Impairment testing of goodwill

Raghava Tirumala | rtirumala@ifrs.org | +44 (0)20 7246 6953
Woung Hee Lee | wlee@ifrs.org | +44 (0)20 7246 6947

Appendices accompanying this paper are included in Agenda Paper 5B

The views expressed in this presentation are those of the presenter, not necessarily those of the International Accounting Standards Board (the Board) or IFRS Foundation.

Copyright © IFRS Foundation. All rights reserved
Agenda

• Set out objectives of Goodwill and Impairment research project relevant for this meeting 3–6

• Recap of past discussions of CMAC and GPF, and how the feedback was considered 7–11

• Explain the possible approaches to improve disclosures about subsequent performance of an acquisition and about impairment of goodwill 12–14
  – Questions to CMAC–GPF members on those approaches 15

• Explain the indicator-only approach to testing goodwill for impairment in providing a relief from the mandatory annual quantitative impairment test of goodwill 16–20
  – Questions to CMAC–GPF members about (a) any concerns because of the relief; (b) the extent of relief that could be provided; and (c) the indicators of impairment that a company should watch out for 21
Objectives of Goodwill and Impairment research project
Objectives of the research project

Whether it is possible to:

- Improve the quality of information provided to users without imposing costs that outweigh benefits
- Simplify and improve application of impairment test without loss of information to investors
Why improve the quality of information?

**IAS 36 requirements**
- Goodwill is allocated to cash generating unit(s) for impairment testing purposes
- This is not necessarily at the level of the acquired entity as a whole

**Investors’ concerns**
- Insufficient information about subsequent performance of the acquired business

**Ongoing research**
- Additional disclosures that help investors understand subsequent performance of acquired businesses
- Pages 12–15
Why simplify the impairment test?

**IAS 36 requirements**
- Goodwill is not amortised
- Quantitative impairment testing annually and whenever there is an indication of impairment
- Recoverable amount* to be calculated every year

**Preparers’ concerns**
- Performing the test annually is costly

**Ongoing research**
- Relief from mandatory annual quantitative test
- Calculating recoverable amount when there are indicators of impairment
- Pages 16–21

* Recoverable amount is higher of fair value less costs of disposal (FVLCD) and value in use (VIU)
Past discussions with CMAC and GPF
Past discussions with CMAC and GPF

• Three meetings—one with CMAC and two with GPF
• Additional disclosures were the focus of all three meetings
• Feedback (see pages 9–11) considered in developing possible additional disclosures that the Board could require
• Agenda Paper 18D of May 2017 Board meeting reflects the latest thinking of staff (see page 13)
## Feedback from CMAC

<table>
<thead>
<tr>
<th>Month</th>
<th>Questions asked</th>
<th>Summary of feedback</th>
</tr>
</thead>
<tbody>
<tr>
<td>November 2015</td>
<td>Do you make any ‘non-GAAP’ adjustments to goodwill or impairment for your analysis?</td>
<td>• Impairment charge generally added back only for determining cash flows&lt;br&gt;• That does not mean that analysts disregard impairment charge or consider that information unhelpful</td>
</tr>
<tr>
<td></td>
<td>Would amortisation of goodwill help or hinder you analysis?</td>
<td>• Mixed feedback about amortisation of goodwill&lt;br&gt;• Current impairment test provides useful information&lt;br&gt;• Impairment test should be made robust rather than introducing other approaches</td>
</tr>
<tr>
<td></td>
<td>Is there any other information that you need for your analysis?</td>
<td>• Additional disclosures to help investors understand the key drivers that justified the purchase consideration&lt;br&gt;• Breakdown of carrying amount of goodwill by past acquisitions</td>
</tr>
</tbody>
</table>

Click the links for full meeting summary and recording.
## Feedback from GPF

<table>
<thead>
<tr>
<th>Month</th>
<th>Questions asked</th>
<th>Summary of feedback</th>
</tr>
</thead>
</table>
| **March 2016** (link to the agenda paper) | In developing disclosures about key assumptions or targets supporting the purchase consideration and comparison of actual performance vis-à-vis targets, what information would be meaningful and possible to prepare? | • In respect of the key assumptions or targets:  
  – Disclosing sensitive key targets could give away an entity’s competitive advantage  
  – Some key targets may not be measurable and auditable, eg acquisition of human competencies  
  – Disclosure of components of goodwill is already required and that information is sufficient  
• In respect of actual performance vis-à-vis the targets:  
  – It is difficult to track actual performance when acquired business is integrated with existing business  
  – Not meeting the targets does not necessarily mean that the acquisition is not successful |

