

STAFF PAPER

March 2017

IASB[®] Meeting

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|--------------------|--------------------------------|--|---------------------|
| Project | Goodwill and Impairment | | |
| Paper topic | Project Update | | |
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Purpose

1. The purpose of this meeting is to:
 - (a) update the Board on the progress of the Goodwill and Impairment research project (the research project) since the June 2016 joint education session with the US Financial Accounting Standards Board (FASB);
 - (b) communicate the activities that we plan to undertake in 2017; and
 - (c) recap the research project approaches developed so far.

Structure of this paper

2. This paper is structured as follows:

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| (a) brief background of the research project; | paragraphs 3–11 |
| (b) progress on the research project since June 2016; | paragraphs 12–17 |
| (c) plan for 2017; and | paragraphs 18–19 |
| (d) research project approaches developed so far. | paragraphs 20–56 |

Brief background of the research project

3. The Board added the Goodwill and Impairment research project to its agenda to consider how to address the following three areas of focus identified in the [Post-implementation Review \(PIR\) of IFRS 3 Business Combinations](#):
 - (a) whether changes should be made to the existing impairment testing requirements in IAS 36 *Impairment of Assets*;
 - (b) subsequent accounting for goodwill (including the relative merits of an impairment-only approach and an amortisation and impairment approach); and
 - (c) the extent to which other intangible assets should be separated from goodwill.
4. See *Appendix A* of this paper for the feedback from the PIR of IFRS 3.
5. The objective of considering changes to the impairment testing model and subsequent accounting for goodwill is to identify:
 - (a) possible simplifications to the impairment testing model that help reduce the cost of testing without making the test less robust ('simplification objective');
 - (b) improvements that (i) make the impairment testing model more effective in capturing impairment losses at the appropriate time and in the appropriate amounts; and (ii) provide additional information about goodwill and impairment to the users of financial statements without imposing costs that exceed the benefits ('effectiveness objective'); and
 - (c) the merits, if any, in introducing other approaches, such as amortisation of goodwill.
6. The objective of considering identification of intangible assets separately from goodwill in a business combination is to determine if there are cost benefit reasons to subsume within goodwill any intangible assets that IFRS 3 currently requires separate recognition.
7. Accordingly, the research project has three strands:
 - (a) simplification of the IAS 36 impairment testing model;

- (b) improving the effectiveness of impairment testing; and
 - (c) identification of intangible assets in a business combination.
8. The research project is not a joint project with the FASB. However, the FASB has two projects on its agenda with objectives similar to those of the research project and both Boards have decided to monitor each other's work because of converged requirements on accounting for business combinations. The current requirements in IFRS Standards and US GAAP on impairment of non-financial assets are not converged. See *Appendix B* of this paper for a high-level comparison of IFRS Standards and US GAAP in respect of impairment of non-financial assets.

Brief background of the related FASB projects

9. The FASB has the following two projects.
- (a) Goodwill impairment, divided into:
 - (i) Phase 1—Accounting for Goodwill Impairment¹; and
 - (ii) Phase 2—Subsequent Accounting for Goodwill for Public Business Entities and Not-for-Profit Entities.²
 - (b) Accounting for Identifiable Intangible Assets in a Business Combination for Public Business Entities and Not-For-Profit Entities.³
10. The objective of Phase 1, Accounting for Goodwill Impairment, is to reduce the cost and complexity of the subsequent accounting for goodwill by simplifying the impairment test. The objective of Phase 2, Subsequent Accounting for Goodwill for Public Business Entities and Not-for-Profit Entities, is to evaluate whether additional changes need to be made to the subsequent accounting for goodwill beyond any changes to the impairment test resulting from Phase 1.

¹ Link to the project webpage
http://www.fasb.org/cs/ContentServer?c=FASBContent_C&pagename=FASB%2FFASBContent_C%2FProjectUpdatePage&cid=1176163679475

² Link to the project webpage
http://www.fasb.org/cs/ContentServer?c=FASBContent_C&pagename=FASB%2FFASBContent_C%2FProjectUpdatePage&cid=1176167307243

³ Link to the project webpage
http://www.fasb.org/cs/ContentServer?c=FASBContent_C&pagename=FASB%2FFASBContent_C%2FProjectUpdatePage&cid=1176165910709

11. The FASB's identifiable intangible assets project is intended to evaluate whether certain identifiable intangible assets acquired in a business combination should be subsumed into goodwill.

Progress on the research project and the FASB's projects since June 2016

12. The Board last discussed the research project at a joint education session with the FASB in [June 2016](#) (Agenda Papers 18–18E). At that meeting, staff of the two Boards provided an update on their respective projects. The two Boards discussed the respective project approaches and summaries. No decisions were made.
13. Since that meeting, we have undertaken only a limited amount of further research. In the next section of this paper (paragraphs 18–19) we have laid out the activities that we plan to undertake in 2017.

Progress on the FASB's projects

14. Before the joint education session in June 2016, the FASB published an exposure draft of proposed simplifications to the US GAAP goodwill impairment testing model. These proposals were the output of Phase 1 of its goodwill impairment project.
15. The impairment test in US GAAP was a two-step process. The first step was to compare the carrying amount of a reporting unit with its fair value. If the carrying amount was higher than the fair value, the second step was to calculate the implied fair value of goodwill and recognise an impairment loss for an amount by which the carrying value of goodwill exceeded the implied fair value of goodwill (but that loss cannot exceed the total goodwill allocated to the reporting unit). In computing the implied fair value of goodwill, an entity had to determine the fair value of all identifiable assets and liabilities of the reporting unit similar to determining fair value of assets acquired and liabilities assumed in a business combination. IAS 36 *Impairment of Assets* does not require an entity to determine the implied fair value of goodwill when measuring a goodwill impairment loss.
16. The proposed simplification eliminates the second step of determining the implied fair value of goodwill with the objective of reducing the cost and complexity of the impairment test. The FASB affirmed the proposals in October 2016 and

subsequently issued the final [Accounting Standards Update \(ASU\) 2017-04, *Simplifying the Test for Goodwill Impairment*](#). With this simplification, one of the differences between IFRS Standards and US GAAP in respect of the goodwill impairment testing process is eliminated. However, the respective models remain unconverged.

