Australian Government
Australian Accounting Standards Board

Staff Paper

Project:	**Business Combinations – Disclosures, Goodwill and Impairment** Proposed amendments to IFRS 3 and IAS 36	**Meeting:**	June 2024 (M204)
Topic:	**Stakeholder feedback, staff analysis and recommendations**	**Agenda Item:** **Date:**	6.1 21 May 2024
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Objective of this agenda item

1 The objective of this agenda item:

(a) To inform the Board about the International Accounting Standards Board (IASB) ED/2024/1 Business Combinations – Disclosures, Goodwill and Impairment*: Proposed amendments to IFRS 3 and IAS 36*, and Basis for Conclusions.

(b) For the Board to consider the staff analysis of stakeholders' feedback and matters for inclusion in the comment letter.

Background

2 In this project, the IASB is exploring whether companies can, at a reasonable cost, provide investors with more useful information about the business combinations that these companies make. The IASB is proposing new disclosures to help users evaluate:

(a) the benefits an entity expects from a business combination when agreeing on the price to acquire a business; and

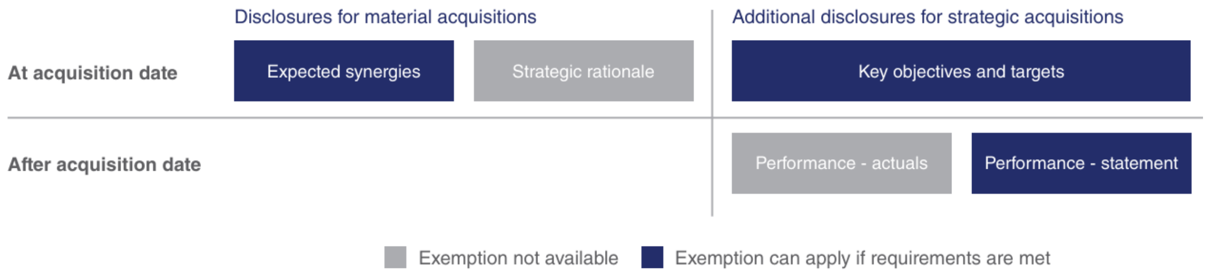
(b) for a strategic business combination, the extent to which the benefits an entity expects from the business combination are being obtained.

3 The IASB's proposals build on its preliminary views expressed in the Discussion Paper Business Combinations – Disclosures, Goodwill and Impairment (DP) published in March 2020 following the IASB's post-implementation review of IFRS 3 *Business Combinations*. Details of the AASB's response to the DP can be found here.

4 In March 2024, the IASB published ED/2024/1 Business Combinations – Disclosures, Goodwill and Impairment*: Proposed amendments to IFRS 3 and IAS 36* (ED2024/1). The due date for comments is 15 July 2024.

5 In March 2024, the AASB issued an Australian equivalent ED – ED329 Business Combinations – Disclosures, Goodwill and Impairment: *Proposed amendments to AASB 3 and AASB 136* (ED329). The due date for comments closed on 3 May 2024.

6 The IASB published an ED – Snapshot which summarises the key disclosure proposals in IFRS 3 as follows:



7 The IASB is also proposing targeted amendments to the requirements in IAS 36 *Impairment of Assets* relating to the calculation of value in use, the allocation of goodwill to cash-generating units and the disclosure requirements. These amendments aim to reduce shielding and reduce management over-optimism.

Outreach activities

8 Staff conducted the following outreach activities to gather views from stakeholders:

(a) 12 April 2024– AASB Disclosure Initiative Advisory Panel (DIAP) meeting where seven members provided feedback to AASB staff and IASB representatives on the ED;

(b) 28 May 2024 – AASB staff attended a roundtable arranged jointly by CPA and CAANZ to obtain the views of their members;

(c) Individual meetings with representatives of seven organisations (preparers and practitioners);

(d) Written submission on ED329 from the Department of Finance.

9 A User Advisory Committee (UAC) meeting will be held on 3 June 2024. Input from UAC members will be provided verbally to the Board.

Feedback from Australian stakeholders, staff analysis and recommendations

10 There are nine questions in the ED. Staff have considered all feedback received in providing their recommendations to the Board.

Question 1— Disclosures: Performance of a business combination (proposed paragraphs B67A–B67G of IFRS 3)
In the PIR of IFRS 3 and in responses to the DP the IASB heard that: • users need better information about business combinations to help them assess whether the price an entity paid for a business combination is reasonable and how the business combination performed after acquisition. In particular, users said they need information to help them assess the performance of a business combination against the targets the entity set at the time the business combination occurred (see paragraphs BC18–BC21). • preparers of financial statements are concerned about the cost of disclosing that information. In particular, preparers said the information would be so commercially

sensitive that its disclosure in financial statements should not be required and disclosing this information could expose an entity to increased litigation risk (see paragraph BC22).

Having considered this feedback, the IASB is proposing changes to the disclosure requirements in IFRS 3 that, in its view, appropriately balance the benefits and costs of requiring an entity to disclose this information. It therefore expects that the proposed disclosure requirements would provide users with more useful information about the performance of a business combination at a reasonable cost.

In particular, the IASB is proposing to require an entity to disclose information about the entity's acquisition-date key objectives and related targets for a business combination and whether these key objectives and related targets are being met (information about the performance of a business combination). The IASB has responded to preparers' concerns about disclosing that information by proposing:

- to require this information for only a subset of an entity's business combinations—strategic business combinations (see question 2); and
- to exempt entities from disclosing some items of this information in specific circumstances (see question 3).

(a) Do you agree with the IASB's proposal to require an entity to disclose information about the performance of a strategic business combination, subject to an exemption? Why or why not? In responding, please consider whether the proposals appropriately balance the benefits of requiring an entity to disclose the information with the costs of doing so.

(b) If you disagree with the proposal, what specific changes would you suggest to provide users with more useful information about the performance of a business combination at a reasonable cost?

<u>Summary of the proposals</u>

11 For strategic business combinations (a subset of material business combinations under IFRS 3), the IASB is proposing (paragraph B67A) to require an entity to disclose the following information (reviewed and monitored by key management personnel (KMP)):

(a) in the year of acquisition, information about the acquisition-date key objectives and the related targets for the business combination. Targets can be disclosed as a range or as a point estimate.

(b) in the year of acquisition and in subsequent reporting periods, information about the extent to which the acquisition-date key objectives and the related targets are being met. Including:

(i) information about actual performance being reviewed to determine whether acquisition-date key objectives and the related targets are being met; and

(ii) a statement of whether actual performance is meeting or has met the acquisition-date key objectives and related targets.

<u>Stakeholder feedback</u>

12 Stakeholders were generally supportive of the proposals to require an entity to disclose information about the performance of strategic business combinations, subject to an exemption. DIAP members highlighted that they agreed with the sentiment of requiring such information for the most important business combinations as it will provide users with better information on the performance of business combinations and help users assess the success of

major acquisitions. Although some stakeholders raised concerns as to whether this information would be better placed in the front half of the annual report, rather than in the financial statements – a concern we heard during outreach on the DP.

13 Some stakeholders raised concerns about what would be considered a strategic business combination, and whether the exemption is sufficient to address commercial sensitivity. These concerns will be discussed in Questions Two and Three respectively.

14 Stakeholders noted that some of this information is already provided in Australia, such as in investor packs, or in an operating and financial review[1] (OFR) which is a key part of annual reporting by listed entities. These stakeholders also acknowledged that such disclosures may not be very detailed, and would vary between companies.

15 DIAP members highlighted concerns around the interaction with the impairment test, such as triggering of impairment testing, and that users may expect that an impairment loss would be recognised, if it was reported in a subsequent period that the acquired business is not meeting the acquisition-date objectives and related targets.

16 DIAP members and other stakeholders noted practical challenges of obtaining information about subsequent performance when the acquired business has been integrated into an entity's existing business.

17 One stakeholder raised a concern about the forward-looking nature of disclosing acquisition-date key objectives and the related targets.

18 One stakeholder noted that comparability will be lacking as it is a management decision on what they monitor.

19 One stakeholder raised a concern about what would be required when there are multiple objectives for a business combination.

20 One stakeholder raised a concern about the audit implications for subsequent performance, and specifically the attribution of an improvement in performance being due to the acquisition and not due to other factors in the rest of the business when integration has occurred.

