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STAFF PAPER

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Project	**Goodwill and Impairment**		
Paper topic	Better disclosures for business combinations		
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Purpose

1. The purpose of this paper is to discuss how to improve disclosure requirements for business combinations, to meet the objective set by the Board in its July 2018 meeting.

2. Board members are asked for any comments they have on the staff's ideas for improvements to the disclosure objectives and disclosure requirements of IFRS 3 for the staff to consider as it develops the papers for a future Board meeting where the Board will determine its preliminary views, if any, to express in the Discussion Paper.

Summary of staff recommendations in this paper

3. The Board set the project an objective of exploring whether disclosures could be improved to help investors to assess more effectively whether a business combination was a good investment decision and whether the acquired business is performing after the acquisition as was expected at the time of the acquisition.

4. In order to meet this objective, the staff suggest improvements to:

   (a) the disclosure objectives of IFRS 3 to:

      (i) clarify some existing disclosure requirements; and

  - (ii) provide new information, helping users of the financial statements (users) to assess the subsequent performance of the acquired business, or combined business;
- (b) add disclosure requirements for entities to provide information that will help users to assess whether the key objectives of the business combination have been achieved; and
- (c) make targeted improvements to existing disclosure requirements of IFRS 3 that are not leading entities to provide the information expected, specifically to disclose:
  - (i) the amount, or range of amounts, of expected synergies;
  - (ii) separately any liabilities arising from financing activities and pension obligations assumed; and
  - (iii) the amounts of the acquiree's revenue, operating profit or loss, and cash flow from operating activities.

Structure of the paper

5. The paper is structured as follows:
   - (a) Background and introduction (paragraphs 6–11);
   - (b) Outreach performed by the staff (paragraphs 12–13);
   - (c) Better disclosures for business combinations (paragraphs 14–114);
     - (i) improving disclosure objectives of IFRS 3 (paragraphs 17–25);
     - (ii) additional disclosures on key objectives of a business combination (subsequent performance) (paragraphs 26–67);
     - (iii) targeted improvements to the existing disclosure requirements of IFRS 3 (paragraphs 68–106); and
   - (d) Other disclosures (paragraphs 107–114);
   - (e) Staff recommendations (paragraphs 115–119); and
   - (f) Question for the Board (paragraphs 120–121).

Background and introduction

6. During and after the Post-implementation Review (PIR) of IFRS 3 *Business Combinations*, users gave mixed feedback about the information provided by entities on business combinations, goodwill and impairment.

   (a) Some said the information currently produced by applying the requirements in IAS 36 *Impairment of Assets* is relevant because it has confirmatory value for users, helps them assess stewardship by management of the reporting entity's economic resources and helps them verify whether an acquisition is working as expected.

   (b) Some said the information currently provided has one or more of the following limitations:

      (i) impairment losses are recognised too late;

      (ii) estimates of recoverable amounts are inherently very judgemental and the assumptions used in the calculations are subjective;

      (iii) disclosures are not sufficient to enable users to assess whether the main inputs/assumptions are reasonable. However, some users said that some of the current disclosures are useful; these included discount rates, long-term growth rates, profit and capital expenditure assumptions and sensitivities; and

      (iv) insufficient information is provided to help users understand the subsequent performance of the acquired business and whether the main targets and expected synergies of the acquisition are being achieved.

   (c) Some users focus more on the timing of the impairment write-down and its overall magnitude than on the specific amount of the impairment loss recognised.

   (d) Some said that the disclosures provided by entities applying the requirements in IFRS 3 do not produce sufficient information for users to properly understand the effect of the business combination on the reporting entity. For example, they said that:

(i) the qualitative description of the factors that make up the acquired goodwill is often generic and not useful;

(ii) they often seek to assess the return on capital that has been deployed in an acquisition and it is often difficult to ascertain the total cost of an acquisition. For these users it is critical to calculate the total cost (or capital employed) including cash paid, cash acquired, debt and pension obligations assumed, fees and restructuring costs, shares and notes issued to the vendor together with any deferred consideration; and

(iii) for their trend analysis, they need clear information on the operating performance of the acquired business, specifically, revenue and operating profit over preceding periods and pro forma prior year comparative information for the combined entity.

7. Users appear to be particularly interested in understanding (a) the key drivers that determined the amount of consideration the acquirer was willing to pay for the acquiree and (b) whether the acquisition has subsequently been successful. On the other hand, preparers generally think that the existing disclosure requirements in IFRS 3 and IAS 36 are excessive.

8. Although the Board did not initially include a review of disclosure requirements in the scope of the research on goodwill and impairment, as a result of further feedback from users after the PIR, the Board directed the staff to consider whether better, timely information about goodwill and impairment can be provided to users whilst still achieving an appropriate cost-benefit balance.

9. In the December 2017 Board meeting, the Board tentatively decided to consider introducing requirements for an entity to disclose:

(a) in the year in which a business combination occurs, the reasons for paying a premium that exceeds the fair value of the net identifiable assets acquired in the business combination, together with key assumptions or targets supporting the purchase consideration; and subsequently each year, a comparison of actual performance with those assumptions or targets.

(b) each year, a breakdown of goodwill by past business combination, explaining why the carrying amount of goodwill is recoverable.

