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iGAAP in Focus

Financial reporting

IASB proposes amendments to improve reporting on acquisitions

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For more information please see the following websites:

www.iasplus.com

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This *iGAAP in Focus* outlines the proposed amendments to IFRS 3 *Business Combinations* and IAS 36 *Impairment of Assets* set out in exposure draft (ED) *Business Combinations—Disclosures, Goodwill and Impairment*, published by the International Accounting Standards Board (IASB) on 14 March 2024.

- The objective of the proposed amendments to IFRS 3 is to require entities to provide users with better information about the performance of a business combination as a reasonable cost
- For strategic business combinations, an entity would be required to provide information about its acquisition-date key objectives and related targets for the business combination and whether these key objectives and related targets are being met. An entity would only have to disclose information that is reviewed by its key management personnel
- Entities would be exempted from disclosing some of the information if that information is commercially sensitive or would expose the entity to litigation risk
- The ED includes several other proposed amendments to the disclosure requirements in IFRS 3, including new disclosure objectives
- The proposed amendments to IAS 36 aim to mitigate the two main reasons for the concerns about the timeliness of impairment losses on goodwill (management over-optimism and shielding[1]) by
  - providing additional guidance on how to allocate goodwill to cash generating units (CGUs)
  - requiring entities to disclose in which reportable segment a CGU containing goodwill is included
- The amendments would also make changes to how an entity calculates an asset's value in use
- The ED does not specify an effective date for the amendments. Entities would be required to apply the amendments prospectively
- The comment period for the ED ends on 15 July 2024.

1. Some stakeholders notified the IASB that goodwill can be shielded from impairment by, for example, the headroom of a business with which an acquired business is combined. Headroom is the amount by which a business's recoverable amount exceeds the carrying amount of its recognised net assets. This headroom can mask the impairment of acquired goodwill when an entity tests the combined business for impairment because any reduction in the recoverable amount of the combined business is first absorbed by that headroom.

Background

In March 2020, the IASB published discussion paper (DP) **Business Combinations—Disclosures, Goodwill and Impairment**. In the DP, the IASB stated its preliminary views on how to develop enhanced disclosure requirements to improve the information entities provide to investors about the businesses those entities buy. The DP included proposals to require entities to disclose management's objectives for acquisitions in the year of acquisition and how acquisitions have performed against those objectives in subsequent periods. The IASB also proposed that amortisation of goodwill should not be reintroduced. To simplify the impairment test, the IASB stated in the DP that amendments should be proposed to provide relief from the annual impairment test of CGUs containing goodwill and simplify how value in use is estimated.

After considering the feedback received in response to the DP, the IASB now proposes amendments to the disclosure requirements in IFRS 3 and the impairment test in IAS 36 that build on the preliminary views in the DP.

Observation

Stakeholder feedback on the DP has revealed mixed views on whether the IASB should retain the impairment-only approach for the subsequent accounting of goodwill, or whether it should reintroduce amortisation of goodwill. On balance, considering the evidence collected, the IASB concluded that it had no compelling case to justify reintroducing amortisation of goodwill and decided to retain the impairment-only model for the subsequent accounting for goodwill.

Respondents to the DP generally disagreed with removing the requirement to perform a quantitative impairment test of CGUs containing goodwill each year. The IASB was persuaded by the concerns expressed and decided to retain this requirement.

Proposed amendments to IFRS 3

Strategic business combinations

The IASB proposes that an entity should be required to disclose information about the performance of a business combination, with specific information being required in respect of strategic business combinations.

As proposed in the ED, a business combination that meets any one of the following thresholds would be considered a strategic business combination:

- in the most recent annual reporting period before the acquisition date:
  - the absolute amount of the acquiree's operating profit or loss is 10% or more of the absolute amount of the acquirer's consolidated operating profit or loss; or
  - the acquiree's revenue is 10% or more of the acquirer's consolidated revenue
- the amount recognised as of the acquisition date for all assets acquired (including goodwill) is 10% 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
- the business combination resulted in the acquirer entering a new major line of business or geographical area of operations.

For strategic business combinations, an entity would be required to disclose:

- in the year of acquisition, its acquisition-date key objectives and related targets (either as a range or a point estimate)
- in the year of acquisition and in each subsequent year, the extent to which these key objectives and related targets are being met, including:
  - information about the actual performance being reviewed to determine whether the key objectives and related targets are being met
  - a statement of whether actual performance is meeting or has met the key objectives and related targets.

