IFRS® Foundation

Discussion Paper

Business Combinations—
Disclosures, Goodwill and Impairment

The views expressed in this presentation are those of the presenter, not necessarily those of the International Accounting Standards Board or the IFRS Foundation.

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Project background & overview

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The Discussion Paper

Objective

To improve the information companies provide to investors, at a reasonable cost, about the acquisitions those companies make.

Timeline

2004	2013–2015	2015–present	March 2020
IFRS 3 issued*	PIR of IFRS 3	Goodwill and Impairment project	Discussion Paper

Feedback

The Board is mainly seeking comments on:

- the usefulness and feasibility of its new disclosure ideas; and
- new evidence or arguments on how to account for goodwill.

* IFRS 3 introduced the impairment-only approach and replaced IAS 22 which required amortisation.

Stakeholders' feedback from the PIR of IFRS 3 includes:

- Investors do not get enough information about acquisitions and their subsequent performance
- The impairment test is complex and costly for companies
- Impairment losses on goodwill are recognised too late
- Goodwill should be amortised. It has been paid for and so, sooner or later, it should have an impact on profit or loss
- It is difficult for companies to account for intangible assets such as customer relationships and brands separately from goodwill

The Board's preliminary views

1 Improving disclosures about acquisitions	Require companies to disclose: • management's objectives for acquisitions; and • how acquisitions have performed against those objectives subsequently. Some targeted improvements to existing disclosures.		
2 Improving the accounting for goodwill	A	Can the impairment test be made more effective?	Not significantly, and not at a reasonable cost.
	B	Should goodwill be amortised?	No, retain the impairment-only model.
	C	Can the impairment test be simplified?	Yes, provide relief from the annual impairment test and simplify value in use.
3 Other topics	• Present on the balance sheet the amount of total equity excluding goodwill. • Do not change recognition of intangible assets separately from goodwill.		

Discussion with AOSSG members

Purpose of meeting

- Discuss initial feedback received

Questions for AOSSG members

- Slides 25—27 list the initial feedback that the Board has heard about improving disclosures for business combinations. Have you heard similar feedback? In particular, do you think:
  - the information should be disclosed in the financial statements or management commentary?
  - concerns over commercial sensitivity and forward-looking information could limit the disclosures of relevant information in your jurisdiction?
- Slides 28—30 lists the initial feedback that the Board has heard on subsequent accounting of goodwill and other topics. We would like to know whether you have:
  - heard any new evidence or arguments in support of either amortisation or impairment only approach?
  - ideas to improve the effectiveness of the existing impairment test?

❶ Improving disclosures about acquisitions

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1 Improving disclosures about acquisitions

What is the issue?

Investors do not get enough information about acquisitions and their subsequent performance

- Such information would allow investors to hold management to account (stewardship).
- IFRS Standards do not specifically require companies to disclose information about the subsequent performance of acquisitions.

Board's preliminary view: require disclosures

At the acquisition date:

- Strategic rationale for acquisition
- Objectives for the acquisition
- Metrics for monitoring achievement of objectives

After the acquisition date:

Performance against objectives

1 Improving disclosures about acquisitions

Board's preliminary view: Companies should disclose information management uses internally to monitor acquisitions

What metrics should be disclosed?

- No single metric suitable, because business combinations are all different
- Management approach:
  - Less costly to produce
  - Insights into how management manages acquisitions
- Can be operational or financial metrics
- Might be information about combined business where integration occurs

Should all material acquisitions be disclosed?

- Disclosure of all material acquisitions could be onerous for serial acquirers
- Preliminary view: define 'management' as 'chief operating decision maker' (CODM) (IFRS 8 *Operating Segments*)
- Are these the acquisitions that investors would like to know more about?

❶ For how long should information be provided?

For as long as management monitors the acquisition

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

Companies should disclose the metrics the CODM uses for monitoring; these may be about the combined business.

What if the CODM changes the metrics they use for monitoring?

Companies should disclose the new metrics and the reasons for the change.

