

STAFF PAPER

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Project	Goodwill and Impairment		
Paper topic	Relief from mandatory annual impairment test		
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Purpose of this paper

1. This Agenda Paper discusses potential relief from the mandatory annual impairment test for cash-generating units (CGUs) that contain goodwill and some identifiable intangible assets.

2. This paper is based on Agenda Paper 18B for the May 2019 Board meeting and seeks to provide further analysis on feedback received from Board members in that meeting. Additional analysis provided in this paper relates to:
 - (a) potential cost savings (paragraph 23, and paragraphs 25–30);
 - (b) robustness of indicator-only model (paragraphs 38–39);
 - (c) reasons for staff recommendation (paragraphs 47–48); and
 - (d) possible indicators of impairment (paragraphs 70–73 and Appendix A).

The staff have indicated the additional analysis by placing it in boxes. Editorial and other consequential changes are also highlighted.

Summary of staff recommendations

3. The staff recommend the Board include a preliminary view in the Discussion Paper to:
 - (a) remove the requirement to carry out an annual quantitative impairment test for goodwill when no indicator of impairment exists; and
 - (b) for intangible assets with indefinite useful lives, and for intangible assets not yet available for use, apply the same relief as for goodwill.

Structure of the paper

4. The paper is structured as follows:
 - (a) Background (paragraphs 5–10);
 - (b) Indicator-based impairment test (paragraphs 11–53);
 - (c) Intangible assets (paragraphs 54–62);
 - (d) Question for the Board;
 - (e) Other issues for consideration (paragraphs 63–73); and
 - (f) Appendix A – Potential indicators of impairment the Board may wish to consider.

Background

5. In its December 2017 meeting, the Board tentatively decided not to propose providing entities with relief from the mandatory annual quantitative impairment testing for goodwill, and instead to focus on improving the effectiveness of goodwill impairment test.
6. Subsequently, after concluding that it would not be possible to make the impairment test significantly more effective, the Board decided tentatively in its July 2018 meeting to refocus the objectives of the research project. One of the refocused objectives is to pursue simplifying the subsequent accounting for goodwill by

exploring possible relief from the requirement to carry out mandatory annual quantitative impairment tests of CGUs that include goodwill.

7. In its May 2019 Board meeting, the Board discussed some of the proposals that the staff intended to recommend. In this paper, the staff revisit some of the arguments that the Board had previously discussed in the context of the refocused objectives of the project, as well as providing some additional analysis on certain comments made by Board members during that meeting.

Existing requirements and feedback received

8. IAS 36 *Impairment of Assets* requires an entity to perform a quantitative impairment test as follows for CGUs to which goodwill has been allocated:
- (a) A mandatory quantitative impairment test for goodwill annually. It may be performed at any time during an annual period, provided the test is performed at the same time every year. Different CGUs may be tested for impairment at different times.
 - (b) In addition, a quantitative test is required at the end of the period if there is an indicator that the CGU may be impaired.
 - (c) If some or all the goodwill allocated to a CGU was acquired in a business combination during the current annual period, that CGU must be tested for impairment before the end of the current annual period.
 - (d) Any excess of the carrying amount of the CGU over its recoverable amount is recognised as an impairment loss.
 - (e) The same requirements also apply to indefinite-lived intangible assets and intangible assets not yet available for use.
9. Paragraphs BC121–BC123 of the Basis for Conclusions on IAS 36 summarise the Board’s reasons for introducing the requirement to carry out an annual quantitative impairment test for CGUs containing goodwill and those intangible assets when IAS 36 was revised in 2004. The Board’s view at that time was that non-amortisation of an asset increases the reliance that must be placed on impairment reviews of that asset to ensure the carrying amount does not exceed its recoverable amount. Due to this

greater reliance on the impairment test, the existence of a rigorous and operational impairment test was seen as a precondition for removing the requirement to amortise goodwill and indefinite-lived intangible assets.

10. In the feedback they provided in the post-implementation review (PIR) of IFRS 3 *Business Combinations*¹, many stakeholders commented that the annual quantitative impairment test of goodwill required under IAS 36 is costly and complex to implement, and any resulting recognition of impairment losses is often not timely and is often inadequate. Some stakeholders also commented that the test provides information of only limited relevance. These comments were further supported by the research during this project. Consequently, some stakeholders think that the benefits of mandating the annual performance of a quantitative impairment test do not justify the costs caused by mandating it. Other stakeholders suggested that the Board should require a quantitative impairment test only if indicators of impairment exist.