17. The FASB also decided to move Phase 2 of its goodwill impairment project and the intangible assets in a business combination project from its standard-setting agenda to research agenda. The FASB decided to evaluate the effectiveness of its simplification amendments described above and monitor the IASB Board’s research project before considering whether additional changes to the subsequent accounting for goodwill, including consideration of permitting or requiring amortisation of goodwill and/or additional changes to the impairment testing methodology, are needed.

Plan for 2017

18. Plan for 2017 is as follows:

| Month | Meeting with | Objective of the meeting |
|-----------------------|---|--|
| March | Global Preparers Forum (GPF) | To seek ideas about possible simplifications to the impairment testing model that would not make the model less robust |
| March | Board | See paragraph 1 of this paper |
| May | Board | To discuss staff proposals on both simplification and improving the effectiveness of the IAS 36 impairment testing model |
| June | Joint meeting of GPF and Capital Markets Advisory Committee | To seek feedback on staff proposals on simplification and improving the effectiveness of the IAS 36 impairment testing model |
| July | Board | To discuss staff proposals on identification and measurement of intangible assets in a business combination |
| July/ September | Accounting Standards Advisory Forum (ASAF) | To seek feedback on the staff proposals on the research project |

| Month | Meeting with | Objective of the meeting |
|-----------------------|--------------|--|
| November/ December | Board | <ul style="list-style-type: none"> – To update the Board on the feedback from ASAF and other consultative groups – To seek tentative decisions from the Board and decide the form of public consultation (ie Discussion Paper or Exposure Draft) |

19. We also plan to undertake field testing of any new approaches that the Board decides to take for improving the effectiveness of impairment testing.

Research project approaches developed so far

20. This section of the paper summarises the approaches that the staff have developed to meet the objectives of the research project. Links to the past Board meeting agenda papers that contain a detailed explanation of the approaches are included in each section below.

Simplification objective

21. One or more of the following approaches might help in achieving the simplification objective.
- (a) a single method to determine the recoverable amount;
 - (b) relief from annual testing;
 - (c) changes to the value in use (VIU) methodology; and
 - (d) additional guidance to assist entities in applying the IAS 36 requirements.

A single method to determine the recoverable amount

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| October 2015 | Agenda Paper 18B | Paragraphs 14–30 |
| February 2016 | Agenda Paper 18C | Paragraphs 12–28 |

22. The objective of IAS 36 is to prescribe procedures that an entity applies to ensure that its assets are carried at no more than their recoverable amount. IAS 36 defines recoverable amount as the higher of an asset’s (or cash generating unit’s (CGU’s)) fair value less costs of disposal (FVLCD) and its VIU. VIU is the present value of the future cash flows to be derived from continuing use and disposal of the asset. The cash flow projections used in VIU calculation should be

based on reasonable and supportable assumptions that represent *management's best estimate* of the range of economic conditions that will exist over the remaining useful life of the asset. However, in FVLCD calculations, an entity is required to use assumptions that *market participants* would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

23. It is not always necessary to determine both a CGU's FVLCD and its VIU. However, if either of these amounts is less than the CGU's carrying value, an entity has to determine the other amount before it concludes the recoverable amount of the CGU. Consequently, in situations in which an entity has to determine both the amounts and the entity determines FVLCD using a discounted cash flow calculation, there is complexity and confusion because of the need to use different inputs for VIU (management's best estimates) and FVLCD (market participant assumptions) calculations.
24. The Board could consider requiring entities to use a single method to determine recoverable amount, instead of the higher of the two methods. This might reduce complexity without loss of information for users of financial statements. That single method could be:
 - (a) FVLCD;
 - (b) VIU; or
 - (c) a method that reflects how the entity expects to recover the asset (or CGU).
25. Additionally, the Board could consider developing guidance to assist entities in better explaining the differences between the market participant assumptions (used in FVLCD) and management's best estimates (used in VIU).

Relief from annual testing

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| October 2015 | Agenda Paper 18B | Paragraphs 31–46 |
| February 2016 | Agenda Paper 18C | Paragraphs 29–49 |

26. IAS 36 requires a CGU to which goodwill has been allocated to be tested for impairment annually, and whenever there is an indication that the CGU may be

impaired.⁴ The Board could permit a CGU to which goodwill has been allocated to be tested for impairment only if there is an indication that goodwill or other indefinite life intangible assets may be impaired (‘indicator-only approach’). This would also be consistent with the impairment requirements in IAS 36 for finite life assets.

27. The following indicators that goodwill may be impaired could be introduced to make the indicator-only approach more robust:
- (a) a qualitative assessment of whether it is more likely than not that the fair value of a CGU to which goodwill is allocated is less than its carrying amount.
 - (b) an assessment of whether actual performance of a business combination was worse than its expected performance. This assessment is relevant only during the first few years following the business combination, for example three years.
28. Permitting an indicator-only approach would align IAS 36 with US GAAP and eliminate another difference between IFRS Standards and US GAAP in respect of impairment testing of goodwill.⁵ An entity that applies US GAAP has the option to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the goodwill impairment test. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. See *Appendix C* for the extract of the qualitative factors from US GAAP.

