STAFF PAPER

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IASB® Meeting

Project	**Goodwill and Impairment research project**		
Paper topic	Improving disclosures about goodwill and impairment		

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Purpose

1. This paper is only for information to the Board about possible improvements to the disclosure requirements about goodwill and impairment, which the Board discussed in its past meetings; and for the Board to consider how the various approaches presented in Agenda Papers 18B–18D affect each other. Consequently, the Board is not being asked any questions on this paper.

2. The Board last discussed improving disclosures in March 2016. No decisions were made by the Board at that meeting.

> Significant changes to this paper from Agenda Paper 18B of the March 2016 meeting are as follows:
>
> - disclosure of the payback period of the investment, which was one of the six approaches under consideration, has been removed in the light of the Board discussion and the staff recommendations;
> - four of the remaining five approaches under consideration have been aggregated into two approaches because of linkages between those approaches; and
> - the analysis of the approaches has been expanded considering feedback from the Board members and other consultative groups.

Structure of the paper

3. This paper is structured as follows:

(a) objectives of improving disclosure requirements;	paragraph 4
(b) possible approaches to improving disclosures;	paragraphs 5–30
(i) reasons for payment of premium, key performance targets and comparison of actual performance with targets;	paragraphs 7–19
(ii) breakdown of goodwill and explanation justifying recoverability;	paragraphs 20–26
(iii) reviewing current disclosure requirements in IAS 36; and	paragraphs 27–30
(c) staff view.	paragraphs 31–33

Objective of improving disclosure requirements

4. The objective of considering possible improvements to the disclosure requirements is to determine whether better and more timely information about goodwill and impairment can be provided to users of financial statements without imposing costs on preparers that exceed the benefits.

Possible approaches to improving disclosures

5. The Board could consider one or more of the following approaches to improve disclosures:

   (a) responding to investor feedback by requiring an entity to disclose one or both of the following:

      (i) the reasons for payment of a premium over and above the value of the net identifiable assets acquired in a business combination, together with key performance assumptions or targets set by the entity for recovering the premium and comparison of actual performance with the targets.

(ii) breakdown of the carrying amount of goodwill by business combination, with an explanation for each combination, of why management considers that the goodwill is recoverable.

(b) reviewing current disclosure requirements in IAS 36 *Impairment of Assets* to determine whether any of those requirements should be modified or removed.

6. In March 2016 (Agenda Paper 6), the staff sought the views of the Global Preparers Forum (GPF) on the disclosure requirements described in paragraph 5(a)(i) of this paper.[1] The staff updated the Board on the feedback from the GPF at the March 2016 meeting of the Board. The staff considered the feedback from GPF in analysing the approaches explained in this paper.

Reasons for payment of premium, key performance targets and comparison of actual performance with targets

7. The Board could require an entity to disclose:

(a) the reasons for payment of premium over and above the value of the net identifiable assets acquired in a business combination;

(b) key performance assumptions or targets set by the entity for recovering the premium; and

(c) comparison of actual performance vis-à-vis the targets for a number of years following a business combination.

8. Key performance targets might include, for example:

(a) the expected revenue of the acquiree (if the acquiree is not integrated);

(b) a specified level of increase in revenue for an existing operating segment that benefits from the acquisition because of access to new markets;

[1] The minutes of the March 2016 meeting of the GPF can be accessed here (http://www.ifrs.org/Meetings/MeetingDocs/Other%20Meeting/2016/GPF/GPF-March-2016-Minutes.pdf)

(c) increased operating margins on a product line through removing a competitor from the market; and

(d) identified cost savings through economies of scale etc.

9. The entity would also identify the periods over which it expects to achieve these targets (for example an increase in revenue of five per cent per year for three years).

10. The number of years for which an entity should continue to provide the comparison of actual performance vis-à-vis the targets could be driven by the time horizon used by the entity’s management when determining the targets. The Board could also consider requiring a minimum period, for example three years after the business combination.

Staff analysis

11. Paragraph B64 of IFRS 3 *Business Combinations* requires an acquirer to disclose:

(a) the primary reasons for the business combination and a description of how the acquirer obtained control of the acquiree; and

(b) a qualitative description of the factors that make up the goodwill recognised, such as expected synergies from combining operations of the acquiree and the acquirer, intangible assets that do not qualify for separate recognition or other factors.

12. The Board learned from the Post-Implementation Review (PIR) of IFRS 3 that the disclosures in financial statements are either limited or boilerplate repetition of phrases used in IFRS 3. Investors said that the disclosures do not provide any insight into the real economic reasons for the business combination or the key drivers that support the valuation.

13. The requirement in paragraph B64 of IFRS 3 could be expanded to require an entity to disclose the information described in paragraph 7 of this paper. This is likely to make entities disclose information specific to the business combination instead of boilerplate repetition of the Standard. The expanded disclosure would provide investors with useful information (a) about the key drivers that justified the valuation of the acquiree; and (b) that will help them make their own assessments of whether the level of goodwill is reasonable. Comparison of actual

performance vis-à-vis the targets would inform the investors about the subsequent performance of the business combination and whether the entity is realising any synergies that it targeted.

Availability of information

14. As stewards of an entity, management is responsible for:

    (a) ensuring that there is a rational basis for paying premium in a business combination;

    (b) setting key performance targets that reflect the synergies expected to be realised by management; and

    (c) monitoring the subsequent performance of a business combination both for internal purposes and for reporting to existing and potential investors, lenders and other creditors.

15. The staff expect that the information described in paragraph 7 of this paper is usually readily available. For large combinations, management is often subject to a legal or regulatory requirement to seek approval from shareholders. In most cases, in documents seeking that approval, management explains the basis for paying a premium and identifies the key performance targets. This information would have also been included in regulatory filings. Furthermore, if entities prepare a management commentary, the staff believe that it is probably common practice for entities to disclose some or all of the information described in paragraph 7 of this paper.

