IFRS

STAFF PAPER

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Project	Goodwill and Impairment		
Paper topic	Expected synergies arising from a business combination		
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Purpose and structure

1. The purpose of this paper is to provide the International Accounting Standards Board (Board) with our analysis of aspects of the feedback to the Board's preliminary view that it should require entities to disclose quantitative information about synergies expected from a business combination (expected synergies). The preliminary view was expressed in the Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment*.

2. This paper continues the 'building blocks' approach described in paragraphs 3–6 of Agenda Paper 18 to the Board's October 2021 meeting. At its meeting in October 2021, the Board tentatively decided that, based on the *Conceptual Framework for Financial Reporting*, it can require entities to provide information about expected synergies in financial statements. The Board has not yet decided whether to proceed with this preliminary view in the light of practical concerns raised by respondents. As explained in Agenda Paper 18B to the Board's October 2021 meeting, we are in the process of analysing these practical concerns and will present this analysis at a future meeting. Nonetheless, we think it would be helpful for the Board to consider feedback on, and make tentative decisions about, other aspects of this preliminary view. We will revisit these tentative decisions if necessary, depending on the Board's later decisions regarding whether to proceed with its preliminary view.

3. The paper is structured as follows:

    (a) summary of staff recommendations (paragraph 4);

(b) background (paragraphs 5–12);

(c) staff analysis and recommendations (paragraphs 13–42), including:

(i) definition of synergies (paragraphs 14–24);

(ii) types of synergies (paragraphs 25–35);

(iii) definition of 'realised' (paragraphs 36–41); and

(iv) other comments (paragraph 42).

Summary of staff recommendations

4. We recommend that the Board:

(a) does not define synergies.

(b) subject to further research to assess whether concerns about commercial sensitivity remain, require entities to disclose quantitative information about synergies at one level below total expected synergies—that is, at the level of total revenue, cost or other synergies.

(c) not require an entity to disclose when the synergies are expected to be realised but to instead require an entity to disclose information about when the benefits resulting from synergies are expected to start and the expected duration of those benefits.

(d) make no other changes to its preliminary view.

Background

The Board's preliminary views

5. Paragraph B64(e) of IFRS 3 *Business Combinations* requires an entity to provide, in the year a business combination occurs:

> 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.

6. As stated in paragraph 2.62–2.63 of the Discussion Paper, users of financial statements (users) said this requirement often results in entities providing a generic description of expected synergies that is not useful. In addition, achieving synergies is often an important objective of a business combination. Users said information on the nature, timing and amount of expected synergies is important.

7. The Board's preliminary view is that it should require an entity to disclose in the year a business combination occurs:

   (a) a description of the synergies expected from combining the operations of the acquired business with the entity's business;

   (b) when the synergies are expected to be realised;

   (c) the estimated amount or range of amounts of the synergies; and

   (d) the estimated cost or range of costs to achieve those synergies.

Feedback

8. Feedback on the Board's preliminary views was mixed. Respondents agreeing with the Board's preliminary view included some national standard-setters, accounting bodies, a few accounting firms, a few preparers and almost all regulators who commented on this preliminary view. Most users who commented on this matter agreed with the Board's preliminary view and said information about expected synergies will be useful.

9. Academic evidence shows disclosures about expected synergies are value relevant and are valued by users.

10. Those disagreeing include some accounting firms, some national standard-setters and most preparers that commented on this topic.

11. Many respondents expressed concern that quantitative information about expected synergies could be commercially sensitive or could be considered to be forward looking in their jurisdiction.

Our plan for analysing feedback

12. As noted previously, we are gathering further information on practical concerns raised by respondents through the development of staff examples, which we will test with users, preparers, auditors and regulators. We will provide the Board with a summary of feedback from the staff examples at a future meeting and will also ask the Board whether it would like to proceed with its preliminary view.

13. This paper considers specific aspects of the feedback on this preliminary view. In particular, it considers the following feedback:

    (a) some respondents suggested defining synergies to prevent diversity in relation to how an entity identifies synergies. They said there are many different types of synergies and those synergies can arise in different ways. Paragraphs 14–24 analyse this further.

    (b) some respondents suggested distinguishing between cost and revenue synergies. Paragraphs 25–35 analyse this further.

    (c) a few respondents asked for clarification regarding when synergies are expected to be ‘realised’. Paragraphs 36–41 analyse this further.

    (d) other comments—paragraph 42 analyses these comments.

Staff analysis

Definition of synergies

Feedback

14. Respondents who suggested defining synergies did so because in their view a lack of definition might lead to diversity in how entities identify and quantify expected synergies. Those respondents said this diversity could result in users receiving diverse and potentially misleading information.