Changes to the VIU methodology

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| October 2015 | Agenda Paper 18B | Paragraphs 47–60 |
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29. To address some of the concerns noted in the PIR of IFRS 3, especially about the high level of subjectivity in the assumptions used, the Board could reconsider the relevance of the following restrictions in the VIU calculations:

⁴ References to a CGU to which goodwill is allocated should be read as references also to a group of CGUs to which goodwill is allocated.

⁵ See Appendix B of [Agenda Paper 18B](#) of the June 2016 joint education session for a high-level comparison of IFRS Standards and US GAAP in respect of impairment of non-financial assets.

- (a) requirement to use a pre-tax discount rate; and
- (b) exclusion of any estimated future cash inflows or outflows expected to arise from improving or enhancing the asset's performance.

30. We are currently analysing these restrictions to determine if they are still relevant or could be relaxed. As part of the analysis, we are considering the Board's redeliberations and decisions on the Exposure Draft *Conceptual Framework for Financial Reporting*.

Additional guidance to assist entities in applying the IAS 36 requirements

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| October 2015 | Agenda Paper 18B | Paragraphs 61–69 |
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31. The Board could also consider providing additional guidance on the following requirements in IAS 36 that have been highlighted as judgemental and difficult to apply in practice in the PIR of IFRS 3:
- (a) allocation of goodwill to a CGU; and
 - (b) determining a terminal value in a discounted cash flow calculation.

Effectiveness objective

32. This section of the paper is divided into:
- (a) possible approaches to make impairment test more effective;
 - (b) possible approaches to improve disclosures about goodwill and impairment; and
 - (c) other approaches to account for goodwill after initial recognition.

Possible approaches to make impairment test more effective

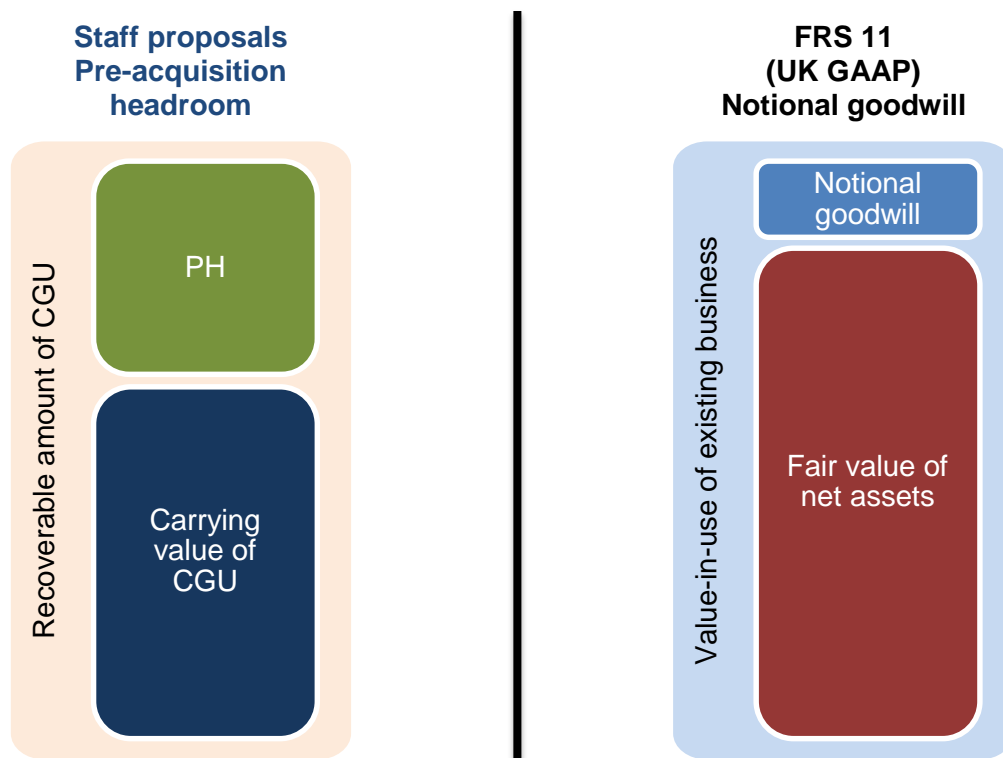
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| March 2016 | Agenda Paper 18C | Paragraphs 16–20 |
| April 2016 | Agenda Paper 18A | Complete paper |
| June 2016 | Agenda Paper 18B | Appendix C |

33. One of the causes for the current impairment test failing to capture impairment losses at the right time and in the right amounts is the so-called shielding effect of unrecognised internally generated goodwill of a CGU. In situations in which an entity allocated acquired goodwill to a pre-combination CGU that is expected to benefit from the synergies of the combination, the unrecognised internally

generated goodwill of the pre-combination CGU shields the acquired goodwill from impairment by absorbing any negative movements in the recoverable amount of the CGU. Consequently, the acquired goodwill is not impaired or is impaired by a lesser amount. To address this issue, we developed the pre-acquisition headroom (PH) approach that was presented to the Board at its March and April 2016 meetings.

