# IASB PUBLISHES EXPOSURE DRAFT - *BUSINESS COMBINATIONS - DISCLOSURES, GOODWILL AND IMPAIRMENT*

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## Background

In March 2024, the International Accounting Standards Board (IASB) issued an Exposure Draft proposing amendments to IFRS 3 *Business Combinations* and IAS 36 *Impairment of Assets*.

In the post-implementation review of IFRS 3, stakeholders had raised concerns about the lack of availability of sufficient and timely information about acquisitions and post-acquisition performance. They also expressed concerns about the effectiveness and complexity of the impairment test for operations to which goodwill has been allocated and the delayed recognition of impairment losses on goodwill due to shielding of goodwill from impairment.

The IASB undertook a project *Business Combinations – Disclosures, Goodwill and Impairment* to explore ways to address stakeholder concerns. As a culmination of the project, the IASB has now issued an Exposure Draft *Business Combinations – Disclosures, Goodwill and Impairment* proposing amendments to IFRS 3 and IAS 36. The Exposure Draft proposes to introduce additional disclosure requirements in IFRS 3 that will require entities to provide information about the strategic rationale, expected synergies and the actual performance of acquisitions in the year of acquisition and in reporting periods after the acquisition. The Exposure Draft also proposes certain amendments to IAS 36 to make targeted improvements to the impairment test, with an objective to reduce shielding of goodwill from impairments being recognised and to simplify the impairment test.

The Exposure Draft is open for comments until 15 July 2024.

**Status**
Exposure Draft

**Accounting impact**
The Exposure Draft proposes amendments to IFRS 3 which would introduce additional disclosure requirements related to information about the strategic rationale and actual performance of acquisitions in the year of acquisition and in reporting periods after the acquisition.

The Exposure Draft also proposes amendments to IAS 36 with the goal being to reduce shielding of goodwill from impairments being recognised and to simplify the impairment test.

### Entities expected to be affected by the proposed amendments

The proposed amendments are expected to affect entities that are acquirers in business combinations, particularly 'strategic business combinations', a new subset of business combinations. Under the proposed requirements, these entities would be required to provide additional disclosures related to the strategic rationale, expected synergies and the actual performance of acquisitions. The proposed amendments to IAS 36 may lead to the earlier recognition of impairment of goodwill in some cases, depending on how the goodwill was allocated to cash-generating units under the existing requirements.

## The Proposed Amendments to IFRS 3

The IASB proposes to require an acquirer to disclose information that enables users of its financial statements to 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.

### Strategic business combinations

To determine whether a business combination is a strategic business combination, the Exposure Draft proposes qualitative and quantitative thresholds, as below:

| Quantitative thresholds | | |
|---|---|---|
| Absolute amount of acquiree's operating profit or loss | ≥ | 10% of the absolute amount of acquirer's consolidated operating profit or loss |
| Acquiree's revenue | ≥ | 10% of the acquirer's consolidated revenue |
| Amount recognised as of the acquisition date for assets acquired (including goodwill) | ≥ | 10% 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 |

| Qualitative thresholds |
|---|
| Acquirer entering into a new major line of business or geographical area of operations |

If a business combination meets any of the criteria above, it will be a strategic business combination.

The proposed amendments also introduce definitions of key objective, strategic rationale and target.

### Proposed disclosure requirements

The Exposure Draft proposes to introduce additional disclosure requirements. Some of the proposed disclosure requirements apply to all (material) business combinations and some apply only to strategic business combinations. The Exposure Draft also provides an exemption from providing some of the disclosures if doing so can be expected to prejudice seriously the achievement of any of the acquirer's acquisition-date key objectives for the business combination.

Proposed disclosure requirements applicable to all (material) business combinations are as below:

| Disclosure requirement | Exemption from disclosure |
|---|---|
| ***Strategic rationale:***<br>(Defined as an entity's reason(s) for entering into a business combination that is aligned with the entity's overall business strategy) | No |
| ***Expected synergies:***<br>Description of the expected synergies that specifies each category of expected synergies. For each category of expected synergies, the acquirer is required to disclose:<br>• the estimated amounts or range of amounts of the expected synergies.<br>• the estimated cost or range of costs to achieve these synergies.<br>• the time from which the benefits from the synergies are expected to start and for how long they are expected to last. | Yes |

The Exposure Draft proposes disclosure requirements for strategic business combinations in the year of acquisition and in subsequent reporting periods. The information to be disclosed is the information reviewed by the acquirer's key management personnel (KMP) (as defined in IAS 24 *Related Party*