<u>Staff analysis</u>

21 Staff have considered the concerns raised by stakeholders in paragraphs 15 – 21 in the table below:

Topic	**Staff analysis**
Interaction with the impairment test	Staff consider that the proposed disclosures should not change when an impairment test is triggered, as management should already be considering whether performance is worse than expected in assessing whether there is any indication that an asset may be impaired. Staff agree that users may expect an impairment loss to be recognised if it was reported in a subsequent period that the acquired business is not meeting the acquisition-date objectives

[1] An OFR must set out information that shareholders or unit holders would reasonably require to assess an entity's operations, financial position, and business strategies and prospects for future financial years.

	and related targets. Where this is not the case, staff consider that the disclosures will provide useful information to users.
Practical challenges due to integration into an entity’s existing business	If management intends to quickly integrate the acquired business into an entity’s existing business and review information about a combined business to assess the performance of the business combination, then this information would be disclosed. An entity is not required to create information about the acquired business in isolation if management assesses the performance of a business combination in a different way (paragraphs BC146 – BC147). Staff consider these provisions sufficient to address stakeholders' concerns about what is required when integration quickly occurs.
Forward-looking nature of disclosing acquisition-date key objectives and the related targets	The IASB acknowledges that some aspects of its proposals, particularly in relation to information about the strategic rationale for a business combination, could require the disclosure of forward-looking information (paragraph BC138). However, some IASB members think other information (such as information about acquisition-date key objectives, related targets and expected synergies) is not forward-looking in the context of the Conceptual Framework because the information relates to assumptions for a historic transaction (paragraph BC139). Paragraph 3.6 of the Conceptual Framework supports the disclosure of forward-looking information in financial statements if that information relates to an entity’s assets or liabilities—including unrecognised assets or liabilities—or equity that existed at the end of the reporting period, or during the reporting period, or to income or expenses for the reporting period and is useful to users. In the IASB’s view, the information it proposes requiring an entity to disclose relates to assets the entity has acquired and liabilities it has assumed in a business combination and is useful to users (paragraph BC140 – 141). Staff are supportive of the explanations provided by the IASB about forward-looking information in the Basis for Conclusions, and that the IASB considered feedback on this matter in developing the exemption.
Comparability	Most respondents to the DP agreed with the preliminary view to require an entity to apply a management approach. The IASB expects that applying the management approach would result in an entity disclosing the most useful information about business combinations and minimise the cost of disclosing the information because the information is already being used by an entity (paragraph BC34). Staff understand the concern raised around comparability, however staff consider a management approach will result in the most useful information to users.
Requirements when there are multiple objectives	The IASB explains that some preparers were concerned that requiring an entity to disclose information about all of its objectives and related targets for a business combination could be onerous and could result in material information being obscured. However, the proposals would not require an entity to disclose detailed information about all objectives and their related targets.

	Instead, an entity would be required to disclose only the key objectives —those that are critical to the success of the business combination (paragraph BC36). Staff consider that limiting the disclosures only to key objectives is an important aspect of the proposals, and while it is possible that there could be multiple key objectives, when that is the case, this would be useful information for users to understand.
Audit implications - attribution of performance	In the IASB's view, the information the IASB's proposals would require an entity to disclose is auditable. In the IASB's outreach, preparers said they prepare significant documentation in determining the amount to pay for a business combination and many auditors said they expect to be able to audit that information (paragraph BC144). The IASB expects auditors and regulators will be able to verify: (a) whether the information disclosed is the information an entity's KMP receive to review a business combination. (b) whether there is adequate explanation and appropriate evidence supporting the information. (c) whether the information disclosed faithfully represents what it purports to represent. For example, by requiring the disclosure of information for only strategic business combinations it is more likely that the performance of a combined business is reflective of the performance of the business acquired because strategic business combinations are those that have a more visible effect on the entity's business (paragraph BC145). Staff agree with the concern about the audit implications for subsequent performance, and specifically the attribution of an improvement in performance being due to the acquisition and not due to other factors in the rest of the business, when integration has occurred, and the acquisition date targets are based on the combined operations. Paragraph BC145(c) seeks to address this point by saying <u>it is more likely</u> that the performance of a combined business is reflective of the performance of the business acquired because strategic business combinations are those that have a more visible effect on the entity's business. Staff do not consider that this is sufficient to address the auditability concern and recommends that the IASB works with the IAASB and auditors on this point. With regards to acquisition date key objectives and targets, we note that there is a difference between the auditor opining on the fact that this information does faithfully represent management's view, versus that the objectives and targets seem reasonable / achievable. This could contribute to the user expectation gap of what an audit does or does not cover.

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

23 The AASB in response to the DP:

- Did not support the requirement to disclose information about the subsequent performance of acquisitions, including the metrics used by the CODM to monitor these acquisitions in the financial statements.
- Noted that the objective of the financial statements is to help ensure that the financial statements provide “relevant information that faithfully represents an entity’s assets, liabilities, equity, income and expenses” and questioned whether the proposed subsequent performance disclosures are required to meet this objective, or whether this information is better addressed by the IASB's project to revise the *Management Commentary Practice Statement*, seeing that the aim of the management commentary is to provide primary users of financial reports with information that is useful in assessing the management’s stewardship of the entity’s economic resources.
- Noted that some stakeholders expressed concerns regarding the auditability of the proposed disclosures, and suggested that this is discussed with the International Auditing and Assurance Standards Board (IAASB) to ensure the disclosure requirements are sufficiently specific and detailed and auditable.

24 The IASB acknowledges that many respondents questioned whether the information should be required in an entity’s financial statements or whether the information would be better suited to another document such as management commentary (paragraph BC9). The IASB considered this feedback but, for the reasons discussed below, concluded that it can and should require the information to be disclosed in financial statements (paragraph BC134).

25 The description of the notes to the financial statements the IASB developed in its Primary Financial Statements project explains that the role of the notes is to provide material financial information necessary:

(a) to enable users to understand the line items presented in the primary financial statements; and

(b) to supplement the primary financial statements with additional financial information to achieve the objective of financial statements (paragraph BC136).

Information about an entity’s acquisition-date key objectives and the related targets for a business combination and expected synergies provides information about the acquisition price for the business combination. The IASB observes that the acquisition price is reflected in the financial statements through the recognition of assets acquired and liabilities assumed in the business combination, including goodwill (paragraph BC137).

26 The IASB observed that not all entities produce a management commentary, and when an entity does so, this commentary might not be as readily available as financial statements. Requiring the information to be disclosed in financial statements would ensure all entities disclose this information in a consistent manner (paragraph BC143).

27 Staff consider that the concerns raised by the AASB, and many others, on this topic in response to the DP, have been considered by the IASB. The new package of proposals, and the basis on which they are determined, has been significantly amended from those in the DP. For example, the new proposals are based on information reviewed by KMP, rather than the CODM (this aspect is discussed further in Question 4), an exemption has been developed, and if management revises the metrics, disclosure based on the new metrics is no longer required.

28 Staff note that in consultation on the ED, our stakeholders have not raised significant concerns with us about whether this information belongs in the financial statements, although as discussed above, some concerns have been raised about auditability, and about the forward-looking nature of some of the proposals.

29 With regards to the IASB's Management Commentary project, the IASB met on 20 March 2024 to receive an update on this project. The IASB will be asked in a future board meeting to determine the direction for the Management Commentary project and to make decisions on the scope of the resulting work following the determination of the ISSB's priorities for its next two-year workplan.

<u>Staff recommendations</u>

30 Taking all of the above into account, staff recommend that in the comment letter the AASB:

(a) acknowledge the AASB concerns, as provided in response to the DP, on location and auditability of the disclosures;

(b) express that, notwithstanding these concerns, given the direction of travel, we support the revised proposals to require an entity to disclose information about the performance of a strategic business combination, subject to an exemption; and

(c) highlight the remaining specific concerns around auditability.

Question for Board members

Q1 Do Board members agree with the staff recommendations in paragraph 30? If not, what would Board members suggest?

Question 2— Disclosures: Strategic business combinations (proposed paragraph B67C of IFRS 3)
The IASB is proposing to require an entity to disclose information about the performance of a business combination (that is, 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—a subset of material business combinations. A strategic business combination would be one for which failure to meet any one of an entity's acquisition-date key objectives would put the entity at serious risk of failing to achieve its overall business strategy. The IASB is proposing that entities identify a strategic business combination using a set of thresholds in IFRS 3—a business combination that met any one of these thresholds would be considered a strategic business combination (threshold approach) (see paragraphs BC56–BC73). The IASB based its proposed thresholds on other requirements in IFRS Accounting Standards and the thresholds regulators use to identify particularly important transactions for which an entity is required to take additional steps such as providing more information or holding a shareholder vote. The proposed thresholds are both quantitative (see paragraphs BC63–BC67) and qualitative (see paragraphs BC68–BC70). (a) Do you agree with the proposal to use a threshold approach? Why or why not? If you disagree with the proposal, what approach would you suggest and why? (b) If you agree with the proposal to use a threshold approach, do you agree with the proposed thresholds? Why or why not? If not, what thresholds would you suggest and why?

<u>Summary of the proposals</u>

31 The IASB considered two ways to identify strategic business combinations:

(a) by applying an open list of factors (open-list approach); or

(b) by applying a closed list of thresholds (closed-list approach).

32 The IASB acknowledged that an approach based on an open list of factors for an entity to consider whether the acquisition was "strategic" would be more principles-based. However, the IASB also considered that such an approach could pose practical challenges. For example, it might be difficult to devise a list of factors that are distinguishable from factors that an entity would consider when making materiality judgements and therefore not capture acquisitions that are strategic to the acquirer. It might also lead to a high level of judgement and result in difficulties to audit and enforce, leading to higher costs.

33 The IASB is proposing a closed-list approach to assessing whether a business combination is strategic by setting quantitative thresholds and qualitative thresholds (a threshold approach).

34 The IASB proposes that a business combination that meets <u>any one</u> of these thresholds would be a strategic business combination:

(a) quantitative thresholds—any one of revenue, operating profit or loss in absolute terms and assets of the acquired business (including goodwill) constitutes at least 10% of the acquirer's corresponding amounts; or

(b) qualitative thresholds—the acquisition results in a company entering a new major line of business or geographical location (paragraph B67C).

