UKEB
UK Endorsement Board

Exposure Draft *Business Combinations – Disclosures, Goodwill and Impairment*: Initial technical paper

Executive Summary

Project Type	Influencing
Project Scope	Moderate

Purpose of the paper

This paper provides the Board with the opportunity to consider some of the key proposals contained in the IASB Exposure Draft *Business Combinations–Disclosures, Goodwill & Impairment* (the 'ED') published on 14 March 2024, which includes proposed amendments to:

- IFRS 3 *Business Combinations*; and
- IAS 36 *Impairment of Assets.*

The paper also summarises feedback received from our initial outreach with UKEB Advisory Groups.

A Draft Comment Letter will be presented at the Board's 24 May 2024 meeting.

Summary of the issue

For IFRS 3 the ED proposes new disclosure requirements, including quantitative information about synergies expected from each material business combination and additional information about the performance of 'strategic' business combinations.

For IAS 36 the ED proposes targeted amendments to the calculation of value in use, clarifications on the allocation of goodwill and new disclosure requirements.

This paper and accompanying appendices present an overview of the key ED proposals and the issues the ED aims to address. The appendices include feedback received from our initial outreach with UKEB Advisory Groups in February and March 2024, ahead of the publication of the ED, based on the IASB's tentative decisions expected to be included in the ED.

Decisions for the Board

The Board is not asked to make any decisions. However, the Board is asked the following questions:

1. Does the Board have any questions or comments on:
   a) the proposed amendments to IFRS 3?
   b) the proposed amendments to IAS 36?
2. Does the Board have any overall comments to inform the development of the Draft Comment Letter?
3. Does the Board have any comments or questions on the suggested outreach detailed in the Next Steps section of this paper?

Recommendation

N/A

Appendices

Appendix A Proposed Amendments to IFRS 3: Preliminary Analysis

Appendix B Proposed Amendments to IAS 36: Preliminary Analysis.

Background

1. The IASB's overall objective of its project is to explore whether companies can, at a reasonable cost, provide investors with more useful information about the acquisitions those companies make[1].

2. The IASB's proposals in the ED build on its preliminary views expressed in the Discussion Paper *Business Combinations – Disclosures, Goodwill and Impairment* published in March 2020 (the 'DP') to address stakeholder concerns identified during the IASB's post-implementation review of IFRS 3 *Business Combinations*.

3. The UKEB Secretariat responded to the DP in its Final Comment Letter (FCL) published on 29 January 2021[2]. For brevity this response is generally referred to in this paper and in the appendices as the UKEB FCL.

4. Having redeliberated its preliminary views set out in the DP, the IASB published an ED on 14 March 2024, with a comment period ending on 15 July 2024. Along with the ED, the IASB published its Basis for Conclusions and a snapshot of the proposals. The ED includes proposed amendments to:

    a) IFRS 3 *Business Combinations*; and

    b) IAS 36 *Impairment of Assets*.

5. The Board approved the UKEB Project Initiation Plan (PIP) for this project at its meeting on 28 March 2024.

Proposed amendments to IFRS 3 *Business Combinations*

6. The IASB proposes to add new disclosure objectives and related disclosure requirements that would result in an entity providing:

    a) quantitative information about the synergies expected to arise from each material business combination; and

    b) information about the performance of a subset of material business combinations—'strategic' business combinations—specifically, information about the entity's acquisition-date key objectives and related targets for each strategic acquisition and the extent to which those key objectives and related targets are met in subsequent periods.

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[1] Paragraph 1.7 of the IASB's March 2020 Discussion Paper *Business Combinations, Disclosures, Goodwill and Impairment.*

[2] Details of the UKEB response to the DP on 29 January 2021 can be found on our project webpage here.

7. Responding to stakeholder concerns raised in response to the DP, including cost, commercial sensitivity and exposure to litigation risk of providing certain information, the IASB is proposing an exemption from some of the proposed disclosures in specific circumstances that could 'prejudice seriously' the achievement of any of the acquirer's key objectives for the business combination.

Proposed amendments to IAS 36 *Impairment of Assets*

8. The IASB proposes some targeted amendments to the requirements in IAS 36 relating to the calculation of value in use, clarifications to the guidance on the allocation of goodwill to cash-generating units and new disclosure requirements.

Effective date and transition

9. The IASB proposes that the amendments to both IFRS 3 and IAS 36 will be required prospectively, with early adoption permitted. There is no proposed relief for first-time adopters of IFRS.

Initial overall impressions

10. Appendix A and Appendix B to this paper provide a more detailed analysis of the proposed amendments to IFRS 3 and IAS 36 respectively, based on the UKEB Secretariat's analysis and outreach with UK stakeholders to date.

11. The UKEB Secretariat's preliminary review of the ED indicates that the contents are broadly consistent with expectations, based upon the IASB staff papers and the IASB's tentative decisions. The Board was provided with an overview of those tentative decisions at the 19 October 2023 Board meeting[3].

12. Preliminary feedback from the UKEB Advisory Groups[4] was obtained prior to the publication of the ED, based on the IASB's tentative decisions.

13. Overall, the Advisory Group (AG) members expressed support for the IASB project objective to improve the information that entities provide to users about the most important business combinations. However, several areas of concern with the tentative decisions were identified in AG meetings.

[3] 19 October 2023 IASB General Update paper – Appendix B includes a summary of the IASB's tentative decisions on this project.

[4] Feedback was obtained from the Investor Advisory Group (26 February 2024), Preparer Advisory Group (5 March 2024), and Accounting Firms and Institutes Advisory Group (14 March 2024). Meeting summaries can be found in the links provided. Feedback was also obtained from the Academic Advisory Group (12 April 2024), after this report had been written, but will be considered in drafting the Comment Letter.

14. The following topics, including any areas of possible concern, are addressed in more detail in the Appendices.

Proposed amendments to IFRS 3 – key areas:

a) new disclosure requirements for all material business combinations - quantitative information on expected synergies;

b) definition of a 'strategic' business combination – threshold approach;

c) new disclosure requirements for each 'strategic' business combination;

d) management approach, for identifying disclosure information for each 'strategic' business combination, using key management personnel;

e) how long information on subsequent performance of each 'strategic' business combination is required to be disclosed;

f) application of the proposed exemption; and

g) location of information.

Proposed amendments to IAS 36 – key areas:

h) simplifications to the 'value in use' calculation in the impairment test; and

i) additional guidance on how an entity allocates goodwill.

15. The following topics are not covered in this paper, since preliminary feedback has not highlighted specific concerns in relation to these topics.

Other proposed amendments to IFRS 3:

a) new disclosure objectives[5];

b) disclosure requirements for strategic rationale (as opposed to primary reasons) for each 'material' business combination;

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[5] The IASB proposes to add two new **disclosure objectives** in proposed paragraph 62A of IFRS 3). "The acquirer shall disclose information that enables users of its financial statements to evaluate:
a) the **benefits that an entity expected** from a business combination when agreeing the price to acquire a business; and
b) for a **strategic business combination** (see paragraph B67C), the **extent to which the benefits** an entity expects from the business combination are **being obtained**."
Per Basis for Conclusion paragraphs BC23–BC28, 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.

c) disclosure of 'liabilities arising from financing activities and defined benefit pension liabilities';

d) clarification that the basis an entity applies in preparing pro-forma information on the contribution of the acquired business, under the existing requirements, is an accounting policy, which requires disclosure;

e) reduced disclosure requirements; and

f) disclosure requirements for the forthcoming IFRS 19 *Subsidiaries without Public Accountability: Disclosures.*

Other proposed amendments to IAS 36:

g) retaining the impairment-only model and not reintroducing amortisation of goodwill;

h) retaining the requirement to perform the impairment test on CGUs containing goodwill on an annual basis, regardless of indicators of impairment; and

j) requirement to disclose in which reportable segment a CGU containing goodwill is included.

Questions for the Board
1. Does the Board have any questions or comments on: a) the proposed amendments to IFRS 3? b) the proposed amendments to IAS 36?