At acquisition date	
if monitored by CODM disclose objectives	if not monitored by CODM disclose reason for not monitoring

Within 2 years*	
if monitoring continues disclose performance against objectives	if monitoring ceases disclose reason for ceasing to monitor

After 2 years*	
if monitoring continues disclose performance against objectives	if monitoring ceases no further disclosure needed

*Two full years after the year of acquisition

1 Further improvements to IFRS 3 disclosures

	Message from stakeholders	Preliminary view of the Board
Expected synergies	• Synergies are often an important part of an acquisition. • Help investors better understand the factors that contributed to the acquisition price.	Require companies to disclose in the year of acquisition the amount, or range of amounts, of synergies expected from an acquisition.
Defined benefit pension liabilities & debt	• Some investors consider these liabilities to form part of the capital employed for acquisitions. • Needed to assess return on capital employed.	Require companies to disclose the amount of defined benefit pension liabilities and debt of the acquiree at the acquisition date, separately from other classes of liabilities.
Pro-forma information	• Existing disclosure requirements lack guidance, resulting in diversity in practice. • Preparers question the usefulness of the information, while investors think that the information is important.	Require companies to disclose both actual and pro-forma revenue, operating profit and cash flows from operating activities.

❷ Improving the accounting for goodwill

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❷ Improving the accounting for goodwill

What are the issues?

Impairment losses on goodwill are recognised too late

Could be due to:
- too optimistic cash flow estimates; or
- shielding of goodwill from impairment by headroom (see next slide)

The impairment test is complex and costly for companies

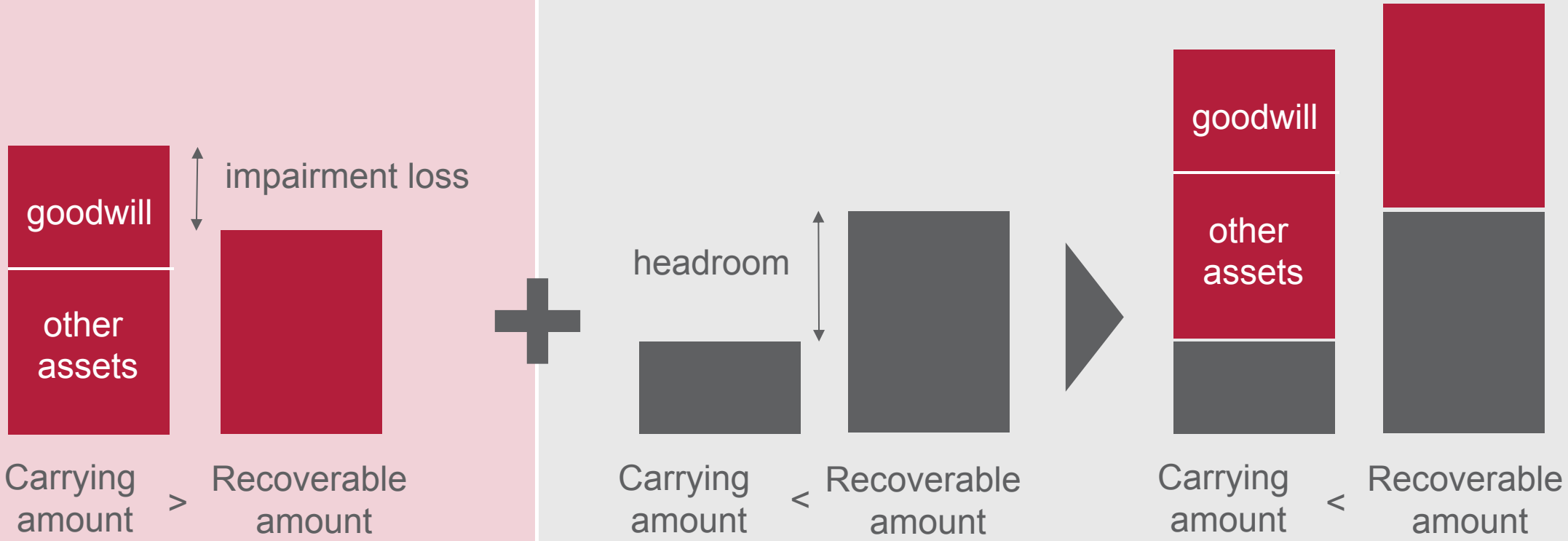
Research undertaken by the Board

A Can the impairment test be made more effective?

