IFRS

STAFF PAPER

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Project	**Goodwill and Impairment research project**
Paper topic	Courses of action for improving application of IAS 36 *Impairment of Assets*

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Purpose

1. The purpose of this paper is:

   (a) to set out courses of action the Board could take; and

   (b) to ask the Board to decide the course of action it wishes to take,

   in response to concerns expressed by stakeholders during and after the Post-implementation Review (PIR) of IFRS 3 *Business Combinations* about applying IAS 36 to test goodwill for impairment.

Structure of the paper

2. The paper is structured as follows:

   (a) background and introduction (paragraphs 3–7);

   (b) collective consideration of possible approaches developed so far (paragraphs 8–25); and

   (c) questions for the Board.

Background and introduction

3. The staff have analysed separately each of the possible approaches for:

(a) simplifying the IAS 36 impairment test (Agenda Paper 18E);

(b) improving the effectiveness of the IAS 36 impairment test (Agenda Paper 18C); and

(c) providing better and timely information about goodwill and impairment to investors (Agenda Paper 18F).

4. All those approaches are hereinafter collectively referred to as ‘project approaches’.

5. In this paper, the staff:

(a) determine the extent to which the project approaches would meet the intended objectives of research project; and

(b) identify the combination of these approaches that are viable and that can form the basis for future action by the Board.

Board members will find it helpful to refer to Agenda Papers 18C, 18E and 18F when considering the staff analysis in this paper.

6. On the basis of conclusions reached in Agenda Paper 18B, the staff think that amortising goodwill should not be part of any future action by the Board.

7. The staff also did not consider the pre-acquisition headroom approach in this paper because the updated headroom approach encompasses the benefits of the pre-acquisition headroom approach. (See paragraphs 13 and 15 of Agenda Paper 18C.)

Collective consideration of project approaches

The extent to which the project approaches meet the objectives

8. On the basis of the analysis in the respective agenda papers, the following table (Table 1) summarises the staff’s assessment of the extent to which each project approach would meet the intended primary objective and other objectives of the research project. (The intended primary objective of each project approach is highlighted in bold text within square brackets.)

Table 1	Simplification *Simplify without making the test less robust*	Effectiveness *Improve timing of goodwill impairment*	Better and (or) timely information	Reduces costs or complexity	Remarks
Relief from the mandatory annual quantitative impairment test **[simplification]**	✓	✘	✘	✓	Although this approach might reduce the cost and complexity of testing goodwill for impairment, it might also reduce both the rigour of the impairment test and the number of useful disclosures currently required by IAS 36.
Not specifying whether the inputs used for calculating value in use are pre-tax or post-tax inputs **[simplification]**	✓	–	✓	✓	There may be some merit in removing the explicit requirement in IAS 36 to use pre-tax inputs in calculating value in use. The staff will bring more analysis of this approach to a future Board meeting.
Removing restrictions on cash flow projections used in calculating value in use **[simplification]**	✓	✓	–	✓	This approach does not in itself make impairment testing more effective. However, it (a) might mitigate some possible concerns about the costs of applying the updated headroom approach; and (b) enhances the relevance of the disclosure of headroom.
Testing goodwill at the entity-level or at the level of reportable segments **[simplification]**	✓	✘✘	✘✘	✓	Giving an option to test goodwill at an entity-level or at the level of reportable segments would lead to loss of information about impairment.
A single method as the sole basis for determining recoverable amount **[effectiveness]**	✓	✓	✓	✓	This approach might not significantly simplify impairment testing because an entity does not need to calculate both value in use and fair value less costs of disposal of a cash-generating unit in all situations. It needs to do this only when calculating one of these amounts has shown that there may be an impairment. Similarly, this approach might not in itself make impairment testing more effective. However, it might mitigate some possible concerns about the costs of applying the updated headroom approach. This approach might also improve the information provided to investors. For example, if value in use is used as the sole basis for measuring recoverable amount, some investors may find value in use more useful than fair value less costs of disposal because value in use reflects the manner in which an entity expects to use the asset.

Table 1	**Simplification** *Simplify without making the test less robust*	**Effectiveness** *Improve timing of goodwill impairment*	**Better and (or) timely information**	**Reduces costs or complexity**	**Remarks**
Updated headroom approach **[effectiveness]**	–	✓✓	✓✓	✗	See Agenda Paper 18C
Disclosure of headroom **[improved disclosures]**	–	✓	✓✓	✗	This disclosure could contribute to making the impairment test effective because entities are likely to undertake more rigorous and extensive calculations than they otherwise would.
Breakdown of goodwill by past acquisition **[improved disclosures]**	–	–	✓	✗	This disclosure might help investors in identifying the carrying amount of goodwill relating to business combinations that they consider unsuccessful.
Reasons for payment of premium, key assumptions or targets supporting the purchase consideration and comparison of actual performance with targets **[improved disclosures]**	–	✓	✓✓	✗✗	For this disclosure to be meaningful, an entity would have to disclose commercially-sensitive information. Preparers may therefore hold the view that the costs of making this disclosure outweigh the benefits. This disclosure could serve to alert investors to a risk that goodwill could become impaired, and could highlight areas in which investors might want to question management.
Payback period **[improved disclosures]**	–	–	–	✗	Only a small minority of stakeholders requested the Board to consider requiring disclosure of the payback period. Furthermore, the definition of the payback period was not clear.