35 The IASB noted that quantitative thresholds (ranging between 5% and 30%) are commonly used in some regulations to require an entity to provide information about business

combinations. The proposed quantitative thresholds are also based on measures defined in IFRS Accounting Standards, for example, IFRS 8 *Operating Segments* uses a 10% threshold to identify the operating segments that are large enough for which an entity is required to disclose information separately.

36 The IASB considered that the objective in setting qualitative thresholds is to capture business combinations that would not meet the proposed quantitative thresholds but are nonetheless strategic because they would represent a strategic shift for an entity. These business combinations include those that would result in the entity entering a new major line of business or geographical area of operations and are based on the thresholds in paragraph 32 of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* used to identify discontinued operations and adapted to reflect the purchase of a business instead of the discontinuance of an operation.

<u>Stakeholder feedback</u>

37 Stakeholder feedback on the threshold approach, and on the specific thresholds has been mixed. Specifically;

(a) DIAP members had concerns with quantitative thresholds being used, and preferred a hybrid approach, which would involve some quantitative thresholds being determinative, and others being used as a guide, alongside other factors.

(b) One stakeholder noted that academic research shows that whenever there is a set quantitative threshold, clustering around that threshold then occurs. This stakeholder supported using quantitative thresholds as a guide, rather than a rule, noting it would be more principles-based.

(c) Preparers and practitioners generally supported the threshold approach, however had concerns about the specific proposed quantitative and qualitative thresholds, noting the following:

    (i) The quantitative thresholds are too low, and it may be easy to meet one of the thresholds depending on the business type (for example, service businesses and the asset threshold). These stakeholders recommended that more than one measure should be met for a business combination to be considered strategic.

    (ii) The asset threshold will result in comparing the acquired business at fair value, including goodwill, against the acquirer's business which may have assets recorded at historical cost. Depending on the nature of the businesses (for example, a bio-tech company, or an exploration company), the assets threshold could be very easy to exceed. This stakeholder recommended a hybrid approach, where the asset threshold is excluded from the closed-list approach to thresholds, but would be considered by an entity alongside other factors, only if the revenue and operating profit thresholds were not met.

    (iii) In an unusual performing year, a business combination could be classified as strategic even if this would not be the case in other years. These stakeholders recommended that using an average over a certain period would be preferable. Other stakeholders disagreed with this suggestion, noting the complexities it would introduce and that the most recent period would be the most relevant when making acquisition decisions.

    (iv) The qualitative thresholds will be subject to interpretation, may be challenging to apply, and may not capture the appropriate business combinations. For example, some stakeholders questioned whether the term 'major' related to both the thresholds i.e. 'lines of business' and 'geographies', or just the former, and also noted that a small acquisition in a new geography may not really be strategic and might be just testing the market. One stakeholder raised a concern that there could be the unintended consequence of impacting how IFRS 5 is applied, for example, this qualitative threshold, combined with the quantitative thresholds, suggests that 'major' can be items which are less than 10% of revenue, operating profit or loss, or assets.

(d) One stakeholder questioned whether the revenue and operating profit numbers of the acquiree used in the threshold calculation need to be prepared in accordance with IFRS Accounting Standards or not, and suggested that this should be made clear.

<u>Staff analysis</u>

38 Stakeholders have expressed concerns with the closed-list approach, and / or with the specific thresholds proposed and staff understand these concerns. Staff acknowledge that there are trade-offs when choosing between an open-list approach and a closed-list approach, and that the IASB has sought to balance these in making its proposals. Staff consider that there is an opportunity to improve the outcome by taking a hybrid approach.

39 Specifically, staff do not support the proposal to identify a strategic business combination based solely on a closed-list approach using a specific set of thresholds, as we do not think it will result in capturing the intended population of acquisitions. Rather we recommend a hybrid approach as described in the following table, together with the rationale:

40

Step	Requirement	Rationale
Step One: Apply the threshold approach (closed-list approach)	A business combination is a strategic business combination if in the most recent annual reporting period before the acquisition date: (a) the absolute amount of the acquiree's operating profit or loss is 10 per cent or more of the absolute amount of the acquirer's consolidated operating profit or loss[2];or (b) the acquiree's revenue is 10 per cent or more of the acquirer's consolidated revenue[3].	Stakeholders were generally comfortable that the revenue and operating profit thresholds should pick up the intended population of business combinations. By making this Step One, if either threshold is met, then management does not need to move to Step Two where judgment will need to be applied. Because we would expect that this would capture the vast majority of strategic business combinations, the benefits of a closed-list approach will be realised, which are that it will be easier to apply, audit and enforce, leading to lower costs.
Step Two: If neither of the thresholds in Step One are met, then apply the open-list approach	An entity applies judgement to consider whether a business combination meets the description of a strategic business combination: A strategic business combination would be one for which failure to meet any one of an entity's acquisition-date key objectives would put the entity at serious risk of failing to achieve its overall business strategy (paragraph BC54).	By making Step Two an open-list approach, which is more principles-based, it will allow for business combinations entered into for different strategic needs to be captured, thus maximising the benefits of an open-list approach, whilst minimising the costs of application because it is only applied to the subset of business combinations which did not meet the thresholds in Step One.
Step Two continued	Factors an entity would consider when assessing whether a business combination meets that description are listed below. The factors would be neither individually determinative nor exhaustive.	Per paragraph BC55, in the IASB's view an entity's overall business strategy could be put at serious risk if, for example, the entity committed a large amount of capital to a business combination that subsequently failed to meet the entity's expectations, or failed to enter major new lines of

[2] Aligns with paragraph B67C(a)(i)

[3] Aligns with paragraph B67C(a)(ii)

Factors to consider	An entity's overall business strategy could be put at serious risk if, for example, the entity: (1) committed a large amount of capital to a business combination that subsequently failed to meet the entity's expectations (paragraph BC55(a)). In making this assessment an entity may consider whether: (a) the amount recognised as of the acquisition date for all assets acquired (including goodwill) is 10 per cent or more of the carrying amount of the total assets recognised in the acquirer's consolidated statement of financial position as at the acquirer's most recent reporting period date before the acquisition date (paragraph B67C); (b) the amount recognised as of the acquisition date for all assets acquired (including goodwill) is 10 per cent or more of the acquirer's market capitalisation as of the acquisition date. (2) failed to enter major new lines of business or geographies that are essential to the entity's overall business strategy through the business combination (paragraph BC55(b)).	business or geographies that are essential to the entity's overall business strategy through the business combination. Staff consider that this rationale should be factored into the open-list approach in Step Two. With regards to the asset threshold, stakeholders had concerns that it will result in comparing the acquired business at fair value, including goodwill, against the acquirer's business which may have assets recorded at historical cost. Some stakeholders preferred a comparison to market capitalisation. The IASB noted that they did consider this but rejected it on the basis that a threshold based on market capitalisation would not be applicable for non-listed entities (paragraph BC64). Staff consider that a benefit of using a hybrid approach is that management can look at the asset threshold through the lens of whether the entity's overall business strategy could be put at serious risk. Further, both total assets and market capitalisation can be considered by entities when relevant and then based on the full facts and circumstances, management can determine whether the business combination is strategic. With regards to the qualitative thresholds, staff are of the view that they are better suited to an open-list approach and by framing them so that management views them through the lens of whether an entity's overall business strategy could be put at serious risk. For example, an entity may enter into a new major line of business or geographical area of operations for many reasons, for example, to test the market without further plans at that time to expand into that new line of business or geographical area – stakeholders considered that such business combinations may not meet the definition of strategic.

41 A hybrid approach, if designed and implemented appropriately, would maximise the benefits of the closed-list and open-list approaches while minimising the costs.

42 Staff also noted two areas requiring clarification:

(a) Staff do not consider it is clear whether the revenue and operating profit numbers of the acquiree used in the threshold calculation need to be prepared in accordance with IFRS Accounting Standards or not. We recommend that this should be stated in paragraph B67C and in the Basis for Conclusions.

(b) There is inconsistency in the ED on terminology for the qualitative thresholds as to whether they are 'major new lines of business or geographies' (paragraph BC55) or 'new major line of business or geographical area of operations' (paragraphs B67C and BC68). This inconsistency adds to the confusion raised by stakeholders as to whether the term 'major' relates to both the thresholds i.e. 'lines of business' and 'geographies', or just the former. If the IASB continues with these thresholds, then we recommend that the IASB removes the inconsistency and clarifies whether 'major' relates to both qualitative thresholds.

Staff recommendations

43 Staff recommend that in the comment letter we put the focus on:

(a) Disagreeing with the closed-list approach;

(b) Proposing an alternative hybrid approach as specified in the table above.

Question for Board members

Q2 Do Board members agree with the staff recommendations in paragraph 43? If not, what would Board members suggest?

Question 3— Disclosures: Exemption from disclosing information (proposed paragraphs B67D–B67G of IFRS 3)
The IASB is proposing to exempt an entity from disclosing some of the information that would be required applying the proposals in this ED in specific circumstances. The exemption is designed to respond to preparers' concerns about commercial sensitivity and litigation risk but is also designed to be enforceable and auditable so that it is applied only in the appropriate circumstances (see paragraphs BC74–BC107). The IASB proposes that, as a principle, an entity be 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 (see paragraphs BC79–BC89). The IASB has also proposed application guidance (see paragraphs BC90–BC107) to help entities, auditors and regulators identify the circumstances in which an entity can apply the exemption. (a) Do you think the proposed exemption can be applied in the appropriate circumstances? If not, please explain why not and suggest how the IASB could amend the proposed principle or application guidance to better address these concerns. (b) Do you think the proposed application guidance would help restrict the application of the exemption to only the appropriate circumstances? If not, please explain what application guidance you would suggest to achieve that aim.