(c) each year, information about the headroom[1] in a cash-generating unit (or groups of units) to which goodwill is allocated for impairment testing.

10. Part of the information that could contribute to meeting the objective described in paragraph 3 could be supplied by the requirement described in paragraph 9(a): to disclose, in the year in which a business combination occurs, the reasons for paying a premium above the fair value of the net identifiable assets acquired in the business combination, together with the key assumptions or targets supporting the purchase consideration; and subsequently each year, a comparison between the actual performance and those assumptions or targets. This idea has been developed further by staff as discussed in paragraphs 26–67.

11. In contrast, the possible requirements described in paragraphs 9(b) and 9(c) would not contribute to meeting that objective[2] and therefore the staff no longer recommend them. They were intended to provide information that would help users to better assess the recoverability of recognised goodwill. They might provide some indirect information on the subsequent performance of the acquired business, or combined business, but that would not have been their main objective.

Outreach performed by the staff

12. The staff have developed the ideas presented in this Board paper taking into account feedback from meetings with:

(a) a small number of individual preparers and auditors;

[1] The headroom is the amount by which the recoverable amount of a unit (or group of units) exceeds its carrying amount.

[2] The Board tentatively decided at its October 2018 Board meeting not to perform a complete review of the disclosure requirements of IAS 36. Instead, the staff have reviewed ideas to improve the disclosure requirements in IAS 36 that had already been discussed by the Board and also ideas the staff had developed in response to feedback from stakeholders during and after the PIR of IFRS 3, to determine whether any of these ideas could help to meet the objective in paragraph 3.

(b) diverse stakeholder groups, including a roundtable in Australia hosted by the Australian Accounting Standards Board; and

(c) the Board's consultative groups, the Capital Markets Advisory Committee (CMAC), the Global Preparers Forum (GPF), and the Accounting Standards Advisory Forum (ASAF).

13. The staff recommendations in the paper are intended to strike a reasonable balance between meeting both the needs of users and being feasible for preparers to produce at a cost that is justified by the benefit to users.

Better disclosures for business combinations

14. The feedback from stakeholders during and after the PIR of IFRS 3 indicates that existing disclosure requirements for business combinations often produce limited or boiler-plate information. The lack of specific information can impede users understanding of why an entity undertook a business combination and what it paid for.

15. Furthermore, the existing disclosure requirements do not provide information to help users to assess whether the key objectives of the business combination have been achieved (subsequent performance).

16. In response to this feedback the staff have developed ideas to:

(a) improve disclosure objectives of IFRS 3;

(b) add disclosure requirements for entities to produce information that will help users to assess whether the key objectives of the business combination have been achieved (subsequent performance); and

(c) make targeted improvements to existing disclosure requirements of IFRS 3 where certain requirements are not providing the information expected.

Improving disclosure objectives of IFRS 3

17. The existing disclosure objectives in IFRS 3 require entities to provide information that enables users to evaluate:

(a) the nature and financial effect of a business combination that occurs during the current reporting period or after the end of the reporting period but before the financial statements are authorised for issue; and

(b) the financial effects of adjustments recognised in the current reporting period that relate to business combinations that occurred in the period or previous reporting periods.

18. Feedback from stakeholders during the PIR of IFRS 3 indicated that, although the existing disclosure requirements of IFRS 3 are extensive, those requirements are frequently used mechanically as a checklist and the resulting disclosures are boiler-plate and provide insufficient information for users. The staff think this problem is caused partly by a lack of specific disclosure objectives that explain fully why users need the information being requested.

19. Furthermore, users are particularly interested in information on whether the key objectives of a business combination have been achieved (subsequent performance). No existing disclosure objective in IFRS 3 addresses this point.

20. Therefore, the staff suggest the Board propose two changes to the disclosure objectives of IFRS 3; firstly, make the disclosure objectives more specific, to help preparers understand why the information is needed, and thereby help to improve the information produced; and secondly, add a new disclosure objective for entities to provide information that users need about the subsequent performance of the acquired business, or combined business.

21. To achieve the staff's suggestion, the following disclosure objectives would be added to the existing disclosure objectives of IFRS 3 to provide users with information:

(a) to evaluate the strategic rationale for the business combination;

(b) to understand the amount of, and evaluate the rationale for, the total consideration transferred to obtain control of the acquiree; and

(c) to evaluate the extent to which the key objectives of the business combinations have been achieved.

22. We understand from feedback that users would like information which would help them to make their own assessment of whether an entity has overpaid for a

business combination, and then subsequently whether the key objectives of the business combination have been achieved. The staff believe these needs should be explained in the final Standard to reinforce the purpose of the disclosure objectives.

23. Adding disclosure objectives that provide (a) information to help users understand the strategic rationale for the business combination and the reasons why the acquirer was willing to pay the amount of consideration for the acquiree, ie what it paid for, and (b) information on the key objectives of the business combination and whether the key objectives are subsequently achieved, would address these needs.

24. In developing the staff's ideas for this paper, the staff have tried to provide specific disclosure objectives, link disclosure requirements to those objectives and explain why the information is required. This is in line with the thinking described in the draft Guidance for the Board (developed as part of the Board's *Disclosure Initiative – Targeted Standards-level Review of Disclosures* project to be used when developing and drafting disclosure objectives and requirements).