✓✓ Significantly contributing to achieving the desired outcome
✓ Moderately contributing to achieving the desired outcome
– Neutral effect or not relevant
✗ Moderately detracting from achieving the desired outcome
✗✗ Significantly detracting from achieving the desired outcome

Approaches that are not viable

9. On the basis of the Board's past discussions, the staff think that the following may not be the Board's preferred project approaches and hence would not be pursued further:

    (a) relief from the mandatory annual quantitative impairment testing of goodwill (paragraphs B1–B23 of Appendix B of Agenda Paper 18E)—

        (i) although this approach might reduce the cost and complexity of testing goodwill for impairment, it might also reduce both the rigour of the impairment test and the number of useful disclosures currently required by IAS 36. Consequently, there are no persuasive arguments for recommending this approach to the Board.

        (ii) some members of the Global Preparers Forum preferred quantitative testing of goodwill less frequently, than annually, for example every three years, which they think would be more robust than a complete relief. However, compared to the current requirement in IAS 36, testing goodwill less frequently than annually is not like to save significant costs because the saving in costs from not having to perform an annual impairment testing will be partially offset by loss of benefit of learning curve from a regular annual impairment test. Either way, this approach would not achieve either the simplification objective, the effectiveness objective, or provide timely information about impairment to investors.

        (iii) this approach moderately contributes to achieving the simplification objective but also detracts from achieving the effectiveness objective and providing better and timely information.

    (b) allowing goodwill to be tested at an entity-level or at the level of a reportable segment (paragraphs B24–B28 of Appendix B of Agenda Paper 18E)—

(i) the staff do not think that an entity should be given an option to test goodwill at the entity-level or at the level of a reportable segment because it could lead to loss of information about impairment. For example, if goodwill impairment exists at the lower level at which the goodwill is monitored, that impairment might not be recognised if a unit that contains goodwill is aggregated with other units that contain sufficient headroom to offset the impairment loss.

(ii) the staff also thought about the possibility of providing additional guidance on allocation of goodwill for impairment testing. The staff think that it is difficult to provide any additional guidance that applies to all entities because the factors that make up the acquired goodwill are not likely to be the same across business combinations. Furthermore, how existing units of an entity benefit from a business combination are specific to the entity.

(iii) this approach moderately contributes to achieving the simplification objective but significantly detracts from achieving the effectiveness objective and providing better and timely information.

(c) requiring an entity to disclose reasons for payment of a premium over and above the value of the net identifiable assets acquired in a business combination, together with key assumptions or targets supporting the purchase consideration and comparison of actual performance with those assumptions or targets (paragraphs B1–B15 of Appendix B of Agenda Paper 18F)—

(i) on the basis of past discussions with the Board's consultative groups, the staff think that investors would support a possible requirement to disclose more information about the acquired business. However, preparers would express concerns that for those disclosures to be meaningful an entity would have to disclose commercially sensitive information. Consequently, if the Board requires those disclosures, entities are likely to disclose only boilerplate information.

(ii) this disclosure also serves as an indicator of possible impairment. If the actual performance is not in line with the key assumptions or targets, this indicator would trigger a requirement to determine the recoverable amount of the unit. However, preparers may argue that if the actual performance in the first few years is not in line with the key assumptions or targets supporting the purchase price, that does not always mean that the acquired assets are impaired. Entities generally take a long-term view of the benefits from the business combination.

(iii) this approach significantly contributes to providing better and timely information and moderately contributes to achieving the effectiveness objective but imposes undue costs that significantly outweigh the benefits.

(d) requiring an entity to disclose the expected payback period (paragraphs B16–B20 of Appendix B of Agenda Paper 18F)—for reasons set out in that paper, the staff think that this disclosure may not contribute to achieving any objectives of the research project.

10. Similarly, on the basis of the Board's past discussions, the staff think that the following possible approaches for improving disclosures (not included in Table 1) are not within the remit of the goodwill and impairment research project (see *Appendix C* of Agenda Paper 18F):

(a) disclosure of measure of total assets and liabilities for each reportable segment; and

(b) reviewing the drafting of the current disclosure requirements in IFRS 3.

11. The staff think that all the remaining project approaches may be the Board's preferred approaches and form a viable basis for any future action by the Board. Other than the updated headroom approach that significantly contributes to the effectiveness objective, all other remaining project approaches moderately contribute to the project objectives.