<u>Summary of the proposals</u>

44 When developing the DP, the IASB did not propose an exemption for any of the disclosure requirements, on the basis that information should not be prevented from being disclosed solely on the basis that it is commercially sensitive (BC74–BC78). In response to the DP, respondents expressed various concerns on the proposed disclosures, with the predominant issue being commercial sensitivity.

45 To strike a balance between preparers' concerns and users' information needs, the IASB is now proposing an exemption that would permit entities not to disclose some information in specific circumstances.

46 The IASB has proposed to permit the application of the exemption only to the disclosure of:

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

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

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

47 The IASB does not propose the exemption for the disclosure requirements about:

(a) the strategic rationale for the business combination; and

(b) the actual performance being reviewed to determine whether acquisition-date key objectives and the related targets are being met.

48 To make the proposed exemption operational and enforceable, the IASB is providing application guidance requiring an entity, as per paragraphs BC90-BC107:

(a) to disclose the fact that the exemption has been applied and the reasons for doing so, for each item of information to which it has been applied;

(b) to consider whether, instead of applying the exemption, information can be disclosed differently without seriously prejudicing the acquisition-date key objectives (e.g., at a sufficiently aggregated level);

(c) to consider factors such as the effect of disclosing the information and the public availability of the information to determine the applicability of the exemption; and

(d) to reassess in each reporting period whether the item of information still qualifies for the exemption. If the exemption is no longer appropriate, the entity must disclose the previously exempted item of information.

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

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

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

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

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

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

The IASB sees no basis to propose an exemption under such circumstances, since the risk is no different from litigation risk that arises from disclosing forward looking information that is required by other IFRS Accounting Standards. However, litigation risk arising from an entity failing to meeting its key objectives for the business combination because it disclosed the information would be addressed by the exemption.

<u>Stakeholder feedback</u>

51 DIAP members and other stakeholders were supportive of an exemption being available, noting that it is practical and necessary. However, these stakeholders also expressed concerns about the application of the exemption and its scope. Specifically,

(a) Stakeholders highlighted that the exemption does not fully address the matter of commercial sensitivity.

(i) The fact that the exemption is designed only to apply to the disclosure of information that can be expected to prejudice seriously the achievement of any of the acquirer's acquisition-date key objectives for the business combination rather than prejudicing seriously the entity as a whole, makes it too limited. For example, a preparer noted that disclosure of a hurdle rate[4], could prejudice seriously future acquisitions because a competitor could use that information to outbid the entity in future deals. Those future deals are unlikely to relate to the acquisition-date key objectives for the current business combination, and thus the exemption would not apply.

[4] A hurdle rate, also known as a minimum acceptable rate of return (MARR), is the lowest rate of return managers or investors expect to receive on an investment or a project.

(ii) The requirement to disclose each item of information to which the exemption has been applied, and the reason, could itself result in disclosing commercially sensitive information.

(b) One stakeholder suggested that there will be a lack of consistency in application, and that examples of when it could and could not be applied would be beneficial.

(c) One stakeholder suggested aligning the exemption wording with the exemption in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* to say that the IASB expects the application of the exemption to be extremely rare. This stakeholder highlighted that the IASB has said that the IAS 37 exemption is working well in practice (paragraph BC80(b)), therefore, it would make sense to more closely align with this wording.

(d) A number of stakeholders noted that the exemption wording itself is confusing and hard to follow. For example, two stakeholders questioned whether the interaction between paragraph B67G and B67A(a) means that in subsequent periods the acquisition date targets do not need to be disclosed if the exemption applied in year one, on the basis that targets are only required to be disclosed in the year of acquisition.

(e) One stakeholder suggested that there might be greater consistency in making disclosures if there is no exemption, but rather only higher-level information is required (for example, by not requiring quantitative information).

<u>Staff analysis</u>

52 We support the IASB's efforts to address some of the concerns expressed in the feedback on the DP, by proposing an exemption to some items of information in specific circumstances.

53 We acknowledge that it is important for users to receive at least some information on the business combination and its performance, which should not be exempted, and therefore agree with the IASB's proposal not to exempt entities from disclosing the strategic rationale and the actual performance of the strategic business combination.

54 We do have concerns that the exemption does not sufficiently address the matter of commercial sensitivity. With regards to the specific issues raised by our stakeholders, we note:

(a) Paragraph BC80 explains that linking the exemption to acquisition-date key objectives for a business combination provides a direct link to the outcome of the business combination to which the information relates, without needing to define specific situations. Whilst we understand the rationale behind the IASB's approach, we share the concern that restricting the exemption to disclosure of information that can be expected to prejudice seriously the achievement of any of the acquirer's acquisition-date key objectives for the business combination rather than prejudicing seriously the entity, makes it too limited. We recommend the exemption be widened to include disclosure of information that can be expected to prejudice seriously the entity.

(i) In Australia, the Corporations Act provides an exemption from disclosing information about business strategies and prospects for future financial years in an OFR, if disclosure of that information is likely to result in 'unreasonable prejudice' to the entity. Relying on the unreasonable prejudice exemption requires consideration of whether there is unreasonable prejudice and whether it is likely to occur. The Regulatory Guide RG 247 *Effective disclosure in an operating and financial review*, published by the Australian Securities and Investments Commission, provides guidance on unreasonable prejudice.

(b) Paragraph BC93 explains that an entity applying the proposed exemption to an item of information would be required to disclose in its financial statements both the fact it applied the exemption and the reason it has not disclosed the item of information. This requirement is similar to the requirement in paragraph 92 of IAS 37. Stakeholders were concerned that this requirement could itself result in disclosing commercially sensitive information. We acknowledge this concern but consider that this approach appears to be working well in practice in IAS 37 and appropriately balances the needs for the exemption, with providing important information to users.

55 With regards to the interaction between paragraph B67G and B67A(a) and whether this means that in subsequent periods the acquisition date targets do not need to be disclosed if the exemption applied in year one, we note that in BC105 it explains that the IASB decided to include in its application guidance a requirement for an entity to reassess at the end of each reporting period whether the item of information still qualifies for the exemption. If it is no longer appropriate to apply the exemption, the entity would be required to disclose that information. For example, if an entity applies the exemption to a target in the year of acquisition, but in the following year the reason for applying the exemption no longer exists, the entity would be required to disclose in the second year what that target was. While we think this requirement has been adequately explained in B67G, further clarification of B67A(a) may be required as the paragraph states that targets are only required to be disclosed in the year of acquisition.

56 With regards to the suggestion from one stakeholder that there might be greater consistency in making disclosures if there is no exemption, but rather only higher-level information is required, we note that BC77 explains that the IASB considered but rejected other alternatives, such as requiring an entity to disclose only qualitative information in the year of acquisition—this alternative would fail to adequately resolve all preparers' concerns about information being commercially sensitive. It could also result in users receiving insufficient information to allow them to understand the benefits expected from a business combination and the extent to which the objectives for a business combination are being met. We are supportive of the IASB's position on this.

Staff recommendations

57 Staff recommend that the comment letter focuses on:

(a) Expressing support for having an exemption in specific circumstances, and application guidance to restrict the application of the exemption to only the appropriate circumstances.

(b) Providing a recommendation that the specific circumstances be widened to those which could seriously prejudice the entity as a whole, rather than being tied to acquisition-date key objectives.

Question for Board members

Q3 Do Board members agree with the staff recommendations in paragraph 57? If not, what would Board members suggest?

Question 4— Disclosures: Identifying information to be disclosed (proposed paragraphs B67A–B67B of IFRS 3)
The IASB is proposing to require an entity to disclose information about the performance of the entity's strategic business combinations (that is, information about its acquisition-date key objectives and related targets for a strategic business combination and whether these key objectives and related targets are being met) that is reviewed by its key management personnel (see paragraphs BC110–BC114). The IASB's proposals would require an entity to disclose this information for as long as the entity's key management personnel review the performance of the business combination (see paragraphs BC115–BC120). The IASB is also proposing (see paragraphs BC121–BC130) that if an entity's key management personnel: • do not start reviewing, and do not plan to review, whether an acquisition-date key objective and the related targets for a business combination are met, the entity would be required to disclose that fact and the reasons for not doing so; • stop reviewing whether an acquisition-date key objective and the related targets for a business combination are met before the end of the second annual reporting period after the year of acquisition, the entity would be required to disclose that fact and the reasons it stopped doing so; and • have stopped reviewing whether an acquisition-date key objective and the related targets for a business combination are met but still receive information about the metric that was originally used to measure the achievement of that key objective and the related targets, the entity would be required to disclose information about the metric during the period up to the end of the second annual reporting period after the year of acquisition. (a) Do you agree that the information an entity should be required to disclose should be the information reviewed by the entity's key management personnel? Why or why not? If not, how do you suggest an entity be required to identify the information to be disclosed about the performance of a strategic business combination? (b) Do you agree that: (i) an entity should be required to disclose information about the performance of a business combination for as long as the entity's key management personnel review that information? Why or why not? (ii) an entity should be required to disclose the information specified by the proposals when the entity's key management personnel do not start or stop reviewing the achievement of a key objective and the related targets for a strategic business combination within a particular time period? Why or why not?