B Should goodwill be amortised?

C Can the impairment test be simplified?

❷ Background—shielding



If acquired business is run separately:
→ tested for impairment separately
→ impairment loss

If acquired business is integrated with acquirer's business:
→ combined business is tested for impairment
→ no impairment loss

❷ Ⓐ Can the impairment test be made more effective?

Board's preliminary view

No feasible alternative test

- It is not feasible to make the impairment test for goodwill significantly more effective at a reasonable cost to companies.
- Shielding cannot be eliminated because goodwill has to be tested for impairment with other assets.

The test is not intended to test goodwill directly

- The test cannot always signal how an acquisition is performing, but that does not mean that the test has failed.
- When performed well, the test ensures that the carrying amount of the CGU as a whole is recoverable.

Disclosure solution

The disclosure requirements discussed on slides 9–10 could provide information that investors need about the performance of acquisitions.

❷ Ⓑ Amortisation of Goodwill vs Impairment-only

Amortising goodwill	Retaining the impairment-only model
some say…	others say…
Goodwill is overstated, so management is not held to account.	The impairment-only model provides useful confirmatory information to investors.
Amortisation is simple and targets acquired goodwill directly.	Amortisation is arbitrary and would be ignored by many investors.
The impairment test is not working as well as the Board intended.	If applied well, the impairment test works as the Board intended, ensuring that, as a group, goodwill and other assets of a business are not overstated.
Goodwill is a wasting asset. Amortisation is the only way to show the consumption of goodwill.	The benefits of goodwill are maintained for an indefinite period, so goodwill is not a wasting asset.
Amortisation would ultimately make the impairment test easier and less costly to apply.	Amortisation would not significantly reduce the cost of impairment testing, especially in the first few years.

❷ Ⓑ Amortisation of Goodwill vs Impairment-only

Board's preliminary view		
There is no compelling evidence that amortisation would significantly improve financial reporting	➡	**Retain the impairment-only approach**

The Board majority was small.
Stakeholders are invited to provide new arguments to help the Board decide how to move forward on this topic.

2 C Simplifying the impairment test

Relief from an annual impairment test

Having to perform the test annually, even when they have no reason to suspect an impairment has occurred, adds unnecessary cost.

- Remove requirement to test CGUs containing goodwill for impairment at least annually.
- Companies must still assess whether there is any indicator of impairment, and perform the impairment test if there is.

Simplifying value in use estimates

IAS 36 contains certain restrictions on value in use that add cost and complexity to the test, and deviates from common industry practice.

- Remove restriction on including some cash flows in value in use estimates.
- Cash flow forecasts still need to be reasonable and supportable.
- Allow use of post-tax discount rates and post-tax cash flows.

❸ Other topics

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❸ Other topics

Presenting total equity before goodwill

Goodwill is different from other assets because it:

- can only be measured indirectly; and
- cannot be sold separately.

Presenting **total equity excluding goodwill** on the balance sheet helps to make this amount **more prominent**, drawing investors' attention to companies whose goodwill constitutes a significant portion of their net assets.

Intangible assets

Some believe that recognising these assets separately helps explain what the company has bought in an acquisition. Others think that the information is of limited use.

In the Board's view:

- there is no compelling evidence to change existing requirement; and
- aligning the accounting treatment for all intangible assets is beyond the scope of this project.

Summary—package of preliminary views

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A balanced package

		Objectives		Board's preliminary view
		More useful information	Reduce cost	
1	Improve disclosures about acquisitions	✓	✗	Yes, change
2	Amortise goodwill	✗	✓	No, do not change
	Provide relief from annual quantitative impairment test	…	✓	Yes, change
	Amend how value in use is estimated	✓	✓	Yes, change
3	Present total equity excluding goodwill	✓	…	Yes, change
	Include some intangible assets in goodwill	✗	✓	No, do not change

✓ In line with objective ✗ In conflict with objective … No significant impact

Initial feedback

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1 Improving disclosures about acquisitions

Overall message

- Users generally think information would be useful
- Preparers understand the needs of users but have some concerns over implementation
- Those agreeing with the need to disclose often support the management approach (providing information that the management uses to monitor)

