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Staff paper

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Contacts	Dehao Fang (fdehao@ifrs.org)

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Purpose and structure

1. As Agenda Paper 18 for this meeting explains, this paper summarises feedback on the proposals to require an entity to disclose information about its performance of a business combination for only a subset of business combinations.

2. The paper is structured as follows:

   (a) key messages (paragraph 3);

   (b) background (paragraphs 4–6);

   (c) feedback summary (paragraphs 7–43); and

   (d) question for the IASB.

Key messages

3. Respondents generally support requiring an entity to disclose information about the performance of a business combination for only a subset of material business combinations. However:

   (a) many respondents disagree with applying a thresholds approach;

(b) most respondents disagree with at least one of the specific thresholds proposed and say the thresholds are inflexible and might lead to unintended consequences; and

(c) some respondents express concerns about the term ‘strategic’ business combinations.

Background

4. The International Accounting Standards Board (IASB) proposed to require an entity to disclose information about performance of a business combination (performance information) for only a subset of material business combinations—which the Exposure Draft referred to as strategic business combinations. The IASB’s intention was to require an entity to disclose information about the performance of a business combination for only the most important business combinations, while also addressing stakeholder concerns about the volume of disclosures being costly and onerous.

5. The IASB proposed using a closed-list of thresholds to identify that subset of business combinations (threshold approach). In particular, the IASB proposed that a business combination meeting any one of the following thresholds would be a strategic business combination:

(a) quantitative thresholds—any one of revenue, operating profit and assets of the acquired business constitutes at least 10% of the acquirer’s corresponding amounts; or

(b) qualitative thresholds—the business combination results in a company entering a new major line of business or geographical location.

6. Question 2 in the Exposure Draft asked:

> (a) Do you agree with the proposal to use a threshold approach? Why or why not? If you disagree with the proposal, what approach would you suggest and why?

(b) If you agree with the proposal to use a threshold approach, do you agree with the proposed thresholds? Why or why not? If not, what thresholds would you suggest and why?

Feedback summary

7. This section summarises feedback on:

   (a) whether to use a threshold approach (paragraphs 8–13);

   (b) quantifying the number of business combinations captured (paragraphs 14–16);

   (c) quantitative thresholds (paragraphs 17–26);

   (d) qualitative thresholds (paragraphs 27–36); and

   (e) other concerns (paragraphs 37–43).

Whether to use a threshold approach

8. Respondents generally support requiring an entity to disclose performance information for only a subset of business combinations for reasons considered by the IASB. However, respondents have split views on whether to use a threshold approach:

   (a) many agree (paragraph 11); and

   (b) many disagree and suggest using a more principles-based approach (paragraphs 12–13).

9. Some stakeholders say it would be inappropriate to identify a business combination as strategic based on meeting only one threshold because entities operating in asset intensive or low margin industries are likely to meet specific thresholds even for insignificant business combinations. These respondents suggest variations of a threshold approach. For example, identifying a business combination as strategic only if the business combination:

(a) meets at least two thresholds; or

(b) meets at least one quantitative threshold and one qualitative threshold.

10. A few respondents disagree with requiring an entity to disclose performance information for only a subset of business combinations and say performance information about all material business combinations would be useful.

Reasons for agreeing

11. Many respondents agree with using a threshold approach and say the approach:

(a) is practical, easy-to-implement and balances costs and benefits; and

(b) can be applied consistently and enforced.

Reasons for disagreeing

12. Many respondents disagree with using a threshold approach and suggest adopting a more principle-based approach to identify the subset of business combinations. Some of these respondents say a more principle-based approach would:

(a) align with the principle-based approach used for developing IFRS Accounting Standards;

(b) clarify the intention and rationale for requiring an entity to disclose performance information for a business combination. This would help preparers apply appropriate judgements in determining which business combinations to disclose performance information about; and

(c) prevent structuring business combinations to meet or avoid meeting the proposed thresholds.

13. Respondents suggest different ways to develop a principle-based approach:

(a) many suggest identifying thresholds (for example, the proposed thresholds) with a rebuttable presumption that a business combination meeting those thresholds would be 'strategic'. An entity would be able to rebut the presumption if a business combination met the thresholds but was not, in the entity's view, a strategic business combination.[1] These respondents say this approach would avoid inappropriately capturing non-strategic business combinations within the scope of the disclosure requirements. Some of these respondents suggest requiring an entity that rebuts the presumption to disclose the fact that it has rebutted the presumption and the reason why.

