The Association of
Accountants and
Financial Professionals
in Business

International Accounting Standards Board
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Re: IFRS Exposure Draft: Business Combinations - Disclosures, Goodwill and Impairment

Dear International Accounting Standards Board Members:

The Financial Reporting Committee (FRC) of the Institute of Management Accountants (IMA) is writing to share its views on the International Accounting Standards Board (Board or IASB) Request for Information – *Business Combinations - Disclosures, Goodwill and Impairment*.

The IMA is a global association representing over 140,000 accountants and finance team professionals. Our members work inside organizations of various sizes, industries and types, including manufacturing and services, public and private enterprises, not-for-profit organizations, academic institutions, government entities and multinational corporations. The FRC is the financial reporting technical committee of the IMA. The committee includes preparers of financial statements for some of the largest companies in the world, representatives from the world's largest accounting firms, valuation experts, accounting consultants, academics and analysts. The FRC reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations. Additional information on the FRC can be found at www.imanet.org (About IMA, Advocacy Activity, Areas of Advocacy, Financial Reporting Committee).

Disclosures: Performance of a business combination

The FRC is concerned that some of the proposed disclosures are not aligned with the objectives of general purpose financial reporting as set out in the Conceptual Framework, in particular, disclosure of objectives and targets. While we acknowledge that the Conceptual Framework sets out that general purpose financial statements should provide information to allow users to assess management's stewardship of the entity's economic resources, this is expressed in terms of "how efficiently and effectively the reporting entity's management <u>has</u>

discharged its responsibilities to use the entity's economic resources" (IFRS CF.1.22 (emphasis added)). General purpose financial statements are, by their nature, records of historical transactions and are not generally designed to communicate management's future plans. And the Conceptual Framework states "...general purpose financial reports do not and cannot provide all of the information that existing and potential investors, lenders and other creditors need. Those users need to consider pertinent information from other sources, for example, general economic conditions and expectations, political events and political climate, and industry and <u>company outlooks</u>." (IFRS CF 1.6 (emphasis added)).

From our perspective discussion of strategy and performance against strategic objectives is an important part of the scope of the management commentary accompanying general purpose financial statements (the content of which is often prescribed under local law or regulation). We note that this view is consistent with the IFRS Practice Statement - Management Commentary, which states that management commentary should include "management's objectives and its strategies for meeting those objectives" and "the critical performance measures and indicators that management uses to evaluate the entity's performance against stated objectives" (IFRS PS - MC 24 b & e).

In addition, we are concerned that these proposals could result in undue focus on merger and acquisition strategy and performance, distracting from other areas of overall company performance. We acknowledge that business combinations can involve an entity utilizing significant economic resources, which warrant additional disclosures that allow users to understand what has been acquired in exchange for those resources. Such disclosures are already required by IFRS 3 and we support some of the enhancements to these disclosures suggested such as improved information about pension and financing liabilities.

There are many organic strategies that require the deployment of significant entity resources and similarly, for material transactions, disclosures providing information about the deployment of resources that are required by other standards (e.g., IAS 16, IAS 38, IFRS 16 and others). The proposed inclusion of disclosures about specific strategic objectives and performance for acquisitions but not for significant organic investments, potentially results in a significant disparity of information within an entity's financial statements (for example, one segment is grown organically, one segment is grown via acquisition). Consistent with our comments on the proposed synergy disclosures, which we set out below, we are concerned that disclosure of targets and performance against them without proper context, might not be properly interpreted, and simply serve to distract and obscure from other information. This could also result in significant disparities in information between different entities' financial statements where they have different growth strategies.

As such, we believe that disclosures of management objectives, targets and performance against targets should not be included as audited footnotes in general purpose financial statements. Should the Board decide to move forward with these proposals, the FRC would like to highlight a number of recommendations for the more detailed proposals, which are set out below.

Disclosures: Strategic business combinations

Should the Board decide to move forward with these proposals, the FRC agrees that any disclosures should be limited to only the most significant transactions. We note that the Board intends a strategic business combination to 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." (IASB ED/2024/1, BC 54). The FRC agrees that this is a reasonable definition of a strategic business combination, and that for transactions that truly meet this threshold it is appropriate for an entity's management to provide more information to users than would be provided for other less significant transactions. As noted above, the management commentary might be the most appropriate place for much of this communication and in many cases such transactions might also be subject to regulatory reporting. However, we believe that the proposed closed list of thresholds is likely to capture significantly more transactions than intended, which will both add to the cost of compliance for preparers as well as making it more likely that immaterial information is included in the financial statements. The thresholds are also likely to cause inconsistencies in reporting between entities.

Although the 10% threshold is consistent with IFRS 8, it is otherwise rather arbitrary. We note that for the asset test, there is an inherent inconsistency in comparing assets at fair value (the acquisition) to assets more likely measured on the basis of cost accumulation (the existing entity), meaning that entities, that have predominantly grown organically might be more likely to classify an acquisition as "strategic" compared to an entity that more regularly executes business combinations. We also note that where entities are operating at, or close to break even, many or all acquisitions might be captured.

In addition, implementing these bright-line thresholds could significantly increase costs for preparers, since establishing whether or not the threshold has been met might involve converting the acquiree's financial statements to IFRS and implementing controls for this process, along with the cost of audit of these procedures. This is work that would not otherwise be required in many jurisdictions, even where reporting on "significant" acquisitions is required (for example, the United States Securities and Exchange Commission's thresholds are 20%).

Similarly, while we acknowledge that "major line of business or geographical area of operations" is used in IFRS 5, it is not a defined term and that could lead to inconsistent application. We do not agree that an acquisition of this type would necessarily meet the definition of strategic.