25. Although there was not much specific discussion of the staff's ideas on possible new disclosure objectives in the staff's outreach, the few comments received were generally supportive. In addition, although preparers raised various issues, some members of GPF agreed there was a need to improve the information for users.

Additional disclosures on key objectives of a business combination (subsequent performance)

Why do users need information on the acquisition's subsequent performance?

26. The staff have developed ideas for disclosure requirements to meet the possible new disclosure objective set out in paragraph 21(c) to provide better information on whether the key objectives of the business combination have been achieved. In doing this, the staff asked CMAC members the following questions:

    (a) Why is information on the acquisition's subsequent performance needed?

(b) What makes information about the performance of the acquired business different to information about the performance of the existing business?

27. The majority of CMAC members indicated that information on the subsequent performance of the acquired business is needed to monitor management's stewardship in making acquisition decisions, to help investors decide whether they can trust management with further capital. However, some CMAC members said they need the information to value the acquired business more accurately.

28. CMAC members also stated that information contained in segment reporting alone is insufficient in addressing the information needs of users relating to the subsequent performance of acquired businesses for the following reasons:

(a) segment information disclosed in financial statements is generally provided at a level higher than that of individual acquisitions. Information contained in segment reporting would not capture acquisition-specific information if the business acquired is not large enough to be a reportable segment; and

(b) IFRS 8 *Operating Segments* currently does not require the disclosure of some information for each reportable segment, such as segment operating cash flow, capital expenditure, assets and liabilities.

29. Hence, the reason for providing this information is primarily to help users to assess stewardship and management's ability to generate value from business combinations. The information also helps users to assess themselves whether the expected benefits of the business combination have reduced and therefore has a secondary benefit of compensating, to some extent, for the limitations of the impairment test.

30. Although preparers raised several issues that would arise in providing the additional information, they acknowledged that there is a need to improve information on whether the key objectives of a business combination have been achieved (subsequent performance).

What information should be provided?

31. Business combinations are diverse, and those combinations can vary in nature and be undertaken for various reasons with various objectives. The objectives of business combinations can also be achieved in several ways depending on the facts and circumstances of each business combination. Consequently, the staff believe no single measure will provide users with information on whether the key objectives have been achieved for all business combinations.

32. The feedback from the staff's outreach also indicated that some preparers believe there is a need for flexibility in how to provide information. For example, some CMAC members commented that management needed flexibility to tailor the disclosures in light of entity-specific circumstances and that different acquisitions would need different factors to describe the subsequent performance of the acquired business, or combined business. Users also agreed that the information to assess post-acquisition performance might vary deal to deal, and one specific measure is unlikely to be suitable for all business combinations.

33. In light of these comments, the staff think the information on subsequent performance should be based on how an entity's management monitors and measures in its internal reporting whether the key objectives of the business combination have been achieved.

34. This approach is a management approach, with some analogies to the approach used in IFRS 8. Adopting such an approach has the following advantages:

    (a) The fact that the information is used internally should make it more robust than information generated solely for external reporting.

    (b) The fact that the information is used internally would minimise costs.

    (c) Entities would not have a free choice about what information to disclose - entities would be required to disclose the information that management uses to measure and monitor a business combination. Moreover, disclosing that information would give users an insight into how management monitors the acquisition.

    (d) Although the information disclosed could differ from information provided by other entities because it is determined by the entity's own management, the primary reason for the information is not to provide comparability with other acquisitions by other entities but to give users insight into how management determines the objectives for the acquisition and monitors success against those objectives.

35. Paragraph B64(d) of IFRS 3 requires an entity to disclose the primary reasons for the business combination. The staff suggest this disclosure requirement be revised and expanded to require an entity to also disclose the key objectives of the business combination. These key objectives would form the basis of the information to help users assess the subsequent performance of the acquired business, or combined business.

36. The staff are therefore suggesting amending paragraph B64(d) to replace the requirement to disclose the primary reasons for the business combination with a requirement for an entity to disclose:

    (a) the strategic rationale for undertaking the business combination, such as how the acquisition links to the acquirer's business strategy; and

    (b) the key objectives of the business combination, being the targets management expect to achieve as a result of undertaking the business combination.

37. Respondents to the PIR of IFRS 3 commented that information provided by the existing requirement in paragraph B64(d) is often boiler-plate and does not provide useful information for users to understand management's rationale for the business combination.

38. The staff think the limited or boiler-plate nature of the information provided can be attributed to the lack of specificity in the generic existing disclosure requirement. The staff think that making the requirement more specific, coupled with the new requirement to provide additional information on the key objectives of the business combination, would improve the information provided.

39. To illustrate the staff's thinking further, the strategic rationale of the business combination is expected to be quite broad (eg to expand entity A's geographical presence by acquiring entity B which has a presence in territory X) but is expected, for example, to be consistent with the business strategy set out by the entity elsewhere in its financial reporting. On the other hand, the key objectives

are more specific targets for that business combination (eg achieve annual sales of CU 100 million of entity A's existing products in new territory X using the acquired sales channels of entity B).

40. In developing ideas on information to assess whether the key objectives of a business combination have been achieved (subsequent performance), the staff discussed the following issues with stakeholders:

    (a) Should this information be required for all material business combinations?