34. The difference between the carrying amount of the CGU and its recoverable amount immediately before the combination is referred to as the 'pre-acquisition headroom' or 'PH'. The PH includes any unrecognised assets of the pre-combination CGU, any differences between the carrying amounts and recoverable amounts of the assets of the pre-combination CGU and any internally generated goodwill. The objective of the PH approach is to remove the sheltering effect from the impairment test by incorporating the PH, measured at the acquisition date, into the impairment test calculation. This is done by adding the PH to the carrying amount of the CGU and then comparing the aggregate of the carrying amount and the PH with the recoverable amount of the CGU in measuring any impairment loss. See Appendix C of Agenda Paper 18B of the June 2016 joint education session for the mechanics of the PH approach.
35. At the June 2016 meeting, we recommended that, as the first step, we develop the PH approach further by considering:
 - (a) the pros and cons, including the likely behavioural incentives/effects, of the different methods that could be used to allocate an impairment loss between acquired goodwill and the PH; and
 - (b) more examples of how the PH approach would apply, including situations in which an impairment loss arises primarily because of the effect of an increase in the discount rate used in measuring the recoverable amount of the CGU.
36. After the June 2016 meeting, we also explored other alternative methods that are similar to the PH approach. In that process we learnt about specified requirements in [Financial Reporting Standard \(FRS\) 11 *Impairment of Fixed Assets and Goodwill*](#) of UK GAAP that involve calculations similar to the PH calculation.

37. FRS 11 was issued in July 1998 and was effective for accounting periods ending on or after 23 December 1998. The development of FRS 11 shadowed the development of IAS 36.
38. Paragraphs 50–53 accompanied by Example 8 of FRS 11 contain requirements that are similar to the PH approach. Those paragraphs apply when an acquired business is merged with existing operations. Applying FRS 11, the headroom is calculated as the difference between the value in use of the existing business immediately before merging the acquired business and the fair value of net assets within that existing business. The headroom is effectively the notional internally generated goodwill of the existing business. See *Appendix D* of this paper for the relevant requirements from FRS 11 and the mechanics of application of the requirements.
39. The comparison of the PH approach with the FRS 11 approach can be viewed as follows:



40. As part of our ongoing research, we are aiming to learn about the experience of the application of this requirement in FRS 11. We will present the results of our research at a future meeting of the Board.

Possible approaches to improve disclosures about goodwill and impairment

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| February 2016 | Agenda Paper 18C | Paragraphs 50–62 |
| March 2016 | Agenda Paper 18B | Complete paper |

41. One or more of the following additional disclosure requirements could be considered:

- (a) key performance targets;
- (b) comparison with actual performance;
- (c) breakdown of carrying amount of goodwill; and
- (d) recoverability of goodwill.

Key performance targets

42. The Board could require disclosure of the key performance targets supporting the purchase price paid, and hence supporting the amount of goodwill recognised.

We envisage that these disclosures would incorporate:

- (a) a quantitative, as well as qualitative, explanation for the purchase price paid. Such explanation would include the targets that the management has identified as benefits of the acquisition and in support of the acquisition price; and
- (b) identification of the periods over which targets are expected to be achieved (for example an increase in revenue at five per cent per year for three years).

43. We would expect the key performance targets to follow from management’s own assessment, which it would have (a) performed when determining whether to undertake the acquisition; and (b) communicated to investors in support of the acquisition.

Comparison with actual performance

44. The Board could require an annual comparison of actual performance against the key performance targets (explained in the immediately preceding section of this paper) for a number of years following the acquisition. We think that the number of years for which the comparison is disclosed should be driven by the time

horizon used by management when determining the key performance targets. The Board may also consider requiring a minimum period, for example three years.

Breakdown of carrying amount of goodwill

45. The Board could require disaggregation of the carrying amount of goodwill at the reporting date by each past business combination. This disclosure, combined with the preceding two disclosures of key performance targets and comparison with actual performance, could assist users of financial statements to make their assessments of whether goodwill arising from a particular acquisition is recoverable.

Recoverability of goodwill

46. For each significant acquisition in the breakdown discussed in paragraph 45 of this paper, the Board could require an entity to provide an explanation to justify why the amount of goodwill is recoverable. For example, management could be required to consider what evidence there is that synergies remain from each major past acquisition.
47. In addition to considering improvements to disclosures through new requirements, we would undertake a review of the existing disclosure requirements in IAS 36 and IFRS 3. The aim of this review would be to see if the existing disclosure requirements can be improved to assist better application and remove any requirements that are no longer necessary in the light of any new disclosures that the Board decides to add.

Other approaches to account for goodwill after initial recognition

48. The following other approaches in respect of subsequent accounting for goodwill were presented to the Board at its past meetings:

- (a) an amortisation and impairment model; and

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| October 2015 | Agenda Paper 18A | Paragraphs 11–20 |
| February 2016 | Agenda Paper 18B | Paragraphs 15–24, 44–90 |

- (b) direct write-off of goodwill.

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| October 2015 | Agenda Paper 18A | Paragraphs 28–36 |
| February 2016 | Agenda Paper 18B | Paragraphs 25–33 |

49. As explained in the June 2016 joint education session Agenda Paper 18A, we think that there needs to be a strong argument to support making fundamental changes to the accounting for goodwill. Stakeholders have always had opposing and strongly held views on subsequent accounting for goodwill, in particular amortisation versus non-amortisation. The feedback during the PIR of IFRS 3 did not provide evidence of (a) decrease in diversity of views; (b) new conceptual arguments; or (c) goodwill amortisation being considered as providing useful information to investors. We have not heard any new arguments since the June 2016 joint education session in support of amortisation of goodwill.
50. Consequently, our primary focus is to achieve the effectiveness objective. This alone could result in sufficient improvements and could address the main concerns heard in PIR of IFRS 3 about goodwill without the need to reconsider accounting for goodwill.

Identification of intangible assets in a business combination

51. The following approaches could be considered by the Board in respect of identification of intangible assets separately from goodwill in a business combination:
- (a) no change to requirements, but improve application guidance;
 - (b) subsume some intangible assets in goodwill;
 - (c) subsume intangible assets that cannot be measured reliably; and
 - (d) allow further grouping of intangible assets.