Indicator-based impairment test

Assessment of different approaches

11. In previous meetings, the Board explored various indicator-based impairment approaches as potential replacements for the existing impairment model. The Board did not express a preference for any approach. The approaches discussed included:
- (a) *Approach 1*—the Board could require an entity to perform a quantitative impairment test of goodwill in the first year after a business combination; and in subsequent years perform the quantitative impairment test only when there are indicators of possible impairment;
 - (b) *Approach 2*—the Board could require an entity to perform a quantitative impairment test of goodwill at least annually (and more frequently whenever there are indicators of possible impairment) for the first few years after a business combination, perhaps 3–5 years; and in subsequent years perform a

¹ The scope of the PIR covered the whole Business Combinations project, which resulted in IFRS 3 (2004), IFRS 3 (2008) and consequential amendments to IAS 27 *Consolidated and Separate Financial Statements*, IAS 36 and IAS 38 *Intangible Assets*.

quantitative impairment test only when there are indicators of possible impairment;

- (c) *Approach 3*—the Board could require an entity to perform a quantitative test of goodwill less frequently than annually, for example once every 3 years; and in the intervening periods perform a quantitative impairment test only when there are indicators of possible impairment; and
- (d) *Approach 4*—the Board could require an entity to perform a quantitative impairment test of goodwill only when there are indicators of possible impairment.

12. In addition to these approaches previously considered by the Board, the Board could consider an optional qualitative test, similar to an option allowed under US GAAP.

Considerations for hybrid impairment models

13. Approaches 1, 2 and 3 are hybrid impairment models, which require an indicator-based impairment test but mandate the performance of quantitative impairment tests in specified reporting periods. However, upon further analysis, the staff do not recommend pursuing these approaches for the following reasons:
- (a) Some preparers supported requiring a mandatory quantitative test in at least some periods, commenting that this will make the impairment test more robust than removing the mandatory annual quantitative test altogether. However, in the staff's view, a key observation from the staff's subsequent research is that the limitations in the effectiveness of the goodwill impairment test have little to do with the frequency of the quantitative test.
 - (b) Incorporating a requirement to perform quantitative test in some periods would make the impairment test more complex than an indicator-only model, but not significantly more effective. For example, there could be some complexity in determining when the quantitative test should be required if a group of CGUs includes businesses acquired in different acquisitions. Therefore, such approaches may not be sufficiently in line with the Board's revised objective of simplifying the accounting for goodwill.

- (c) These hybrid approaches do not align the impairment test of goodwill with that of other assets. An indicator-only model would allow goodwill to be tested in the same way as other assets within the scope of IAS 36 (paragraphs 31–32). Adopting the hybrid impairment testing models does not help to achieve that objective.
- (d) There is no clear principle that could help to determine in which period(s) a mandatory quantitative impairment test would be necessary. Therefore, this would need to be determined arbitrarily.
- (e) A “one size fit all” mandatory element in hybrid models might not work for entities across different industries. A key objective of requiring a quantitative test in specified period(s) is to ensure that the robustness of the impairment test is not compromised. These hybrid models seek to accomplish this goal by requiring a quantitative impairment test during the periods when the acquired business is most susceptible to impairment. However, feedback from our consultative groups indicates that the length of investment horizons and “high-risk periods for impairment” varies across different industries. For example, for an entity operating in a dynamic and rapidly evolving industry, it may be apparent within the first year of acquisition whether the acquisition is a success and, therefore, whether it is likely that any impairment has occurred. On the other hand, for an entity operating in a sector with a long investment horizon, for example, the Oil & Gas sector, it may be many years after the acquisition before one could assess whether the goodwill arising from the initial acquisition was impaired.

Considerations for optional qualitative test

14. In 2011, the Financial Accounting Standards Board (FASB) introduced an optional qualitative test in US GAAP for testing goodwill for impairment. 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. This forms a basis for determining whether it is necessary to perform the quantitative goodwill impairment test.

15. The staff think that the objective of both the indicator-only impairment test (Approach 4) and the optional qualitative test allowed under US GAAP is to exempt entities from performing a quantitative test if it would not result in the recognition of an impairment loss. The difference is that the optional qualitative test in US GAAP sets a threshold such that an entity is required to perform a quantitative impairment test only if it is more likely than not (more than 50% likelihood) that the fair value of a reporting unit is less than its carrying amount. On the other hand, IAS 36 does not have a threshold. Instead, IAS 36 requires a quantitative impairment test if there is an indication at the end of the period that the asset (or CGU) may be impaired. The staff are not aware of any compelling reason for the IASB to consider specifying a threshold of likelihood to determine when it would be necessary to conclude that an asset (or CGU) ‘may be’ impaired.
16. One of the advantages of pursuing an indicator-only impairment test is that it would remove complexity and help to improve consistency within IAS 36 by making the same impairment model (paragraphs 31–32) applicable to all asset classes within the scope of the Standard. Given that the objectives of both the indicator-only approach and the optional qualitative test in US GAAP are to avoid imposing a quantitative test when it would not result in an impairment test, the staff think that it is not necessary to create a new impairment model within the framework of IAS 36 by adopting the optional qualitative test for CGUs containing goodwill.
17. In addition, if the Board intends to require entities to disclose the existence of an indicator of impairment when no impairment loss is ultimately recognised (see paragraphs 64–65), making it optional to look for indicators of impairment may not achieve this. This is because an entity could elect to go straight to the quantitative test without first seeking an indicator of impairment that the entity would be required to disclose under an indicator-only model.