If the concept of strategic business combinations is retained, the FRC recommends that the Board provide the definition of such a transaction, along with indicators for management to consider when making a principles-based judgment, as to which transactions meet the definition.

Disclosures: Exemption from disclosing information

Should the Board decide to move forward with these proposals, the FRC agrees that an exemption from disclosure is vital and we welcome the inclusion of an exemption in the proposals.

In order to ensure that the exemption is applied consistently, we suggest that additional application guidance is provided. This area of application will clearly be highly subjective since there is always the opportunity for information to be used by others in an unintended manner.

In particular, the FRC welcomes the Board's consideration of litigation risk, and notes that "In the IASB's view, litigation risk arising from an entity failing to meet its acquisition-date key objectives for a business combination because it disclosed the information (paragraph BC82(a)) would be addressed by the exemption." (IASB ED/2024/1, BC 83). In some jurisdictions where litigation risk is heightened, this might result in entities applying the exemption broadly. This would be a particular area where we suggest application guidance and illustrative examples are provided.

We remain concerned that information, that is considered confidential/sensitive or that could prejudice future transaction negotiations is not, on the face of it, covered by this exemption given that a future transaction would not necessarily form part of the "acquisition date key-objectives for the business combination", and believe that it is important for such information to be protected.

Disclosures: Identifying information to be disclosed

Should the Board decide to move forward with these proposals, the FRC agrees that following a management view would help to minimize the cost of preparing information. Key management personnel (KMP), is a well understood defined term, however we note that there is significant variability in how companies organize themselves and review acquisitions and so there is still a possibility of a lack of comparability between companies.

In addition to our overall concern that targets, and performance against them, should not in concept form part of the audited financial statements, there are other more practical reasons why their inclusion is likely to be more difficult than perhaps the Board envisaged.

Although continuing to disclose performance against targets as long as KMP continues to review seems reasonable in theory, determining the appropriate duration of this information will likely be more complex in practice: In many cases we believe that due to quick integration of acquisitions, ongoing monitoring might be limited. Any performance targets as at the acquisition date are quite likely to be amended/adjusted once the Group controls the acquired company and has full visibility of operations, and integration begins. It seems likely that in many cases this will simply result in companies disclosing that acquisition date targets are no longer relevant or being monitored quite quickly after the acquisition date.

In addition, inclusion of non-financial targets in audited footnotes will drive additional effort and cost to ensure that such data is properly controlled and is auditable, while perhaps not providing significant incremental benefit.

Should the Board proceed with this disclosure, we would suggest that it is made explicit that progress against targets is not a required disclosure in interim financial statements prepared in accordance with IAS 34.

Disclosures: Other proposals

We note that one of the stated objectives of the new disclosure is to provide "better information about business combinations to help [users] assess whether the price an entity paid for a business combination is reasonable" (IASB ED/2024/1, BC 18). Since in general, business combinations are the result of competitive transactions and are assumed to be at fair value, it is unclear why the price paid would not be "reasonable". In BC25 the two disclosure objectives proposed address performance of a business post acquisition. As discussed above, we believe that including such disclosures is not appropriate.

The FRC does not support all of the disclosure of additional information about the expected synergies, the costs to achieve those synergies and the timescales to achieve and benefit from synergies. Existing disclosures provide information about the composition of goodwill, bridging the gap between price paid and identified net assets. For those acquisitions that truly meet the definition of "strategic" as defined in the basis for conclusions (IASB ED/2024/1, BC 54), we agree that a narrative description of the broad nature of expected synergies is reasonable.

It is not clear to us whether the new disclosure is intended to capture only those synergies paid for, or also those synergies that represent opportunity over and above the purchase price. To the extent that the intention is to include all entity specific synergies and not just those synergies included in the fair value, we note our objections in general to including information in the financial statements that relates to actual or potential future plans, rather than to actual assets, liabilities and performance.

Further, we note that the expected synergies can change over time, compared to the potential synergies identified at acquisition. There are multiple reasons why an entity's approach could be modified after acquisition arising both from a better understanding of the acquired business, as it is integrated, as well as from other external factors or capital allocation opportunities in the rest of the business. We agree that it would be overly complex and costly to track these changes and the actual costs over time. However, in this context, we question the value of the disclosures in the first place, especially as perceived changes to approach will not have any context and thus could mislead.

The FRC does not object to the other disclosure changes proposed.

Changes to the impairment test

The FRC agrees that the current impairment test requirements can lead to shielding of goodwill impairments. The FRC acknowledges that in some cases management over-optimism can be a driver of delayed impairments but notes that delayed impairments can be a function of the impairment test itself.

The FRC supports the changes suggested to the value in use calculation. In addition, we note that IAS 36.33(b) states that entities shall base cash flow projections on the most recent financial budgets/forecasts approved by management, which implies that no changes should be made (other than as specifically permitted by the Standard). There are multiple approaches across entities for setting budgets/forecasts, including the use of stretch targets. A helpful additional amendment would be to clarify that management should adjust the approved budget/forecast to reflect an expected case within a range of outcomes.

The FRC agrees that in general entities do not monitor goodwill, other than as is required for the annual impairment test. To allow preparers to more cost effectively operationalize the proposed requirements we suggest that the Board provide more detail on what is involved in "monitoring of a business". For example, is it necessary that a profit measure is regularly reviewed? Is it necessary that a specific budget/forecast is developed for that business? We also note that the "lowest level" that business is monitored in a large group, could be very low. There does not appear to be any requirement for any level of seniority in terms of who is performing the monitoring for the purpose of determining where to establish groups of cash-generating units.

We would be pleased to discuss our comments with the IASB or its staff at your convenience.

Sincerely,

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