IFRS

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 discusses possible approaches that the Board has considered in past meetings for improving disclosures about business combinations, goodwill and impairment.

2. This paper is for information only and contains no questions for the Board. Board members will find it helpful to refer to this paper when considering the courses of action described in Agenda Paper 18D for the December 2017 Board meeting.

Objective of improving disclosure requirements

3. 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.

Structure of the paper

4. The paper is structured as follows:

   (a) background and introduction (paragraphs 5–6);

(b) *Appendix A*—Possible approaches for improving disclosures that may be the Board's preferred approaches;

(c) *Appendix B*—Possible approaches for improving disclosures that may not be the Board's preferred approaches; and

(d) *Appendix C*—Possible approaches for improving disclosures that are not within the remit of this project.

Background and introduction

5. In past Board meetings, the Board discussed the following possible approaches to improve the quality of information provided to investors about business combinations, goodwill and impairment:

(a) *requiring new disclosures (ie disclosures that are currently not required by IFRS Standards)*—requiring entities to disclose one or more of the following:

(i) 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.

(ii) expected payback period of the entity's investment in the business combination, ie the expected time to recover the cost of the acquisition (either with or without considering the effect of discounting).

(iii) 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.

(iv) headroom in a cash-generating unit (group of units) that include(s) goodwill or indefinite-lived intangible assets.[1] Headroom is the excess of the recoverable amount of a

[1] Any reference in this paper to disclosure of headroom should be read as disclosure of headroom in a unit (group of units) that include(s) goodwill or indefinite-lived intangible assets.

cash-generating unit (group of units) over its carrying amount.

(v) a measure of total assets and total liabilities for each reportable segment.

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

(c) *reviewing current disclosure requirements* in IFRS 3 *Business Combinations* to determine whether the drafting of those requirements could be improved.

6. On the basis of the Board's past discussions, the staff think that:

(a) the approaches set out in paragraphs 5(a)(iii), 5(a)(iv) and 5(b) may be the Board's preferred approaches (see *Appendix A* for the analysis of the approaches);

(b) the approaches set out in paragraphs 5(a)(i) and 5(a)(ii) may not be the Board's preferred approaches (see *Appendix B* for the analysis of the approaches); and

(c) the approaches set out in paragraphs 5(a)(v) and 5(c) are not within the remit of this project (see *Appendix C* for the analysis of the approaches).

Appendix A
Possible approaches for improving disclosures that may be the Board's preferred approaches

Breakdown of goodwill and explanation justifying recoverability

A1. 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

A2. 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 Post-implementation Review of IFRS 3 *Business Combinations*. The disaggregation would highlight goodwill acquired in combinations that investors consider as unsuccessful. 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.

A3. Disaggregation of goodwill by each past combination together with information described in paragraph B1 of *Appendix B* would help users make their own assessment of whether goodwill acquired in a past combination is recoverable.

A4. The Board could also require a reconciliation of this disaggregation with goodwill allocated to cash-generating units.

Feedback from past discussions with the Board's consultative groups

A5. CMAC members stated that disclosing a breakdown of goodwill by past acquisition can provide useful information. That information helps them in identifying the carrying amount of goodwill relating to acquisitions that they consider unsuccessful. However, members of the Global Preparers Forum (GPF) questioned the usefulness of this information, especially long after an acquisition.

Staff thoughts on availability of information

A6. 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 unit or group of units expected to benefit from the synergies of the combination. Consequently, if a unit (or units) contains goodwill allocated from different acquisitions, the goodwill in the unit (or units) will be regarded as a single asset for impairment testing.

A7. 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 entity's presentation currency. However, the entity may have to incur some costs to track goodwill acquired in other past combinations.

A8. To be able to explain why goodwill from a past acquisition is still recoverable, an entity would need to consider whether there is evidence that synergies from that acquisition still exist. For old combinations, gathering the evidence 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 to be recoverable may end up being boilerplate and of no use to investors.

A9. Alternatively, the Board could consider requiring disclosure of goodwill recognised in the preceding 3–5 years by each business combination. The sum of those amounts need not necessarily equal the carrying amount of goodwill.

Disclosure of headroom

A10. At a past joint meeting of CMAC and GPF, a few GPF members suggested that the staff should focus on headroom to improve effectiveness of the impairment test. A simple approach could be to require entities to disclose the headroom annually.

A11. Currently, IAS 36 requires disclosure of the headroom only when a reasonably possible change in a key assumption on which management has based its determination of the unit's (group of units') recoverable amount would cause its (their) carrying amount to exceed its (their) recoverable amount.