Next steps

16. The Secretariat plans to present a Draft Comment Letter for discussion and approval at the 24 May 2024 Board meeting.

17. Outreach planned, as outlined in the PIP, includes discussions with the following:

a) FRC Corporate Reporting Review team[6].

b) User roundtable – 7 May 2024.

[6] Initial meeting on the IASB's tentative decisions prior to the publication of the ED took place in January 2024.

c) Preparer one-to-one interviews – throughout May 2024.

18. Other outreach planned after the publication of the Draft Comment Letter (DCL) includes discussions with the following:

a) UKEB Rate-regulated activities Technical Advisory Group (RRA TAG) – 27 June 2024.

b) Other UKEB Advisory Groups previously consulted prior to the publication of the ED.

c) Corporate Reporting User Forum (CRUF) UK – 6 June 2024.

d) Other national standard setters.

Questions for the Board
2. Does the Board have any overall comments to inform the development of the Draft Comment Letter?
3. Does the Board have any comments or questions on the suggested outreach set out above?

Detailed Project Timeline

Expected Dates	Milestone
January / February 2024	**Secretariat:** Preliminary analysis and outreach before publication of ED
23 February 2024	**Board:** Education session (Private meeting)
26 February 2024	**Secretariat:** Outreach—UKEB Investor Advisory Group (IAG)
5 March 2024	**Secretariat:** Outreach—UKEB Preparer Advisory Group (PAG)
14 March 2024	**Secretariat:** Outreach—UKEB Accounting Firms and Institutes Advisory Group (AFIAG)
14 March 2024	**IASB:** Exposure Draft published with comment deadline 15 July 2024
28 March 2024	**Board:** Project Initiation Plan (PIP) approved
12 April 2024	**Secretariat:** Outreach—UKEB Academic Advisory Group (AAG)

Expected Dates	Milestone
26 April 2024	**Board:** Discusses technical paper – this document
24 May 2024	**Board:** Consideration and approval of DCL
31 May 2024 (estimate)	**Secretariat:** Publishes DCL and Invitation to Comment on website and alerts key stakeholders (as soon as possible after 24 May Board meeting)
June 2024	**Open consultation:** 30-day DCL comment period
15 July 2024	**IASB:** Exposure Draft comment deadline
18 July 2024	**Board:** Discusses and approves Final Comment Letter (FCL), Feedback Statement and draft Due Process Compliance Statement
26 July 2024 (estimate)	**Secretariat:** Submits FCL to IASB and publishes FCL and Feedback Statement on website (as soon as possible after 18 July Board meeting)
19 September 2024	**Board:** Notes completed DPCS
20 September 2024	**Secretariat:** Publishes DPCS on website

UK Endorsement Board

Appendix A: Proposed Amendments to IFRS 3: Preliminary Analysis

Quantitative information about expected synergies

What is the issue?

A1. IFRS 3 currently only requires a qualitative description of the factors that make up goodwill, such as expected synergies from the combined operations[1]. During the *Business Combinations—Disclosures, Goodwill and Impairment* project, the IASB received feedback from users that they need better information about business combinations and the nature, timing and amount of the anticipated benefits of expected synergies, to help users:

a) understand why an entity entered into the business combination; and

b) form their own opinions about whether the acquisition price paid was reasonable.

A2. The UKEB FCL[2] in response to the IASB's DP:

> Did not support the proposed disclosures on synergies because:
>
> a) They would require the disclosure of commercially sensitive or confidential information.
>
> b) Given the significant judgement involved, the proposed disclosures may be difficult to verify, leading to significant increase in costs of verifying and auditing them.
>
> c) The audit expectation gap may increase as public perception may be that auditors are confirming that predicted synergies will be realised.
>
> d) The costs may be disproportionate to the benefit.
>
> e) The proposal is for a one-off disclosure at the date of acquisition, leading to brief and limited increase in management accountability.
>
> Recommended that, if proposals to disclose synergies were developed:
>
> a) Synergies are defined by the IASB, in order to support consistency and comparability.
>
> b) Illustrative examples are developed and field-tested.

[1] Paragraph B64(e) of IFRS 3.
[2] Paragraphs A12 and A13 UKEB Final Comment Letter published 29 January 2021.

IASB proposals

A3. The IASB has retained its proposal to require the disclosure of quantitative information on expected synergies for each material business combination in the year of acquisition.

> The proposal is to require an entity to disclose additional information about expected synergies, in the year of acquisition*, for each material business combination. The information would include:
>
> - specifying each category of synergy (revenue, cost-saving, tax, etc);
> - when the benefits are expected to start;
> - how long the benefits are expected to last;
> - quantitative information by category of the amount of synergy, expressed as a range or point estimate; and
> - an estimate of the cost to achieve those synergies.
>
> * an entity would not be required to disclose information about the achievement of expected synergies in subsequent periods (paragraphs BC161-BC162).

A4. The IASB tentatively decided not to define synergies (paragraphs BC159–BC160)[3].

A5. The IASB proposes an exemption[4] from providing information about expected synergies, in certain circumstances, because disclosing information about expected synergies could be commercially sensitive, or could be regarded as forward-looking in certain jurisdictions and expose the entity to litigation risk (paragraphs BC150–BC154), even when the information is disclosed only by category.

A6. However, to preserve as much quantitative information as possible, before applying the exemption an entity would be required to consider[5], whether it is possible to disclose expected synergies in a different way—for example, at a sufficiently aggregated level, as opposed to by each category—without prejudicing seriously any of the acquisition-date key objectives for the business combination.

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3 Whilst lack of definition might lead to diversity in how entities identify and quantify expected synergies, which could result in users receiving varied and potentially misleading information, the IASB decided against doing so, as the term appears to be widely understood and paragraph B64(e) of IFRS 3 already requires an entity to disclose qualitative information about expected synergies and entities appear to identify expected synergies appropriately (paragraphs BC159-BC160).

4 The proposed exemption is discussed in more detail later in this paper. See Basis for Conclusions paragraphs BC74–BC107.

5 The proposed application guidance can be found in paragraphs in B67E and B67F in the Exposure Draft and Basis for Conclusion paragraph B98.

A7. The IASB proposes to amend Illustrative example IE72 to include an example of quantitative information in the year of acquisition for expected synergies:

> **Illustrative Example E72**
> (Proposed amendments are underlined)
>
> B64(e) The goodwill of CU2,500 arising from the acquisition consists largely of the synergies and economies of scale expected from combining the operations of AC and TC.
>
> B64(ea) The business combination is expected to generate recurring annual revenue synergies of CU80–CU100 and recurring annual cost synergies of CU100–CU125. The costs to achieve these synergies are expected to include recurring costs of CU15 to achieve the revenue synergies and a one-off cost of CU75 to achieve the cost synergies. Management expects the benefit of the revenue synergies to start from 20X4 and the benefit from the cost synergies to be fully realised by 20X3.

Initial feedback from UKEB Advisory Groups

A8. The following feedback was received on the IASB's tentative decisions:

a) *Defining the word 'synergies'* – overall, Advisory Group (AG) members expressed support for the IASB decision not to define the word 'synergies', given the existing requirements in IFRS 3.

b) *Disaggregation of synergies* – IAG members were concerned by the application guidance permitting synergies to be sufficiently aggregated to overcome commercial sensitivity, since this would result in the loss of information that is not commercially sensitive that might otherwise have been disclosed separately. IAG members agreed with paragraph BC152(a), that users require disaggregated cost and revenue synergies because they analyse such information differently; many entities that provide such information outside financial statements do so at a disaggregated level.

c) *Highly judgemental* – both AFIAG and PAG members expressed concern about the highly judgemental nature of expected synergies, particularly revenue synergies, and questioned the value to users, whilst being costly to provide along with audit evidence that assumptions are 'reasonable and supportable'.

d) *Auditability and audit expectation gap* – AFIAG members noted the difficulty in auditing such highly judgemental information and therefore may not be able to provide the assurance that users are looking for.

e) *Availability of information* – PAG and AFIAG members were concerned that such information might not be available at acquisition-date, especially where the acquisition is close to the year end, when due diligence may not be completed. The proposed exemption does not mention availability.

f) *'Measurement period'* – AFIAG members highlighted that whilst other information disclosed in the year of acquisition might be provisional and adjusted in the 'measurement period'[6], the same opportunity to adjust information about expected synergies was not available[7], so information disclosed might be inconsistent and therefore of limited use. PAG members also noted that management's view of expected synergies changes over time.

g) *Commercially sensitive* – PAG members were concerned that certain synergies, such as employee-related cost-savings, were commercially sensitive, so the exemption may be commonly used. However, it may not fully address the concern of commercial sensitivity due to the requirement to disclose each item to which the exemption has been applied and the reason.

h) *Clarity of requirements* – there appears to be some confusion between the requirements to disclose (i) quantitative information for expected synergies and (ii) management's key objectives and related targets (see proposed disclosure requirements for 'strategic' business combinations, later in this paper), where such targets might be the achievement of synergies, as opposed to, for example, percentage increases in revenue, profit or market share.