    (b) What measures should be disclosed, do these always need to be quantitative and can the measures change?

    (c) Should this information be provided in the financial statements or in the management commentary?

    (d) How long should this information be provided?

Should this information be required for all material business combinations?

41. Existing IFRS 3 disclosure objectives and related disclosure requirements are applied for material business combinations. If individually immaterial business combinations are material collectively, the disclosures must be provided but may be provided in aggregate.

42. The staff received mixed feedback on whether additional disclosure requirements to help users to assess whether the key objectives of a business combination have been achieved should be applied to all material business combinations or only to what some call 'super-material' business combinations (ie fundamental or strategic business combinations):

    (a) some GPF and CMAC members, for example, suggested that disclosures for subsequent performance should be required only for major acquisitions.

    (b) ASAF members generally did not support an additional threshold to determine whether disclosures are required because requiring another level of materiality would add additional complexity and judgement to a subject where the judgements are already difficult.

43. Instead of setting a new threshold, the staff recommend that disclosures to meet this objective are required only for business combinations that are monitored by the chief operating decision maker (CODM) as defined in IFRS 8.

44. The staff think that the CODM would review all significant or strategic business combinations, and that this would establish an appropriate level of disclosure that balances users' needs with practical considerations for preparers.

45. There are some parallels between acquisitions and disposals. In both cases, users need information in the year of transaction about the contribution of an entity that was acquired or disposed of. Therefore, the staff also considered using the threshold included in the definition of a discontinued operation in IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, namely a component of an entity that represents a separate major line of business or geographical area of operations.

46. Although this would provide symmetry between acquisitions and disposals, a judgement would still need to be made. On balance, the staff believe using the CODM approach a better solution for the following reasons:

    (a) This is a logical extension of the management approach articulated in paragraph 34, whereby the information provided is based on what management (defined as the CODM) uses to monitor the business combination. If another threshold was set this could result in disclosure of information that crosses the threshold but is not used by management to monitor the business combination.

    (b) Stakeholders will be familiar with the application of this approach, and for those entities in the scope of IFRS 8, will already be applying it.

    (c) As discussed in paragraph 34, in considering what information should be provided, using information already being used internally should minimise costs and that information is likely to be more robust than information generated solely for external reporting.

    (d) Information that the CODM does not monitor a business combination could in itself be useful information for users.

What measures should be disclosed, do these always need to be quantitative and can the measures change?

47. The staff discussed with stakeholders the following examples of measures to identify what measures entities use to monitor business combinations in practice:

    (a) the amount of synergies to be achieved and monitoring the achievement of these synergies in subsequent reporting periods;

    (b) acquisition date financial and/or operating key performance indicator (KPI) targets and monitoring these in subsequent reporting periods;

    (c) comparing acquisition date cash flow forecasts for the business combination to actual cash flows in subsequent reporting periods;

    (d) calculating the return on segment (or cash-generating unit(s)) assets with an analysis of how the business combination contributed to the year on year changes in the return achieved compared to that expected at the acquisition date; and

    (e) estimating the payback period for the business combination at acquisition date and measuring progress in achieving that payback in subsequent reporting periods.

48. During the staff's outreach, there was not much discussion on the examples listed in the preceding paragraph. Examples of measures provided by preparers included revenue, EBITDA, return on assets, comparison of acquisition plan cash flows against actual cash flows and qualitative metrics.

49. Some preparers also stated that some decisions for undertaking a business combination could be driven by strategic objectives not by financial objectives, making it hard to quantify the measures used to assess the achievement of those objectives.

50. Some preparers also stated that they might not monitor the business combination by comparison to the original acquisition plan assumptions. Instead, the acquired business is combined with the existing business and targets are set for the combined business as part of the business planning cycle, which are then updated annually. Users stated that if management does not monitor the business combination, that fact itself has information value and should be disclosed. One

CMAC member also suggested that requiring disclosure of this information would be an incentive for management to monitor more closely and rigorously whether the key objectives of the business combination have been achieved, thus promoting better corporate governance.

51. Many preparers commented that it can be difficult to track the acquired business after integration. Users mentioned that information on the combined business could still provide some useful information.

52. The staff believe, if the acquired business is subsequently integrated, subsequent monitoring will often be of the combined business and that information prepared on this basis can be useful, particularly where the business combination impacts the combined business through synergies.

53. Some preparers commented that detailed disclosure of the acquirer's post-acquisition intentions for the acquired business and of precise targets or measures could be commercially sensitive. In the staff's view, in most cases an entity should be able to provide the information in such a way that avoids disclosing commercially sensitive information and still provide sufficient information to users (eg disclosing the variance against the target along with some qualitative commentary rather than necessarily disclosing the absolute measure).

54. Users have highlighted that this information is important to them and material to their decisions about management's stewardship of an entity's economic resources. The staff believe where information is material to users, concerns about commercial sensitivity should not prevent this information being required. This will be an area to explore further in the Discussion Paper.