*Disclosures*). The proposed disclosure requirements and the availability of exemption from disclosure are as follows:

**In the year of acquisition**

| Acquisition-date ***key objectives*** | Related ***targets*** |
|---|---|
| An objective that is critical to the success of the business combination | The level of performance that will demonstrate whether a key objective has been met |

*Exemption available*

**In the year of acquisition and in subsequent periods:**

The extent to which the acquisition-date key objectives and the related targets are being met

| Information about the actual performance | A statement of whether actual performance is meeting or has met the acquisition-date key objectives and related targets (referred to as performance statement in this publication). |
|---|---|
| *No exemption* | *Exemption available* |

The acquirer is required to disclose the information about the actual performance and the performance statement for as long as the acquirer's KMP review the actual performance of the strategic business combination against its acquisition-date key objectives and the related targets.

The following table depicts the requirements in the Exposure Draft related to the disclosure of the information about the actual performance and the performance statement in case the acquirer's KMP do not start the review or stop the review:

| Reporting period | Status of review by the KMP | Disclosure requirement |
|---|---|---|
| The year of acquisition | The KMP have not started the review and do not plan to review | Disclose the fact and the reasons for not undertaking the review. |
| The first and second annual reporting period after the year of acquisition | The KMP stop the review | Disclose the fact and the reasons for stopping the review.<br>If the acquirer's KMP continue to receive information based on the metric originally used to measure the achievement of that key objective and the related targets, the acquirer shall also disclose that information. |

If the KMP stop the review after the end of the second annual reporting period after the year of acquisition, no specific disclosure requirement is proposed.

### Applying the exemption from disclosing information

To apply the exemption from disclosure to an item of information, the Exposure Draft proposes to require the acquirer to consider factors such as:

- the effect of disclosing the information:

  A general risk of potential weakening of competitiveness or a possibility of unfavourable view by the capital markets cannot be the reason for applying the exemption.

- the public availability of information.

If it is possible to disclose the required information in a different way - for example, at a sufficiently aggregated level – the entity should, instead of applying the exemption, disclose the information in that different way.

If the acquirer applies the exemption to an item of information, it shall disclose the fact and the reasons for it. At the end of each reporting period, the acquirer would be required to reassess whether the item of information is still eligible for the exemption. If it is no longer appropriate to apply the exemption, the acquirer shall disclose the item of information to which it had applied the exemption previously.

## The Proposed Amendments to IAS 36

### What is the issue that the IASB is trying to address?

Stakeholders raised primarily two concerns related to impairment testing:

- Impairment losses on goodwill are sometimes not recognised on a timely basis. This is often due to shielding of goodwill from impairment because of the headroom in an existing business, with which an acquisition is integrated. Another factor resulting in delayed recognition of impairment on goodwill is management overoptimism.
- The impairment test can be costly and time consuming.

To address these concerns, the IASB is proposing targeted changes to the impairment testing of goodwill, including related disclosures and value in use calculations.

### Proposed changes to impairment testing of goodwill

IAS 36.80 requires an entity to allocate goodwill acquired in a business combination 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. IAS 36.80 further requires each unit or group of units to which the goodwill is so allocated to (**emphasis added**):

(a) represent the lowest level within the entity at which ***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.

However, management often does not specifically monitor goodwill separately. Therefore, at times, entities have defaulted to allocating goodwill at the operating segment level which is the highest level at which goodwill can be allocated. This increases the risk of shielding of goodwill from impairment.

To address this issue, the IASB has proposed the following amendments:

- Amendment to IAS 36.80(a) to clarify that each unit or group of units to which the goodwill is allocated shall represent the lowest level within the entity at which the ***business associated with the*** goodwill is monitored for internal management purposes.
- Insertion of new paragraph 80A, to clarify that an entity first applies paragraph 80(a) to determine the lowest level at which the business associated with the goodwill is monitored for internal management purposes.
- Insertion of new paragraph 80B to clarify that the requirement in paragraph 80(b) sets the highest level at which an entity is permitted to allocate goodwill for the purpose of applying paragraph 80(a) and is therefore applied only after paragraph 80(a) has been applied.

Due to the proposed amendment to IAS 36.80(a), even if an entity does not monitor goodwill separately, if it monitors the business associated with the goodwill for internal management purposes, that will be the lowest level for allocation of goodwill. As a result of the insertion of proposed paragraphs 80A and 80B, an entity cannot default to allocating goodwill to the operating segment, as it will be required to first apply IAS 36.80(a).

The following example illustrates the effect of the proposed amendments on the allocation of goodwill and the possibility of shielding of goodwill from impairment.