No change to requirements but improve application guidance

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| November 2015 | Agenda Paper 18A | Paragraphs 20–29, 52–60 |
| February 2016 | Agenda Paper 18A | Paragraphs 17–27, 49–57 |
| March 2016 | Agenda Paper 18A | Complete paper |
| June 2016 | Agenda Paper 18A | Appendices C and D |

52. Without considering any changes to the requirements in IFRS 3, the Board could consider improving the application guidance in IFRS 3 and IAS 38 *Intangible*

Assets for those intangible assets that feedback suggests are difficult to identify and measure, for example customer relationship intangible assets.

Subsume some intangible assets in goodwill

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| November 2015 | Agenda Paper 18A | Paragraphs 30–36 |
| February 2016 | Agenda Paper 18A | Paragraphs 28–34 |

53. The Board could consider requiring some identifiable intangible assets to be subsumed within goodwill for cost-benefit reasons. The following bases could be considered by the Board to identify the intangible assets to be subsumed within goodwill:

- (a) the feedback from PIR of IFRS 3 suggests that separate measurement of the following intangible assets is complex and costly, and separate recognition of these intangible assets produces information that some users do not find useful:
 - (i) some customer-related intangible assets, in particular customer relationships;
 - (ii) brand names;
 - (iii) non-contractual intangible assets;
 - (iv) intangible assets that are not capable of being sold or licensed separately;
 - (v) intangible assets for which there is no active market; and
 - (vi) intangible assets in the early stage of development.
- (b) indefinite life intangible assets that are difficult to value on an individual basis (subsuming those assets in goodwill would not increase pressure to amortise goodwill unless those assets are subsequently reassessed as having a finite life);
- (c) intangible assets that would not be capitalised if they were internally generated, for example research, customer relationships, brands, etc. However, whilst this would result in accounting consistent with the accounting for internally generated intangible assets, it would result in an inconsistency with the accounting for intangible assets that are acquired separately.

Subsume intangible assets that cannot be measured reliably

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| November 2015 | Agenda Paper 18A | Paragraphs 37–46 |
| February 2016 | Agenda Paper 18A | Paragraphs 35–42 |

54. One of the conditions in IFRS 3 (2004) for an acquirer to recognise separately the acquiree’s identifiable intangible asset is that the intangible asset can be measured reliably. This condition was removed in IFRS 3 (2008). The Board could consider reintroducing the reliable measurement condition. However, we observe that this would need to be considered in the light of the Board’s redeliberations and decisions on the Exposure Draft *Conceptual Framework for Financial Reporting* with respect to the Board’s use of the term ‘faithful representation’. This is likely to reduce the costs of identification and measurement of intangible assets acquired in a business combination.

Allow further grouping of intangible assets

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| November 2015 | Agenda Paper 18A | Paragraphs 47–51 |
| February 2016 | Agenda Paper 18A | Paragraphs 43–47 |

55. Paragraph 37 of IAS 38 permits an acquirer to recognise a group of complementary intangible assets as a single asset provided the individual assets have similar useful lives. The Board could consider allowing further grouping of intangible assets, ie relax the requirement for when a group of complementary intangible assets can be recognised and measured as a single asset.
56. For intangible assets that are difficult to measure on an individual basis, the Board could allow accounting for such intangible assets together with other intangible assets (as a ‘portfolio’ of intangible assets).

Question to the Board

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| <p>Do the Board members have any questions or comments on the plan for 2017 (paragraphs 18–19 of the paper) and the research project approaches laid out in paragraphs 20–56 of this paper?</p> |
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Appendix A Feedback from the PIR of IFRS 3

Impairment requirements

(This is a reproduction of Appendix A of Agenda Paper 18B of the June 2016 joint education session)

A1. The Board’s report and feedback statement on the IFRS 3 PIR provided the following next steps to address impairment:

| Area of focus | Assessed significance | Possible next steps |
|--|-----------------------|---|
| Effectiveness and complexity of testing goodwill for impairment. | High | Research will be undertaken. We could review IAS 36 and we could consider improvements to the impairment model; particularly whether there is scope for simplification. |

A2. The PIR identified concerns that the current impairment requirements are costly and complex to apply and there are some shortcomings in the information provided to investors. Consequently, some think the benefit of the information provided to investors does not justify the costs of applying the current impairment requirements.

A3. The main challenges in applying the current impairment requirements identified during the PIR were:

- (a) the overall costs involved in performing the impairment test, including the requirement to perform it annually;
- (b) limitations of the value in use (VIU) calculation, including the prohibition on including expansion capital expenditures in cash flow projections and the requirement to use a pre-tax discount rate; and
- (c) the high degree of subjectivity in the assumptions used in the impairment test, including allocating goodwill to cash-generating units (CGUs) for impairment testing purposes, and reallocating that goodwill if a restructuring occurs.

A4. The following are the key messages we heard from users of financial statements about the current information provided about goodwill and impairment:

- (a) Some say the current information is useful because it provides confirmatory value about the performance of the acquisition and about the stewardship of management.
- (b) However some say the current information has limitations for the following main reasons:
 - (i) impairment losses are recognised too late.
 - (ii) impairment calculations are inherently very judgemental and the assumptions used in the calculations are subjective.
 - (iii) disclosures are not sufficient to assess whether the main inputs/assumptions are reasonable. However some users said that some of the current disclosures are useful; these included discount rates used, long-term growth rates, profit and capital expenditure assumptions and sensitivities.
 - (iv) insufficient information to help them understand the subsequent performance of the acquired business and whether main targets/synergies of the acquisition are met, which are considered key to their analysis.
- (c) Some users focus more on the timing of the impairment write-down and its overall magnitude rather than the specific amount of impairment recognised.