Initial comment

A9. Contrary to the position in the FCL to the DP, current outreach supports the IASB's decision not to define synergies. We understand that the IASB plans to undertake field testing with preparers on the proposed changes.

A10. We acknowledge the efforts of the IASB to balance the need of users and the concerns of commercial sensitivity and cost for preparers, by providing an exemption from disclosing certain information on expected synergies, if doing so could prejudice seriously the achievement of any of the acquirer's acquisition-date objectives.

A11. Whilst our initial outreach suggested there was confusion between the requirements (see paragraph A8(h) above), paragraphs BC162-163 clarify that the

[6] The measurement period is up to one year after the acquisition date, during which the acquirer may adjust the provisional amounts recognised for a business combination.

[7] The Basis for Conclusions paragraph BC139 suggests that assumptions reflected in the acquisition price and the assets and liabilities recognised as a result of the business combination, including expected synergies, are fixed at the date of acquisition.

two proposals are separate: expected synergies would apply only in the year of acquisition and disclosure of whether those synergies have been achieved would not be required. However, if one of management's key objectives is to achieve those synergies and management is monitoring such information, then the entity would need to disclose if the key objective i.e. the synergies, have been achieved. This may need to be clearer in the standard itself.

Subset of 'strategic' business combinations - threshold approach

What is the issue?

A12. IFRS 3 currently requires an entity to disclose some information for each business combination that occurs during the reporting period and additional information for material business combinations. An entity is required to disclose such information either separately for each material business combination, or in aggregate for individually immaterial business combinations (paragraph BC45).

A13. Stakeholders expressed concerns about requiring entities to disclose information about each material business combination, since the volume of disclosures could be onerous and could obscure the most important information, especially where some entities frequently acquire other businesses (paragraph BC46).

A14. Some users said information about the performance of business combinations is needed only for 'major' or 'fundamental' business combinations (paragraph BC47).

A15. The IASB decided to propose in the DP that information certain information (key objectives, targets and subsequent performance) should be required for only a subset of material business combinations – those monitored by the Chief Operating Decision Maker (CODM). This would result in an entity disclosing the most important information about the most important business combinations, to balance users' need for information with the costs of disclosure.

A16. A few stakeholders responding to the DP disagreed with requiring an entity to disclose information for only a subset of material business combinations, expressing concern about how the requirements would interact with the concept of materiality (paragraph BC51).

A17. The UKEB FCL in response to the DP:

> Supported the principle of improved disclosures on acquisitions to support stewardship and accountability.
> Recommended that disclosures would need to be made for all material acquisitions (not just those monitored by CODM) to support the usefulness of information for users and comparability across entities[8].

IASB proposal

A18. The IASB proposes to add new disclosure requirements for a subset of material business combinations—strategic business combinations— and exempt entities from disclosing some items of this information in specific circumstances.

A19. As described in the Basis for Conclusions (paragraphs BC54-BC55 and BC62)

> 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.
>
> In the IASB's view, a strategic business combination should capture business combinations with significant strategic value to an entity. An entity's overall business strategy could be seriously put at risk, for example:
>
> (a) by committing a large amount of capital to a business combination that subsequently fails to meet expectations; or
> (b) by failing to enter major new lines of business or geographies through the business combination that are essential to the entity's overall business strategy.
>
> To identify 'strategic' business combinations, the IASB proposes using both:
>
> (a) quantitative thresholds (per paragraphs BC63-BC67); and
> (b) qualitative thresholds (per paragraphs BC68-BC70).

A20. 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 is material, as it does for any other item of information disclosed in financial statements (paragraph BC53).

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8 Paragraphs 14 and 15 UKEB Final Comment Letter published 29 January 2021, in response to the March 2020 DP *Business Combinations – Disclosures, Goodwill and Impairment*

A21. A business combination that meets any one of the proposed thresholds detailed below (per paragraph B67C), would be a 'strategic' business combination:

> A business combination is a strategic business combination if:
>
> a) in the most recent annual reporting period prior to the acquisition date:
>
> (i) the absolute amount of the acquiree's operating profit is 10 per cent or more of the absolute amount of the acquirer's consolidated operating profit[9]; 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 value of the total assets recognised on the acquirer's consolidated statement of financial position as at the acquirer's most recent reporting period date prior to the acquisition date; or
>
> c) the business combination resulted in the acquirer entering a new major line of business or geographical area of operations.

Series of business combinations

A22. In feedback to the IASB, 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 (paragraph BC71).

A23. The IASB was unable to develop a method for identifying a series of business combinations entered into to achieve the same strategic objective, but considers the qualitative thresholds might at least help an entity to identify the first in such a series (paragraph BC72–BC73).

Initial feedback from UKEB Advisory Groups

A24. Overall, AG members supported the concept of disclosing the most important information for a subset of the most important business combinations. However, AFIAG members suggested a three-tiered approach (all, material and strategic) adds another level of judgement and complexity, and ultimately cost.

A25. Other concerns raised are listed below:

a) *Terminology* – both IAG and PAG members noted that all business combinations should be 'strategic' and doubted the choice of adjective to

[9] Operating profit or loss will be defined as part of the IASB's Primary Financial Statements project.

describe the most important business combinations, noting it could be confusing. Per paragraph BC47, terms suggested by stakeholders include 'major' and 'fundamental'.

b) *Quantitative thresholds* – both AFIAG and PAG members raised concerns that the quantitative thresholds may be too low and may not include the correct criteria. For example, it was suggested that 'operating profit before exceptional items' would be preferable. The apparent inconsistency with using only pre-tax thresholds, whilst recognising that some business combinations are to achieve tax synergies was highlighted.

c) *Non-IFRS reporting acquisitions* – A PAG member noted the challenge of reworking the respective quantitative thresholds for the acquired business where it does not report under IFRS pre-acquisition and has different accounting policies and underlying assumptions.

d) *Qualitative thresholds* – both PAG and AFIAG members were uncertain whether there would be a common understanding of the qualitative thresholds, and therefore they would be difficult to apply. PAG members also questioned whether the term 'major' related to both the thresholds i.e. 'lines of business' and 'geographies', or just the former.

e) *Series of strategic business combinations* – one IAG member noted that users need information on a series of 'strategic' acquisitions to enable them to assess the performance of management and stewardship; an individual acquisition in a series, whether the first or otherwise, may not meet the definition of 'strategic' and hence the information that users need may not be disclosed.

Initial Comment

A26. The FCL supported disclosures for all material business combinations. However, the IASB has refined its preliminary view and proposes to require certain disclosures for only a subset of material business combinations ('strategic' business combinations).

A27. The proposals do not address how a 'series' of strategic acquisitions should be disclosed, despite this being information needed by users.

A28. It is not clear whether the description of a 'strategic' business combination as set out in the Basis for Conclusions (paragraph BC54) is a principle that should be applied before applying the quantitative and qualitative thresholds in paragraph

B67C of IFRS 3[10]. For clarity, the IASB might consider elevating certain paragraphs in the Basis for Conclusion to the standard itself.