Analysis

Whether to define synergies

15. During the development of the Discussion Paper, the Board did not discuss whether, and if so how, to define synergies. Various IFRS Standards such as IFRS 3, IFRS 13 *Fair Value Measurement*, IAS 36 *Impairment of Assets* and IAS 38 *Intangible Assets* already use the terms 'synergy' and 'synergies' but do not define the phrase.

16. We think it is unnecessary to define synergies. In particular,

(a) as explained in paragraphs 5–6 of this paper, the Board's preliminary view expands on an existing requirement in paragraph B64(e) of IFRS 3. We think that since this paragraph already requires an entity to provide qualitative information about expected synergies to the extent that they are a material factor making up goodwill, there is no need to define synergies further.

(b) although feedback during the development of the Discussion Paper suggested users need more quantitative information about expected synergies, feedback did not suggest that entities were not appropriately identifying expected synergies.

(c) while IFRS 3 does not define synergies, paragraph BC313 of IFRS 3 includes a description of synergies in the context of the going concern element of an acquired business, and states:

> The going concern element represents the ability of the established business to earn a higher rate of return on an assembled collection of net assets than would be expected if those net assets had to be acquired separately. That value stems from the synergies of the net assets of the business, as well as from other benefits (such as factors related to market imperfections, including the ability to earn monopoly profits and barriers to market entry—either legal or because of transaction costs—by potential competitors).

(d) notwithstanding our view that it is unnecessary to define 'synergies' paragraphs 19–23 of this paper consider possible definitions of synergies the Board could propose if it decides to do so. Those definitions draw from descriptions of synergies in IFRS Standards and other common definitions of the term. As noted in those paragraphs, those definitions and descriptions are similar, which indicates there may already be a common understanding of synergies and therefore no need to define the term.

17. Some respondents suggested defining synergies as well as specifying whether an entity would be required to disclose quantitative information about total expected synergies or separately for different types of synergies. For example, one respondent suggested that as part of defining synergies, the Board should include common examples of synergies. Suggested examples included reductions in headcount, expected cost savings associated with shutting down a production line or closing a location, or anticipated sales growth from expanding product or service offerings.

18. Paragraphs 25–35 of this paper consider whether and how to clarify the types of synergies an entity discloses. We think this clarification may also make defining synergies unnecessary.

How to define synergies

19. Although some respondents suggested defining synergies, they did not provide any suggested definition. Notwithstanding our view that it is unnecessary to define synergies, we consider below how the Board could define synergies if it so decides.

20. While IFRS Standards do not define synergies, paragraph BC313 of IFRS 3—see paragraph 16(c) of this paper—describes synergies in the context of the going concern element of a business combination.

21. Some academic literature also defines synergies. These definitions are generally consistent with the description in paragraph BC313. For example, Damodaran (2005)[1] defines synergies as 'the additional value that is generated by combining two firms, creating opportunities that would not been available to these firms operating independently'.

22. English language dictionaries also provide a definition of 'synergy' which are generally consistent with the descriptions and definitions noted above. For example:

[1] Damodaran, Aswath, The Value of Synergy (October 30, 2005). Available at SSRN: https://ssrn.com/abstract=841486 or http://dx.doi.org/10.2139/ssrn.841486

(a) the Collins English Dictionary defines synergy as ‘the working together of two or more drugs, muscles, etc., to produce an effect greater than the sum of their individual effects’

(b) the Oxford English Dictionary defines synergy as ‘interaction or cooperation of two or more organisations, substances, or other agents to produce a combined effect greater than the sum of their separate effects’

23. Accordingly, if the Board were to define synergies, we think a definition of synergies should explain that synergies:

(a) arise from a combination of two or more entities. In other words, they arise as a result of the business combination; and

(b) result in a combined value that is greater than the sum of the values of the entities when considered separately.

Conclusion

24. Based on our analysis, we recommend that the Board does not define synergies.

Question 1
Does the Board agree with staff recommendation not to define synergies? If not, and the Board instead decides instead to define synergies in IFRS 3, does the Board agree with the definition of synergies in paragraph 23?

Types of synergies

25. As explained in paragraph 17, some respondents suggested specifying whether an entity would be required to disclose quantitative information about total expected synergies or separately for different types of synergies.

26. As explained previously, we are working on staff examples to help the Board assess commercial sensitivity concerns related to disclosing quantitative information about expected synergies which will also help inform any decision about the types of synergies to disclose. However, a tentative decision based on our research and analysis to date about the types of synergies the Board thinks entities should disclose

will help us develop and discuss the staff examples with stakeholders. We will provide the Board with the feedback from our work on the staff examples at a future meeting at which time the Board will have an opportunity to reconsider any tentative decision it makes at this meeting.