***Fact pattern:***

Entity A operates a chain of retail stores selling clothing. It operates separate stores for men's clothing and women's clothing. It identifies two operating segments – men's attire and women's attire. Each retail store is identified as a cash generating unit (CGU).

Entity A does not have any presence in City X. To enter the market in City X, in January 20X1, it acquires a retail store for women's clothing (Store M) from Entity B in City X. It recognises goodwill of CU2 million from the acquisition of Store M. Store M will be a part of the operating segment of women's attire.

Entity A's management does not monitor goodwill separately for internal management purposes. It monitors each store separately for internal management purposes.

The carrying amounts as at 31 December 20X1 are as below:

| | |
|---|---|
| Net assets of Store M (excluding goodwill) | CU10 million |
| Goodwill allocated to Store M | CU2 million |
| Net assets of operating segment – women's attire | CU80 million |

The recoverable amount (value is use) of Store M is CU11 million.

The recoverable amount (value in use) of the operating segment – women's attire is CU100 million.

***Analysis:***

*Under the existing requirements:*

Entity A does not monitor goodwill for internal management purposes. Therefore, under the current requirements of IAS 36.80, it can allocate the goodwill recognised on the acquisition of Store M to the operating segment – women's clothing as that is the highest level set by IAS 36.80(b) at which goodwill can be allocated.

The carrying amount of the net assets of the operating segment – women's attire as at 31 December 20X1 is CU80 million.

The carrying amount of the net assets of the operating segment – women's attire, including goodwill recognised on the acquisition of Store M, as at 31 December 20X1 is CU82 million. The recoverable amount of this operating segment is CU100 million. Therefore, no impairment is recognised.

*Under the proposed approach:*

The ***business associated with the goodwill*** that is monitored for internal management purposes is the CGU of Store M. Therefore, the goodwill is allocated to the CGU of Store M for impairment testing.

The carrying amount of the CGU of Store M, including goodwill, is CU12 million (i.e CU10 million + CU2 million). The recoverable amount of the CGU of Store M is CU11 million.

Therefore, Entity A is required to recognise an impairment loss of CU1 million, which will be allocated to goodwill.

Thus, under the existing requirements, due to the headroom available in the operating segment – women's attire, goodwill is shielded from impairment. Under the proposed requirements, this shielding is reduced.

It should be noted that the proposed approach will not entirely eliminate shielding of goodwill, as some level of shielding is inevitable due to combining of carrying amounts of assets for impairment testing.

## Proposed changes to the value in use calculation

To address the concerns about the cost and complexity of the impairment test, the IASB has proposed the following amendments to the value in use calculation:

- *Removing the restriction on including cash flows from uncommitted future restructuring or asset enhancement:*

  IAS 36.33 currently does not allow inclusion of estimated future cash inflows or outflows expected to arise from future restructurings or from improving or enhancing the asset's performance in cash flow projections for measuring value in use.

  IAS 36.44 currently prohibits estimates of future cash flows to include estimated future cash inflows or outflows that are expected to arise from:

  (a) a future restructuring to which an entity is not yet committed; or

  (b) improving or enhancing the asset's performance.

  The proposed amendments remove these restrictions. The IASB believes that the proposed approach would make the impairment test less prone to error because estimates of value in use would be based more closely on cash flow projections that are prepared, monitored and used internally for decision-making. The IASB also expects the proposed approach to reduce the cost and complexity of impairment testing by reducing the need to amend management's financial budgets or forecasts (BC205).

  Under the proposed approach, the estimates of future cash flows will continue to be required for the asset in ***its current conditions***. However, the estimates would include:

  a) future cash outflows necessary to ***maintain the level of economic benefits*** expected to arise from the asset in its current condition – for example, the replacement of assets with shorter lives in a CGU consisting of assets with different estimated useful lives.

  b) future cash flows associated with the ***current potential*** of the asset ***to be restructured, improved or enhanced***.

  Proposed treatment when a provision is recognised for restructuring:

  The Exposure Draft proposes that when an entity becomes committed to a restructuring and a provision for restructuring is recognised in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, its calculation of value in use for an asset affected by the restructuring:

  (a) continues to include estimates of future cash inflows and outflows that reflect the cost savings and other benefits from the restructuring; and

  (b) excludes estimates of future cash outflows for the restructuring because these cash outflows are included in the restructuring provision in accordance with IAS 37.

- *Removing the requirement to calculate value in use on a pre-tax basis:*

  The Exposure Draft proposes to remove the requirement to estimate the future cash flows and the discount rate on a pre-tax basis. The estimated future cash flows and the discount rate should be consistent with each other. For example, if the discount rate is determined on a post-tax basis, future cash flows are also estimated on a post-tax basis.