A29. A change of wording from the tentative decisions to the ED (paragraph BC55[11]) has potentially clarified that the term 'major' relates to both qualitative thresholds (line of business and geographies), although paragraphs B67C and BC68 still includes the more ambiguous phrasing. For clarity, the IASB could consider aligning paragraphs B67C and BC68 (which say 'new major') with paragraph BC55 ('major new') and possibly elevating paragraphs in the Basis for Conclusions to the standard itself.

New disclosure requirements for 'strategic' business combinations

What is the issue?

A30. In the PIR of IFRS 3 and in responses to the DP, the IASB heard that users need better information about business combinations (paragraphs BC18–BC21) to help them assess:

a) whether the price an entity paid for a business combination is reasonable;

b) management's stewardship of an entity's economic resources used in a business combination; and

c) whether the subsequent performance of the business combination has been successful. In particular, information against the targets the entity set at the time the business combination occurred.

A31. Preparers of financial statements are concerned about the cost of disclosing that information, in particular that the information would be so commercially sensitive that its disclosure in financial statements could expose an entity to increased litigation risk (see paragraph BC74-BC78).

A32. In the DP, the IASB's preliminary view was to require a company to disclose information about the strategic rationale and the chief operating decision maker's (CODM's) objectives for an acquisition as at the acquisition date. That information

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10 The Basis for Conclusions (paragraph BC54) provides a definition for a 'strategic' business combination, that "*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*". The ED goes on to say that "*entities identify a strategic business combination using a set of thresholds*" and that "*business combination that met any one of these thresholds would be considered a strategic business combination*". Those thresholds are set out in the standard in B67C.

11 - Paragraph BC55 says "major new lines of business or geographies that are essential to the entity's overall business strategy…." and paragraph BC68 says "entering a new major line of business or geographical area of operations".

should be based on how the CODM monitors and measures whether the acquisition is meeting its objectives. In the preliminary view, disclose about changed metrics would be required only in limited circumstances, where disclosing information about the original metric was impracticable, but it was not the intention to require an entity to disclose and updated key objective or target that reflects updated expectations (paragraph BC126).

A33. The UKEB FCL in response to the DP:

- Supported the stewardship objective underlying the disclosure proposals and acknowledged the views of many users that the existing disclosure requirements relating to acquired businesses do not meet their needs.
- Agreed with the IASB's view that the proposed disclosure of objectives for the acquisition, and the metrics used to monitor progress in meeting those objectives, is not forward-looking information.
- Agreed in principle with the proposals because they would:
    - allow entities to choose their own metrics, supporting understandability and relevance. Whilst this may reduce comparability with other entities, given every acquisition is unique, we do not see this as a valid objection. The disclosures would be comparable for the same entity year on year.
    - provide investors with further insight to better assess management's stewardship of the entity's economic resources.
- Recommended illustrative examples and field-testing.

The response also recommended that the requirement should be:

- To disclose the metrics chosen to monitor subsequent performance of the acquisition (e.g. *market share growth)* rather than to disclose targets in place to monitor subsequent performance of the acquisition against those metrics (e.g. *5% market share growth*).
- For qualitative disclosure of performance against chosen metrics (e.g. '*The acquisition of laundry powder brand X is exceeding targets for number of product innovations*') rather than disclosure of the quantitative targets in place to track progress and actual performance against those targets (e.g. '*We exceeded our target of 5 new product innovations in the first two years … by introducing 9 product innovations in the first 18 months*').

IASB proposals

A34. The IASB's has proposed new disclosure requirements for each 'strategic' business combination, as set out in the proposed new paragraph B67A below.

> New paragraph B67A:
>
> The acquirer shall disclose the information described in this paragraph for each strategic business combination (see paragraph B67C). The information to be disclosed is the information reviewed by the acquirer's key management personnel (as defined in IAS 24 *Related Party Disclosures*).
>
> The acquirer shall disclose:
>
> a) in the year of acquisition, the acquisition-date key objectives[12] and the related targets[13]. Targets can be disclosed as a range or as a point estimate.
>
> b) in the year of acquisition and in each subsequent reporting period, the extent to which the acquisition-date key objectives and the related targets are being met. This information shall include:
>
> (i) information about actual performance being reviewed to determine whether acquisition-date key objectives and the related targets are being met; and
>
> (ii) a statement of whether actual performance is meeting or has met the acquisition-date key objectives and related targets.

A35. An acquisition-date target reflects the entity's acquisition-date assumptions for the business combination and might not be the same as management's current expectation of the future performance of the business combination at the reporting date (paragraph BC37).

A36. The qualitative statement would require an entity to disclose only whether it met its objectives or targets and would not require an explanation of differences between the actual performance and key objective and related target (paragraph BC43).

[12] The IASB proposes to add the following definition for key objective to IFRS 3: An objective (that is, a specific aim) for a business combination that is critical to the success of the business combination. A **key objective** is more specific than the strategic rationale for a business combination. Paragraph BC35 provides an example of an objective '*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)*'.

[13] The IASB proposes to add the following definition for target to IFRS 3: A target describes the level of performance that will demonstrate whether a key objective for a business combination has been met. A target shall be specific enough for it to be possible to verify whether the related key objective is being met. A target is measured using a metric that could be denominated in currency units or another unit of measurement. BC38 provides examples of a target, such as '*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*'.

A37. An entity is not required to disclose information about changed metrics, that reflects updated expectations for the business combination, since a changed metric would not provide information about the acquisition price—a key reason for the proposed disclosure requirements (paragraphs BC129).

A38. Users will still receive information that there has been a change in metric if an entity makes that change before the end of the second annual reporting period after the year of acquisition. (How long information is required to be disclosed is discussed later in this paper.)

A39. Illustrative example IE72 has been amended to provide an example of the proposed disclosure requirement for acquisition-date key objectives and related targets and subsequent performance against those acquisition date targets.

Illustrative Example 72

(Amendments to reflect new requirements are underlined)

An acquirer would be required to disclose the following additional information applying the disclosure requirements in paragraphs B67A–B67B of IFRS 3 if the business combination is a strategic business combination (see paragraph B67C of IFRS 3).

B67A(a) The entity plans to integrate TC into its North American operations, and management will review the performance of the acquisition based on information about AC's North American operations.

B67A(a) In line with AC's strategy, management's key objectives and related targets for this business combination are:

- to increase the annual revenue and profit of the entity's North American operations. This key objective will be assessed using targets of increasing annual revenue by 45% and profit by 40% by 20X4 (compared to 20X1).
- to increase the entity's market share in North America by 20X4. This key objective will be assessed using a target of increasing market share from approximately 15% in 20X1 to approximately 20%.

B67A(b)(i) For the financial period ended 31 December 20X2, AC increased:

- its annual revenue by 20% and profit by 18% for the North American operations; and
- its approximate market share to 16% in North America.

B67A(b)(ii) Performance to date is in line with expectation.

Integration

A40. As explained in paragraphs BC146–BC147, if management's intention is to quickly integrate the acquired business into an entity's existing business and intends to review information about a combined business to assess the performance of the business combination, then this information is what would be disclosed. An entity is not required 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.

Initial feedback from UKEB Advisory Groups

A41. Whilst AG members supported the concept of disclosing information for a subset of the most important business combinations the following concerns were raised:

a) *Availability of information* – some PAG members were concerned that information on management's key objectives and related targets may not be readily available due to the timing of the acquisition, even if information was not commercially sensitive enough to use the exemption.

b) *Commercial sensitivity* – management's key objectives and related targets may be employee-related. The exemption does not address all concerns around commercial sensitivity due to the requirement to disclose each item to which the exemption has been applied and the reason.

c) *Management bias* – PAG members expressed concern that the disclosure requirements would drive management behaviour to set non-ambitious, achievable targets to appear in good light in the future with regards to subsequent performance.

d) *Forward looking information* –AFIAG members also mentioned management bias, in the context of the information being required to be disclosed in the financial statements, and therefore to be auditable. They suggested that such forward looking information would best be disclosed in the management commentary, as it was likely to be more accurate and therefore more useful to users, despite users' assurance from information being audited as part of the financial statements.

e) *Interaction with impairment test* – One PAG member questioned the potential expectation of users that an impairment loss would be recognised, if it was reported in a subsequent period that the acquired business is not meeting the acquisition-date objectives and related targets.