27. Domodaran (2005) describes two broad types of synergies:

(a) operating synergies—that allow entities to increase their operating income from existing assets, increase growth or both; and

(b) financial synergies—resulting in higher cash flows or a lower cost of capital (discount rate) or both.

28. Some respondents suggested distinguishing between cost and revenue synergies. When we discussed this matter with the Capital Markets Advisory Committee (CMAC) and Global Preparers Forum (GPF) in October 2020, CMAC and GPF members generally distinguished cost from revenue synergies. Some CMAC members said they often get more information about cost synergies than revenue synergies. A few respondents to the Discussion Paper said they would also like quantitative information on other types of synergies, for example tax synergies.

29. Given the feedback, we think the most useful information for users that would also be practical for preparers to provide is quantitative information about expected synergies that is one level below total synergies—such as total cost and total revenue synergies.

30. The evidence gathered so far indicates that quantitative information can be provided at this level. In the fieldwork we performed last year, most entities we spoke to estimated expected synergies at a level lower than total revenue, cost or other synergies as part of the acquisition process. Accordingly, we think it would be possible to aggregate and disclose quantitative information about expected synergies at one level below total synergies—ie at the total revenue, cost or other synergies.

31. Preparers raised concerns about commercial sensitivity in relation to the disclosure of expected synergies arising from a business combination. Respondents said information about expected synergies could be commercially sensitive if it provides information about potential restructurings or could be used by customers and competitors to understand an entity’s cost base.

32. We think quantitative information at the level of total cost synergies for example would not be commercially sensitive (subject to our testing of examples as discussed in paragraph 12). This level of aggregated information would not be detailed enough to give competitors information about how an entity's cost structure works. In addition, it would not require an entity to provide detailed information about for example, any expected redundancies.

33. Some feedback on the Board's Discussion Paper supports our view. A few preparers said information about expected synergies will not be commercially sensitive if provided at a high enough level. For example, one participant in our fieldwork identified synergies as a key objective that the entity's Chief Operating Decision Maker (CODM) monitored to measure the success of a business combination. The CODM allocated a target for synergies at a detailed level, for example:

    (a) revenue synergies from cross selling products and increasing overall prices; and

    (b) cost synergies from better purchasing power from suppliers, technology sharing and improved working practices.

34. The fieldwork participant said disclosing quantitative information about total expected revenue synergies and total expected cost synergies would not be commercially sensitive but disclosing the detailed breakdown about where those synergies are expected to arise could be because it could affect the attainment of those synergies.

35. Subject to further research to assess whether concerns about commercial sensitivity remain, we think entities should disclose quantitative information about synergies at one level below total expected synergies—ie at the level of total revenue, cost or other synergies.

Question 2
Does the Board agree with our recommendation that, subject to further research to assess whether concerns about commercial sensitivity remain, entities should disclose quantitative information about synergies at one level below total expected synergies—that is, at the level of total revenue, cost or other synergies?

Definition of 'realised'

36. The Board's preliminary view would require an entity to explain when expected synergies arising from a business combination are expected to be 'realised' (see paragraph 7).

37. Feedback on the Discussion Paper identified two possible understandings regarding when synergies are 'realised':

    (a) when the entity has taken steps to benefit from the expected synergies; or

    (b) the duration of the benefit resulting from the expected synergies.

38. The difference in views can be illustrated with an example—Entity A manufactures and sells a product for which it has exclusive sales rights in a jurisdiction for a period of 5 years. The entity intends to exit the market at the end of those 5 years. As a result of a business combination the entity expects to be able to consolidate warehouse facilities between its existing and acquired business and therefore expects to close a warehouse in the year following the business combination. This will result in cost synergies that will benefit the entity for 4 years from the period the warehouse is closed until the end of its exclusive sales rights period. In this example the entity expects to:

    (a) take steps to obtain the benefit in the year following the business combination; and

    (b) benefit from the cost synergies from years 2–5 (a period of 4 years).

39. We think both bits of information would be useful—they provide information about when an entity expects the benefits resulting from synergies to begin and the duration of those benefits. We think this information would help users develop their own cash flow forecasts for the entity. In the example in paragraph 38, it could be misleading if an entity were to describe the benefits of synergies being realised in the year following the business combination without specifying the limited duration of the expected benefits. Users might incorrectly assume the cash flow savings will continue indefinitely.

40. We are reviewing information entities disclose for a sample of recent business combinations. Whilst we will provide the Board with our findings of this review at a

later date, we note that of the information we have reviewed to date, many acquiring entities disclose information about expected synergies at the time of the acquisition in press releases and in management commentary. Entities disclosing quantitative information about expected synergies often quote ‘expected annual synergy run-rates’ (that is ongoing cost or revenue synergies resulting from a business combination) that will be achieved within a planned number of years after the acquisition. This therefore provides information about:

(a) when the entity expects the benefit resulting from the synergies to start (when the plan to achieve the annual synergy run-rate is expected to be completed); and

(b) the expected duration of the benefits resulting from those synergies (quoting the figures as an annual synergy run-rate generally implies the entity expects the synergies to continue on an ongoing basis for an indefinite period[2]).

