International Acccounting Standards
Board (IASB)
Dr Andreas Barckow, Chair
30 Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

15 July 2024

Dear Dr Barckow,

**Re: ED 2024 1 Business Combinations: Disclosures, Goodwill and Impairment**

BusinessEurope welcomes the opportunity to comment on the Exposure Draft "Business Combinations: Disclosures, Goodwill and Impairment". We appreciate the efforts of the International Accounting Standards Board (the "Board") to find a middle ground between the information requests of users and the concerns raised by preparers of financial statements.

With regard to the definition of a strategic business combination, we support the Board's efforts to define a threshold-based approach. However, in certain circumstances (e.g. when operating margins are low due to unusual circumstances), the criteria have the potential to classify business combinations as strategic while they are not regarded as such by the entity's management nor investors, leading to an artificial overstatement of the strategic importance of the acquired business. Thus, BusinessEurope proposes that the criteria, if kept in the final amendment, are to be applied on a "two out of three" basis, or considering the average threshold amount over the past three years, to ensure the validity of the classification and attached information. As an alternative, the criteria for a strategic business combination in B67C could be replaced by the principles stated in paragraph BC 54, with the thresholds being considered indicators.

We disagree with the required quantification of the synergies as they contain forward looking and sensitive information which may introduce litigation risk and weaken the negotiating position of the reporting entity. The quantification is also subject to judgement and uncertainty and will not only be costly to produce but also to audit. We also note that most acquired businesses are integrated into the acquirers' operations very quickly and thus providing information on an individual level is not possible, while information for the combined business does not fulfil the information needs of users (i.e. to assess the performance of the acquired business). We see potential disadvantages for IFRS adopters against competitors applying other accounting standards. Maintaining an economic level playing field is of utmost importance.

We agree and support in general the proposals regarding the impairment testing in accordance with IAS 36 but have some concerns regarding the allocation of goodwill to (groups of) cash generating units.

Please find our detailed comments in the Appendix to this letter.

Yours sincerely,

Erik Berggren
Senior Adviser

APPENDIX

Response to Question 1:
In general, we agree that, for business combinations that are considered to be of strategic relevance, increased transparency should apply. Indeed, we would expect companies to increase the level of information for such business combinations as a matter of course..

We also consider that the base case for business combination will be one in which the acquired business will be rapidly integrated into the existing business activities. In this case, the ED requires that disclosure should be made for the combined business. This in turn does not provide for an adequate basis for the review of the performance of a specific business combination. We further note that providing information on a combined basis goes beyond the objective of the ED and might discourage companies from growing other than organically. This situation would be detrimental in general, as it could be expected to dissuade entities from engaging in acquisition activity. It would also contradict the objective of maintaining a level playing field with US GAAP preparers.

Response to Question 2:
We appreciate the efforts made by the IASB to provide a practical approach to the identification of a strategic business combination. As the BC of the ED sets out, a strategic business combination is one that – if it fails to meet any one of an entity's acquisition-date key objectives – would seriously put at risk the entity achieving its overall business strategy.

Given that there may be multiple acquisition-date key objectives, it seems to us unlikely that failing only one of them would put the overall business strategy at risk. This is a high hurdle to overcome, and thus few business combinations would be classified as such. We think that this is consistent with the management's view of what constitutes a strategic acquisition.

We note however, that the proposed thresholds do not seem to be aligned with the description.
In contrast to the above definition, the 10%-thresholds on operating profit, revenue or acquired assets (incl. goodwill) would probably be met much more easily, i.e. business combinations may be – based on the threshold approach – classified as strategic although the overall business strategy is not put at risk if that business combination is unsuccessful.

We note that the Board has looked at other standards to identify known and existing thresholds. However, we are not convinced that the thresholds in this instance are fit for purpose and have the following concerns:

The criteria regarding the 10% of revenue and operating profit may be distorted by multi-year seasonality and extraordinary circumstances. For example, companies undergoing a significant change in their product portfolio may be subject to unusual decreases in revenue and operating profit. Especially for the operating profit, such situations may trigger a close to zero result, in which case all of the business combinations of the subsequent period would be regarded as strategic business combinations.