Initial comments

A42. Contrary to the view expressed in our response to the DP, the IASB is proceeding with its proposals to require entities to disclose acquisition-date key objectives and related targets, and the subsequent performance against them. However, this information will be required only for 'strategic' business combinations and only when key management personnel are monitoring that information.

A43. We also acknowledge the proposed exemption, which can be applied if disclosure of the information could be expected to prejudice seriously the achievement of any one of the entity's key objectives for the combination. However, the exemption does not address all concerns around commercial sensitivity due to the requirement to disclose each item to which the exemption has been applied and the reason.

A44. The Illustrative Example in IE72 uses the term 'profit'. We suggest that this might be updated to 'operating profit' to align with IFRS 18 *Presentation and Disclosure in Financial Statements*, with the proposed quantitative thresholds for identifying 'strategic' business combinations and with the proposed amendment to the requirement for pro-forma information on the contribution of an acquired business.

Management approach

What's the issue?

A45. In the DP, the IASB's preliminary view was to require an entity to disclose information reviewed by the entity's CODM, a term used in IFRS 8 *Operating Segments*[14].

A46. Based on feedback on the DP, the IASB identified two main drawbacks with using CODM to identify information that an entity would be required to disclose:

a) CODM is linked with the information the entity is required to disclose in accordance with IFRS 8 and 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 role the CODM plays in reviewing the performance of business combinations. Therefore, continuing to use CODM to identify

[14] IFRS 8 *Operating Segments* does not provide an absolute definition of the term 'Chief Operating Decision Maker' (CODM) but explains it is intended to mean a function rather than a particular executive with a specific title. The function is that of allocating resources to operating segments and assessing their performance.

information might not result in consistent application of the proposed requirements.

A47. The UKEB FCL in response to the DP:

- Expressed concern that users may not receive the information they need if disclosures would be based only on information that the CODM reviews.
- Recommended that disclosures would need to be made for all material acquisitions, rather than only those whose performance is reviewed by CODM,
  - to support the usefulness of information for users and comparability across entities.
  - to provide more consistency of disclosure across entities and reporting periods.
- Noted that the proposal assumes this is a cost-efficient approach because the information already exists. However, the such information would typically need development to be presented in a form suitable for disclosure, so cost efficiency was not a valid reason for restricting disclosure to those entities monitored by the CODM.

IASB proposal

A48. The IASB decided to specify management as an entity's key management personnel (KMP), as the term:

a) has similar benefits to using CODM because it would utilise terminology within IFRS Accounting Standards[15]; and

b) is not linked with segment reporting, so any confusion regarding the relationship between the proposed disclosure requirements and disclosure requirements in IFRS 8 would therefore be avoided.

A49. The IASB proposes that the information an entity discloses about each 'strategic' business combination should reflect information the KMP of the entity uses to review and measure the success of the business combination– the 'management approach' (paragraphs BC33 and BC108–BC130).

[15] IAS 24 *Related Party Disclosures* defines key management personnel (KMP) as those persons having authority and responsibility for planning, directing, and controlling the activities of the entity, directly or indirectly, including any directors (whether executive or otherwise) of the entity [IAS24.9]. Other IFRS Accounting Standards use KMP to identify information to be disclosed by an entity—for example, paragraph 34(a) of IFRS 7 *Financial Instruments: Disclosures*.

A50. The management approach[16] gives consistency between what is reported to users and what is reported to management internally and should:

a) result in entities disclosing the most useful information, because information used by management for decision-making will likely also be relevant for users;

b) minimise the cost of disclosing the information because the information is already being prepared and used by the entity; and

c) result in entities disclosing information that is less prone to error, because information prepared and reviewed regularly for management's use would likely be analysed more closely than information generated solely for external reporting.

Initial feedback from UKEB Advisory Groups

A51. There appears to be general support from AG members around the IASB decision to require entities to use KMP, as the level of management monitoring information that would require disclosure for 'strategic' business combinations. However, one PAG member suggested that information monitored by CODM was preferable, suggesting that information reported to CODM in an internal monthly management pack is what users would expect to be disclosed in the financial statements.

Initial comments

A52. The FCL suggested that users may not receive the information they need if disclosures were based only on information reviewed by the CODM. The IASB now proposes to require disclosure of information reviewed by KMP.

A53. We have not identified any specific issues with a 'management approach' using KMP, due to limited feedback to date. We will continue to investigate this matter during our outreach.

How long information on subsequent performance is required to be disclosed

What's the issue?

A54. Users need to receive information about a 'strategic' business combination for a reasonable period of time, whilst preparers do not want to disclose information indefinitely, as that would be onerous and costly.

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16 Agenda paper 18A The management approach and of Agenda paper 18B Other aspects of the management approach for the February 2023 IASB meeting provide more information on the management approach.

A55. Specifying a fixed time period for disclosure could be viewed as arbitrary and could result in an entity being required to develop information specifically to meet disclosure requirements. Specifying a core time period would require an entity to disclose information based on what is used internally by the entity's management. This information would therefore be less costly because it already exists (paragraph BC120).

A56. As explained in BC128, an entity may change the metrics over time that it uses to assess the success of the business combination. Requiring entities to disclose information based on changed metrics would:

a) reduce comparability of the financial statements over time;

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

c) 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.

A57. In the DP, the IASB proposed that a company would be required to disclose the required information for as long as its CODM continues to monitor the acquisition to see whether it is meeting its objectives. If the CODM stops monitoring whether those objectives are being met before the end of the second full year after the year of acquisition, the company should be required to disclose that fact and the reasons why it has done so.

A58. The UKEB FCL responding to the DP:

- Agreed in principle with the proposals. If rapid integration was planned, the objectives for the acquisition would reflect this. If rapid integration occurred but was not planned, and monitoring stopped or objectives changed, disclosures would also be required. In both scenarios, useful information would be provided.

- Recommended that disclosure is required when monitoring of material acquisitions stops, together with an explanation of why it has stopped. It did not support the proposal to require disclosure of reasons why management has stopped monitoring the acquisition if management stops monitoring within two years. This proposal seemed arbitrary given the differing timescales required to integrate acquisitions in different sectors and at different stages in the business lifecycle.

IASB proposal

A59. The IASB proposes to specify the core time period (paragraph BC119) to require an entity to disclose information about the performance of 'strategic' business combinations, for as long as the entity's KMP review the performance of the 'strategic' business combination against acquisition-date key objectives and related targets (paragraphs BC115–BC130).

> **How long information is required to be disclosed**
>
> Proposed paragraph B67B says: The acquirer is required to disclose the information described in paragraph B67A(b) for as long as the acquirer's key management personnel review the actual performance of the strategic business combination against its acquisition-date key objectives and the related targets.
>
> However, if the acquirer's key management personnel:
>
> (a) have not started reviewing and do not plan to review whether an acquisition-date key objective and the related targets disclosed applying paragraph B67A(a) for the strategic business combination are being met, the acquirer shall disclose that fact and the reasons for not doing so.
>
> (b) stop reviewing whether an acquisition-date key objective and the related targets for the strategic business combination are met before the end of the second annual reporting period after the year of acquisition, the acquirer shall disclose that fact and the reasons for doing so.
>
> If the acquirer's key management personnel continue to receive information based on the metric originally used to measure the achievement of that key objective and the related targets during the period up to the end of the second annual reporting period after the year of acquisition, the acquirer shall also disclose that information.

A60. 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, an entity would still need 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 (paragraph BC123).

A61. This information would be required for each key objective and target of the business combination. In other words, an entity's management might review the performance of one key objective but not another. The entity would be required to disclose information about the performance of the key objective management is still reviewing but state that it is not reviewing the performance of the other key objective(s) and why.