A5. Based on our user outreach during and subsequent to the PIR, users appear to be particularly interested in understanding the following information about goodwill and impairment:

- (a) what management thought were the key drivers that justified the valuation of the acquisition (and hence the amount of goodwill);
- (b) assessing whether an acquisition has been successful; and
- (c) assessing the accountability of management.

Subsequent accounting for goodwill

(This is a reproduction of Appendix A of Agenda Paper 18A of the June 2016 joint education session)

A6. The Board’s report and feedback statement on the PIR of IFRS 3 provided the following possible next steps to address subsequent accounting for goodwill:

| Area of focus | Assessed significance | Possible next steps |
|---|-----------------------|---|
| Subsequent accounting for goodwill (ie impairment-only approach compared with an amortisation and impairment approach). | High | <p>Research will be undertaken. We could consider whether and how the costs of accounting for goodwill can be reduced without losing the information that is currently being provided by the impairment-only approach, and which our review of academic studies suggested was value-relevant. This could include considering:</p> <ul style="list-style-type: none"> (a) how improvements to the impairment-only approach (in particular to the impairment test) could address some of the concerns that have been raised; and (b) whether a variation on an amortisation and impairment model could be developed with an amortisation method that does not undermine the information currently provided by the impairment-only approach. |

A7. Many participants during the PIR suggested reintroducing amortisation of goodwill because they state that it reflects consumption of the economic resource acquired in the business combination over time. Some suggested this could be reintroduced with an indicator based impairment test rather than an annual test, reducing cost and complexity.

A8. Some investors supported an impairment only approach because they think that this approach helps them to assess the stewardship of management and assess whether an acquisition is working as expected. Other investors support the amortisation of goodwill, because they think that goodwill acquired in a business combination is consumed and replaced by internally-generated goodwill over time.

Identification and measurement of intangible assets in a business combination

(This is a reproduction of Appendix B of Agenda Paper 18A of the June 2016 joint education session)

A9. The Board’s report and feedback statement on the IFRS 3 PIR provided the following possible next steps to address identification and measurement of intangible assets:

| Area of focus | Assessed significance | Possible next steps |
|--|-----------------------|--|
| Identification and fair value measurement of intangible assets such as customer relationships and brand names. | Medium/high | <p>Research will be undertaken. We could consider whether particular intangible assets (eg, customer relationships) should be subsumed into goodwill.</p> <p>We could also consider what additional guidance could be given to assist in the identification of customer relationship intangible assets and their associated measurement.</p> |

A10. The PIR identified concerns that, for some intangible assets, measurement at fair value is costly (because of the need to use valuation specialists), complex and time-consuming. The PIR also identified that some users of financial statements say that the valuations of some intangible assets are subjective and do not provide useful information. Customer relationship intangible assets were the most frequently cited examples by preparers, users and other parties. Brands were also commonly cited. Consequently some participants in the PIR think the benefit of the information provided to users about these intangible assets does not justify the costs of separately recognising them. Nevertheless, some users support recognising these intangible assets separately because it provides an insight on why an acquisition was made and about the primary assets/value drivers of the acquiree.

A11. Some participants also stated that the following other intangible assets are challenging to measure (and also in some cases to identify):

- (a) non-contractual intangible assets.
- (b) intangible assets that are not capable of being sold or licensed separately.
- (c) intangible assets for which there is no active market.

(d) intangible assets in the early stage of development.

A12. The main challenges identified during the PIR in measuring intangible assets were:

- (a) the assumptions used in valuation models and in estimating the useful life are difficult to determine and are subjective. Valuation models are sometimes sensitive to small changes in those assumptions.
- (b) there are various valuation methods and there is diversity on when/how they are used.
- (c) when there are multiple intangible assets, judgement is needed not only to value them individually but also to determine relationships between them. For example customer relationships would need to be considered in determining the fair value of an acquired brand.

A13. The staff have identified the following as the two main concerns we have heard from users of financial statements during the PIR about the presentation and disclosure of intangible assets in a business combination:

- (a) **Presentation of amortisation expense:** Some users have concerns that amortising intangible assets that they consider to be continually replaced, such as brands and customer-related intangible assets, results in double counting of expenses. For this reason they want to add back the amortisation charge on these intangible assets to derive an underlying earnings number. However, they say they are often unable to differentiate between amortisation they want to add back and amortisation they wish to keep in profit. Although this information should be available from the intangible asset reconciliation (see paragraph 118(e) of IAS 38) some users have said it should be available on the face of the statement of comprehensive income because of its importance and/or because they need the distinction to be available in interim/quarterly reports (where the note reconciliation may not be provided).
- (b) **Additional disclosure:** Some users have told us that there is insufficient information about the assumptions used in valuations models for intangible assets acquired in a business combination and in the

assessment of their useful lives. Some noted that it would be useful to require the disclosures in IFRS 13 *Fair Value Measurement* on valuation techniques and inputs for these intangible assets.