With regard to the criteria of the acquired assets, we ask the Board to consider clarifying whether the acquired asset include adjustments from the purchase price allocation. In addition, for business combinations containing non-controlling interests, we note that IFRS 3 gives the acquiring company the choice to either recognize the goodwill in full (including the amount attributable to non-controlling interests) or in part (limiting the goodwill to the share of the acquirer). We therefore wonder how companies should take this optionality into consideration and ask the Board to provide guidance on this matter.

Taking into account the comments made above, we therefore suggest that the criteria, if maintained in the final amendments, should be applied on a "two out of three"-basis in order to mitigate the risk of business combinations being classified as strategic when management does not regard them as strategic and, consequently, application of the amendments would lead to an artificial overstatement of the relevance of such a transaction. Alternatively, the average of each threshold amount over the past three years could be used, to avoid "one-off" distortions.

Response to Question 3:
We appreciate that the IASB has taken note of preparers' concerns with regard to the sensitivity of the information provided. We believe that this is crucial to protect the competitive position of the preparer, especially since the disclosures are to be made as early as when the business combination occurs, i.e. long before the expected synergies may unfold and give effect to the assumed advantage of the business combination (e.g. in comparison to an organic growth strategy). We are convinced that investors will place more value on a confidential strategy that is well-executed than on a well-disclosed strategy that fails due to competitive insight obtained via that disclosure.

However, we believe that the criteria of the proposed exemption make the exemption overly hard to apply. We assume that entities will struggle to pinpoint the disadvantageous effects of a disclosure to a sufficient extent in order to meet the criteria. Furthermore, the very detailed description required would highlight the concerns, thereby defeating the purpose of the exemption.

We therefore think that the Board should better describe and provide examples for situations in which the use of the exemption would be intended, so companies will

actually be relieved from providing onerous disclosures to safeguard their competitive position.

Response to Question 4:
In general, we agree with the proposals set out above. However, we believe that the base case for business combinations (strategic as well es non-strategic) will be the integration of the acquired business into the ongoing operations of the acquirer. As set out in ED.IFRS 3.B67A, the information that management uses to review the performance shall be the information to be disclosed. However, providing information on a combined basis only is unlikely to respond to the concerns raised by users (i.e. too little information about the business combination's performance) because the integrated business is subject to impacts other than just the performance of the acquired business. It also gives away sensitive information about the combined business, which in some cases may be an operating or even reportable segment. Providing information about targets and metrics on this level by far exceeds the intended purpose of the disclosures and is likely to have unintended economic impacts on the disclosing entity.

Further we note that companies will only monitor business combinations that they consider to be of truly strategic relevance. Disclosing the fact that a company does not monitor an acquired business although it is classified under the ED as be strategic (e.g. by applying the threshold approach) seems therefore contradictory and raises the question whether the proposed thresholds are suitable to identify business combinations that are really of strategic relevance.

We therefore think that the ongoing provision of information on strategic business combinations should be restricted to business combinations that are reviewed on an individual basis.

Response to Question 5:

<u>Objective</u>

We agree in general with the objective. However, we believe that there are very limited cases in which companies will actually be able to fulfil the objective (for reasons provided in the responses to other questions).

<u>Strategic rationale</u>
We believe that there will be little (if any) difference to the current disclosure requirements where IFRS 3 asks for the "primary reasons" for the business combination. We presume that companies will disclose some of the expected synergies on a concrete / quantitative and others on a general / qualitative basis due to the sensitivity of the information, e.g. whether cost synergies which will be realized by restructuring measures. In any case, as investors will welcome deal details and reward

communication, the company has an intrinsic incentive to do so while ensuring that sensitive information is treated appropriately.

