with the existing business?

If a company plans to integrate an acquired business, the company's objectives and targets for an acquisition might be based on the combined business rather than the acquired business in isolation. In that case, the company would disclose the combined business information.

If integration results in a company not reviewing, or stopping to review in the first few years after the acquisition, the company would disclose that fact rather than performance information.

Figure 2—Summary of key disclosure proposals



Changes to the impairment test

What is an impairment test?

A company applying the impairment test in IAS 36 compares the carrying amount of an asset with its 'recoverable amount'.

A company estimates the recoverable amount as the higher of:

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

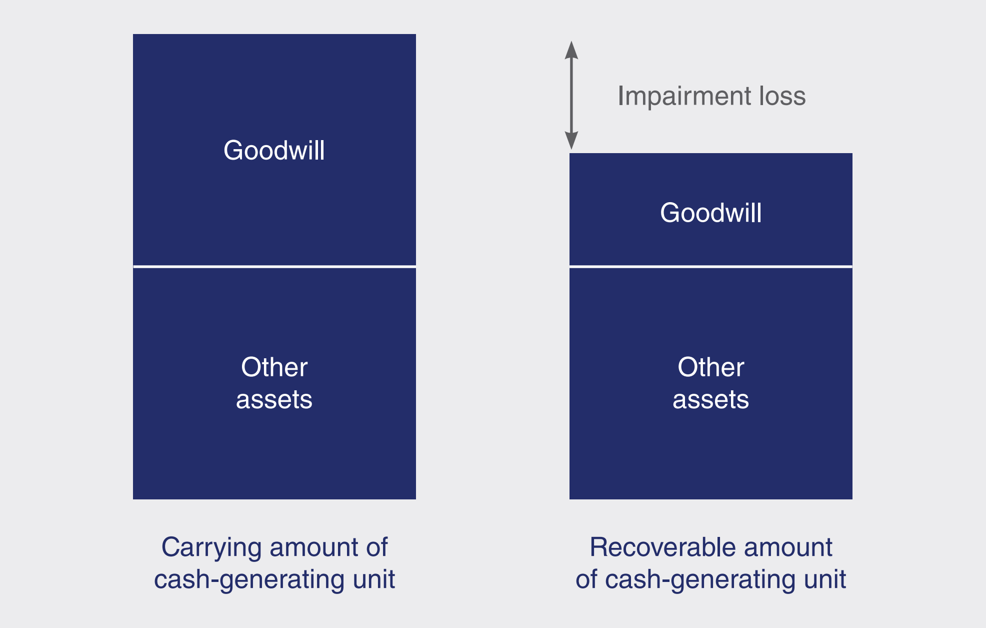
If an asset's recoverable amount is less than its carrying amount, the company recognises an impairment loss for that asset.

Goodwill does not generate cash flows on its own. Therefore, it is tested for impairment together with other assets as part of a group of assets called a cash-generating unit.[2]

If a company recognises an impairment loss, it first reduces the carrying amount of any goodwill allocated to the cash-generating unit, then reduces the carrying amount of other assets.

The impairment test is therefore applied to goodwill only indirectly. The impairment test is designed to ensure that the group of assets (including goodwill) is measured at no more than its combined recoverable amount—the impairment test does not test the value of goodwill separately.

Figure 3—Impairment loss on goodwill



2 References to a cash-generating unit should be read to also refer to a group of cash-generating units.

What is the problem?

Stakeholders reported that:

- impairment losses on goodwill are sometimes not recognised on a timely basis; and
- the impairment test can be costly and complex.

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

- management over-optimism—management's assumptions in measuring the recoverable amount are over-optimistic.
- shielding—headroom in an existing business (with which an acquisition is integrated) can shield goodwill from impairment. Headroom largely arises because not all the value of that business is included on a company's balance sheet. For example, internally generated intangible assets might not be recognised on a company's balance sheet.

The IASB concluded that it is not feasible to design a different impairment test that more effectively targets goodwill.

However, the IASB is proposing targeted changes to the current impairment test which are intended:

- to reduce shielding;
- to reduce management over-optimism; and
- to change how a company calculates the value in use of an asset.

Reducing shielding

The objective of the impairment test for cash-generating units containing goodwill is to ensure the combined carrying amount of the group of assets is not more than its recoverable amount. Some level of shielding is therefore inevitable in the impairment test. However, the IASB proposes changes to the impairment test to reduce shielding by clarifying how a company allocates goodwill to cash-generating units.