16. Consequently, in requiring an entity to disclose the information in the financial statements, the Board could allow the entity to incorporate the information by cross-reference from the financial statements to the management commentary, if the management commentary is available to users of financial statements on the same terms as the financial statements and at the same time. This is consistent with one of the principles of effective communication described in the Discussion Paper *Disclosure Initiative—Principles of Disclosure* that information provided should not be duplicated unnecessarily in different parts of the financial statements or the annual report.

17. The staff expect that requiring the disclosure in the financial statements would encourage entities to prepare the information more rigorously so that it stands up to scrutiny by the auditors. In addition, not all entities maybe subject to a requirement to produce a management commentary.

18. In respect of subsequent performance after a business combination, the staff considered whether it would be complex and subjective to identify or isolate data, especially when the acquired business is integrated into the acquirer's existing business. In the staff's view, this is not likely to be a concern. The acquirer's management's decision to integrate the acquired business with existing business would be reflected in the key performance targets. The targets in such situation are likely to relate to both the acquired business and the existing business affected by the business combination.

19. The staff expect that an entity would consider materiality in disclosing this information. For smaller combinations, the staff presume that goodwill and impairment issues are less likely to have a material effect.

Breakdown of goodwill and explanation justifying recoverability

20. The Board could consider requiring an entity to:

    (a) disclose a disaggregation of the carrying amount of goodwill at the reporting date by each past business combination; and

    (b) explain, for each significant business combination, why the carrying amount of goodwill is recoverable.

Staff analysis

21. Disclosure of disaggregation of goodwill by each past combination was suggested by members of the Capital Markets Advisory Committee (CMAC) at its November 2015 meeting, and by other investors during the PIR of IFRS 3. The disaggregation would highlight goodwill acquired in combinations that investors consider as unsuccessful combinations. Consequently, there may be pressure on the entity to justify why that goodwill is recoverable and to perform a more rigorous impairment test of that goodwill.

22. Disaggregation of goodwill by each past combination together with information described in paragraph 7 of this paper would help users make their own assessment of whether goodwill acquired in a past combination is recoverable.

23. The Board could also require a reconciliation of this disaggregation with goodwill allocated to cash-generating units (CGUs).

Availability of information

24. IAS 36 does not require tracking of goodwill by each past business combination. For impairment testing, goodwill acquired in a business combination is allocated to a CGU or group of CGUs expected to benefit from the synergies of the combination. Consequently, if a CGU (or CGUs) contains goodwill allocated from different acquisitions, the goodwill in the CGU (or CGUs) will be regarded as a single asset for impairment testing.

25. However, in applying IAS 21 *The Effects of Changes in Foreign Exchange Rates*, an entity would be tracking goodwill acquired in past combinations of foreign operations with a functional currency that is different from the presentation currency. Consequently, the entity may have to incur some costs to track goodwill acquired in other past combinations.

26. To explain why goodwill is still recoverable, an entity would be required to consider whether there is evidence that synergies from a past acquisition still exist and can be identified. For old combinations, the evidence gathering would be costly because it may become very difficult to identify or isolate the benefits arising from those combinations. Consequently, an entity’s explanation of why management considers goodwill recoverable may end up being boilerplate and of no use to investors.

Reviewing current disclosure requirements in IAS 36

27. The feedback from the PIR on IFRS 3 and subsequent outreach provided some evidence that the current disclosure requirements in IAS 36 are not being well applied.

28. In 2013 the European Securities and Markets Authority (ESMA) published a review of accounting practices followed by a sample of European issuers in

respect of impairment testing of goodwill and other intangible assets. The review looked into the 2011 financial statements of 235 European issuers from 23 countries. ESMA stated that although the majority of disclosures related to goodwill impairment testing were provided, in many cases these were boilerplate and not entity-specific. ESMA made the following recommendations to issuers to improve their disclosures:

(a) better specify the key assumptions used in the impairment test;

(b) include sensitivity analyses with sufficient detail and transparency, especially in situations in which indicators are present that impairment might have occurred;

(c) disclose the growth rates used to extrapolate cash flow projections based on budgets and forecasts; and

(d) disclose specific discount rates for each material cash-generating unit rather than average discount rates.

29. Some of the large accounting firms have also issued publications that identify common errors when applying the disclosure requirements in IAS 36. For example over aggregating, not disclosing assumptions, not disclosing all reasonably possible changes in key assumptions, etc.

30. The Board could decide to review the current disclosure requirements in IAS 36 to identify improvements to assist better application or to remove redundant disclosures. The overall assessment of the disclosure requirements in IAS 36 would be best performed after the Board has collectively considered the approaches to simplify/improve the impairment testing model in IAS 36 and the improvements to disclosures described in paragraph 5(a) of this paper.

Staff view

31. The staff think that the Board should consider, as part of the research project, requiring entities to disclose:

(a) the reasons for payment of premium over and above the value of the net identifiable assets acquired in a business combination;

(b) key performance assumptions or targets set by the entity for recovering the premium;

(c) comparison of actual performance vis-à-vis the targets for a specified number of years following a business combination; and

(d) disaggregation of the carrying amount of goodwill by each past acquisition.

32. In the staff’s view, for reasons explained in this paper, adding the requirements listed in paragraph 31 of this paper (a) would, if the requirements are applied appropriately, significantly improve the information provided to investors; and (b) would not result in significant additional cost or complexity for entities.

33. Furthermore, in the staff’s view, review of the current disclosure requirements in IAS 36 should be undertaken after the Board has collectively considered the approaches to simplify/improve the impairment testing model in IAS 36 and the disclosure requirements listed in paragraph 31 of this paper.