Description of synergies
While we understand users' needs for information about the expected synergies, we doubt that a categorization would provide useful information. On the contrary, the sorting of the expected synergies into categories may seem artificial. Instead, we think that a qualitative inclusive description would better articulate the rationale of the transaction.

Furthermore, providing detailed information on the synergies might introduce litigation risk as well as there would be risk of breaching legal requirements in regards to consultations on restructuring, termination of employees and contracts if such have to be disclosed in the annual report before the initiation of the legal proceedings, negotiations with workers councils etc.

Estimated amounts, costs and timing of synergies
We disagree with the proposal to require entities to disclose quantitative information on estimated synergies. Firstly, such a quantification is subject to judgement and estimation uncertainty because of a lack of detailed information about the acquired business (which is usually available only after the transaction). Consequently, the reliability and auditability of such an amount would depend on individual assumptions and a costly controlling system which needs to be described extensively in the notes. Secondly, it would also give away information – when combined with the costs to achieve these synergies – about the reservation price (i.e. the maximum price that the acquirer would have been willing to pay). This in turn could lead to litigation questions on both sides of the transaction (the acquirer and the seller) regarding the fairness of the negotiated price and weaken the negotiation position for future transactions.

Contribution of an acquired business
While we agree with the clarification of the term "operating profit" which is clearly described in IFRS 18, we remain hesitant with regard to the proposals in ED IFRS 3.B64(q)(ii). The preparation of this information, that is widely known as "pro forma" information, is subject to the availability of accounting-relevant data of the acquired business. Since the volume and quality of data are not always sufficient, companies must use judgement and be able to adapt to the situation.

This kind of pro forma reporting is cost-intensive for preparers and might not be very useful for investors. According to BC168 of the ED, the intention of the disclosure is to help investors to determine a baseline performance against which they can compare future performance. However, the financial results in the year of acquisition are dominated by purchase price allocation distortions (e.g. deferred revenue haircuts, step-up of inventory and amortisation of intangible assets) and integration costs, and thus do not provide a reliable baseline of operational performance. Moreover, it is backward looking and to some extent arbitrary since there is a high degree of uncertainty how the past might have looked like if something would have hypothetically

happened earlier. Therefore, we would like to ask the Board to reconsider whether the benefits of this current disclosure requirement in IFRS 3 really outweighs the costs for preparers.

While we agree to disclose the basis of preparation for such information, we do not support the proposal to classify it as an accounting policy, leading to less flexibility in adaptation to the individual situation. Furthermore, we are not convinced that the term accounting policy can be properly applied to a hypothetical past.

Finally, the insertion of paragraph B64(ea) into the range of disclosures required for individually immaterial business combinations which are collectively material has the effect of rendering obligatory the detailed disclosures about synergies for these business combinations. Given that the synergies will relate to a number of separate business combinations, entities will probably have to provide broad ranges of estimates and classifications of such synergies. We think that providing such quantitative information will entail a great deal of effort and are not convinced that the resulting information would be of any real use to users.

Response to Question 6:
We support the IASB's proposal to disclose the reportable segment that contains a cash-generating unit or a group of cash-generating units that contains goodwill. Many entities already provide this information to stakeholders in the notes to the financial statements and have not experienced any criticism of shielding or management over-optimism.

We would like to express our concerns that the proposed wording in paragraph 80 could result in unintended consequences. The proposal changes the current definition of a goodwill carrying unit from "the lowest level within the entity at which goodwill is monitored for internal management purposes" to "the lowest level within the entity at which the business associated with the goodwill is monitored for internal management purposes".

Companies, especially large market caps, usually have a detailed reporting structure in place which goes down to several organizational layers. This enables the respective middle management to run their day-to-day operations, while key management personnel only receive aggregated data.