55. The outreach confirmed the staff's conclusion that the best way to provide post-acquisition performance information is an approach based on how the entity's management monitors and measures the success of an acquisition internally rather than the prescription of a particular measure. In the reporting period when a business combination occurs, the entity would disclose those measures the CODM plans to use, in future internal reporting, to assess the extent to which the key objectives of the business combination have been achieved and, in subsequent reporting periods, disclose the amounts of those measures to enable users to assess the extent to which the key objectives of the business combination have been

achieved. Furthermore, the staff believe if an entity does not monitor the business combination after the acquisition, it should disclose that fact and the reasons for not monitoring.

56. Stakeholders mentioned that the measures used to monitor subsequent performance may change, for example, if there is an internal reorganisation prior to end of the period for which the information is to be provided. In such cases, the staff think the acquirer should disclose the new measures it plans to use and why it has made that change and then use the new measures in providing information on whether the key objectives of the business combination have been achieved.

57. Finally, the staff think the examples of the measures in paragraphs 47-48, that some preparers sometime decide to use internally to monitor an acquisition, could be included in the Discussion Paper as additional guidance.

Should this information be provided in the financial statements or in management commentary?

58. Some preparers and auditors have suggested that some of the information, particularly on the strategic rationale for a business combination and whether the key objectives of the business combination have been achieved, should be included in the management commentary rather than the audited financial statements. In particular, they were concerned with providing forecast information in the audited financial statements; such information may be difficult for auditors to verify and some believe that it might also give rise to a risk of litigation for the entity.

59. Having said that, the staff believe that requiring disclosure of such information in the financial statements would encourage entities to prepare the information more rigorously because of the scrutiny by auditors, ultimately providing more useful information for users.

60. Furthermore, not all entities might be subject to a requirement to produce a management commentary and not all management commentaries might be available to users on the same terms as the financial statements and at the same time.

61. Regarding the concern that providing forward looking information could give rise to a risk of litigation, the staff believe the ideas would not require the entity to

provide detailed quantitative forecasts of future cash flows. An entity is able to determine how the information is provided, as long as sufficient information is provided to help users to evaluate the extent to which the key objectives of the business combination have been achieved.

62. Since the concerns of providing forward looking information should be able to be addressed in most cases and users have explained the importance of having this information, primarily for stewardship purposes (see paragraph 27), the staff think an entity should disclose such information in the financial statements, rather than in management commentary, to ensure the information is always provided.

How long should this information be provided?

63. Users expressed various views on how long such information would be needed, for example:

    (a) for a short period post-acquisition (eg one or two financial periods).

    (b) for as long as expected synergies have yet to be achieved.

64. Preparers also suggested various periods, for example:

    (a) up to three years or until the acquired business cannot be distinguished from the rest of the segment that contains it.

    (b) a much longer period, because in some industries, eg Oil & Gas, a longer period may be necessary to demonstrate whether the key objectives have been achieved.

65. From the feedback received, the staff believe that the information is useful for users for a relatively short period. The staff suggest that the information should be provided for the reporting period in which the business combination occurs and, in general, for at least the next two annual reporting periods.

66. If an entity continues to provide the information to its CODM and concludes that this information is still necessary for users to fully assess whether the key objectives of the business combination have been achieved, then the staff think the information should be provided for longer than the period suggested in the preceding paragraph.

67. If the entity ceases to assess whether the key objectives of a business combination have been achieved prior to the end of the second annual reporting period following the reporting period the business combination occurred, the staff think an entity should disclose the reasons for this.

Targeted improvements to the existing disclosure requirements of IFRS 3

68. Feedback during the PIR suggested that some existing disclosure requirements of IFRS 3 need to be improved. The staff have also performed a limited review of the existing disclosure requirements of IFRS 3 to identify other amendments and suggest that changes in the following areas could contribute to achieving the possible new disclosure objectives of IFRS 3 discussed in paragraphs 17–25:

    (a) the amount, or range of amounts, of expected synergies;

    (b) separate disclosure of any liabilities arising from financing activities and pension obligations assumed; and

    (c) the amounts of revenue, operating profit or loss, and cash flow from operating activities of the acquiree.

69. In addition to the ideas discussed in this paper, the staff believe that there is also scope for some more specific, targeted improvements to disclosures, which the staff consider are best raised in the next phase of the project, in order to focus the Discussion Paper on the key proposals for improved disclosures. Once stakeholder feedback has been received on the Discussion Paper, the Board can consider what other amendments it might wish to propose in an Exposure Draft.

70. Other additional targeted changes could include removal of some existing disclosure requirements in IFRS 3 if the information they provide is not useful.

The amount, or range of amounts, of expected synergies

71. Paragraph B64(e) of IFRS 3 requires an entity to disclose a qualitative description of the factors that make up the goodwill recognised, such as expected synergies from combining operations of the acquiree and the acquirer, intangible assets that do not qualify for separate recognition, or other factors.

72. Feedback from the PIR of IFRS 3 showed that in applying this requirement entities often provide generic and boiler-plate information which is not useful for

users because it does not help them assess the rationale for the business combination and its financial effect.

73. Many CMAC members stated that additional information on the nature, timing and amount of expected synergies would allow users to better understand the transaction, forecast the entity's financial performance and monitor stewardship.

74. Together with the existing disclosure requirement in paragraph B64(e) of IFRS 3, the staff suggest that an entity should be required to disclose, where synergies from combining operations of the acquiree and acquirer are expected:

(a) a description of the synergies and of the expected timing of achieving those synergies;

(b) the amount (or range of amounts) of the synergies; and

(c) the expected costs (or range of expected costs) to achieve the synergies.