A62. In the IASB's view this information is useful because users said that knowing an entity's management is not reviewing or has stopped reviewing the performance of 'strategic' business combinations is relevant in their assessment of management's stewardship of the entity's resources.

A63. If an entity changes the metrics or targets it uses to measure the performance of a business combination, before the end of the second full year after the year in which the business combination occurs, the entity would be required to disclose that it has stopped monitoring against the original target and the reason being that it has changed the metrics, but would not be required to provide performance information based on the new metrics.

Initial feedback from UKEB Advisory Groups

A64. IAG members considered the two-year minimum disclosure period to be fair, noting that integration often happens in a much shorter period, so users might expect an entity to stop monitoring, unless acquisition-date targets were at a combined business level.

A65. The following concerns were raised:

a) *Indefinite disclosure* — PAG members raised concern that disclosures against acquisition-date targets could be required indefinitely if, for example, an acquisition in a new geographical area is not integrated into an existing business unit nor integrated at a later date and management is still monitoring against the acquisition-date targets.

b) *Management bias* — PAG members expressed concern that the disclosure would drive management behaviour to set specific targets, so as to create the opportunity to change targets and stop reporting against acquisition-date targets.

c) *Expectation gap* — AFIAG members suggested that the proposals may lead users to expect that all 'strategic' business combinations would be monitored for at least two full years after the year of acquisition.

Initial comments

A66. The FCL recommended disclosure if an entity stops monitoring a material acquisition, but did not support the disclosure of the reason why it stops monitoring if within two years of the acquisition, as this was arbitrary. The IASB has retained this proposal.

A67. As highlighted by AG members, some information could be required to be disclosed indefinitely and this may be difficult to reconcile to the IASB's intention to balance users' needs with costs.

A68. We have not yet received extensive feedback on the required time period for the proposed disclosures on the subsequent performance of 'strategic' business combinations, so we will continue to explore this in our outreach.

Proposed Exemption

What's the issue?

A69. In the PIR of IFRS 3 and in response to the DP, preparers said the information required (quantitative information on expected synergies for each material business combination, and key objectives and related metrics for each 'strategic' business combination) would be so commercially sensitive[17] that its disclosure in financial statements should not be required and that disclosure of forward-looking information could expose an entity to increased litigation risk (see paragraph BC22).

A70. An exemption was not proposed in the DP. 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 (BC74–BC78).

A71. The UKEB FCL to the DP:

> Said that commercial sensitivity and confidentiality are valid reasons for lack of disclosure, as they contribute to confidence in transactions and markets. In addition, disclosure of commercially sensitive information could create commercial disadvantage if it is not required under other financial reporting regimes.

IASB proposal

A72. The IASB is proposing to exempt an entity from disclosing only some of the information that would be required applying the proposals in the ED in specific circumstances.

[17] Per BC75, some respondents to the DP provided examples of information which they think could be so commercially sensitive that it should not be required in financial statements:
(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 is particularly concerning when undertaking 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 request some of the cost savings be passed on to them.
(c) *employee-related information*—respondents said disclosing information related to employees (for example, redundancy information) could demotivate employees or pre-empt some jurisdictions' legal requirements to first inform employees or trade unions about potential redundancies.

A73. The IASB developed a core principle underpinning the exemption:

> **Exemptions – core principle**[18]
>
> An entity be exempted from disclosing some information that would be required by the proposals "if doing so can be expected to prejudice seriously[19] the achievement of any of the acquirer's acquisition-date key objectives for the business combination" (paragraph B67D)
>
> Paragraph BC91 suggests that the principle of exemption implies a likelihood assessment because the prejudicial outcome must be 'expected' by the entity.

A74. Per BC77, the IASB has proposed to permit the application of the exemption only to the disclosure of:

a) quantitative information about expected synergies required for each material business combination;

b) the acquisition-date key objectives and the related targets required for a 'strategic' business combination; and

c) a qualitative statement of whether actual performance is meeting or has met the objectives and targets required for a 'strategic' business combination.

A75. Per BC 88, the IASB proposes not to exempt an entity from disclosing information about:

a) the strategic rationale required for each material business combination (not discussed in detail in this paper - 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, as required for each 'strategic' business combination.

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[18] The principle used for the proposed exemption is also similar to the requirement in paragraph B35 of IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* issued by the International Sustainability Standards Board in June 2023.

[19] This approach is similar to the approach for the exemption in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. Feedback suggests that the exemption in IAS 37 works well in practice. 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.

A76. The IASB proposes a non-exhaustive list of factors to consider eligibility for the proposed exemption:

> <u>Exemption (Proposed paragraphs B67D to B67G)</u>
>
> B67D To determine whether an item of information is eligible for the exemption, an acquirer considers this non-exhaustive list of factors:
>
> a) the effect of disclosing the item of information—an entity must be able to describe a specific reason for not disclosing an item of information that identifies the seriously prejudicial effect the entity expects to result from disclosing the information. A general risk of a potential weakening of competitiveness due to disclosing an item of information is not, on its own, sufficient reason to apply the exemption. An entity shall not use the exemption to avoid disclosing an item of information only because that item of information might be considered unfavourably by the capital market.
>
> b) the public availability of information—for example, if an entity has made information publicly available, it would be inappropriate to apply the exemption to that information. Examples of publicly available documents include press releases, investor presentations and regulatory filings made by the entity that are available to the public.
>
> B67E Before applying the exemption described in paragraph B67D to an item of information, the acquirer shall first consider whether, instead of applying the exemption, it is possible to disclose information in a different way—for example, at a sufficiently aggregated level—such that the disclosure objective in paragraph 62A could be met without prejudicing seriously any of the acquirer's acquisition-date key objectives for the business combination. If it is possible to do so, the acquirer would disclose the information in that different way. If it is impossible to do so, the acquirer shall disclose the fact that it has applied the exemption and the reasons it has not disclosed the item of information[20].
>
> B67F For example, if the acquirer concludes that information about expected synergies from combining operations of the acquiree and the acquirer (as required by paragraph B64(ea)) would be eligible for the exemption, before applying the exemption the acquirer would first consider whether it is possible to disclose the information about expected synergies aggregated in total for all categories without prejudicing seriously any of the acquisition-date key objectives for the business combination. If it is possible to do so, the acquirer would disclose information about expected synergies from a business combination aggregated in total for all categories.

[20] The requirement to disclose for each item that an exemption has been applied and the reason why that item of information has not been disclosed is similar to the requirement in paragraph 92 of IAS 37. For example, if an entity has three key objectives for a business combination with corresponding targets, the entity would need to disclose the reason for applying the exemption for each key objective and each target to which it applied the exemption.

> B67G For each item of information required by paragraph B67A(a) [*acquisition-date key objectives and targets*] to which the acquirer applies the exemption described in paragraph B67D, the acquirer shall reassess at the end of each reporting period whether the item of information is still eligible for the exemption. If it is no longer appropriate to apply the exemption, the acquirer shall disclose the item of information to which it had applied the exemption. For example, if at the end of the reporting period a particular target would no longer be eligible for the exemption the acquirer would disclose that target. An acquirer shall carry out that reassessment for as long as the acquirer would otherwise be required to disclose information about the performance of the business combination applying paragraphs B67A–B67B.

A77. Paragraph BC81 clarifies that in applying the exemption, an entity might, for example, not disclose a particular item of information when:

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

b) there are legal obligations that prevent the entity from disclosing a particular item of information, the breach of which can be expected to result in consequences that would prevent the entity from achieving one of its key objectives for the business combination.

A78. The IASB proposes no exemption to address litigation risks arising when an entity doesn't meet its objectives for a business combination;

a) due to factors outside the entity's control; or

b) because management did not efficiently and/or effectively discharge its responsibilities.

The IASB sees no basis to propose an exemption under such circumstances, since the risk is no different from litigation risk that arises from disclosing forward-looking information that is required by other IFRS Accounting Standards.

A79. However, litigation risk arising from an entity failing to meeting its key objectives for the business combination because it disclosed the information would be addressed by the exemption.