(b) some suggest an approach similar to the open-list approach considered by the IASB in developing the proposed thresholds approach. Such an approach would involve describing a strategic business combination and supplementing that description with an open list of factors an entity would consider when assessing whether a business combination meets that description.[2] These respondents say an indicator-based approach would allow entities to cater to their own unique circumstances while aligning with the management approach adopted for disclosing performance information. Some of these respondents suggest using the description of a strategic business combination in paragraph BC54 of the Basis for Conclusions on the Exposure Draft[3] (Basis for Conclusions) to describe a strategic business combination.

(c) a few respondents suggest including the description of strategic business combinations from BC54 of the Basis for Conclusions in the standard and allowing management to assess whether a business combination is strategic based solely on that description.

(d) a few respondents, mostly preparers and preparer groups, suggest allowing management to decide whether a business combination is strategic.

(e) a few suggest adding a catch-all provision that would ensure all strategic business combinations are captured, even if they do not meet any of the

[1] Most respondents did not specify whether the rebuttable presumption approach should also require an entity to classify a business combination as strategic even if it did not meet any thresholds.

[2] Paragraphs BC56–BC61 of the Basis for Conclusions discuss the IASB's consideration of such an approach.

[3] Paragraph BC54 of the Basis for Conclusions described a strategic business combination as a business combination "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".

thresholds. This would help to prevent important combinations from being missed due to unforeseen circumstances.

Quantifying the number of business combinations captured

14. We performed outreach with 41 preparers across various regions to understand how the IASB’s proposals, if implemented, would affect them. Amongst other things, we asked these preparers what proportion of their past business combination would be captured by the proposed thresholds.

15. During the outreach:

    (a) most preparers say they to do not have any business combinations that would have met the quantitative thresholds in the last three years.

    (b) many preparers say they have one to two strategic business combinations in the last 10 years. These preparers would have more business combinations that met the qualitative thresholds than those that met the quantitative thresholds.

    (c) some of these preparers say given the entity’s size, it would be unlikely for them to have business combinations that meet the quantitative thresholds.

    (d) some preparers say they have immaterial business combinations that would have met the qualitative thresholds.

16. Two accounting standard setters quantify the proportion of business combinations in their jurisdictions that would meet the proposed thresholds:

    (a) one says its research shows that 20% of business combinations undertaken by listed entities in South Korea in 2023 would meet the proposed asset threshold (see paragraph 17(b) for the threshold). The respondent says including revenue and operating profit criteria could potentially identify more than 20% as strategic business combinations.

    (b) one says academic research suggests that where data exists:

(i) about half of the business combinations in the United Kingdom between 1997-2021 would meet either the proposed asset or revenue threshold.

(ii) the acquiree in approximately 40% and 10 % of business combinations in the United Kingdom belong to an industry or a country different from the acquirer respectively. The respondent did not specify if the acquisition would constitute a new *major* line of business or geographical location.

Quantitative thresholds

17. The IASB proposed three quantitative thresholds for identifying strategic business combinations. A business combination would be a strategic business combination if:

(a) in the most recent annual reporting period before the acquisition date:

(i) the absolute amount of the acquiree's operating profit or loss is 10 per cent or more of the absolute amount of the acquirer's consolidated operating profit or loss; or

(ii) the acquiree's revenue is 10 per cent or more of the acquirer's consolidated revenue; or

(b) the amount recognised as of the acquisition date for all assets acquired (including goodwill) is 10 per cent or more of the carrying amount of the total assets recognised in the acquirer's consolidated statement of financial position as at the acquirer's most recent reporting period date before the acquisition date.

18. Feedback on the quantitative thresholds includes:

(a) setting the thresholds at 10% (paragraphs 19–20);

(b) measures on which the thresholds are based (paragraphs 21–23); and

(c) suggestions and clarification requests (paragraphs 24–26).

Setting the thresholds at 10%

19. Some respondents did not specifically comment on setting the quantitative thresholds at 10%. Some respondents, including most users and both organisations representing groups of securities regulators, agree with setting the quantitative thresholds at 10% to identify strategic business combinations. They say the 10% thresholds would appropriately identify the population of important business combinations without over-burdening preparers with excessive disclosure requirements.

20. However, many other respondents say the 10 % thresholds are too low and would inappropriately capture too many business combinations. In particular:

    (a) many say the 10% thresholds do not align with the description of 'strategic business combinations' in paragraph BC54 of the Basis for Conclusions (see the footnote to paragraph 13(b)). These respondents say the failure of a business combination that accounts for only 10% of the acquiree's operating profit, revenue or total assets is unlikely to put the entity at serious risk of failing to achieve its overall business strategy. In their view, this number should be considerably higher.