75. Preparers generally acknowledged that providing quantitative information on expected synergies would be useful for users, but some expressed the following concerns:

(a) it is often difficult to assign values to expected synergies;

(b) costs of collecting the necessary information to quantify the synergies; and

(c) the information could be commercially sensitive.

76. If synergies are a significant factor in the transaction, the staff think that information about expected synergies should be readily available because the staff expect that the entity would consider the amount of the expected synergies when deciding how much it is willing to pay for the acquiree.

77. The staff understand that it may be difficult to determine a precise amount for the synergies and that often only a range of amounts is available. In these circumstances an entity should disclose that range.

78. The staff's approach would be to require the amount (or range of amounts) of the expected synergies to be disclosed rather than the value of (or amount paid for) those synergies. Hence, an entity that expects cost synergies of between CU 100–150 million from an acquisition, but due to risks associated with achieving those

synergies, the entity-specific nature of some of those synergies and/or good bid negotiation only paid CU 80 million for those synergies, would be expected to disclose a range of CU 100–150 million.

79. This is because the staff believe users want to know what synergies the entity has paid for, so they can assess whether the business combination is a good investment decision. In addition, it may be difficult for an entity to isolate how much of the consideration was paid for particular synergies, given the negotiation process that occurs in an acquisition and that the acquisition cost is a single price and any allocation of that price to the synergies would be arbitrary.

80. Consistent with paragraph 54, users have highlighted that information on synergies is important and therefore concerns of commercial sensitivity should not be allowed to prevent this information being required. However, the staff believe that useful information can be provided to users without the need for an entity to provide precise, detailed information that could be commercially sensitive.

Separate disclosure of any liabilities arising from financing activities and pension obligations assumed

81. The staff understand that some users treat the amount of debt and pension obligations assumed in a business combination as part of the total capital employed in the transaction. The feedback from the PIR of IFRS 3 indicated that it is sometimes difficult for these users to determine the amount of debt and pension obligations of the acquired business assumed in a business combination.

82. Paragraph B64(i) of IFRS 3 requires an entity to disclose the amounts recognised as of the acquisition date for each major class of assets acquired and liabilities assumed. However, some entities include debt and pension obligations assumed in an acquisition within current or long-term liabilities and do not disclose them separately.

83. Amendments to IAS 7 *Statement of Cash Flows* issued in January 2016 require entities to disclose the aggregate amount by which liabilities arising from financing activities changed because of obtaining control of subsidiaries or other businesses. However, the amendments do not require an entity to disclose the change for each business combination separately.

84. Similarly, paragraph 141(h) of IAS 19 *Employee Benefits* requires disclosure of the impact of business combinations on plan assets and the present value of the defined benefit obligation, but this may not result in the disclosure of the change for each business combination separately.

85. The staff suggest stating that liabilities arising from financing activities and pension obligations are always considered to be major classes of liabilities assumed thereby requiring separate disclosure of any such liabilities assumed in a business combination.

86. The staff think this information will help users to assess the total amount of capital employed in each acquiree and it should not significantly increase costs to preparers because they already have this information in determining what amounts to recognise in accordance with IFRS 3.

87. Feedback from outreach showed general support for this improvement from stakeholders, with users strongly supporting this improvement, although the support for disclosing pension obligations was not as strong, and preparers not expressing any objection.

88. Having said that, there is some concern that explicitly requiring the disclosure of these items could be viewed as a rule rather than a principle.

89. Although staff understand that this idea could be considered to be a rules-based change in reaction to (arguably) poor application of the existing disclosure requirement, the staff still believe this requirement to be appropriate. The staff believe this would be a simple change to make and view this potential amendment as clarifying the information that is important to users rather than establishing a rule.

90. An alternative approach would be to try and improve the application of the disclosure requirement and provide, within paragraph B64(i), additional guidance on what a major class is for this disclosure and to provide examples, including liabilities arising from financing activities and pension obligations assumed.

The amounts of revenues, operating profit or loss, and cash flow from operating activities of the acquiree

91. Paragraph B64(q) of IFRS 3 requires an entity to disclose:

(a) the amounts of revenue and profit or loss of the acquiree since the acquisition date included in the consolidated statement of comprehensive income for the reporting period; and

(b) the revenue and profit or loss of the combined entity for the current reporting period as though the acquisition date for all business combinations that occurred during the year had been at the beginning of the annual reporting period.

92. Paragraph B64(q) also permits an entity not to disclose this information if it is impracticable and that fact is disclosed, and an explanation is provided of why the disclosure is impracticable.

93. IFRS 3 provides limited guidance on how such information should be prepared, and this has led to diversity in practice. For example, the term ‘profit or loss of the acquiree’ is not defined. Nor is it clear whether acquisition adjustments need to be assumed for the entire annual period when preparing profit or loss information as if the business combination had occurred at the beginning of the annual reporting period. In addition, if the acquiree’s financial statements had not been prepared in accordance with IFRS or with the acquirer’s accounting policies, retrospective adjustments to the acquiree’s financial information might be required, which could result in additional costs.