2004 revisions to IAS 36

A12. When revising IAS 36 as part of the first phase of the business combinations project in 2004, the Board considered requiring entities to disclose a range of information about units (groups of units) that included goodwill or indefinite-lived intangibles. The Board's objective was to achieve a reasonable balance between (a) providing investors with useful information for evaluating the reliability of the estimates used in testing goodwill for impairment; and (b) the potential magnitude of the disclosures that an entity should provide in its financial statements.

A13. One proposal made in the Exposure Draft of those revisions to IAS 36 was to require entities to disclose the amount by which a unit's recoverable amount exceeded its carrying amount. The Board did not finalise the proposal as exposed but decided, in its redeliberations, to require an entity to disclose that information only in situations described in paragraph A11 (ie when a reasonably possible change in a key assumption would cause the carrying amount to exceed recoverable amount).

A14. As explained in paragraph BC207 of the Basis for Conclusions on IAS 36, the Board was sympathetic to the feedback on the Exposure Draft and concerns of field visit participants that the proposals went beyond their intended objective. For example, field visit participants and respondents to the Exposure Draft argued that:

(a) it would be extremely difficult to distil the recoverable amount calculations into concise but meaningful disclosures because those calculations typically are complex and do not normally result in a single point estimate of recoverable amount—a single value for recoverable amount would normally be determined only when the bottom-end of the recoverable amount range is less than a unit's carrying amount. These difficulties make it doubtful that the information, particularly the sensitivity analyses, could be produced on a timely basis.

(b) disclosing the proposed information, particularly the values assigned to, and the sensitivity of, each key assumption on which recoverable amount calculations are based, could cause significant commercial harm to an entity. Users of financial statements might, for example, use the quantitative disclosures as the basis for initiating litigation against the entity, its board of directors or management in the highly likely event that those assumptions prove less than accurate. The increased litigation risk would either encourage management to use super-conservative assumptions, thereby resulting in improper asset write-downs, or compel management to engage independent experts to develop all key assumptions and perform the recoverable amount calculations. Additionally, many of the field visit participants expressed concern over the possible impact that disclosing such information might have on their ability to defend themselves in various legal proceedings.

Staff analysis

A15. The staff think that the Board could consider the following factors in assessing whether it could require disclosure of headroom:

(a) the trend in the headroom together with the other disclosures currently required in IAS 36 provide relevant information to investors to assess the reliability of the impairment test. Requiring an entity to disclose headroom for a unit (group of units) containing goodwill or indefinite-lived intangible assets might not impose a significant additional burden because headroom information is generally available from the current impairment testing model. However, determining the precise headroom may involve some additional costs. This is because the current measurement basis does not produce a single point estimate of recoverable amount, and consequently, an entity would have to perform additional tasks to determine a precise recoverable amount.

(b) another possible concern from preparers is that, using the headroom information and other disclosures currently required by IAS 36, an investor would then be able to perform a reverse calculation to derive an entity's budgets. A GPF member had already raised this concern in the context of the current requirement in IAS 36 to disclose headroom as part of sensitivity analysis, in some circumstances (see paragraph A11) and suggested that the Board should consider removing that requirement. However, other GPF members and CMAC members did not support the suggestion.

(c) the disclosure of headroom has some interaction with other simplification/effectiveness approaches that the Board is discussing—using a single method as the sole basis for determining recoverable amount; and removing restrictions on cash flow projections used in calculating value in use. If the Board prefers to continue with the current higher-of-the-two basis for determining recoverable amount, and to retain the restrictions on cash flow projections used in calculating value in use, the trend in the headroom is likely to become distorted if an entity switches between value in use and fair value less costs of disposal. Furthermore, if an entity normally determines the recoverable amount using value in use, the headroom of that unit (group of units) is, arguably, not the full headroom because of the prohibition that the IAS 36 imposes on cash flows expected to arise from an uncommitted future restructuring or from improving/enhancing an asset's performance. Consequently, there could be concerns about the relevance of the information that would be provided by disclosing headroom. The staff think that moving to a single method and (or) removing the prohibitions on cash flow projections used in calculating value in use could enhance the relevance of the disclosure of headroom.

Reviewing current disclosure requirements in IAS 36

A16. 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.

A17. 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.

A18. Some of the large accounting firms have also issued publications that identify poor practices in applying the disclosure requirements in IAS 36. Examples are over-aggregating, not disclosing assumptions, not disclosing all reasonably possible changes in key assumptions.

Feedback from past discussions of the Board's consultative groups

A19. The staff sought feedback from CMAC and GPF about whether any existing disclosure requirements in IAS 36 are not helpful. The staff received very limited feedback on the existing disclosures.

A20. CMAC and GPF members generally stated that disclosure of a pre-tax discount rate is not useful as that rate is not observable and is generally not used for valuation purposes (also see paragraphs A1–A8 of *Appendix A* of Agenda Paper 18E for the December 2017 Board meeting).