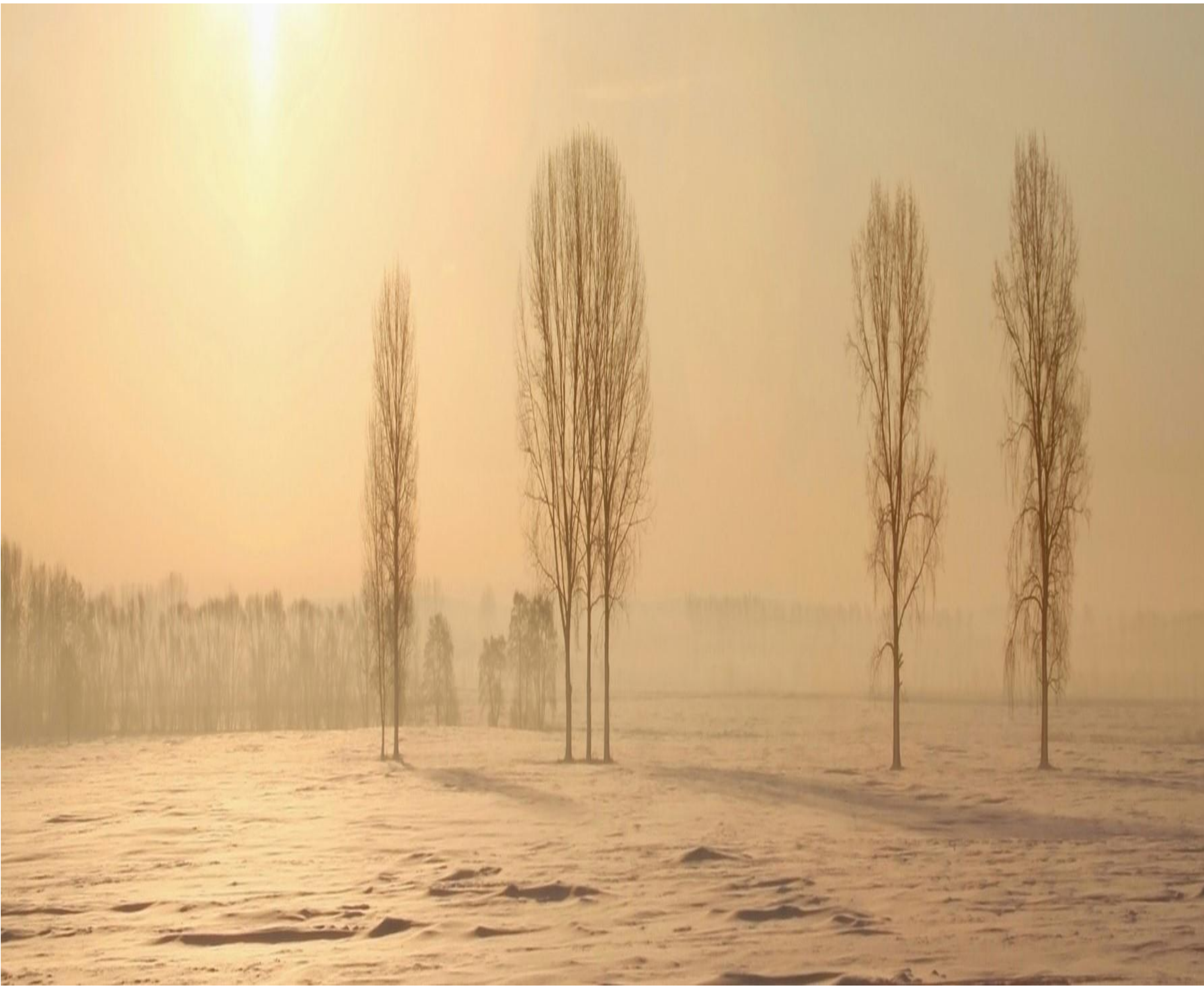
  The IASB believes that the proposed amendment would make the impairment test easier to understand by aligning it with valuation practice and better align the value in use calculation in IAS 36 with fair value in IFRS 13 *Fair Value Measurement* (BC219).

## Transition

The Exposure Draft proposes the amendments to IFRS 3 to be applicable prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after the effective date.

The proposed amendments to IAS 36 are proposed to be applicable prospectively to impairment tests performed after the effective date.

Earlier application of the amendments would be permitted for both IFRS 3 and IAS 36. Earlier application would be required to be disclosed.



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