94. Users state that they need this information in order to help them predict the future performance of the acquired business and as a starting point to help them monitor the subsequent performance of the acquired business, or combined business.

95. The staff suggest requiring an entity to disclose the amounts of revenue, operating profit or loss[3] before acquisition-related transaction and integration costs, and cash flow from operating activities of the acquiree, since the acquisition date, included in the consolidated statement of comprehensive income and consolidated cash flow statement for the reporting period.

96. In comparison to the existing disclosure requirement shown in paragraph 91(a), the staff suggestion in the preceding paragraph defines the profit or loss measure

[3] The meaning of operating profit or loss would follow the definition by the *Primary Financial Statements* project, but be adjusted to exclude any acquisition-related transaction or integration costs.

and would add a requirement to provide cash flow information. In addition, the staff suggest removing the existing requirement to provide information of the combined entity as though the acquisition date for the business combination was the beginning of the annual reporting period (paragraph 91(b)).

97. There were mixed views from users on the information that should be required. Staff heard support for net earnings[4], whereas others would like to have operating profit or loss information and varied views were also heard on whether this should be before acquisition-related costs and/or acquisition related adjustments.

98. As was also the case in the feedback in the PIR of IFRS 3, some preparers participating in the staff's outreach stressed that providing the pro forma information is difficult and costly and they questioned its usefulness.

99. The staff's ideas shown in paragraph 95 would provide more guidance on the information that should be provided. This should reduce diversity in practice and make the information more useful for users. Although different users requested different profit or loss information, the staff believe that operating profit or loss before acquisition-related transaction and integration costs would provide most users with useful information. Excluding the effects of acquisition-related transaction and integration costs would assist in making the information more relevant.

100. Some stakeholders might argue that the information in paragraph 95 may not be readily available in situations where integration occurs immediately after acquisition. The staff think integration would generally not occur immediately. The staff also think that requiring an operating profit or loss measure as the profit or loss measure means that some of the items that are harder to allocate, (eg finance costs, taxation), would not be required to be allocated and therefore this may make it less common that the disclosure is considered to be impracticable.

101. The staff also think providing information on cash flow from the acquiree's operating activities could help users to evaluate the effect of the business combination on the acquirer's (consolidated) cash flows for the current period and

[4] The staff assume 'net earnings' refers to profit or loss as defined by IAS 1 *Presentation of Financial Statements*.

to further help users to formulate their expectations of the future returns from the business combination. It will also assist those users who prefer to use cash flow rather than profit measures in their analysis.

102. The objective of providing the information discussed in paragraph 95 is to help users estimate the potential full-year effect of the acquired business so that they can predict the future performance of the acquired business and to have information to compare that future performance against. Where the operations of the acquired business are subject to significant seasonality, the staff think sufficient information to help users of its financial statements to understand that seasonality should be provided to enable a full-year effect to be estimated.

103. The staff believe the provision of the information in the preceding paragraph would enable the requirement to provide revenue and profit or loss of the combined entity as if the business combination had occurred at the beginning of the annual reporting period to be removed. Based on the feedback received, this disclosure requirement gives rise to significant costs for preparers and the information provided is only hypothetical.

104. The staff acknowledge there will be circumstances when, because of the proximity of a business combination to the end of a reporting period, this will limit the usefulness of the information provided since it will be hard for users to estimate a full-year effect. Additionally, in some circumstances, providing the information discussed in paragraph 95 could be impracticable. If not disclosing this information or, due to the proximity of the business combination to the end of a reporting period, the information does not provide users with sufficient information to meet the disclosure objectives of IFRS 3, then the entity would need to consider what further information could be provided to users instead.

105. In the circumstances in the preceding paragraph, the Board could consider requiring historic annual information (revenue, operating profit or loss and cash flow from operating activities) for the most recent annual reporting period of the acquired business. In order to make it more practicable and less costly for preparers to provide this information, the Board could consider permitting entities to merely list the material adjustments that would be required to align the

information with the acquirer’s accounting policies without quantifying those adjustments.

106. The staff believe these proposals could be a pragmatic solution to the feedback received, balancing the information users need with the costs to preparers to provide the information.

Other disclosures

Disclosures related to other project objectives

107. In the July 2018 Board meeting, the Board also decided to pursue the following objectives:

   (a) simplifying accounting for goodwill by exploring whether to:

      (i) reintroduce amortisation; and/or

      (ii) provide relief from the mandatory annual quantitative impairment testing for goodwill.

   (b) improving the calculation of value in use (VIU) by removing from IAS 36:

      (i) the restriction that excludes from the calculation those cash flows that are expected to result from a future restructuring or from a future enhancement; and

      (ii) the requirement to use pre-tax inputs in the calculation.

108. Depending on the decisions taken by the Board on these objectives, the Board may need to consider additional disclosure requirements which have not been discussed in this paper, such as:

   (a) relevant information associated with the amortisation of goodwill such as useful lives, amortisation method and accumulated amortisation;

   (b) indicators of impairment that triggered a quantitative impairment test;

   (c) the amount of cash flows from future restructurings and future enhancements to which an entity is not yet committed but which are included in the calculation of VIU and the reason why these have been included; and

(d) discount rates that an entity uses in calculating VIU and whether they are pre-tax or post-tax rates.