Whilst this detailed reporting is necessary to aggregate the information needed to monitor the business (including that resulting from prior acquisitions), it does in no way imply that the business or the resulting goodwill is monitored also on this level. Goodwill should be monitored where the synergies are expected to materialize; this is usually at a higher organizational level. Acquisitions usually generate value for several lines of business or over several geographies and this should be reflected in the level of the goodwill impairment test. Therefore, we strongly encourage the Board to refrain from changing the definition of the carrying units for goodwill in paragraph 80(a), as this

would confuse the operational reporting level with strategic decision-making level at which goodwill or synergies are actually reviewed.
We are convinced that it was not the intention of the IASB to fragment goodwill into micro-CGUs (as further explained in paragraph 80A(b)), but we are equally convinced that the new words contained in paragraph 80(a) will leave regulators and auditors no choice but to look at the level of detailed information available in the consolidation systems of companies and force preparers to allocate goodwill to the lowest level of data in those systems.

The IASB should specify which level of management is reviewing the business, and also clarify that the main focus of the proposal is to allocate goodwill to the level at which the synergies will be realised. We would therefore suggest the following alternative wording:

> *"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 synergies ~~business~~ associated with the goodwill is monitored ~~for internal~~ by key management personnel ~~purposes~~;..."*

Response to Question 7:
We strongly agree that companies should be able to include future cash flows in the estimation of value in use that are currently excluded. Since these cash flows are part of the business plans reported to and approved by the key management personnel, they should also be reflected in the value in use calculation without making artificial adjustments to remove them.

We believe that it does make sense to make use of internal budgets and forecasts, which take the dynamic management of the business into consideration, and to allow those effects to be incorporated in the cash flow projections that are used to determine the value in use. To the extent that it allows entities to adopt cash flow estimations closer to the forecast used by management in the business plans, we agree with the IASB that this proposal might make the impairment test less prone to error because estimates of value in use would probably be closer to cash flow projections which are regularly prepared, monitored and used internally for decision-making, rather than forecasts that are produced solely for external financial reporting.

The IASB's proposal could eliminate an inconsistency in IAS 36 in the sense that it would capture within the value in use the cash flows that will arise from any existing potential to restructure or enhance an existing asset (or cash-generating unit) rather than ignoring this potential and thus align it with the way restructuring cash flows are considered when determining fair value. As a result, the only difference between fair value and value in use calculations would stem from potential synergies, which are usually of lesser impact if the goodwill cash generating units also represent the reportable segments in accordance with IFRS 8.

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We would like to make one remark with respect to the treatment of a restructuring provision in the impairment test (ED IAS 36.44B), where the ED assumes that the provision for restructuring would not be part of the carrying amount of the CGU. However, if the restructuring provision is part of the carrying amount (net assets) of a cash-generating unit, the estimates of future cash outflows for the restructuring should be included in the value in use to ensure consistency (IAS 36.75 ff.). Perhaps it would be better if the Board required instead that the computation of value in use be consistent with the carrying amount of the relevant CGU.

Furthermore, we welcome the option to use post-tax discount rates in estimating value in use. The pre-tax discount rate requirement has proven ineffective. It is widely accepted that in the typical case of impairment testing on a cash-generating unit level, a pre-tax calculation is often difficult to achieve, given that a market-based cash-generating unit discount rate cannot be determined on a pre-tax basis.

Therefore, we support the IASB's proposal to remove the explicit requirement to use pre-tax inputs and pre-tax discount rates to calculate value in use. This proposal would reduce the costs of the impairment tests, provide more useful information, and make the tests more understandable. In addition, using post-tax discount rates and post-tax inputs would be more consistent with other IFRS Standards.
Response to Question 8:
We agree with the proposals from the IASB.

Response to Question 9:
We welcome the IASB's proposal to require application of the proposed amendments prospectively with early application permitted. Applying the amendments retrospectively would outweigh the benefits from doing so. Some of the proposed requirements may be difficult to implement retrospectively without the use of hindsight. This would be consistent with previous amendments to IFRS 3.