For example, IAS 36 specifies the highest level to which a company can allocate goodwill—an operating segment—and the IASB is proposing to clarify that this level is not a default.

Reducing management over-optimism

IAS 36 contains requirements designed to reduce management over-optimism. For example, companies are required to use reasonable and supportable assumptions when preparing the impairment test.

The IASB noted that management over-optimism is generally a problem with applying the impairment test and is, in part, best addressed by auditors and regulators.

However, the IASB is proposing one change to the impairment test to help further reduce management over-optimism. This change would require a company to disclose in which reportable segment a cash-generating unit containing goodwill is included.

This disclosure would help investors compare their own assumptions about the value of goodwill with those that management uses in performing the impairment test and would therefore enable investors to better assess the reasonableness of management's assumptions.

Value in use

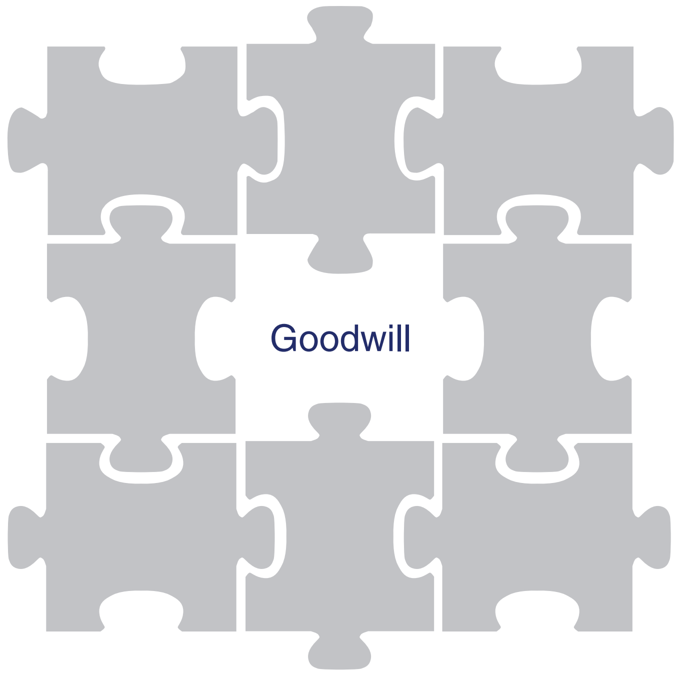
To respond to concerns about the cost and complexity of the impairment test, the IASB proposes changing the calculation of value in use by:

- removing the restriction on including cash flows from uncommitted future restructuring or asset enhancement; and
- removing the requirement to calculate value in use on a pre-tax basis.

Removing these restrictions would bring inputs used in the impairment test closer to the information used by management, which should result in investors receiving more relevant information.

The IASB noted that the other restrictions in IAS 36 on the cash flows a company can include in calculating value in use are sufficient to ensure the robustness of the impairment test. For example, the requirement to base cash flow forecasts on management's budgets and forecasts and the requirement to assess an asset in its current condition.

In addition to the changes to value in use the IASB also noted that IAS 36 already has cost relief measures for performing an impairment test. Paragraph 99 of IAS 36 allows a company to use a prior calculation of the recoverable amount in specific circumstances.



No reintroduction of amortisation

The IASB considered reintroducing amortisation of goodwill. The IASB received substantial and conflicting evidence from stakeholders on this topic. Feedback shows that stakeholders have differing views, supported by evidence, on the appropriate model to account for goodwill.

Many IASB members acknowledged the pros and cons of both models. However, based on the evidence, the IASB concluded it does not have a compelling case to change from the impairment-only model either to improve information provided to investors or to reduce costs for companies.

An In Brief article by IASB member Rika Suzuki, published in January 2023, provides more information about this decision.

Information for respondents

The deadline for comments on the Exposure Draft is 15 July 2024

You can submit comments on our Open for comment page.

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To stay up to date with the latest developments in this project and to sign up for email alerts, please visit our project page.

Exposure Draft package

The Exposure Draft package includes:

- the IASB's detailed proposals, in the form of draft amendments to IFRS Accounting Standards.
- the Basis for Conclusions on the Exposure Draft, which summarises how the IASB developed its proposals.
- questions for respondents.

This document

This Snapshot has been compiled by the IFRS Foundation for the convenience of interested parties. The views expressed in this document are those of the staff who prepared it and are not necessarily the views or the opinions of the IASB.

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