<u>Summary of the proposals</u>

58 The IASB is proposing to specify management as an entity's KMP as defined in IAS 24 *Related Party Disclosures*. The DP proposed to require an entity to disclose information about the performance of a business combination reviewed by the entity's chief operating decision maker (CODM), as described in IFRS 8 *Operating Segments*.

59 The IASB decided to specify management as an entity's KMP, as the term:

(a) has similar benefits to using CODM, utilising terminology within IFRS Accounting Standards; and

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

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

61 The management approach gives consistency between what is reported to users and what is reported to management internally and should:

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

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

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

62 The proposals include a core disclosure period, and a specified time frame:

(a) The core disclosure period is for as long as KMP are reviewing the information; management is regarded as reviewing if management compares actual performance in subsequent periods with the acquisition-date key objectives and the related targets for the business combination.

(b) The specified time frame (two full years after the year of acquisition of a business combination) triggers additional disclosure requirements if management do not start reviewing, and do not plan to review, or stop reviewing. The Basis for Conclusions explains that the proposed specified time frame is an appropriate balance between requiring an entity to disclose relevant information and the risk of imposing a time frame that is too long and onerous for preparers.

Stakeholder feedback

63 DIAP members and other stakeholders supported using KMP, as the level of management monitoring information that would require disclosure for 'strategic' business combinations. There was general support for the proposed timeframe, however, some stakeholders noted that it appears arbitrary and others noted that integration often happens in a much shorter period.

64 DIAP members and other stakeholders highlighted some practical application concerns. Specifically:

(a) Preparers highlighted that they typically review the performance on an ad hoc basis, rather than annually. They questioned what would be expected for reporting purposes when management monitors the performance of the acquisition on a different cycle from the financial reporting period.

(b) One stakeholder noted that some data may be collated over a long period of time, but not for monitoring purposes. They questioned if the KMP is still receiving the information but not reviewing it, whether the entity would be required to prepare the relevant disclosures. This was echoed by another stakeholder who noted that in practice the pack is prepared for KMP by a junior staff member, KMP may, or may not, then review or use this information.

<u>Staff analysis</u>

65 We agree with the IASB's proposal to define a level of management and that the appropriate level of management should be the entity's KMP.

66 We also support the IASB's proposal to disclose information about the performance of a business combination for as long as the entity's KMP continues to monitor it against its acquisition-date key objectives and targets.

67 In cases when an entity's KMP has not started reviewing and does not plan to review the required information, we also support the proposal for an entity to disclose that fact and the reasons for not reviewing the information, as it will be useful for users to understand why an entity does not monitor a strategic business combination.

68 We noted stakeholder concerns about what is required when KMP receives information, but does not necessarily review or use this information.

(a) During the proposed specified time period (two full years after the year of acquisition of a business combination), we agree that it is a reasonable minimum period for the information to be disclosed, when KMP still receive that information. Users need to receive information about a 'strategic' business combination for a reasonable period of time, whilst preparers do not want to disclose information indefinitely, as that would be onerous and costly.

(b) After that specified time period, even if KMP are still receiving the information, if KMP are not reviewing the actual performance of the strategic business combination against its acquisition-date key objectives and the related targets there is no requirement to disclose. We agree with this proposal and consider that it addresses concerns raised by our stakeholders.

69 With regards to what would be expected for reporting purposes when management monitors the performance of the acquisition on a different cycle from the financial reporting period, we do not think this is sufficiently clear in the proposals.

(a) In response to the DP one concern highlighted by preparers related to post-acquisition reviews—some respondents said information is sometimes reported to an entity's management as part of a post-acquisition review, instead of on a regular basis. This post-acquisition review is a one-off review that might take place a few years after a business combination occurs. An entity reviews assumptions made in the business plan prepared as part of the business combination and compares those assumptions against actual outcomes (paragraph BC118).

(b) The IASB explains in paragraph BC120(c) that the core time period would capture ad hoc information reviewed by an entity's management—for example, from 'post-acquisition reviews' described in paragraph BC118(b).

(c) Our understanding of this is that at each reporting period, if KMP reviewed the actual performance of the strategic business combination against its acquisition-date key objectives and the related targets, at any time during that reporting period, that is the information it would disclose, i.e. the information does not need to align with the end of reporting period date. We think this should be specified more clearly in the requirements.

(d) For completeness, staff consider that in the reporting periods before this review takes place the entity should disclose:

   (i) the reasons it has not yet started reviewing whether an acquisition-date key objective and the related targets for a business combination are met; and

   (ii) when it plans to start reviewing whether an acquisition-date key objective and the related targets for a business combination are met.

<u>Staff recommendations</u>

70 Staff recommend that in the comment letter we express:

(a) Support that the information an entity should be required to disclose should be the information reviewed by the entity's KMP.

(b) Support for requiring disclosure of information about the performance of a business combination for as long as the entity's KMP review that information.

(c) Support for disclosing the information specified by the proposals when the entity's KMP do not start, and do not plan to start, or stop reviewing the achievement of a key objective and the related targets for a strategic business combination within a particular time period.

(d) A recommendation that the requirements specify that at each reporting period, if KMP reviewed the actual performance of the strategic business combination against its acquisition-date key objectives and the related targets, at any time during that reporting period, that is the information it would disclose.

(e) A recommendation that the requirements specify that at each reporting period, if KMP have not started reviewing the actual performance of the strategic business combination against its acquisition-date key objectives and the related targets, that it should disclose that fact, and when it plans to perform this review.

Question for Board members

Q4 Do Board members agree with the staff recommendations in paragraph 70? If not, what would Board members suggest?

Question 5— Disclosures: Other proposals

The IASB is proposing other amendments to the disclosure requirements in IFRS 3. These proposals relate to:

New disclosure objectives (proposed paragraph 62A of IFRS 3)

The IASB proposes to add new disclosure objectives in proposed paragraph 62A of IFRS 3 (see paragraphs BC23–BC28).

Requirements to disclose quantitative information about expected synergies in the year of acquisition (proposed paragraph B64(ea) of IFRS 3)

The IASB proposes:

• to require an entity to describe expected synergies by category (for example, revenue synergies, cost synergies and each other type of synergy);

  • to require an entity to disclose for each category of synergies:

  • the estimated amounts or range of amounts of the expected synergies;

  • the estimated costs or range of costs to achieve these synergies; and

  • the time from which the benefits expected from the synergies are expected to start and how long they will last; and

• to exempt an entity from disclosing that information in specific circumstances. See paragraphs BC148–BC163.

<u>The strategic rationale for a business combination (paragraph B64(d) of IFRS 3)</u>

The IASB proposes to replace the requirement in paragraph B64(d) of IFRS 3 to disclose the primary reasons for a business combination with a requirement to disclose the strategic rationale for the business combination (see paragraphs BC164–BC165).

Contribution of the acquired business (paragraph B64(q) of IFRS 3)

The IASB proposes to amend paragraph B64(q) of IFRS 3 to improve the information users receive about the contribution of the acquired business (see paragraphs BC166–BC177). In particular, the IASB proposes:

• to specify that the amount of profit or loss referred to in that paragraph is the amount of operating profit or loss (operating profit or loss will be defined as part of the IASB's Primary Financial Statements project);

• to explain the purpose of the requirement but add no specific application guidance; and

• to specify that the basis for preparing this information is an accounting policy.

Classes of assets acquired and liabilities assumed (paragraph B64(i) of IFRS 3)

The IASB proposes to improve the information entities disclose about the pension and financing liabilities assumed in a business combination by deleting the word 'major' from paragraph B64(i) of IFRS 3 and adding pension and financing liabilities to the illustrative example in paragraph IE72 of the Illustrative Examples accompanying IFRS 3 (see paragraphs BC178–BC181).

Deleting disclosure requirements (paragraphs B64(h), B67(d)(iii) and B67(e) of IFRS 3)

The IASB proposes to delete some disclosure requirements from IFRS 3 (see paragraphs BC182–BC183).

Do you agree with the proposals? Why or why not?

Summary of the proposals

71 The IASB is also proposing other amendments to the disclosure requirements in IFRS 3, including new information, clarifying some of the current requirements and deleting some of the disclosure requirements deemed to be obsolete.

72 The feedback we have received has been focused on expected synergies, thus we have summarised the requirements on this aspect of the proposals below.

73 The DP proposed to add to IFRS 3 quantitative information on expected synergies which included a description of the synergies expected from combining the operations of the acquired business with the company's business, when the synergies are expected to be realised, the estimated amount or range of amounts of the synergies, and the estimated cost or range of costs to achieve those synergies.

74 Users of financial statements have said that information on the nature, timing and amount of expected synergies is important and useful for their analysis. It would allow them to:

(a) understand better the benefits a company's management expected when agreeing the price to acquire a business.

(b) assess whether the price paid was reasonable.

(c) hold management to account for its progress in achieving those synergies.

75 However, many respondents to the DP, including respondents that agreed that the proposed information was useful, disagreed with the DP proposals noting that the information was commercially sensitive (and should not be required in the financial statements), forward-looking in their jurisdiction, and could expose the entity to litigation risks.