41. In our view therefore, it is feasible for an entity to provide information about both when the benefits resulting from expected synergies are expected to start and the expected duration of those benefits. Accordingly, we recommend that the Board not require an entity to disclose information about when the expected synergies are expected to be realised but to instead require an entity to disclose when the benefits resulting from expected synergies are expected to start and the expected duration of those benefits.

Question 3
Does the Board agree with our recommendation to not require an entity to disclose when the expected synergies are expected to be realised but to instead require an entity to disclose information about when the benefits resulting from expected synergies are expected to start and the expected duration of those benefits?

[2] Whilst we acknowledge some might conceptually have different views on whether any synergy can continue for an indefinite period, the requirement to disclose the expected duration of the benefit would require an entity to disclose the duration it expected the benefit arising from the synergies to last for when agreeing the price to pay for the business combination (see also item 2 in paragraph 42).

Other comments

42. A few respondents made other comments in relation to the Board's preliminary view. The table below analyses these comments.

Respondents' comments	Staff analysis and conclusion
1. Materiality A few respondents suggested considering whether to require the quantitative disclosure of expected synergies only for business combinations monitored by the entity's Chief Operating Decision Maker (CODM)—that is, similar to the Board's preliminary view on the business combinations for which an entity would be required to disclose subsequent performance information about.	We recommend no change The Board is yet to redeliberate its preliminary view to use an entity's CODM as the basis to identify the business combinations for which an entity would disclose subsequent performance information about. However, the Board's preliminary view to require an entity to disclose quantitative information about expected synergies would amend an existing requirement in IFRS 3 (paragraph B64(e)—see paragraph 5 of this paper). The existing requirement does not use the CODM as the basis but is subject to the general requirement in IAS 1 *Presentation of Financial Statements* to consider materiality. We are unaware of any concerns in identifying business combinations to which an entity applies the existing requirement and accordingly recommend no change in this respect. In addition, the preliminary view to require an entity to disclose information about the subsequent performance of business combination is a new requirement and we

Respondents’ comments	Staff analysis and conclusion
	think there is no need for these preliminary views to have the same basis of preparation.
2. Synergies expected at the time of agreeing price or subsequently? One respondent suggested specifying whether information about expected synergies should be based on management’s expectations at the time of the acquisition or subsequent to closing the transaction. That respondent said expected synergies included in the deal pricing model will explain better the agreed purchase price, however, synergy expectations subsequent to closing—for example, at the reporting date—might help better assess the subsequent realisation of synergies, and thus performance of the business combination.	We recommend no change Paragraph 2.60 of the Discussion Paper says the Board’s preliminary view to require entities to disclose quantitative information about expected synergies supports the disclosure objective of helping users understand the benefits management expected when agreeing the price to acquire a business. In our view the information that an entity should disclose information about expected synergies *at the time of the business combination.* The synergies expected at the time of the business combination is the value of synergies that has been reflected in the assets recognised as a result of the business combination, including goodwill and therefore, helps users understand the benefits management expected when agreeing the price to acquire the business—ie the proposed disclosure objective.
3. Other components of goodwill Some respondents said synergies are not the only reason an entity enters into a business combination. Those respondents said information about other components of	We recommend no change The Board’s preliminary view builds on the requirement in paragraph B64(e) of IFRS 3 for entities to provide a qualitative description of the factors that make up the goodwill recognised in a business

Respondents' comments	Staff analysis and conclusion
goodwill would be equally useful. A few of those respondents said if the Board does not also require similar information about other components of goodwill, it should specify that disclosing the quantitative information about expected synergies could inform users about the size of other components of goodwill and could accordingly, be material even if the quantitative amount of expected synergies is small.	combination. Accordingly, an entity is already required to provide information about any material components of goodwill. Paragraph 2.62 of the Discussion Paper notes that users said the information they want is not about goodwill itself, but information that gives them a better understanding of why a company paid the price it did for the acquired business. Although we understand business combinations are undertaken for a variety of reasons, paragraph 2.63 of the Discussion Paper says achieving synergies is often an important objective. Our review of financial statements, discussed in paragraph 40, also indicates synergies are often highlighted as a factor making up goodwill. Accordingly, in our view, because synergies are often highlighted as a key component of goodwill providing quantitative information of expected synergies but not other components of goodwill, adequately responds to user needs.

Question 4
Does the Board agree with our recommendation to make no other changes to the preliminary view as a result of the feedback described in paragraph 42?