The information disclosed would reflect the information that is reviewed by the entity's key management personnel.

An entity would be required to disclose this information for as long as the entity's key management personnel review the performance of the business combination.

If an entity's key management personnel:

- have not started 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
- have stopped reviewing whether an acquisition-date key objective and the related targets for the 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 during the period up to the end of the second annual reporting period after the year of acquisition, the entity would be required to disclose that information.

The IASB also proposes to exempt an entity from disclosing some of the information that would be required applying the proposals in the 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.

As a principle, an entity would 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. The ED also includes proposals for an application guidance to help entities, auditors and regulators identify the circumstances in which an entity can apply the exemption.

Other proposals

The IASB proposes the following other amendments to the disclosure requirements in IFRS 3, including:

New disclosure objectives	The ED includes a proposal for a new disclosure objective. Under the proposal, the acquirer is required to disclose information that enables users of its financial statements to evaluate: • the benefits an entity expects from a business combination when agreeing on the price to acquire a business • for a strategic business combination, the extent to which the benefits an entity expects from the business combination are being obtained.
The strategic rationale for a business combination	The IASB proposes to replace the existing requirement to disclose the primary reasons for a business combination with a requirement to disclose the strategic rationale for the business combination.
Requirements to disclose quantitative information about expected synergies in the year of acquisition	Under the proposals, an entity would be: • required to describe expected synergies by category (for example, revenue synergies, cost synergies and each other type of synergy) • required 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 – the time from which the benefits expected from the synergies are expected to start and how long they will last • exempted from disclosing that information in specific circumstances.

Contribution of the acquired business	Changes are proposed to the current requirements to disclose the contribution of the acquired business, with the objective that such changes would improve the information users receive about the contribution of the acquired business. In particular, it is proposed: • to specify that the amount of profit or loss referred to in the requirement is the amount of operating profit or loss (operating profit or loss will be defined in the forthcoming IFRS 18 *Presentation and Disclosure in Financial Statements)* • to specify that an entity is required to develop an accounting policy to prepare this information that results in disclosing information that helps users forecast future performance of the combined entity
Classes of assets acquired and liabilities assumed	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 the description of the classes of assets acquired and liabilities assumed for which information is required and adding pension and financing liabilities to the Illustrative Examples accompanying IFRS 3.

Proposed amendments to IAS 36
To address concerns about the timeliness of impairment losses on goodwill due to shielding, the IASB is proposing additional guidance on how to allocate goodwill to CGUs.

The ED retains the existing requirements that each CGU or group of CGUs to which the goodwill is allocated should represent the lowest level within the entity at which the business associated with the goodwill is monitored for internal management purposes and not be larger than an operating segment in paragraph 5 of IFRS 8 *Operating Segments*, before aggregation. But the ED adds an explanation that to apply this requirement an entity:

- identifies the CGUs or groups of CGUs expected to benefit from the synergies of the combination
- to then determine the lowest level for which there is financial information about these CGUs that management regularly uses to monitor the business associated with the goodwill. That financial information reflects how the benefits expected from the synergies of the combination are managed.

An entity would be required to disclose in which reportable segment a CGU or group of CGUs containing goodwill is included.

In addition, the IASB proposes amendments to how an entity calculates an asset's value in use. In particular, the amendments would:

- 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
- 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 and to disclose the approach applied.

Proposed amendments to the forthcoming IFRS 19
The IASB proposes to amend the forthcoming IFRS 19 S*ubsidiaries without Public Accountability: Disclosures* to require eligible subsidiaries applying the standard to disclose:

- information about the strategic rationale for a business combination
- quantitative information about expected synergies, subject to an exemption in specific circumstances
- information about the contribution of the acquired business
- information about whether the discount rate used in calculating value in use is pre-tax or post-tax.

Transition, effective date and comment period

The amendments to IFRS 3, IAS 36 and IFRS 19 would have to be applied prospectively from the effective date without restating comparative information. There is no proposal for a specific relief for first-time adopters.

The ED does not propose an effective date. The effective date will be decided when the IASB redeliberates the proposals.

The comment period for the ED ends on 15 July 2024.

Further information

If you have any questions about the proposed amendments, please speak to your usual Deloitte contact or get in touch with a contact identified in this *iGAAP in Focus*.

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