Disclosing objectives and performance of acquisitions

Board's preliminary view

- At the acquisition date disclose:
  - Strategic rationale and objectives
  - Metrics for monitoring achievement of objectives
- After the acquisition date disclose:
  - Performance against objectives using the metrics

Board's preliminary view

- Management defined as the Chief Operating Decision Maker (CODM) as per IFRS 8 *Operating Segments*
- Provide additional disclosures about objectives and targets based on the information about acquisitions that the CODM monitors

1 Improving disclosures about acquisitions

Disclosing objectives and performance of acquisitions

Initial feedback received

- Information is not currently provided and is needed for stewardship purposes
- Better placed in management commentary
- Integration prevents information being provided
- Information may be forward-looking and commercially sensitive
- Why is a different materiality threshold applied?
- Most say the information the CODM monitors is not granular enough

Additional feedback needed

- How can entities be encouraged to provide this information if not required in financial statements?
- Do entities really not know how acquisitions are performing when integrated? Often turns out there is some information management are using to monitor
- How does local legislation or regulation define forward-looking information? Is a target different to a forecast?
- What parts of the disclosures are commercially sensitive and why? Press releases announcing deals often provide detailed targets. Presumably these are not commercially sensitive?
- Applying the CODM approach, does this prevent the volume of disclosures being onerous or not?

1 Improving disclosures about acquisitions

Targeted disclosure improvements

Board's preliminary view

Companies should disclose:

- Amount of expected synergies
- Debt and pension liabilities acquired
- Actual and pro-forma revenue, operating profit and operating cash flow

Initial feedback received

- Users find information about synergies useful. Some preparers say they are difficult to calculate
- General agreement for debt and pension liability disclosures
- General agreement for disclosure of operating profit; some reservations about operating cash flow

Additional feedback needed

- Some users say that information about synergies is sometimes provided in investor presentations or press releases at the time of acquisition. Why can't this be disclosed in financial statements? Where expected, haven't management made an estimate of synergies when deciding what price to pay?

2 Improving the accounting for goodwill

Overall message

- Stakeholders remain split over impairment-only vs amortisation
- No new evidence or arguments provided for either view since the DP was published

Simplifying and improving the impairment test

Board's preliminary view

- No compelling evidence that amortisation would be a significant improvement – retain impairment-only model
- Current impairment test cannot be significantly improved
- Provide relief from annual impairment test
- Simplify VIU calculation
  - include restructuring cash flows
  - allow post-tax calculations

Initial feedback received

- Some regulators say that addressing management optimism is not only an application issue
- Some have ideas for additional disclosure to discourage over-optimism (eg disclosure of actual vs forecasted cash flows)
- More guidance is needed on allocating goodwill to CGUs – both at the time of acquisition and after internal reconstruction
- Some are concerned that an indicator-only impairment test makes it harder to challenge management

2 Improving the accounting for goodwill

Simplifying and improving the impairment test

Initial feedback received (continued)

- The existing practical expedient in IAS 36, allowing companies to roll forward impairment tests, should be made easier to apply
- Users say information about assumptions used in the annual impairment test is useful
- Some are concerned about further over-optimism if uncommitted restructuring cash flows are included
- If restructuring cash flows are included in VIU, some say the difference between VIU and FVLCD will be minimal and that the Board should consider requiring only one method

Additional feedback needed

- What can the Board do to make the Standard easier for regulators to enforce?
- What additional guidance for allocation of goodwill to CGUs would be appropriate for the majority of entities? What words in IAS 36 are causing difficulties in practice?
- What makes it harder to challenge management's indicator assessments than the assumptions management makes in annual quantitative tests?
- What prevents companies from applying the existing practical expedient in IAS 36 today and what would make it easier to apply?

3 Other topics

Intangible assets and presenting total equity excluding goodwill

Board's preliminary view

- No compelling evidence that the recognition criteria for intangible assets acquired in a business combination should be changed
- Companies should present total equity excluding goodwill

Initial feedback received

- Views continue to be mixed about whether the separate recognition of all identifiable intangible assets in a business combination provides useful information
- Most stakeholders disagree with presenting total equity excluding goodwill
  - calls into question whether goodwill is an asset
  - unnecessary as stakeholders are able to compute the amount easily

Questions?

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