Initial feedback from UKEB Advisory Groups

A80. There was general support for the IASB proposing an exemption to address preparer concerns with commercial sensitivity. PAG members were pleased to see an exemption was provided, and potentially more readily available than the exemption under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*,

where it can only be used "in extremely rare cases". The exemption was also supported by AFIAG members.

A81. However, concerns were expressed about the application of the exemption:

a) *Aggregated information* — IAG members expressed concern with the proposed application guidance for an entity to consider aggregating information (e.g. aggregating revenue synergies with cost synergies), since this would lead to loss of transparency between the usually more precise cost-savings that investors place a lot of reliance upon, and the potentially optimistic revenue synergies.

b) *Commercial sensitivity of exemption disclosures* — PAG members highlighted that the application guidance for the exemption did not fully address the matter of commercial sensitivity; the requirement to disclose each item of information to which the exemption has been applied, and the reason, could itself result in disclosing commercially sensitive information.

c) *Heightened scrutiny* — PAG members were concerned by the heightened scrutiny that any entity applying an exemption would attract.

Initial comments

A82. As noted in previous sections of this paper, the exemption does not address all concerns around commercial sensitivity, due to the disclosure requirements when the exemption is applied i.e. disclosing what item the exemption has been applied to and the reason for using the exemption.

A83. It is not yet clear whether the proposed exemption can be applied in all appropriate circumstances and whether the proposed application guidance would help restrict the application of the exemption to only the appropriate circumstances. We will continue to seek feedback on the proposed exemption during our outreach.

Location of information

What is the issue?

A84. Many respondents to the DP (per paragraphs BC 132–BC133) questioned whether the proposed required information (about expected synergies and subsequent performance of a business combination) should be disclosed in an entity's financial statements or whether it would be better suited to another document, such as management commentary, 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.

A85. Some respondents suggested the IASB consider the disclosures for business combinations as part of its Management Commentary project[21].

A86. The UKEB FCL in response to the DP:

> Agreed in principle with including the disclosures in the notes to the financial statements, since it brings them within the scope of audit, providing additional assurance about their faithful representation.

IASB proposals

A87. The IASB's proposals require the disclosure in the financial statements. 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.

A88. The IASB determined that the information required meets the objective of financial statements. 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 (paragraph BC135).

A89. Further, in the view of some IASB members, information the IASB proposes requiring an entity to disclose about management's acquisition-date key objectives, their related targets and expected synergies are fixed at the date of acquisition and not forward-looking in the context of the Conceptual Framework.

A90. 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 made at the time a business combination occurred. i.e. historic transaction. These assumptions are then reflected in the acquisition price and the assets and liabilities, including goodwill, recognised as a result of the business combination.

[21] The IASB is currently deciding on the direction of the IASB Management Commentary project..

A91. The IASB acknowledges that some aspects of its proposals could require the disclosure of forward-looking information. However, 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.

Initial feedback from UKEB Advisory Groups

A92. IAG members welcomed the proposals to disclose the required information in the financial statements, due to the increased scrutiny and assurance that disclosure in the financial statements would provide.

A93. However, concerns were raised by both PAG and AFIAG members:

a) *Forward-looking information* - PAG and AFIAG members challenged that such information for expected synergies and management's key objectives and related targets was forward-looking and was better placed in management commentary.

b) *Inconsistency* – one PAG member noted that an entity does not disclose what its strategy is within the financial statements, so including information about 'strategic' acquisitions within the financial statements is inconsistent.

c) *Connectivity* – whilst one AFIAG member noted that the disclosure of such information might lessen the gap between the 'front' and 'back half' of the annual report, such disclosures could be mandated in the 'front half'[22].

d) *Management bias* – AFIAG members noted the potential for management bias to disclose un-ambitious and achievable targets to not only reflect management in a good light on subsequent performance, but to also assist in audit assurance.

e) *Usefulness* – one AFIAG member suggested that disclosures outside of the financial statements, such as in management commentary, would lead

[22] It was referenced that such information could be mandated to be included in the strategic report in the UK. All companies, except small companies and micro-entities must prepare a strategic report in accordance with s414A of the Companies Act 2006. The Financial Reporting Council (FRC)'s Guidance on the Strategic Report (June 2022) serves as a best practice statement. At the request of the Department for Business, Energy and Industrial Strategy (BEIS), the FRC developed and published in 2024 non-mandatory guidance on the application of the strategic report requirements introduced into The Companies Act 2006 by The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013 (SI 2013/1970) (the Regulations). The guidance was updated in 2018 and 2022.

to better quality information for users, due to management bias described above.

f) *Auditability* – as mentioned in other sections, some AFIAG members expressed that challenges with auditing forward-looking information and the potential expectation gap with the assurance auditors can provide.

Initial comment

A94. Consistent with our FCL, including the disclosures in the notes to the financial statements would bring the information within the scope of audit, providing additional assurance about their faithful representation. However, we acknowledge that there may be an expectation gap between the assurance provided by auditors and the assurance perceived by users.

Appendix B: Proposed Amendments to IAS 36: Preliminary Analysis

Simplifications to the 'value in use' calculation in the impairment test

What is the issue?

B1. Goodwill is tested for impairment within the cash-generating units (CGUs) expected to benefit from the synergies of a business combination, because goodwill does not generate cash flows independently. The impairment test, therefore, tests goodwill indirectly. IAS 36 *Impairment of Assets* requires an entity to test CGUs containing goodwill for impairment at least annually[1], even if there is no indication that the CGUs might be impaired.

B2. When testing for impairment, the recoverable amount is calculated at the higher of value in use and fair value less costs of disposal. In measuring value in use, entities are required to exclude future cash flows expected to arise from a future restructuring to which the company is not yet committed, or from improving or enhancing the asset's performance. IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* provides guidance on determining when a company is committed to a restructuring.

B3. IAS 36 also requires a company to estimate cash flow projections for an asset in its current condition.

B4. Feedback from the PIR of IFRS 3 suggested that:

a) impairment losses on goodwill are sometimes recognised too late, long after the events that cause the impairment; and

b) the impairment test is costly and complex to apply.

B5. Excluding specified cash flows requires management to adjust its financial budgets or forecasts. For example, management can find it challenging to distinguish maintenance capital expenditure from expansionary capital expenditure, and to identify which cash flows need to be excluded.

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[1] This requirement, introduced in 2004, replaced the requirement in IAS 22 *Business Combinations* to amortise goodwill over its useful life.

B6. In its March 2020 Discussion Paper (the 'DP'), the IASB proposed to amend how an entity calculates value in use to:

a) Reduce cost and complexity—removing the constraint would reduce the need to amend management's financial budgets or forecasts.

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.

B7. The IASB proposed to remove the restriction in IAS 36 that prohibits companies from including cash flows arising from a future uncommitted restructuring, or from improving or enhancing the asset's performance.

B8. Feedback to the DP indicated general agreement that proposals should be developed to simplify and improve how entities calculate value in use. However, the main concerns raised with the proposal to remove certain constraints from cash flow forecasts were that it:

a) could increase the risk of management over-optimism; and

b) lacks a conceptual basis.

B9. Some IASB members also expressed concerns that:

a) including such 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.

b) the IASB was failing to respond to feedback about impairment losses on goodwill sometimes being recognised too late (paragraph BC214).

B10. The UKEB FCL[2] in response to the DP:

> Supported the proposal to remove the requirement to exclude any estimated future cash inflows or outflows expected to arise from future restructuring or from improving or enhancing the asset's performance from the value in use calculation, subject to some recommendations.
>
> The benefits of this proposal were considered to be:

[2] See paragraphs A37 to A40 UKEB Final Comment Letter published 29 January 2021.

i. It is more logical to assess value in use after factoring in planned restructuring activities, since these may be central to the rationale for the acquisition and are also likely to have been factored into the purchase price.

ii. Removing the requirement for the impacts of restructuring to be excluded from the value in use calculation may make the calculation less onerous and costly, as fewer adjustments to internal cash flow forecasts may be needed.