A21. One GPF member suggested that disclosure of sensitivity analysis should be removed because this disclosure could make it easy to derive an entity's budgets. However, other members did not support deletion of disclosure of sensitivity analysis. This feedback is consistent with investors' feedback during PIR of IFRS 3 that sensitivity information is useful.

A22. A few CMAC members suggested that the Board could consider requiring an entity to disclose a measure of total assets and liabilities for each reportable segment. That information would allow them to assess the return generated in each reportable segment and compare it with the average cost of capital.

Currently, IFRS 8 *Operating Segments* requires an entity to report a measure of total assets and total liabilities for each reportable segment if such amounts are regularly provided to the chief operating decision maker. A few GPF members thought that such disclosures would be relevant only in certain industries. (See paragraphs C1–C8 of *Appendix C*.)

A23. A few GPF members suggested that the staff should focus on the headroom (the excess of the recoverable amount of a cash-generating unit (group of units) over the carrying amount) to improve effectiveness of the impairment test. One suggestion was that a simple approach could be to require entities to disclose the headroom annually. Investors could then identify whether there is a declining trend in the headroom and perform their own impairment assessment. Currently, the only time when the headroom is required to be disclosed is when a reasonably possible change in a key assumption on which management has based its determination of the unit's (group of units') recoverable amount would cause its (their) carrying amount to exceed its (their) recoverable amount. (See paragraphs A10–A15.)

Appendix B
Possible approaches for improving disclosures that may not be the Board's preferred approaches

Reasons for payment of premium, key assumptions or targets supporting the purchase consideration and comparison of actual performance with targets

B1. 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 assumptions or targets supporting the purchase consideration and (consequently the goodwill acquired) in a business combination; and

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

B2. Key assumptions or 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;

(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.

B3. 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).

B4. 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 making the assumptions or targets. The Board could also consider requiring a minimum period, for example three years after the business combination.

Staff analysis

B5. 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.

B6. The Board learned from the 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.

B7. The requirement in paragraph B64 of IFRS 3 could be expanded to require an entity to disclose the information described in paragraph B1. To satisfy this requirement, entities would need to 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 it is reasonable to view the carrying amount of goodwill as recoverable. Comparison of actual performance vis-à-vis the targets would inform investors about the subsequent performance of the business combination and whether the entity is realising any synergies that it targeted.

Feedback from past discussions with the Board's consultative groups

B8. CMAC members generally supported a possible requirement to disclose more information about the acquired business. However, many GPF members expressed concerns that for those disclosures to be meaningful an entity would have to disclose commercially sensitive information. Consequently, in their view, if the Board requires those disclosures, entities are likely to disclose only boilerplate information.

B9. A few GPF members argued that providing the disclosures for each individual acquisition would be difficult because post-acquisition integration could make it difficult for management to track those targets or assumptions vis-à-vis actual performance.

Staff thoughts on availability of information

B10. To enable management to discharge its responsibilities, the staff expect that management would generally need to:

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

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

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

B11. The staff expect that the information described in paragraph B1 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.

B12. 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 B1. (The Board could consider whether to allow the entity to incorporate the information by cross-reference from the financial statements to the management commentary (see discussion in the Discussion Paper *Disclosure Initiative—Principles of Disclosure*)).

B13. 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 may be subject to a requirement to produce a management commentary.

B14. 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.

B15. 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.

Payback period

B16. The Board could consider adding a requirement for entities to disclose the expected payback period of the investment in a business combination, ie the expected time to recover the purchase price paid for an acquisition (either with or without considering the effect of discounting).

Staff analysis

B17. In 2015 the Accounting Standards Board of Japan (ASBJ) staff published a research paper on amortisation of goodwill. As part of the work performed in developing the research paper the ASBJ staff surveyed and held discussions with financial statement users in Japan. In the research paper the ASBJ staff noted:

> As shown in the survey result, Japanese users' views were mixed as to whether they prefer the impairment-only approach or the amortisation and impairment approach. However, the result showed that the majority of users expressed support for the amortisation and impairment approach. In order to deepen our understanding, we reached out to Japanese users to seek their rationale. During the discussion, some explained that financial information is richer under the amortisation and impairment approach, for example, because it would provide some

indication about management views on the expected payback period for investments.[2]

B18. In its 2014 Discussion Paper, the EFRAG/OIC/ASBJ Research Group stated that in determining the amortisation period an entity would normally consider 'the expected payback period of the investment on a business combination, which is normally estimated at the time when the business combination takes place.' However, the EFRAG/OIC/ASBJ Research Group noted that 'the payback period itself would not meet the definition of an amortisation period, and an entity would need to make the appropriate adjustments in determining the amortisation period.'[3]

B19. The staff do not think the expected payback period would normally correspond with an appropriate amortisation period for goodwill. Consequently, an amortisation model for goodwill would be unlikely to provide information about the payback period to users. However, the staff note that if users are interested in this information, the Board could consider adding a requirement to disclose the payback period.