Compatibility between the remaining project approaches

12. The following table (Table 2) shows for each possible approach whether it is compatible with other approaches.

Table 2

	Pre-tax versus post-tax inputs	Removing restrictions on value in use	A single method for recoverable amount	Updated headroom	Disclosure of headroom	Breakdown of goodwill by past acquisition
Pre-tax versus post-tax inputs	—					
Removing restrictions on value in use	✓	—				
A single method for recoverable amount	✓	✓	—			
Updated headroom	✓	✓	✓	—		
Disclosure of headroom	✓	✓	✓	✓	—	
Breakdown of goodwill by past acquisition	✓	✓	✓	✓	✓	—

✓ Compatible
✗ Not compatible

13. From Table 2, it is clear that:

(a) all remaining project approaches are compatible with one another; and

(b) the remaining possible disclosures are not dependent on any of the remaining possible simplifications or possible effectiveness approaches. Consequently, the Board could pursue the possible disclosures whether or not the Board pursues the other remaining project approaches.

Courses of action for improving the application of IAS 36

14. On the basis of Table 2, the staff think that the Board could pursue one of the following courses of action for improving the application of IAS 36:

(a) no further action;

(b) simplifying the calculation of value in use by removing:

  (i) the explicit requirement to use pre-tax inputs; and

  (ii) the prohibition on including estimated cash flows from (1) uncommitted future restructuring; and (2) improving or enhancing the asset's performance.

(c) a combination of the following approaches:

  (i) simplifying the calculation of value in use as described in bullet (b);

  (ii) using a single method as the sole basis for determining the recoverable amount; and

  (iii) applying the updated headroom approach.

No further action

15. The concerns expressed by stakeholders during and after the PIR of IFRS 3 about testing goodwill for impairment do not highlight any flaws in the IAS 36 impairment testing model. The concerns are about the degree of subjectivity and the use of judgement.

16. Measuring recoverable amount is a valuation concept and valuation by definition is subjective. Any actions of the Board may not remove the subjectivity that is at the heart of IAS 36.

17. If the Board decides not to pursue any further action, the staff will ask the Board at a future meeting whether it wishes to seek any feedback from the public on the research findings.

Simplifying the calculation of value in use

18. See analysis in *Appendix A* of Agenda Paper 18E.

19. The combination of the two approaches set out in paragraph 14(b) moderately contribute to all three objectives of the research project and might reduce the cost and complexity in calculating value in use.

Combination of approaches that would achieve some balance between the project objectives

20. The Board could consider pursuing a combination of the project approaches set out in paragraph 14(c).

21. The updated headroom approach significantly contributes to achieving the effectiveness objective and providing better and timely information while imposing some costs. The other project approaches of using single method for determining recoverable amount and removing the prohibition on cash flows used in calculating value in use might to some extent mitigate the costs of applying the updated headroom approach by resolving the concern that the current measurement basis of IAS 36 does not produce a single point estimate of recoverable amount.

22. The possible approaches for simplifying calculation of value in use moderately contribute to all three objectives of the research project and might reduce the cost and complexity in calculating value in use.

23. This combination could achieve some balance between all three objectives of the research project.

Possible approaches for improving disclosures

24. As explained in paragraph 13(b), the Board could pursue the two possible disclosures irrespective of the course of action that it choses for improving the application of IAS 36.

25. See *Appendix A* of Agenda Paper 18F.

Questions for the Board

Questions for the Board
1. Does the Board agree that the following possible approaches should not be pursued further? (paragraph 9) a. relief from the mandatory annual quantitative impairment testing of goodwill; b. allowing goodwill to be tested for impairment at the entity-level or at the level of reportable segments; c. requiring disclosure of reasons for payment of a premium over and above the value of the net identifiable assets acquired in a business combination, together with key assumptions or targets supporting the purchase consideration and comparison of actual performance with those assumptions or targets; and d. requiring disclosure of payback period of the investment in a business combination. 2. Which of the following courses of action for improving application of IAS 36 does the Board wish to pursue? (paragraphs 14–23) a. no further action. b. simplify the calculation of value in use by removing: i. the explicit requirement to use pre-tax inputs; and ii. the prohibition on including estimated cash flows from uncommitted future restructuring and from improving or enhancing the asset's performance. c. a combination of the following approaches: i. simplify the calculation of value in use by removing: 1. the explicit requirement to use pre-tax inputs; and 2. the prohibition on including estimated cash flows from uncommitted future restructuring and from improving or enhancing the asset's performance.

ii. using a single method as the sole basis for determining the recoverable amount; and

iii. applying the updated headroom approach.

3. Does the Board wish to pursue the following disclosures? (paragraph 24–25)

   a. headroom on an annual basis in a cash-generating unit (or groups of units) to which goodwill is allocated for impairment testing; and

   b. breakdown of goodwill by past business combination explaining why the carrying amount of goodwill is recoverable.

4. Does the Board agree that the following possible approaches for improving disclosures are not within the remit of the goodwill and impairment research project? (paragraph 10)

   a. requiring disclosure of measure of total assets and liabilities for each reportable segment; and

   b. reviewing the drafting of the current disclosure requirements in IFRS 3.