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## Business Combinations – Disclosure, Goodwill and Impairment

### Exposure Draft outreach

#### Objective

- 1 The objectives of this session are to obtain input from EFRAG FR TEG-CFSS members on the following proposals of the Exposure Draft [Business Combinations – Disclosures, Goodwill and Impairment](#) (the ED) in preparation for the ASAF meeting that will take place 8 and 9 July 2024:
  - (a) Identifying strategic business combinations
  - (b) Exemption
  - (c) Impairment test
- 2 The questions to EFRAG FR TEG-CFSS members are included after each of the proposals and are the same questions as asked in the ASAF presentation (agenda paper 07-02).

#### Project Background

- 3 The IASB issued the ED in March 2024, proposing amendments to IFRS 3 *Business Combinations* and targeted changes to IAS 36 *Impairment of Assets*.
- 4 EFRAG issued its draft comment letter on the ED ([DCL](#)) on 30 April 2024 and requests comments **by 28 June 2024**.

#### EFRAG Secretariat outreach activities

- 5 During May and June 2024, the EFRAG Secretariat has been conducting outreach on the key proposals and gathering further insights on EFRAG's preliminary views in its DCL.
- 6 The outreach activities have included one-to-one calls with preparers and one auditor, participating and observing in user outreach events as well as outreach events organised by national standard setters and accountancy and professional bodies (Accountancy Europe and Business Europe).
- 7 As at the date of writing this paper, the EFRAG Secretariat have reached out to 16 European stakeholders (10 preparers, 3 user groups, 2 auditors/ auditor organisation and one NSS).

We expect to have a few more outreach calls and are currently organising a User-Preparer Roundtable for 5 July 2024 which will include participation from the IASB.

#### **Timeline for EFRAG's Final Comment letter**

- 8 EFRAG FR TEG will meet on 10 July 2024 to recommend for approval the final comment letter to the EFRAG FRB which is scheduled for 17 July 2024.

#### **Topics for discussion at ASAF**

- 9 At the July ASAF meeting, the IASB staff will seek views from ASAF members on the following proposals in the ED:
- (a) Identifying strategic business combinations
  - (b) Exemption
  - (c) Impairment test
- 10 The ASAF presentation included as Agenda paper 07-02 provides a summary of the IASB proposals and feedback heard so far.

### **Identifying strategic business combinations**

#### *IASB proposal*

- 11 The IASB is proposing to require an entity to disclose information about the performance of a business combination - information about the entity's acquisition-date key objectives and related targets for the business combination - and whether these key objectives and related targets are being met for only strategic business combinations.
- 12 The IASB (BC54) describes a strategic business combination as 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.
- 13 The IASB is proposing that entities identify a strategic business combination using a set of quantitative and qualitative thresholds - a business combination that met any one of these thresholds would be considered a strategic business combination. In summary the thresholds proposed are:
- (a) Quantitative thresholds - Revenue, operating profit or assets (including goodwill) of acquired business constitutes at least 10% of the acquirer's comparative amounts (most recent annual reporting period before the acquisition date)
  - (b) Qualitative thresholds - Business combination results in entity entering a new major line of business or geographical area of operation.

#### *EFRAG DCL*

- 14 In its DCL, EFRAG:
- (a) Supports the proposed thresholds although expressed concern on the volatility of the operating profit threshold.

- (b) Notes concerns that proposed thresholds may capture immaterial acquisitions; but acknowledges that the general concept of materiality would apply and recommends the IASB to elaborate on this in the Basis for Conclusions
- 15 In its DCL, EFRAG asks constituents the following questions on identifying strategic business combinations:
- (a) Do you expect to have difficulties in applying either the proposed quantitative or the qualitative thresholds? If so, please explain why.
- (b) Have you identified cases where applying an open-list approach would be more appropriate than the proposed closed-list approach? If so, please explain.
- (c) Do you consider there could be cases where the 10% measure proposed for the quantitative thresholds (based on the acquirer's consolidated operating profit, revenue and total assets) would not be appropriate, as it would still capture small business combinations (if 10% is too low) or omit to capture "strategic" acquisitions (if 10% is too high)?, If so, in which cases and which other measure would you propose?
- (d) Do you consider it useful to have guidance on assessing whether a series of business combinations could in aggregate be strategic?