    (b) some suggest setting higher thresholds (suggestions range from 15% to 100% and most commonly between 20% to 30%). These respondents often refer to thresholds that exist in regulations in their jurisdictions that require entities to disclose additional information about significant acquisitions and say the higher thresholds works well in their jurisdictions.

    (c) a few say setting the thresholds at 10% is arbitrary and unjustified.

    (d) paragraph BC67(c) of the Basis for Conclusions explains that setting the threshold at 10% would be similar to the threshold used in IFRS 8 to identify operating segments for which an entity is required to disclose information separately. One respondent disagrees with using the threshold in IFRS 8. In their view, the threshold in IFRS 8 was designed to provide information about businesses that have grown organically, which are usually smaller than businesses acquired externally.

Measures on which the thresholds are based

21. Many respondents did not specifically comment on the measures on which the quantitative thresholds are based. Some respondents explicitly agree with the measures on which the quantitative thresholds are based (that is, revenue, total assets and operating profit). In their view, the measures would help capture the right population of business combinations.

22. However, many respondents disagree with at least one of the measures and most respondents express at least some concerns with the measures. These include:

    (a) many respondents who say an entity's operating profit may be volatile. Using operating profit as a measure could result in an immaterial business combination being classified as strategic because the operating profit of the acquirer in the base period is unusually low. A few respondents say revenue could also be volatile—for example, in industries where revenue is influenced by volatile commodity prices.

    (b) a few respondents raise concerns about using the asset measure, which compares the amount recognised as of the acquisition date for all assets acquired (including goodwill) with the book value of the acquirer's assets. The difference in measurement bases of the numerator and denominator could result in an entity capturing insignificant business combinations when the acquirer's book value is considerably lower than its fair value.

23. One respondent says specifying quantitative thresholds would be incompatible with paragraph 2.11 of the Conceptual Framework for Financial Reporting (Conceptual Framework).[4]

Suggestions and clarification requests

24. Many respondents suggest changes to the quantitative thresholds, including:

[4] Paragraph 2.11 of the Conceptual Framework for Financial Reporting states '…Consequently, the [IASB] cannot specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation'.

(a) using the average operating profit over the past few annual reporting periods (a few of these respondents also suggested using a similar average for revenue) instead of using operating profit for only the most recent annual reporting period;

(b) removing the quantitative threshold for operating profit;

(c) allowing an entity to adjust operating profit or revenue for unusual items;

(d) excluding amounts attributable to non-controlling interests; and

(e) requiring different percentage thresholds for different measures, for example, by setting a higher threshold for revenue than for operating profit (or vice versa).

25. Some respondents suggest considering additional or alternative quantitative thresholds including, for example:

(a) market capitalisation;

(b) total liabilities acquired;

(c) acquisition premium paid;

(d) consideration paid; or

(e) enterprise value / sum of consideration paid and net debt assumed.

26. Many respondents request clarifying how to apply the quantitative thresholds if:

(a) the financial statements of the acquiree are not prepared in accordance with IFRS Accounting Standards or if the acquiree is a newly formed entity or an unincorporated business;

(b) the acquirer’s and acquiree’s pre-acquisition accounting policies differed;

(c) the acquiree and acquirer had different reporting period ends;

(d) the acquirer measured acquisition-date non-controlling interests of the acquiree at the proportionate share of the acquiree’s identifiable net assets instead of fair value (paragraph 19 of IFRS 3).

(e) the acquirer prepares only separate financial statements in accordance with IAS 27 *Separate Financial Statements* for regulatory reporting purposes;

(f) the initial accounting for a business combination is incomplete by the end of the reporting period and the entity reports only provisional amounts in accordance with paragraph 45 of IFRS 3;

(g) the acquirer remeasures the assets of the acquiree to their fair values as part of the business combination process;

(h) the business combination is part of a step acquisition; and

(i) there were pre-acquisition transactions between the acquiree and acquirer.

Qualitative thresholds

27. The IASB proposed two qualitative thresholds for identifying strategic business combinations. A business combination would be a strategic business combination if the business combination resulted in the acquirer entering a new major line of business or geographical area of operations.

28. Most respondents do not provide specific feedback on the qualitative thresholds. A few respondents agree with the proposed qualitative thresholds and some disagree.

29. This section discusses:

(a) concerns (paragraphs 30–32);

(b) suggestions and clarification requests (paragraphs 33–36).

Concerns

30. Many respondents highlight challenges in applying the proposed qualitative thresholds. For example:

(a) when an entity enters a new location (such as a new country or a city) within a larger geographical segment (such as a continent), it is unclear whether this would constitute a new geographical area of operations.