Click the links for full [meeting notes](#) and [recording](#).
<table>
<thead>
<tr>
<th>Month</th>
<th>Questions asked</th>
<th>Summary of feedback</th>
</tr>
</thead>
<tbody>
<tr>
<td>March 2017</td>
<td>Feedback on the following possible simplifications to the impairment test of goodwill:</td>
<td>• Several members favoured relief from annual testing and relaxing the restrictions on cash flows included in VIU calculations</td>
</tr>
<tr>
<td></td>
<td>• Using either FVLCD or VIU as the sole basis for calculating recoverable amount</td>
<td>• In relation to using either FVLCD or VIU as the sole basis for calculating recoverable amount, some members indicated a preference for a model that uses VIU</td>
</tr>
<tr>
<td></td>
<td>• Relief from annual testing</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Relaxing some restrictions on cash flows included in VIU calculations</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Additional guidance on applying IAS 36</td>
<td>Click the links for full <a href="#">meeting notes</a> and <a href="#">recording</a>.</td>
</tr>
</tbody>
</table>
Additional disclosures about acquired businesses
Staff current thoughts—disclosures

Key assumptions or targets supporting the purchase consideration
(These disclosures follow on from management’s own assessment and communications to external stakeholders at the time of acquisition)

Comparison of actual performance vis-à-vis assumptions made at the time of acquisition
(The number of years for which a company will disclose this comparison will depend upon the time horizon set by the company at the time of acquisition)

Breakdown of goodwill by past acquisition
(The Board could additionally require reconciliation of this disaggregation with the existing requirement to disclose goodwill allocated to cash-generating unit(s))

See Appendix 1 of this paper for a summary of Agenda Paper 18D of May 2017 Board meeting
• Additionally, existing disclosure requirements in IAS 36 could be reviewed to assess if any disclosures are not useful*

• Some feedback from GPF members that:
  – disclosure of pre-tax discount rate is not useful because post-tax discount rates are generally used in calculating value in use
  – disclosing sensitivity analysis should be removed because those disclosures make it easy to derive an entity’s budgets

* See Appendix 2 of this paper for extract of paragraphs 134–137 of IAS 36 that contain requirements about disclosure of estimates used to measure recoverable amounts of cash-generating units containing goodwill
Questions to CMAC–GPF

• Do you have any comments or feedback about the possible additional disclosures explained in page 13?
• Do you think any of the existing disclosure requirements in IAS 36 are not useful (see page 14 and Appendix 2)?
Indicator-only approach to goodwill impairment testing
Staff current thoughts—indicator approach

**Approach 1**
Complete relief from mandatory annual test—Goodwill tested for impairment only when there is an indication of possible impairment

**Approach 2**
Partial (less constrained) relief from annual testing—Mandatory quantitative test for the first year after acquisition and indicator-based impairment test in later years

**Approach 3**
Partial (more constrained) relief from annual testing—Mandatory quantitative test for the first few years after acquisition and indicator-based impairment test in later years (the Board could require the test to be performed for 3–5 years)
Indicators of impairment

• IAS 36 provides a list of indicators that an entity must consider as a minimum (see page 20)

• The following additional indicators could be added:
  – Actual performance not in line with the key performance assumptions or targets supporting the acquired goodwill
Consequences of introducing indicator-only approach

• Cost and complexity of goodwill impairment test are reduced
• Inputs to the quantitative test currently disclosed every year will be disclosed only when there is an impairment loss
• Questions about timely recognition of impairment might arise
• Success of the approach depends upon proper application of the Standard and the audit and enforcement framework
## Indicators currently listed in IAS 36

<table>
<thead>
<tr>
<th>External information (¶12 of IAS 36)</th>
<th>Internal information (¶12 of IAS 36)</th>
<th>Internal reporting (¶14 of IAS 36)</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Observable indications that asset’s value has significantly declined</td>
<td>• Obsolescence or physical damage of an asset</td>
<td>• Cash flows for acquiring and operating the asset is higher than budgeted</td>
</tr>
<tr>
<td>• Significant changes with an adverse effect in the technological, market, economic, or legal environment</td>
<td>• Significant changes with an adverse effect on selling or using an asset</td>
<td>• Actual net cash flows or operating profit from asset are worse than budgeted</td>
</tr>
<tr>
<td>• Market interest rates have increased, affecting discount rate</td>
<td>• Economic performance of an asset is worse than expected</td>
<td>• A significant decline in budgeted cash flows or operating profit from asset</td>
</tr>
<tr>
<td>• Carrying amount of net assets is more than its market capitalisation</td>
<td></td>
<td>• Operating loss or net cash outflows for the asset</td>
</tr>
</tbody>
</table>

See Appendix 2 of this paper for extract of paragraphs 7–17 of IAS 36
Questions to CMAC–GPF

• Do you have any concerns about the relief from annual test?
• Which relief approach on page 17 would you prefer and why?
• Could you suggest any indicators that could be added to the list in IAS 36, especially indicators of overpayment?
• The existing internal reporting indicators (see page 20) are financial indicators. Do you think there could be non-financial indicators of impairment?