*What EFRAG has heard so far during the outreaches*

- 16 Respondents generally supported the proposed closed-list approach as being the most practical approach. However, several respondents **called for a more-principle-based approach** noting that the IASB proposal may not capture the most important acquisitions from a user perspective.
- 17 **A suggestion made by several respondents** (including users) was for the IASB to develop a rebuttable presumption - where an acquisition meets one or more of the qualitative or quantitative thresholds, an entity should be able to rebut the presumption that the acquisition is "strategic" if it can demonstrate that the acquisition does not meet the overall description of a strategic business combination set out in paragraph BC54 of the ED. The entity would be required to disclose the reason for the rebuttal. This would highlight the importance of the description in paragraph BC54 which could be include in the final standard.

Quantitative thresholds

- 18 Most (all) respondents (preparers, users and auditors, NSS) considered operating profit or loss to be a very volatile figure to measure the size of an entity and it can even be close to zero or negative and often bearing little relationship with the size of an entity. **These respondents suggested to delete the operating profit threshold.**
- 19 While respondents generally agreed with the quantitative threshold of 10%, some indicated that few of their recent business combinations would meet the proposed quantitative thresholds, which can be interpreted that they may be seen as too low. In other cases, for example smaller sized entities that are growing through acquisitions, the opposite might happen. A rebuttable presumption could address these concerns. Another suggestion was to use averages of the past "x" years instead of using the most recent

annual reporting period, for the operating profit and/or revenue thresholds. A further suggestion by some respondents was to use enterprise value as a threshold.

Qualitative thresholds

- 20 Several respondents did not consider the qualitative thresholds would capture the right population of “strategic” acquisitions.

**Questions to EFRAG FR TEG-CFSS**

- 21 Do you agree with the threshold approach?
- 22 Do you think the proposed thresholds would appropriately capture what your stakeholders view as being strategic business combinations? If not, what additional or different quantitative or qualitative thresholds would you suggest considering?

## Exemption

*IASB proposal*

- 23 The IASB is proposing to exempt an entity from disclosing some of the information in the ED in specific circumstances.
- 24 The ED includes a principle for the exemption, that an entity is exempt from disclosing some information, if doing so can be expected to prejudice seriously the achievement of any of the entity’s acquisition-date key objectives for the business combination.
- 25 The IASB is proposing application guidance to help entities, auditors and regulators identify the appropriate circumstances when the exemption can be applied.

*EFRAG DCL*

- 26 In its DCL, EFRAG:
- (a) Welcomes the proposed exemption, as it would address some of the concerns expressed by constituents (e.g., on commercial sensitivity).
  - (b) Suggests including illustrative examples of ‘specific circumstances’ to support entities in its application, as these circumstances could be interpreted differently
- 27 In its DCL, EFRAG asks constituents the following question regarding the proposed exemption:
- (a) Do you consider that the IASB should suggest further application guidance and/or include illustrative examples to clarify the meaning of the “specific circumstances” that the exemption would be applied to? If so, what application guidance or illustrative examples would you suggest?

*What EFRAG has heard so far during the outreaches*

- 28 Participants (preparers, users, auditors, others) were generally supportive of the proposed exemption and considered it to be necessary for those cases where the information would be very commercially sensitive. **There was also general agreement in providing additional guidance and illustrative examples to ensure the appropriate application of the**

**exemption.** However, some challenges or concerns in applying the exemption were noted. More detailed feedback is provided below, by stakeholder group:

Preparers

- 29 Preparers generally supported the proposed exemption, while highlighting potential implications on competitiveness and litigation risks from disclosing some of the information. One preparer disagreed that litigation risks should not qualify for the exemption.
- 30 They noted some challenges in applying the exemption:
- (a) It could be challenging to apply the exemption, as documentation and approval by auditors would be difficult (similar to the application of the exemption under IAS 37);
  - (b) The exemption's wording leaves room for interpretation, making it challenging to enforce;
  - (c) Providing the reasons for applying the exemption could itself be harmful to the entity. The IASB will need to carefully relook at this requirement.
- 31 Concerning the application guidance and illustrative examples, participants highlighted:
- (a) The need for additional guidance and illustrative examples to clarify the application of the exemption, with some participants having differing views supporting that they would not be useful;
  - (b) The preference by some for a principles-based approach, rather than specific illustrative examples.