Appendix B High-level comparison of IFRS Standards and US GAAP (impairment of non-financial assets)

(This Appendix is a reproduction of Appendix B of Agenda Paper 18B of the June 2016 joint education session)

The staff have prepared the following summary of the main differences between the current requirements in IFRS Standards and US GAAP for impairment of non-financial assets that are relevant to our discussions at this meeting.

| IFRS | US GAAP | | |
|--|---|---|--|
| <p>One-step impairment test.</p> <p>The carrying amount of an asset or CGU is compared with its recoverable amount. Recoverable amount is the higher of its fair value less costs of disposal and its value in use.</p> <p>The impairment loss is measured as the difference between carrying amount and recoverable amount.</p> | <p>Goodwill ⁶</p> <p>Two-step impairment test.</p> <p>Step One—The carrying amount of a reporting unit is first compared with its fair value. If the carrying amount is higher than the fair value, an entity must perform Step Two. If the carrying amount is lower than the fair value, no impairment is recorded.</p> <p>Step Two—Calculate the implied fair value of goodwill. The impairment loss recognised is the amount by which the carrying amount of goodwill exceeds the implied fair value of goodwill within its reporting unit.</p> <p>Optional qualitative assessment: An entity may first assess qualitative factors to determine whether the two-step goodwill impairment test is necessary. If the entity</p> | <p>Indefinite-lived intangible assets:</p> <p>One-step impairment test.</p> <p>The carrying amount of an asset is compared with its fair value.</p> <p>The impairment loss is recognised as the excess of the carrying amount over the fair value of the asset.</p> <p>Optional qualitative assessment: An entity may first assess qualitative factors to determine whether quantitative impairment test is necessary. If the entity determines, based on the qualitative assessment, that it is more likely than not that the fair value of an indefinite-lived intangible asset is below its carrying amount, the quantitative impairment test is performed. Examples of events and</p> | <p>Long-lived assets:</p> <p>Two-step impairment test.</p> <p>Step One—The carrying amount is first compared with the undiscounted cash flows. If the carrying amount is lower than the undiscounted cash flows, no impairment loss is recognised.</p> <p>Step Two—If the carrying amount is higher than the undiscounted cash flows, an impairment loss is measured as the difference between the carrying amount and fair value.</p> |

⁶ The FASB have issued simplifications amendments in January 2017 removing Step Two (see paragraphs 14–16 of this paper).

| IFRS | US GAAP | |
|-------------|--|--|
| | <p>determines, based on the qualitative assessment, that it is more likely than not that the fair value of a reporting unit is below its carrying amount, the two-step impairment test is performed. Examples of events and circumstances that an entity would need to consider in doing qualitative impairment test are provided.</p> <p>An entity can bypass the qualitative assessment for any reporting unit in any period and proceed to Step one of the two-step test.</p> | <p>circumstances that an entity would need to consider in doing qualitative impairment test are provided.</p> <p>An entity can bypass the qualitative assessment for any asset in any period and proceed to the quantitative test.</p> |

| IFRS STANDARDS | US GAAP |
|---|---|
| Impairment testing is required when there is an indication of impairment. | Similar requirement. |
| Annual impairment testing is required for goodwill, indefinite life intangible assets and intangible assets not yet available for use. Annual test may be performed at any time during the year provided performed at the same time each year. | Similar requirement except intangible assets not yet available for use are tested only if there is an indicator of impairment. |
| Depending on the circumstances, assets may be tested for impairment as an individual asset, as part of a CGU or as part of a group of CGUs. When possible, an impairment test is performed for an individual asset. Otherwise, assets are tested in CGUs. | Depending on the circumstances, assets are tested for impairment as an individual asset, as part of an asset group or at the reporting unit level. Depreciable assets are tested for impairment in asset groups unless an individual asset generates identifiable cash flows largely independent of the cash flows from other asset groups. |
| A CGU is the smallest group of assets that generates cash inflows that are largely independent of the cash inflows of other assets or groups of assets. | An asset group is the lowest level for which there are identifiable cash flows that are largely independent of the net cash flows of other groups of assets. A reporting unit is an operating segment or one level below an operating segment if certain conditions are met. (Both may differ from a CGU under IFRS Standards.) |

| IFRS STANDARDS | US GAAP |
|--|---|
| Goodwill is allocated to CGUs or groups of CGUs that are expected to benefit from the synergies of the business combination from which it arose. Each unit or group of units shall represent the lowest level at which goodwill is monitored for internal management purposes and shall not be larger than an operating segment. | Goodwill is allocated to reporting units that are expected to benefit from the synergies of the business combination from which it arose. |
| An impairment loss for a CGU is allocated first to any goodwill and then pro rata to other assets in the CGU that are within the scope of IAS 36. | An impairment loss for an asset group is allocated pro rata to assets in the asset group, excluding working capital, goodwill, corporate assets and indefinite-lived intangible assets. |
| Reversals of impairment are recognised, other than for impairments of goodwill. | Reversals of impairments are prohibited. |

Appendix C

Extracts from Topic 350-20 of FASB Codification relating to qualitative factors for goodwill impairment

35-3C In evaluating whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount, an entity shall assess relevant events and circumstances. Examples of such events and circumstances include the following:

- a. Macroeconomic conditions such as a deterioration in general economic conditions, limitations on accessing capital, fluctuations in foreign exchange rates, or other developments in equity and credit markets
- b. Industry and market considerations such as a deterioration in the environment in which an entity operates, an increased competitive environment, a decline in market-dependent multiples or metrics (consider in both absolute terms and relative to peers), a change in the market for an entity's products or services, or a regulatory or political development
- c. Cost factors such as increases in raw materials, labor, or other costs that have a negative effect on earnings and cash flows
- d. Overall financial performance such as negative or declining cash flows or a decline in actual or planned revenue or earnings compared with actual and projected results of relevant prior periods
- e. Other relevant entity-specific events such as changes in management, key personnel, strategy, or customers; contemplation of bankruptcy; or litigation
- f. Events affecting a reporting unit such as a change in the composition or carrying amount of its net assets, a more-likely-than-not expectation of selling or disposing of all, or a portion, of a reporting unit, the testing for recoverability of a significant asset group within a reporting unit, or recognition of a goodwill impairment loss in the financial statements of a subsidiary that is a component of a reporting unit
- g. If applicable, a sustained decrease in share price (consider in both absolute terms and relative to peers).