76 The IASB decided to proceed with the DP proposals on requiring information on expected synergies about the business combination at the acquisition date, subject to some amendments. As noted by users of financial statements, it was important for their analysis. The IASB also observed that many entities already provide information on expected synergies outside of the financial statements – so the information is already available.

77 In developing the proposals, and noting the suggestions by respondents to the DP, the IASB considered the following:

(a) Level of aggregation at which an entity should disclose the information. The IASB is proposing to require an entity to disclose information about the nature of expected synergies by category - for example, total revenue synergies, total cost synergies and totals for each other type of synergy (e.g., tax synergies). In the IASB's view, disclosing information about expected synergies by category would, in most cases, respond to concerns that expected synergy information could be commercially sensitive. The IASB is also proposing to allow an entity to apply the proposed exemption (see Question 3) described to information about expected synergies. However, before applying the exemption an entity would be required to consider whether, instead of applying the exemption, disclosing the total amount of expected synergies could resolve concerns about commercial sensitivity. The IASB expects information at a total synergies level would not be as sensitive as information specified by category.

(b) Duration of expected synergies – In responding to feedback received on the DP, the IASB is proposing an entity to disclose the time from which the synergies are expected to start and how long they are expected to last. In applying this requirement, the entity would have to identify whether the synergies are expected to be finite or indefinite.

(c) Definition of expected synergies - The IASB considered, and decided not to, provide a definition for synergies. The IASB observed that some respondents to the ED said a lack of definition might lead to diversity in how entities identify and quantify expected synergies and thus reduce the information usefulness to users of financial statements. However, the IASB noted that the term “synergies” is already understood by entities given that paragraph B64(e) of IFRS 3 requires an entity to disclose qualitative information about expected synergies. It is expected that when synergies are a material aspect of the business combination, entities should be able to quantify them.

(d) Interaction on information about expected synergies and performance of a business combination – Some respondents to the DP asked for clarity on the proposals for performance information and expected synergies and noted difficulties to provide information on synergies in periods after the business combination occurs. The IASB explains in paragraph BC162 that these two proposals are separate. The proposed requirement for an entity to disclose information about expected synergies would apply only in the year of acquisition. It would not require an entity to disclose information subsequently about whether those synergies have been achieved. The IASB also explains that the entity’s KMP might assess whether expected synergies have been achieved in reviewing the performance of the business combination. If this is the case, the proposals on disclosing information about the performance of a business combination would require the entity to disclose the information about synergies being reviewed by the entity’s KMP.

Stakeholder feedback

78 Stakeholders expressed concerns about the proposals on expected synergies noting:

(a) There will be difficulties quantifying expected synergies and splitting them into categories;

(b) This approach may be different from how management assesses what the expected benefits of an acquisition would be;

(c) It will be highly subjective due to its forward-looking nature, which will also make it challenging and costly to audit;

(d) The benefits to users may not exceed the costs of preparing the information and producing audit evidence that assumptions are ‘reasonable and supportable’.

(e) The proposals will increase the user expectation gap on what an audit involves. For example, will auditors be opining on whether they agree that the disclosed synergies are management’s view, or that the synergies are reasonable and supportable, and will users be able to tell what the auditors have opined on.

79 One stakeholder suggested that a management approach should be applied in this area, for the same rationale that a management approach has been applied to acquisition date key objectives and targets. Rather than requiring disclosures of synergies, a management approach would require entities to make disclosures about the principles followed and governance processes in place that management used to decide whether to enter into the acquisition. This stakeholder noted that this would be similar to risk management disclosures required in IFRS 7 *Financial Instruments: Disclosures*.

80 Stakeholders acknowledged that the proposal to allow a range of amounts on expected synergies should address some of the practical concerns on the difficulties of estimating expected synergies.

81 In response to the proposals in the DP on this topic, the AASB agreed with the IASB's preliminary view to require companies to disclose more comprehensive information about the synergies expected to be realised from an acquisition. Some stakeholders did, however, express concern about the auditability of the proposed synergy disclosures. Concerns were also expressed that quantifying expected synergies may be difficult and very judgemental and that it may be difficult for auditors to assess whether management’s expectations are reasonable. The AASB noted that our understanding is that auditing these disclosures should be possible provided the framework against which the disclosures are to be audited is

sufficiently specific and detailed. However, we suggested that the IASB discuss the auditability of the proposed disclosures with the IAASB to ensure that this is the case.

Staff analysis

82 Staff agree with the proposals relating to:

(a) The new disclosure objectives;

(b) Replacing the requirement to disclose the primary reasons for a business combination with a requirement to disclose the strategic rationale for the business combination;

(c) Improving the information users receive about the contribution of the acquired business;

(d) Improving the information entities disclose about the pension and financing liabilities assumed in a business combination; and

(e) The proposals to delete some disclosure requirements from IFRS 3.

83 Staff are generally supportive of the proposals to require an entity to describe expected synergies by category (subject to an exemption in specific circumstances) because users have highlighted the importance of this information. However, in light of the concerns about the challenges and costs of preparing, and auditing, the expected synergies by category, we recommend that the circumstances in which entities can disclose the total amount of expected synergies, rather than by category, be widened to include circumstances where this level of aggregation aligns with how management has evaluated the acquisition. This would result in applying a management approach to the synergy disclosures.

(a) Information on expected synergies should be available to the entity (management information) as part of the M&A process or other internal sources. Stakeholders highlighted that this information may, or may not, be split by categories – where information is not split by categories, staff consider the costs of preparing this information may outweigh the benefits to users. Further, the fact that management has not assessed the synergies in this manner would also be useful information for users.

(b) In the IASB's view, the information the IASB's proposals would require an entity to disclose is auditable. In the IASB's outreach, preparers said they prepare significant documentation in determining the amount to pay for a business combination and many auditors said they expect to be able to audit that information (paragraph BC144). This does not align with feedback from our stakeholders and staff consider that the IASB should undertake further outreach with preparers and auditors on the auditability of the disclosures, and the associated costs.

Staff recommendations

84 Staff recommend that in the comment letter we express:

(a) Support for the following proposals:

(i) The new disclosure objectives;

(ii) Replacing the requirement to disclose the primary reasons for a business combination with a requirement to disclose the strategic rationale for the business combination;

(iii) Improving the information users receive about the contribution of the acquired business;

(iv) Improving the information entities disclose about the pension and financing liabilities assumed in a business combination; and

(v) The proposals to delete some disclosure requirements from IFRS 3.

(b) Recommendations relating to the proposed synergy disclosures as follows:

(i) Widening the circumstances in which entities can disclose the total amount of expected synergies, rather than by category.

(ii) For the IASB to conduct further analysis and outreach on the auditability and associated costs of these disclosures.

Question for Board members

Q5 Do Board members agree with the staff recommendations in paragraph 84? If not, what would Board members suggest?

Question 6— Changes to the impairment test (paragraphs 80–81, 83, 85 and 134(a) of IAS 36)
During the PIR of IFRS 3, the IASB heard concerns that the impairment test of cash generating units containing goodwill results in impairment losses sometimes being recognised too late. Two of the reasons the IASB identified (see paragraphs BC188–BC189) for these concerns were: • shielding; and • management over-optimism. The IASB is proposing amendments to IAS 36 that could mitigate these reasons (see paragraphs BC192–BC193). *Proposals to reduce shielding* The IASB considered developing a different impairment test that would be significantly more effective at a reasonable cost but concluded that doing so would not be feasible (see paragraphs BC190–BC191). Instead, the IASB is proposing changes to the impairment test (see paragraphs 80–81, 83 and 85 of IAS 36) to reduce shielding by clarifying how to allocate goodwill to cash generating units (see paragraphs BC194–BC201). *Proposal to reduce management over-optimism* The IASB's view is that management over-optimism is, in part, better dealt with by enforcers and auditors than by amending IAS 36. Nonetheless, the IASB is proposing to amend IAS 36 to require an entity to disclose in which reportable segment a cash generating unit or group of cash-generating units containing goodwill is included (see paragraph 134(a) of IAS 36). The IASB expects this information to provide users with better information about the assumptions used in the impairment test and therefore allow users to better assess whether an entity's assumptions are over-optimistic (see paragraph BC202). (a) Do you agree with the proposals to reduce shielding? Why or why not? (b) Do you agree with the proposal to reduce management over-optimism? Why or why not?

Summary of the proposals

85 The IASB tried to address two reasons for the late recognition of goodwill impairment – shielding and management over-optimism.

86 To reduce shielding, the ED clarifies that:

- when allocating goodwill (GW), an entity needs to identify the CGU (or groups of CGUs) benefiting from synergies and then determine the lowest level at which the business associated with the GW is monitored;
- for GW allocation purposes, the operating segment level is the highest level permitted.

87 To reduce over-optimism, the IASB suggests that an entity discloses the reportable segment containing the CGU and the amount of GW allocated to that CGU.

88 In the AASB's submission to the DP, the Board recommended that the IASB considered explaining what is meant by the reference to 'the lowest level at which GW is monitored for internal management purposes'. In addition, the AASB also recommended clarifying that the reference to management does not intend the KMP but a lower level of management.

Stakeholder feedback

89 In general, the stakeholders expressed support for the proposal. The stakeholders welcomed the clarification on the allocation of GW. Whilst most of the stakeholders noted that the current practice is usually consistent with the proposal, they acknowledge that the clarification will help with the enforcement.