Users

- 32 Users empathised with preparers that there could be legal reasons for entities not to disclose some of the information, while highlighting the importance of providing the reasons why it is applied.
- 33 **However, users also noted that the exemption should be used only when necessary** and not as means to avoid disclosure of information. Users called for additional guidance to ensure proper application.
- 34 Users highlighted the importance of the following information:
- (a) The information on contingencies and potential liabilities; therefore, litigation risks should not be a reason not to disclose the information;
  - (b) The quantitative information about expected synergies; hence, the exemption should not apply to this information.

Auditors

- 35 Auditors also agreed that additional application guidance and illustrative examples should be provided.
- (a) Concerning the application guidance of aggregating the information if too commercially sensitive, there was a concern on how to handle non-financial information.

Other

- 36 Other constituents noted the following concerns:
- (a) Disclosing the reason for applying the information could be itself prejudicial information and could harm competitiveness;
  - (b) It would be challenging to apply the exemption;
  - (c) There is room for judgement and lack of clear application guidance;
  - (d) Auditors may find it difficult to scrutinise the exemption, as management would often claim that the information is prejudicial.
- 37 Other participants also agreed that additional guidance and illustrative examples are necessary for providing clarifications on the exemption's application.

**Questions to EFRAG FR TEG-CFSS**

- 38 Considering feedback from stakeholders in your jurisdiction, would the exemption address preparers' concerns with disclosing the information in financial statements? If not, why and what changes would you suggest to the principle and/or application guidance of the proposed exemption?
- 39 Are there situations in your jurisdiction in which the proposed exemption might be applied but which you view as inappropriate?

## Overall disclosure proposals

### *IASB proposals*

- 40 The IASB ED includes a package of proposals to address investors' concerns about insufficient information about an acquisition's performance – investors sometimes use information from impairment test as a proxy to assess an acquisition's success.
- 41 Acquisitions—referred to as 'business combinations' in IFRS Standards— are often large transactions for the entities involved. Per data collected by the IASB (see slide 13 of agenda paper 07-02) these transactions play a central role in the global economy. For example, deals announced in 2023 totalled \$3.2 trillion.
- 42 The proposed amendments to IFRS 3 *Business Combinations* are:
- (a) Disclose information used by key management personnel about performance of strategic business combinations on
    - (i) Key objectives, targets in year of acquisition
    - (ii) Performance against key objectives, targets in subsequent periods
    - (iii) Other improvements to existing disclosures, including disclosing quantitative information about expected synergies in the year of acquisition.
  - (b) Exempt an entity from disclosing some information in specific circumstances

### *EFRAG DCL*

- 43 EFRAG welcomes the IASB's efforts to develop improved disclosure requirements in IFRS 3 that will provide users with more useful information about business combinations. Overall,

EFRAG considers that the IASB is trying to achieve the right balance to improve the disclosure requirements, at a reasonable cost to preparers, notably by significantly changing the proposals in the 2020 IASB Discussion Paper following EFRAG's suggestions.

- 44 However, EFRAG included several questions to constituents on aspects of the proposals for which EFRAG needed further feedback before finalising its position.

*What EFRAG has heard so far during the outreaches*

- 45 **Overall, preparers and auditors were critical of the overall disclosure proposals citing:**
- (a) Sensitivity concerns (commercial sensitivity, legal sensitivity etc) with providing the proposed performance information in the financial statements and saying that the proposed exemption might not be helpful and would lead to endless discussions with the auditors
  - (b) Disagreeing with providing non-GAAP type of information (non-GAAP KPIs) in the financial statements and noting that this type of information should be provided in the management report
  - (c) Strong disagreement to provide quantitative information on expected synergies arguing that this was forward-looking information that would be very difficult to quantity and even more difficult to audit
  - (d) There were mixed views from respondents on defining the level of management as KMP, with some respondents preferring to refer to the CODM and others preferring not to define the level of management noting that the "decision-maker" can vary from entity to entity.
- 46 **The one NSS respondent** said that they generally supported the efforts and the balance the IASB tried to achieve. However, this respondent shared mixed views on the location of providing the proposed information. There was also a question about whether only GAAP information should be included in the financial statements (that supports the recognition and measurement of the acquisition), and non-GAAP information (that does not support the acquisition price) should not be provided in the financial statements. However, there are challengers to link GAAP and non GAAP information to the acquisition price.
- 47 **Users/investors** had the opposite view to preparers and continue to argue they need better information that explains why major acquisition were made, justifies the price paid and holds management accountable for major acquisitions.