...

35-3F⁷ The examples included in paragraph 350-20-35-3C(a) through (g) are not all-inclusive, and an entity shall consider other relevant events and circumstances that affect the fair value or carrying amount of a reporting unit in determining whether to perform the quantitative goodwill impairment test. An entity shall consider the extent to which each of the adverse events and circumstances identified could affect the comparison of a reporting unit's fair value with its carrying amount. An entity should place more weight on the events and circumstances that most affect a reporting unit's fair value or the carrying amount of its net assets. An entity also should consider positive and mitigating events and circumstances that may affect its determination of whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If an entity has a recent fair value calculation for a reporting unit, it also should include as a factor in its consideration the difference between the fair value and the carrying amount in reaching its conclusion about whether to perform the quantitative goodwill impairment test.

⁷ ASU 2017-04 (referred to in paragraph 16 of this paper) amended paragraphs 350-20-35-3F and 350-20-35-3G. The text reproduced in this Appendix is the amended text.

35-3G⁸ An entity shall evaluate, on the basis of the weight of evidence, the significance of all identified events and circumstances in the context of determining whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. None of the individual examples of events and circumstances included in paragraph 350-20-35-3C(a) through (g) are intended to represent standalone events or circumstances that necessarily require an entity to perform the quantitative goodwill impairment test. Also, the existence of positive and mitigating events and circumstances is not intended to represent a rebuttable presumption that an entity should not perform the quantitative goodwill impairment test.

⁸ ASU 2017-04 (referred to in paragraph 16 of this paper) amended paragraphs 350-20-35-3F and 350-20-35-3G. The text reproduced in this Appendix is the amended text.

Appendix D

Extracts of requirements in FRS 11

Allocation when acquired businesses are merged with existing operations

- 50 Where an acquired business is merged with an existing business and results in an income-generating unit that contains both purchased and (unrecognised) internally generated goodwill:
- (a) the value of the internally generated goodwill of the existing business at the date of merging the businesses should be estimated and added to the carrying amount of the income-generating unit for the purposes of performing impairment reviews;*
 - (b) any impairment arising on merging the businesses should be allocated solely to the purchased goodwill within the newly acquired business;
 - (c) subsequent impairments should be allocated pro rata between the goodwill of the acquired business and that of the existing business;
 - (d) the impairment allocated to the existing business should be allocated first to the (notional) internally generated goodwill; and
 - (e) only the impairments allocated to purchased goodwill (and, if necessary, to any recognised intangible or tangible assets) should be recognised in the financial statements.

* *The internally generated goodwill will not be recognised in the financial statements.*

- 51 An acquired business may be merged with an existing operation of the reporting entity in such a way that a single income-generating unit includes the assets and liabilities of both the acquired and the existing businesses. This combined income-generating unit contains both acquired and internally generated goodwill and any future impairment needs to be apportioned between the two. This can be done by notionally adjusting the carrying amount of the income-generating unit to recognise a notional carrying amount for the internally generated goodwill of the existing operation at the date of merging the two businesses.
- 52 The notional carrying amount of the internally generated goodwill is estimated by deducting the fair values of the net assets and purchased goodwill within the existing income-generating unit from its estimated value in use before combining the businesses. This calculation will need to be done whenever an acquisition that gives rise to goodwill is merged with an existing business. The notional balance is assumed to be subject to the same pattern of amortisation as is applied to the purchased goodwill.
- 53 Because the comparison with value in use will have resulted in the recognition of any impairment of the existing business at the time of merging it with the acquired business, any initial impairment in the combined income-generating unit will, by definition, relate to the acquired business. Any subsequent impairment cannot be attributed directly to either the acquired or the existing businesses and is therefore apportioned between the notional internally generated goodwill and the purchased goodwill pro rata to their current carrying values.

Example 8: Allocation of impairment losses when an acquired business is merged with existing operations

Assumptions

An entity acquires for £60 million a business having net assets with a total fair value of £40 million, resulting in purchased goodwill of £20 million. The acquired business is merged with an existing operation that has net assets with a fair value of £100 million and a carrying amount of £70 million. The value in use of the existing operation at the time of the acquisition is £150 million, implying that the existing operation had internally generated goodwill of £50 million.

Five years later, the carrying amount of the net assets of the combined income-generating unit is £105 million and the carrying amount of the purchased goodwill is £10 million (goodwill is being amortised over 10 years). Value in use is £119 million and there is no reliable estimate of net realisable value.

| <i>Calculation of impairment loss</i> | <i>£m</i> |
|---|------------|
| Carrying amount of net assets | 105 |
| Carrying amount of goodwill | 10 |
| Notional carrying amount of the internally generated goodwill at the date of acquisition (assuming notional amortisation on same basis as for purchased goodwill) | 25 |
| Total | 140 |
| Value in use | 119 |
| Impairment | 21 |

The impairment is allocated on a pro rata basis (2:5) to the purchased goodwill and internally generated goodwill, resulting in the recognition of an impairment loss of £6 million and purchased goodwill being written down to £4 million.

If value in use were £98 million, the resulting total impairment loss of £42 million would be allocated first to the goodwill (purchased and notional amount of internally generated) of £35 million, then to any intangible assets, then to the tangible fixed assets in the income-generating unit, resulting in the recognition of an impairment loss of £17 million (write-down of purchased goodwill £10 million, write-down of intangible and tangible assets £7 million).