Due to the risk of a bias towards optimism in the value in use calculation, the response recommended that, if the proposal is developed:

i. expected values are used to incorporate risk into the cash flows, for example to recognise that there is typically greater risk associated with revenue cash flows than cost cash flows.

ii. The proposal is redrafted so that entities are required to include cash flows from uncommitted restructuring or asset improvements (as opposed to simply removing the restriction, which could lead to inconsistent practice).

IASB proposals

B11. The IASB has continued with its preliminary view and proposes to remove the restriction in IAS 36 that prohibits companies from including, in the value in use calculation, cash flows arising from a future uncommitted restructuring, or from improving or enhancing the asset's performance (paragraphs BC204—BC214).

B12. The IASB is also proposing to allow companies to use post-tax cash flows and post-tax discount rates in estimating value in use (paragraphs BC215—BC222). We do not discuss this requirement further in this paper.

B13. The IASB is proposing to retain the requirement to assess assets or CGUs in their current condition (paragraph 44 of IAS 36). This requirement is considered 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.

Paragraph 44 of IAS 36 will be amended, as below (deleted text is struck through) and paragraphs 44A and 44B added (as underlined)

Composition of estimates of future cash flows

44. Future cash flows shall be estimated for the asset in its current condition.

~~Estimates of future cash flows shall not include estimated future cash inflows or outflows that are expected to arise from:~~

a) ~~a future restructuring to which an entity is not yet committed; or~~
b) ~~improving or enhancing the asset's performance.~~

44A. Estimates of future cash flows of an asset in its current condition include:

a) future cash outflows necessary to maintain the level of economic benefits expected to arise from the asset in its current condition. When a cash-generating unit consists of assets with different estimated useful lives, all of which are essential to the ongoing operation of the unit, the replacement of assets with shorter lives is considered to be part of the day-to-day servicing of the unit when estimating the future cash flows associated with the unit. Similarly, when a single asset consists of components with different estimated useful lives, the replacement of components with shorter lives is considered to be part of the day-to-day servicing of the asset when estimating the future cash flows generated by the asset.
b) future cash flows associated with the current potential of the asset to be restructured, improved or enhanced. If the asset has the current potential to be restructured, improved or enhanced, and the cash flow projections associated with the restructuring, improvement or enhancement meet the requirements in paragraph 33, estimates of future cash flows for the asset shall include estimated future cash inflows and outflows that are expected to arise from that restructuring, improvement or enhancement.

44B. When an entity becomes committed to a restructuring and a provision for restructuring is recognised in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, its calculation of value in use for an asset affected by the restructuring:

a) continues to include estimates of future cash inflows and outflows that reflect the cost savings and other benefits from the restructuring (as long as these cash flows meet the requirements in paragraph 33); and
b) excludes estimates of future cash outflows for the restructuring because these cash outflows are included in the restructuring provision in accordance with IAS 37.

B14. In the IASB's view, concerns about management over-optimism would be addressed more effectively by auditors or regulators.

B15. The IASB decided that 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.

B16. The IASB considers that, 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. 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 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).

Initial feedback from UKEB Advisory Groups

B17. There were mixed views regarding the proposal to remove the restriction that currently prohibits including uncommitted future restructurings in cash flow projections for value-in use calculations. The following concerns were raised:

a) *Management over-optimism* – AFIAG members noted removing the restriction on cash flows could increase the risk that management may use inputs that are too optimistic in estimating value in use, and result in a higher value in use calculation and therefore higher recoverable amount.

b) *Delayed impairment* – resulting from including over-optimistic assumptions in cash flow projections. The delayed recognition of impairment losses is one of the concerns with the existing IFRS requirements, so it would be counter-intuitive to remove the restriction.

c) *Auditability* – PAG members suggested difficulty in providing auditors with evidence to support uncommitted cash flows and AFIAG members anticipated difficulty in providing assurance for uncommitted restructurings.

d) *Lack of distinction* – between the two methods of calculating recoverable amount, being value in use and fair value less cost of disposal.

e) *Impact of climate-related targets* – one PAG members was unclear whether, if the restriction on cash flows were removed, there might be an expectation to immediately impair certain assets that are planned to be replaced in the future to meet climate-related targets.

Initial comment

B18. The FCL's support for the proposal was subject to recommendations that:

a) expected values are used to incorporate risk into the cash flows, to recognise that there is greater risk associated with revenue as opposed to cost cash flows; and

b) the proposal is redrafted so that rather than "remove the restriction" on including cash flows arising from uncommitted restructuring or asset improvements, the proposal says "require the inclusion" of such cash flows.

B19. We note that the IASB is not proposing to incorporate the UKEB recommendations, nor to address the potential lack of comparability by a requirement to disclose when recoverable amounts include cash flows from uncommitted restructuring or asset improvements.

Additional guidance on how an entity allocates goodwill

What is the issue?

B20. Because goodwill does not generate cash flows independently and cannot be measured directly, it has to be tested for impairment in conjunction with other assets and is therefore often allocated to groups of CGUs. A company allocates acquired goodwill to the CGUs it expects to benefit from the acquisition.

B21. 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 *Operating Segments*, before aggregation.

B22. Allocating goodwill to CGUs in this way prevents an allocation of goodwill to a lower level that could only be done arbitrarily. It also aligns the goodwill testing to how a company's management monitors its operations.

B23. Even though the purpose of the impairment test is to test the recoverability of the combined carrying amount of the assets within the CGUs—rather than test the recoverability of the acquired goodwill directly—during the PIR of IFRS 3 stakeholders expressed concerns that impairment losses are not recognised on a timely basis. Hence, the IASB considered whether it could change the test to make it more effective at recognising impairment losses on goodwill on a timely basis.

B24. The IASB identified two broad reasons (see paragraphs BC188–BC189) for concerns about the possible delay in recognising impairment losses on goodwill:

a) *management over-optimism*;

b) *shielding*—a CGU, or group of CGUs, containing goodwill, typically contains headroom[3]. The headroom shields acquired goodwill against the recognition of impairment losses.

B25. In developing its preliminary views for 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.

B26. The UKEB FCL[4] in response to the DP:

> Recommended that the IASB "*add guidance on identifying cash-generating units and on allocating goodwill to cash-generating units*".
>
> Recommended that the IASB develops and consults on proposals which would require entities to:
>
> i. Disclose how CGUs have been identified and whether that has changed from the prior period (currently only required for CGUs for which an impairment has been recognised or reversed during the period).
>
> ii. Disclose where goodwill is more likely to be shielded, for example when goodwill has been allocated to a CGU where the acquisition has been integrated with an existing business.
>
> iii. Explore options for testing goodwill for impairment at a more disaggregated level, so that testing is more targeted. One option to explore would be to require allocation of goodwill to CGUs which represent the lowest level within the entity at which the results of the acquired business are monitored for internal management purposes. This would increase cost in comparison to the current model. The assessment of whether the increase in cost is reasonable, needs to be made with reference to the costs and consequences of delays in recognition of goodwill impairments.

IASB proposals

B27. The IASB considered developing a different impairment test that would be significantly more effective at a reasonable cost but concluded that doing so would not be feasible (see paragraphs BC190–BC191).

B28. The IASB proposes some targeted changes to paragraph 80 of IAS 36 to improve the application and enforcement of those requirements, which in turn could help reduce shielding.

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[3] The headroom of a cash-generating unit is the amount by which its recoverable amount exceeds the carrying amount of its recognised net assets—including goodwill.

[4] See paragraphs A23 and A42 UKEB Final Comment Letter published 29 January 2021.

B29. Paragraph 80 of IAS 36 contains requirements for allocating goodwill to CGUs or groups of CGUs expected to benefit from synergies of the combination. 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.

B30. 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. 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.

B31. 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 intention 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.

Initial feedback from UKEB Advisory Groups

B32. We did not receive any specific feedback on the proposal from our initial outreach.

Initial comment

B33. The IASB's proposals do not reflect all the recommendations that the UKEB made in its FCL. We will seek feedback in our planned outreach on whether the IASB's proposals are likely to be effective in reducing shielding.