**Questions to EFRAG FR TEG-CFSS**

- 48 Considering feedback from stakeholders in your jurisdiction, do you think the proposals to improve disclosures about business combinations would meet investors need for better information while appropriately considering the costs of disclosing that information?

## **Restructuring and asset enhancement cash flows**

*IASB proposal*

- 49 The IASB is proposing to remove the prohibition to include in the value in use calculation any estimated future cash inflows or outflows expected to arise from future restructurings

or from improving or enhancing the asset's performance. As consequential amendments the IASB provide some guidance on which cash flows to include in a new paragraph 44A, deletes current guidance on application of the removed prohibition in paragraphs 45 to 49 and replaces these with a shortened regulation on how to account for provisions in a new paragraph 44B.

#### *EFRAG DCL*

- 50 EFRAG agrees with the proposal to no longer prohibit the inclusion of cash flows arising from a future restructuring to which the entity is not yet committed or cash flows arising from improving or enhancing an asset's performance, on the basis that it brings the cash flows inputs to the value in use measurement in much better alignment with the internal forecasting.
- 51 However, EFRAG notes that removing these prohibitions leads to a need for guidance on what is, and what is not, to be included as part of uncommitted future restructuring or enhancing an asset's performance.
- 52 Furthermore, where a significant amount of the value in use is derived from uncommitted future restructuring or enhancement of an asset's performance, users would know the extent to which the calculated value in use is influenced by expected uncommitted restructuring and future enhancements. Therefore, further guidance in this regard would be helpful.

#### *What EFRAG has heard so far during the outreaches*

- 53 The proposed amendments to the calculation of value in use has not stirred a large volume of emotions. Preparers are generally supportive of the proposal and do not see significant problems in determining the border of the value in use calculation.
- 54 Users report more scepticism or outright disagreement with the proposal stating that it will provide management with too much leeway to avoid impairments.
- 55 Several constituents noted that value in use becomes closer to fair value less cost to sell and questions if it would be sufficient only to test against fair value less cost of sales.

#### **Questions to EFRAG FR TEG-CFSS**

- 56 Considering feedback from stakeholders in your jurisdiction, do you think the change would help reduce the complexity of the impairment test while enhancing the relevance of information provided to users?
- 57 Can you give examples of additional cash flows that would be included applying the proposals?

## **Impairment test**

#### *IASB proposal*

- 58 The IASB is not proposing to change the impairment test but is proposing clarifications on how to allocate goodwill before the impairment test. Goodwill is to be allocated to the lowest level within the entity at which the business associated with the goodwill is



monitored for internal management purposes. The amendments change the focus from the goodwill itself to the business associated with the goodwill when it comes to the internal monitoring decisive for the goodwill allocation to CGUs or groups of CGUs.

*EFRAG DCL*

- 59 EFRAG supports the proposed amendments regarding goodwill allocation to cash-generating units but notes that the amendment in paragraph 80A(b) could be interpreted in different ways and recommends the IASB to reconsider the drafting of that paragraph. Whilst EFRAG agrees with the idea of allocating goodwill to the lowest level possible, EFRAG is not convinced that the proposed amendments will change much from existing practices.

*What EFRAG has heard so far during the outreaches*

- 60 Preparers report that they do not expect to change behaviour, either because they already allocated goodwill to CGUs below operating segments or because they do not manage goodwill and allocates goodwill to operating segment levels for impairment testing.
- 61 Users report that they are generally not satisfied with the information on goodwill. They want goodwill to be allocated to the lowest CGU levels and they want information on the goodwill allocated to such CGU levels.
- 62 Auditors and standard setters indicate that the proposed amendments may not go far enough to trigger real changes in behaviour. Further guidance should be provided on how goodwill is to be allocated to CGUs below operating segment levels.

**Question to EFRAG FR TEG-CFSS**

- 63 Do you have comments or concerns about the other proposed changes to the impairment test? Considering feedback from stakeholders in your jurisdiction, do you think the proposed changes to IAS 36 would improve the effectiveness and reduce the cost and complexity of the test?