90 A stakeholder suggested that the shielding is often a result of an inappropriate purchase price allocation when some intangibles are included in the GW instead of being recognised separately. Therefore, more guidance on the recognition of intangible assets within IFRS 3 and additional disclosure explaining what the GW is represented by would help.

91 Some stakeholders expressed concerns that considering the previous references to KMP, the reference to management in paragraph 80A(b)[5] may be unclear, and further clarification is required.

92 A stakeholder suggested that to achieve the intended change, the current paragraph 80(b)[6] should be removed when the new guidance is added. The proposed paragraph 80A(b) explains that GW is allocated to the CGU management uses to monitor the business associated with GW. By default, this level should never be higher than the segment level.

Staff analysis

93 Staff considered the feedback received and whether the entity should be required to disclose the composition of GW. The acquirer subsumes into GW intangible assets that are not identifiable (e.g. workforce) or other items that do not qualify for recognition (e.g. potential contracts with new customers that are being negotiated). Staff think that the preparers may find it difficult to identify all material items subsumed in GW, and the information may be difficult to audit as a high level of judgement and detailed knowledge of the acquired business would be required. Therefore, staff suggest that additional disclosure is not proposed.

94 With respect to feedback on clarification of the management level responsible for monitoring the business, staff noted that paragraph BC201 clarifies that the level of CGU tested for impairment might not correspond with the level that is being reviewed to comply with the proposed disclosure requirements on business acquisitions. Further, it explains that the use of KMP for the proposed disclosure requirements in IFRS 3 is intended to identify the most important information by focusing on a senior level of management. However, the purpose of the impairment test is to allocate GW at the lowest level at which its management monitors the relevant business.

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[5] Par 80A(b) requires the entity "to determine the lowest level for which there is financial information about the cash-generating units identified in paragraph 80A(a) that management regularly uses to monitor the business associated with the goodwill. …"

[6] Par 80: "For the purpose of impairment testing, goodwill acquired in a business combination shall, from the acquisition date, be allocated to each of the acquirer's cash-generating units, or groups of cash-generating units, that is expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units or groups of units. Each unit or group of units to which the goodwill is so allocated shall:
(a) represent the lowest level within the entity at which the business associated with the goodwill is monitored for internal management purposes; and
(b) not be larger than an operating segment as defined by paragraph 5 of IFRS 8 *Operating Segments* before aggregation."

95 Staff understand that the level of management referenced for GW impairment is intended to be lower than KMPs. However, to avoid any confusion, it would be helpful if this is clarified in the Basis for Conclusion.

96 Staff agree with the stakeholder's feedback that by applying the proposed guidance on GW allocation in paragraph 80A(b), the CGU to which GW is allocated is unlikely to be higher than an operating segment. However, defining the maximum level in the standard may still be helpful. Staff, therefore, do not suggest removing paragraph 80(b).

<u>Staff recommendations</u>

97 Staff recommends that the Board agree with the proposed clarification on GW allocation to reduce shielding and with the additional disclosure to reduce management optimism. Staff also suggest that the Board recommends that the IASB clarifies in the BCs that the management level referred to in paragraph 80A(b) can be lower than the KMPs used when considering business combinations disclosures in IFRS 3.

Question for Board members

Q6 Do Board members agree with the staff recommendations in paragraph 97? If not, what would Board members suggest?

Question 7— Changes to the impairment test: Value in use (paragraphs 33, 44–51, 55, 130(g), 134(d)(v) and A20 of IAS 36)
The IASB is proposing to amend how an entity calculates an asset's value in use. In particular, the IASB proposes: • to remove a constraint on cash flows used to calculate value in use. An entity would no longer be prohibited from including 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 (see paragraphs BC204–BC214). • to remove the requirement to use pre-tax cash flows and pre-tax discount rates in calculating value in use. Instead, an entity would be required to use internally consistent assumptions for cash flows and discount rates (see paragraphs BC215–BC222). (a) Do you agree with the proposal to remove the constraint on including cash flows arising from a future restructuring to which the entity is not yet committed or from improving or enhancing an asset's performance? Why or why not? (b) Do you agree with the proposal to remove the requirement to use pre-tax cash flows and pre-tax discount rates in calculating value in use? Why or why not?

Summary of the proposals

98 The ED proposes to simplify the calculation of Value in Use (ViU) by removing the restriction in paragraph 33(b) on the inclusion of cash flows (CFs) from future restructurings or from improving or enhancing the asset's performance. Paragraph 44A[7] further clarifies what may constitute future CFs on an asset in its current condition.

99 Further, the ED suggests amending paragraph 51 to allow the use of post-tax basis CFs if a post-tax discount rate is used.

Stakeholder feedback

100 Whilst most of the stakeholders were supportive of the proposals, some DIAP members expressed concerns that removing the restrictions on CFs may result in further shielding as it could create new CFs and suggested adhering to the current guidance.

101 In 2020, the AASB also expressed similar concerns in the comment letter on DP, mainly that removing the constraints could further delay recognising impairment losses due to overly optimistic cash flow forecasts. Also, assessing whether cash flows from future restructurings or asset enhancements are reasonable and supportable could be difficult and judgemental. Whilst the AASB supported the removal of the restrictions, it suggested developing guidance that clarifies when it would be reasonable and supportable to include cash flows from uncommitted future restructuring and asset enhancements. For example, the guidance could

[7] Paragraph 44A (a): Estimates of future cash flows of an asset in its current condition include:

(a) future cash outflows necessary to maintain the level of economic benefits expected to arise from the asset in its current condition. When a cash-generating unit consists of assets with different estimated useful lives, all of which are essential to the ongoing operation of the unit, the replacement of assets with shorter lives is considered to be part of the day-to-day servicing of the unit when estimating the future cash flows associated with the unit. Similarly, when a single asset consists of components with different estimated useful lives, the replacement of components with shorter lives is considered to be part of the day-to-day servicing of the asset when estimating the future cash flows generated by the asset.

(b) future cash flows associated with the current potential of the asset to be restructured, improved or enhanced. If the asset has the current potential to be restructured, improved or enhanced, and the cash flow projections associated with the restructuring, improvement or enhancement meet the requirements in paragraph 33, estimates of future cash flows for the asset shall include estimated future cash inflows and outflows that are expected to arise from that restructuring, improvement or enhancement.

specify that the entity needs to be able to demonstrate both its intent and financial ability to implement the restructuring and has developed a reasonably detailed plan.

102 A stakeholder suggested that the amendment should clarify the requirement for CF to be derived from an asset in its current condition as the concept of considering the CF that could be generated due to the potential of an asset in its current condition could be lost.

103 A stakeholder also noted that Illustrative Examples (IE) 5 Treatment of future restructuring and IE 6 Treatment of future costs are to be removed. The stakeholder suggested that the examples should be amended rather than deleted to explain the new requirements.

104 The feedback above is further supported by the AASB comment in the submission letter to DP that ViU model is difficult to understand and it may be difficult to determine when to in- or exclude cash flows and the related assets and liabilities for items such as lease liabilities and asset retirement obligations. AASB suggested developing illustrative examples to assist with understanding the principles of the ViU model.

105 In respect of post-tax CF, the majority of stakeholders supported the proposal and welcomed the simplification.

106 Two stakeholders suggested that the IASB needs to clarify whether and how tax losses should be considered when calculating the ViU. For example, although historical tax losses and related DTA are currently excluded from both the asset/CGU's carrying amount and the cash flow model, it is unclear whether this approach remains the same post-change. We understand that in practice, the deductibility of future losses is often included by the valuers in the fair value calculation. However, estimating future tax losses when determining future CFs could be complex.

107 One stakeholder suggested that only one method (pre-tax or post-tax) should be allowed, so comparability among companies is retained.

108 In addition, feedback indicated that the IASB should use this opportunity to clarify issues relating to the treatment of deferred tax (DT) balances arising on business acquisitions as diversity in practice exists. The example of some of the issues are as follows:

(a) It is unclear whether DT balances on temporary differences should be included when the cash flow model is post-tax. Whilst some stakeholders may interpret the new guidance to always include these balances, there are views that the impairment test follows the 'compare like with like' principle in IAS 36 paragraph 75 and, therefore, whether those DT balances should be included depends on whether the existing temporary differences specific to the entity are incorporated into the cash flow model.

(b) It is unclear how to deal with a discounting effect when DT balances are included, given DT balances are undiscounted whilst CFs in ViU model are discounted.

(c) It is unclear whether deferred tax liability (DTL) that is subsumed in GW (as it relates to recognition of certain intangible assets post-business combination) should always be included in the ViU model. Complexity increases if GW balance has been allocated to a different CGU after acquisition.

109 In its response to the DP, the AASB also recommended that if post-tax CFs are allowed, the IASB should explain that the relevant CFs include reversals of existing temporary differences.

110 A stakeholder also noted that clarifying the difference between Fair Value (FV) and ViU in the BCs would be helpful. This feedback is supported by AASB's comment on the DP when it suggested developing a modified single model approach and reserving the use of an FVLCD type model for assets expected to be disposed of may have merits. If the two separate models were retained, AASB suggested that the IASB clearly explains the differences between the two models.

Staff analysis

7a) Removing restrictions on future CFs

111 Staff noted that by removing the constraints on future CFs, the IASB tried to reduce the cost and complexity of calculating ViU as it would bring the calculation closer to the internal forecasts, and management would not be required to distinguish maintenance expenditure from expansionary expenditure.