Disclosure of the amount of equity, less goodwill and some intangible assets

109. The staff considered requiring an entity to disclose:

(a) the amount of equity the entity would have reported if it had not recognised goodwill and some intangible assets acquired in a business combination: those intangible assets that, based on circumstances at the acquisition date would not have been recognised if they had been internally generated; and

(b) the profit or loss an entity would have reported without amortisation and without any impairment losses, on goodwill and on those intangible assets identified in paragraph (a).

110. Providing this information would increase the transparency of the amount included in equity and in profit or loss as a result of the recognition of goodwill and of the intangible assets mentioned in the preceding paragraph. In addition, during the PIR, some users stated that they wanted to remove amortisation of intangible assets to remove the inconsistency between organically growing entities and entities growing by acquisitions, to help them better assess the performance of the acquired business.

111. During the staff's outreach with the ASAF, the staff did not receive any strong support for this disclosure idea. Some ASAF members mentioned that information is readily available and users can make these adjustments themselves. One ASAF member also highlighted that the definition of which intangible assets to capture in this disclosure can differ between users and the disclosure will suit some users but not all users, thus limiting the benefits of disclosing this information.

112. The staff had previously considered a similar idea (see **February 2016 Agenda Paper 18A**) whereby amortisation of intangible assets would be presented separately on the face of the income statement and had similarly not recommended the Board to pursue this idea since the intangible assets whose amortisation charge would be presented in this way would vary by user and

industry. Instead the staff thought management should apply judgement in deciding whether to provide some kind of disaggregation of amortisation expense on the face of the financial statements in accordance with paragraph 85 of IAS 1 *Presentation of Financial Statements*.

113. Furthermore, the Board has tentatively decided in the *Primary Financial Statements* project to require goodwill to be presented as a separate line item in the statement of financial position which would make the carrying amount of goodwill more visible.

114. Nevertheless, the staff think that there is a link between these ideas and the decision on whether to reintroduce amortisation or not. Therefore, the staff propose that a decision on whether to support the ideas in paragraph 109 be deferred to a future Board meeting, when the reintroduction of amortisation is discussed.

Staff recommendations

115. The staff recommend the following improvements to the disclosure objectives and disclosure requirements of IFRS 3 in order to meet the objective set by the Board in July 2018 of identifying better disclosures for business combinations.

Improving disclosure objectives of IFRS 3

116. To add the following disclosure objectives to the existing disclosure objectives of IFRS 3 to provide users with information:

(a) to evaluate the strategic rationale for the business combination;

(b) to understand the amount of, and evaluate the rationale for, the total consideration transferred to obtain control of the acquiree; and

(c) to evaluate the extent to which the key objectives of the business combinations have been achieved.

Additional disclosures on key objectives of a business combination (subsequent performance)

117. Paragraph B64(d) of IFRS 3 be amended to require an entity to disclose:

    (a) the strategic rationale for undertaking the business combination, such as how the acquisition links to the acquirer's business strategy; and

    (b) the key objectives of the business combination, being the targets management expect to achieve as a result of undertaking the business combination.

118. An acquirer is required to disclose:

    (a) in the reporting period when a business combination occurs, what measures the CODM plans to use, in future internal reporting, to assess the extent to which the key objectives of the business combination have been achieved; and

    (b) in the reporting period in which the business combination occurs and for at least the next two annual reporting periods, the amounts of those measures being used to assess the extent to which the key objectives of the business combination have been achieved.

Targeted improvements to the existing disclosure requirements of IFRS 3

119. An acquirer shall disclose for each business combination that occurs in the current reporting period:

    (a) where synergies from combining operations of the acquiree and acquirer are expected, a description of synergies and of the expected timing of achieving those synergies, the amount (or range of amounts) of the synergies and the expected costs (or range of expected costs) to achieve the synergies (adding to paragraph B64(e) of IFRS 3);

    (b) the amounts recognised as of the acquisition date for each major class of identifiable assets acquired and liabilities assumed, stating that liabilities arising from financing activities and pensions obligations are considered to be major classes of liabilities assumed for the purposes of this disclosure requirement (amendment to paragraph B64(i) of IFRS 3); and

(c) the amounts of revenue, operating profit or loss[5] before acquisition-related transaction and integration costs, and cash flow from operating activities of the acquiree, since the acquisition date included in the consolidated statement of comprehensive income and consolidated cash flow statement for the reporting period (amendment to paragraph B64(q) of IFRS 3).

Question for the Board

120. The disclosure ideas that the staff have recommended in this paper will be one part of the various ideas that will be considered by the Board at a future Board meeting where the Board will decide which preliminary views, if any, to express in the Discussion Paper, on how to achieve the objectives set out in paragraph 3 of Agenda Paper 18A.

121. Board members are asked for any comments they have on the staff's ideas for the staff to consider as it develops the papers for that future Board meeting.

Question for the Board
Do Board members have any comments on the staff's ideas for improvements to the disclosure objectives and disclosure requirements of IFRS 3 for the staff to consider as it develops the papers for a future Board meeting where the Board will determine its preliminary views, if any, to express in the Discussion Paper?

[5] The meaning of operating profit or loss would follow the definition by the *Primary Financial Statements* project, but be adjusted to exclude any acquisition-related transaction or integration costs.