B20. In the outreach with users during the Post-implementation Review of IFRS 3, the staff did not receive any requests for information about the payback period of the investment. However, it was referred to in three comment letters by other respondents, including the ASBJ. None of these letters provided a definition of what they considered to be the payback period.

[2] The information in this paragraph is taken from paragraphs 44 and 45 of the research paper.

[3] The information in this paragraph is taken from paragraph 84(c) of the discussion paper.

Appendix C
Possible approaches for improving disclosures that are not within the remit of this project

Measure of total assets and liabilities for each reportable segment

C1. A few CMAC members suggested that the Board should require disclosure of a measure of total assets and liabilities for each reportable segment, even if such amounts are not regularly provided to the chief operating decision maker.[4] They think that (a) capital allocation and monitoring the invested capital is a very important responsibility of management; and (b) IFRS 8 provides entities with some opportunity to avoid disclosing this information.

C2. Those CMAC members suggest that this information would allow them (a) to assess the returns that an entity is generating in each of the reportable segments by comparing it with the entity's average cost of capital; and (b) to understand the effects of a business combination on the rates of returns of the reportable segment that includes the acquired business. On the other hand, a few GPF members thought that such disclosures would be relevant only in certain industries.

April 2009 Improvements to IFRSs

C3. IFRS 8, as issued in November 2006, required an entity to disclose:

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

(b) a measure of liabilities for each reportable segment if such an amount is regularly provided to the chief operating decision maker.

C4. Although the feedback on the Exposure Draft of IFRS 8 was that a measure of assets is not always available, particularly in service industries or other industries with low utilisation of physical assets, the Board noted that the requirement to disclose a measure of segment assets in all cases was required to maintain convergence with the equivalent standard in the US. (See paragraphs BC34 and BC35 of the Basis for Conclusions on IFRS 8.)

[4] Paragraph 23 of IFRS 8 *Operating Segments* requires an entity to report a measure of total assets and liabilities for each reportable segment *if* such amounts are regularly provided to the chief operating decision maker.

C5. Subsequently, the Board was informed that its conclusion in 2006 contradicted long-standing interpretations in the US and created an unintended difference from practice in the US. After reconsideration and discussion of the interaction between the disclosure and measurement requirements in paragraphs 23 and 25 of IFRS 8, the Board concluded that those reasons given in paragraph C4 'no longer reflected its thinking'. Therefore, the Board amended IFRS 8 in 2009 to clarify that a measure of segment assets should be disclosed only if that amount is regularly provided to the chief operating decision maker.

March 2017 Exposure Draft Improvements to IFRS 8 *Operating Segments*

C6. In the Exposure Draft, the Board proposed amending IFRS 8 to clarify that an entity may disclose segment information in addition to that reviewed by, or regularly provided to, the chief operating decision maker if that helps the entity to meet the core principle in paragraphs 1 and 20 of IFRS 8.

C7. This proposal was in response to feedback during the Post-Implementation Review of IFRS 8 from investors wanting the Board to mandate disclosure of specified items such as depreciation, gross margin, cash flows etc. The Board proposed not to mandate any additional line items. The Board's considerations are explained in paragraphs BC27–BC31 of the March 2017 Exposure Draft. The comment period on the March 2017 Exposure Draft ended in July 2017.

Staff analysis

C8. The staff think that any possible changes to IFRS 8 are not within the remit of the goodwill and impairment research project. The Board could consider the explanations in paragraphs C1–C2 as part of its redeliberations of the March 2017 Exposure Draft.

Reviewing the drafting of the current disclosure requirements in IFRS 3

C9. In the past discussions of the Board about one of the possible new disclosures explained in paragraphs B1–B15 of *Appendix B*, some Board members thought that one of the reasons for investors' concern about boilerplate disclosures about business combinations could be that the current drafting of IFRS 3 does not clearly set out the objective of the disclosures.

C10. Consequently, the Board could consider reviewing the disclosure requirements in IFRS 3 to improve the drafting of the requirements. This review could be performed as part of the Disclosure Initiative if and when the Board decides to perform a standards-level review of disclosures.

C11. The March 2017 Discussion Paper *Disclosure Initiative—Principles of Disclosure* includes a section describing an approach that has been developed by the staff of the New Zealand Accounting Standards Board (NZASB staff) for drafting disclosure objectives and requirements in IFRS 3. In paragraph 8.1 of that Discussion Paper, the Board observed that (a) it has not yet formed any views about the NZASB staff's approach; and (b) if feedback on the NZASB staff's approach is positive, it might consider the NZASB staff's approach in its Standards-level Review of Disclosures project.