112 Staff considered the feedback that removing restrictions on future CFs could result in shielding. However, BC207-208 explains that IASB decided not to introduce additional constraints as those included in IAS 36 *Impairment* are considered sufficient. In particular, the requirements:

(a) to base cash flow projections on reasonable and supportable assumptions (paragraph 33(a));
(b) to base cash flow projections on budgets/forecasts approved by an entity's management (paragraph 33(b));
(c) to assess assets in their current condition (paragraph 44); and
(d) to disclose key assumptions (paragraph 134(d)(i)).

Staff consider that this explanation in BC sufficiently addresses the concerns relating to management over optimism.

113 Paragraph 44A[8] provides some guidance on the future CFs of an asset in its current condition and CFs associated with the restructuring. Staff noted that some IASB members disagreed with the proposal as, in their view, these CFs do not represent CFs from an asset in its current condition (BC214).

114 As the IASB already considered the risk of headroom and explained the existing safeguards in the BCs, and the majority of stakeholders agreed with the proposal, staff recommend supporting the proposed removal of constraints on including future restructuring and asset enhancement CFs. However, replacing IE 5 and IE 6 with the updated guidance rather than removing them completely could help the users with the application of the standard.

7b) Removing the requirement to use pre-tax cash flows and pre-tax discount rates

115 Staff also considered the feedback on tax balances in the ViU calculation. Staff noted that BCZ84 of IAS 36 *Impairment* explains that ViU should include present value of future tax cash flows that would result if the tax base of the asset were equal to its value in use. To avoid double counting, an entity needs to exclude the effect of temporary differences. To avoid that complexity, the pre-tax CFs model was originally preferred.

116 The IASB noted that pre-tax cash flows at pre-tax discount rate should provide the same result as post-tax cash flows at post-tax discount rate. The IASB decided not to provide further guidance on double-counting as the feedback indicated that the current practice is already to use post-tax CFs and post-tax discount rates.

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[8] 44A Estimates of future cash flows of an asset in its current condition include:
(a) future cash outflows necessary to maintain the level of economic benefits expected to arise from the asset in its current condition. When a cash-generating unit consists of assets with different estimated useful lives, all of which are essential to the ongoing operation of the unit, the replacement of assets with shorter lives is considered to be part of the day-to-day servicing of the unit when estimating the future cash flows associated with the unit. Similarly, when a single asset consists of components with different estimated useful lives, the replacement of components with shorter lives is considered to be part of the day-to-day servicing of the asset when estimating the future cash flows generated by the asset.
(b) future cash flows associated with the current potential of the asset to be restructured, improved or enhanced. If the asset has the current potential to be restructured, improved or enhanced, and the cash flow projections associated with the restructuring, improvement or enhancement meet the requirements in paragraph 33, estimates of future cash flows for the asset shall include estimated future cash inflows and outflows that are expected to arise from that restructuring, improvement or enhancement.

117 However, staff understand that the post-tax discount rates and cash flows are used mainly to simplify the current requirements and calculate pre-tax cash flow and discount rate. Staff acknowledge that the large accounting firms have already developed internal guidance but are unsure whether any diversity in practice currently exists. Therefore, clarifying how to reflect tax balances in ViU calculation may help reduce misinterpretation of the proposal and would be accessible to all users.

118 Staff noted that IASB explained in BC219 that using post-tax cash flows will better align the ViU with fair value of the asset. However, no further explanation of these two concepts is provided. Considering that the models are getting more aligned, staff consider that an explanation of the concept and the main differences would result in a better understanding of what the proposal is trying to achieve.

<u>Staff recommendations</u>

119 For the reasons above, staff recommend the Board support the proposal but suggest in the comment letter that IASB:

(a) Provide guidance on the meaning of an asset in current condition;

(b) Update IE 5 and IE 6 to reflect the new guidance;

(c) Clarify in the standard how to consider tax and deferred tax balances when calculating ViU using the post-tax CFs; and

(d) Explain the main differences between Fair Value and Value in Use in the BC.

Question for Board members

Q7 Do Board members agree with the staff recommendations in paragraph 119? If not, what would Board members suggest?

Question 8— Proposed amendments to IFRS X Subsidiaries without Public Accountability: Disclosures
The IASB proposes to amend the forthcoming IFRS X *Subsidiaries without Public Accountability: Disclosures* (Subsidiaries Standard) to require eligible subsidiaries applying the Subsidiaries Standard to disclose: • information about the strategic rationale for a business combination (proposed paragraph 36(ca) of the Subsidiaries Standard); • quantitative information about expected synergies, subject to an exemption in specific circumstances (proposed paragraphs 36(da) and 36A of the Subsidiaries Standard); • information about the contribution of the acquired business (proposed paragraph 36(j) of the Subsidiaries Standard); and • information about whether the discount rate used in calculating value in use is pretax or post-tax (paragraph 193 of the Subsidiaries Standard). See paragraphs BC252–BC256. Do you agree with the proposals? Why or why not?

Summary of the proposals

120 In May 2024 the IASB issued IFRS X *Subsidiaries without Public Accountability: Disclosures* (Subsidiaries Standard). The new standard includes simplified disclosure requirements for subsidiaries without public accountability while retaining the recognition and measurement principles from full IFRS Accounting Standards.

121 As the ED proposes new disclosure requirements to IFRS Accounting Standards, it needs to consider whether some of the proposed disclosures should be included in the Subsidiaries Standard.

122 The IASB proposes to include four disclosure requirements listed in the table above.

123 Considering AASB 1060 *General Purpose Financial Statements Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities* has a similar objective, the AASB has decided not to issue the Subsidiaries Standard immediately. Instead, the AASB will wait for stakeholders' feedback from the post-implementation review of AASB 1060 and for the final version of *IFRS for SMEs* that is currently being updated. After contemplating the feedback on AASB 1060 and changes made to *IFRS for SMEs*, the AASB will consider whether and how to adopt the Subsidiaries Standard in Australia.

124 Therefore, during the outreach, staff amended the question and asked whether the disclosure requirements suggested for inclusion in the Subsidiaries Standard should be added to AASB 1060.

Stakeholder feedback

125 We have received limited feedback from stakeholders as not all of them were familiar with AASB 1060. Most of the responding stakeholders considered that the suggested disclosures were excessive and questioned whether the users need that information.

Staff recommendations

126 Staff recommend not to comment on question 8.

Question for Board members
Q8 Do Board members agree with the staff recommendations in paragraph 126? If not, what would Board members suggest?

Question 9—Transition (proposed paragraph 64R of IFRS 3, proposed paragraph 140O of IAS 36 and proposed paragraph B2 of the Subsidiaries Standard)
The IASB is proposing to require an entity to apply the amendments to IFRS 3, IAS 36 and the Subsidiaries Standard prospectively from the effective date without restating comparative information. The IASB is proposing no specific relief for first-time adopters. See paragraphs BC257–BC263. Do you agree with the proposals? Why or why not? If you disagree with the proposals, please explain what you would suggest instead and why.

Stakeholder feedback

127 All stakeholders agreed that the amendments relating to business combination disclosures should be applied prospectively. However, some stakeholders questioned whether GW should

be reallocated to lower levels of CGUs using the new guidance and whether reallocated GW should be immediately tested for impairment as higher levels of CGU could provide shielding in previous impairment tests. If the new test resulted in impairment, a transitional relief allowing recognising the impairment in equity should be allowed.

Staff analysis

128 Staff noted that paragraph BC261 explains that IASB considered whether to require an entity to perform an impairment test at the transition date and recognise any changes in the asset carrying amount directly in equity. However, IASB decided against doing so as the users would understand whether the impairment is a result of changes to the impairment test or a result of an impairment event.

129 Staff noted that the IASB did not consider whether an entity should review the level of CGU the GW is allocated to using the new guidance. Staff understand that the guidance on GW allocation is a clarification rather than a new requirement. However, it could still result in change in practice.

130 Staff agree with the comment that any change in the level to which GW is allocated should be followed by an impairment test. While an entity is required to perform the impairment test annually, there is a risk that the impairment would not be recognised in e.g. the interim financial report.

Staff recommendation

131 Staff suggest that the AASB include in the comment letter a recommendation to IASB to consider whether the allocation of GW should be reviewed under the new guidance with changes recognised retrospectively.

Question for Board members

Q9 Do Board members agree with the staff recommendations in paragraph 131? If not, what would Board members suggest?

Next steps

132 The comment period to IASB ED/2024/1 closes on 15 July 2024. Staff suggest a comment letter reflecting the Board's decisions from this meeting will be finalised out-of-session by the Chair.

133 The proposed timing is as follows:

During week beginning	Deliverable
10 - 20 June 2024	Staff will draft the comment letter reflecting the Board’s comments.
20 June 2024	Staff circulate a draft comment letter to the Chair for final comments.
20 - 25 June 2024	The Chair reviews the comment letter and provides comments.
25 June - 2 July 2024	Staff update the comment letter.
3 July 2024	The comment letter is signed by the AASB Chair and submitted to the IASB.

Questions for Board members

Q10 Do Board members agree with the staff recommendation that the AASB submission is finalised out-of-session by the Chair?

Q11 Do Board members have any comments or concerns about the proposed timing of the finalisation of the AASB comment letter?