(b) an entity may enter a new line of business or geographical area of operation with an immaterial business combination and subsequently expand its presence through more substantial business combinations or through organic growth. It is unclear whether the qualitative thresholds capture the initial smaller business combination.

(c) it can be difficult to set a boundary between different lines of businesses.

31. Some respondents say a business combination allowing an entity to enter a new geographical area of operations or a line of business does not necessarily mean the business combination is strategic and the proposed qualitative thresholds would therefore inappropriately capture many business combinations.

32. A few respondents disagree with basing the qualitative thresholds on thresholds in IFRS 5 *Non-Current Assets Held for Sale and Discontinued Operations*[5] used to identify discontinued operations. They say:

(a) there are application challenges in applying the IFRS 5 thresholds; and

(b) acquisition transactions differ from disposal transactions and using the same criteria can lead to new challenges. For example, when an entity exits a line of business or geographical area of operations, it has a good understanding of the significance of that business or geographical area. In contrast, when an entity initially enters a new line of business or a geographical area of operations, the significance of that new business or geographical area could be difficult to assess.

Suggestions and clarification requests

33. A few respondents suggest considering additional or alternative qualitative thresholds including, for example:

[5] Paragraph BC69 of the Basis for Conclusions states the qualitative thresholds are based on the thresholds in paragraph 32 of IFRS 5 used to identify discontinued operations. The thresholds have been adapted to reflect the purchase of a business instead of the discontinuance of an operation.

(a) the acquisition of a separate reporting segment;

(b) acquiring key technologies;

(c) meeting regulatory thresholds; or

(d) other industry-specific considerations.

34. A few respondents suggest requiring a business combination that meets the qualitative threshold to also meet a minimum quantitative threshold to be classified as a strategic business combination.

35. One preparer says in practice a business combination meeting the qualitative thresholds would likely also meet the asset threshold. Consequently, there is no need for the qualitative thresholds.

36. Some respondents ask for clarifications including:

(a) what constitutes a new major line of business or geographical area of operations~~)~~;

(b) whether the adjectives ‘new’ and ‘major’ apply to both ‘line of business’ and ‘geographical area of operating’ or only to ‘line of business’;

(c) whether a business combination needs to be both 'new' and 'major' or if it only has to be 'new' or 'major'; and

(d) whether an immaterial business combination meeting the qualitative threshold would be a strategic business combination.

Other concerns

Series of business combinations

37. Paragraphs BC71–73 of the Basis for Conclusions discuss the IASB’s considerations in respect of identifying a series of business combinations that would not, individually be captured by the proposed thresholds, but that are entered into to achieve the same

strategic objective(s). These paragraphs explain that the IASB was unable to develop a method for identifying such business combinations.

38. Some users say the IASB should revise the thresholds to capture a series of business combinations entered into to achieve the same strategic objective. However, they acknowledge the difficulty in developing a method to do so.

39. A few users suggest requiring entities to disclose performance information when the total size of business combinations undertaken by an entity in a particular line of business or geographical area surpasses a particular threshold over a specific period (for example, two years).

40. One respondent (a standard-setter) says if an entity has the same strategic rationale for multiple business combinations[6], it should assess whether those business combinations would be strategic when considered in aggregate.

Impact on smaller entities

41. A few respondents say quantitative thresholds could capture many business combinations undertaken by smaller entities, because it may be easier for smaller entity to have business combinations that exceed the threshold. Conversely, some larger entities say their business combinations are unlikely to surpass the quantitative thresholds due to their larger sizes.

Use of the term 'strategic'

42. Some respondents express concerns about the term 'strategic' business combinations to describe the subset of business combinations for which an entity would be required to disclose performance information. Their reasons include:

[6] The IASB proposed to replace the requirement for an entity to disclose the primary reasons for a business combination with a requirement to disclose the strategic rationale for a business combination. We will present feedback on this proposed requirement at a future IASB meeting.

(a) almost all of an entity's business combinations would be strategic, otherwise, the entity would not have pursued those business combinations.

(b) the term may be difficult to translate into other languages. This challenge could lead to confusion with existing accounting terms or conflict with local regulations.

(c) the term ‘strategic business combination’ may imply that the identification of business combinations for which to disclose performance information follows a management approach (similar to the identification of the information to be disclosed—see Agenda Paper 18D), when that is not the case.

43. Some respondents use alternative terms, such as ‘significant’ / ‘fundamental’ / ‘important’ business combinations, when describing the subset of business combinations which the IASB should require entities to disclose performance information about.

Question for the IASB
Do IASB members have any questions or comments on the feedback in this agenda paper?