Recommendation on approach to providing relief

18. Based on the analysis above, the staff recommend that the Board should focus on the indicator-only model (approach 4) as its approach to provide relief from the mandatory annual quantitative impairment test. Therefore, the analysis in the rest of this paper considers only the indicator-only impairment model.

Advantages of indicator-only impairment model (approach 4)

19. In the staff's view, an indicator-only model could:
- (a) save costs for preparers (paragraphs 20–30); and
 - (b) allow entities to apply the same impairment test for all CGUs, regardless of whether they contain goodwill or some identifiable intangible assets (paragraphs 31–32).

Cost savings for preparers

20. A key benefit of providing relief from the mandatory annual impairment test is that such relief can potentially reduce costs for preparers of financial statements. Some respondents to the PIR of IFRS 3 highlighted the costs involved in performing the impairment test, including the requirement to perform the impairment test annually in the absence of impairment indicators. Nevertheless, some preparers have commented that cost-savings from this relief may not be substantial.
21. The staff think that the cost of implementing a quantitative impairment test for goodwill consists of three separate components:
- (a) the cost of initially setting up the valuation model used for the impairment test;
 - (b) the cost of gathering inputs used in the valuation model to determine the recoverable amount; and
 - (c) if the entity changes its valuation model due to changes in circumstances, the cost of updating the valuation model.
22. Although providing relief from the mandatory annual impairment test does not reduce the costs relating to the initial set up or updating of the valuation model, the staff think that at least some of the costs of performing the quantitative test relate to the gathering of inputs used to perform the impairment test. Providing relief from the mandatory annual impairment test could reduce such costs by reducing the frequency of the test.
23. The following are examples of how relief from the mandatory annual quantitative impairment test may help preparers to save costs:

- (a) Where goodwill is allocated to a group of CGUs for which there are no indicators of impairment, in order to perform a quantitative impairment test of the goodwill, valuations of those CGUs would still need to be estimated. Under an indicator-only impairment model, the entity would not be required to perform those valuations as long as there was no indicator of impairment of the goodwill. For some entities where there are many CGUs in the group of CGUs to which goodwill is allocated (eg oil & gas fields in particular region), relief from the annual quantitative test could be a significant cost saving.
- (b) When an entity restructures its business operations, the existing mandatory annual impairment model would require the entity to revise its impairment model even if there is no reason to believe that the restructured business is impaired. An indicator-only impairment model could help to save cost in such circumstances.

24. Studies of stakeholders' reactions to the optional qualitative test ('Step 0') introduced by FASB could provide some insights into the cost benefits of relief from the mandatory annual impairment test of goodwill. Publicly available survey reports indicate that there is a steady increase in the number of public companies electing to use the qualitative test as a first step. Since the introduction of the optional qualitative test, the percentage of public companies in US responding to the survey that applied the qualitative test increased from 29 percent in 2013 to 59 percent in 2016². This suggests that such relief does provide cost benefits to preparers.

25. The survey in 2017³ reported the percentage of public companies in US responding to the survey that applied the qualitative test had reduced to 52%. In the 2016 survey (there was no similar question in the 2017 survey) 63% of all companies surveyed (public and private) believed the optional qualitative goodwill impairment assessment was meeting its stated objective of reducing costs.

² Duff & Phelps. (2016). *2016 U.S. Goodwill Impairment Study*. Financial Executives Research Foundation, Inc.

³ Duff & Phelps. (2017). *2017 U.S. Goodwill Impairment Study*. Financial Executives Research Foundation, Inc.

26. Differences from the impairment test under IFRS Standards may need to be considered when analysing stakeholders' reactions to impairment testing under US GAAP. The goodwill impairment model under US GAAP, as it stands⁴, involves a two-step process which requires the computation of both the fair value of the reporting unit and the implied fair value of goodwill. An entity is required to assess the implied fair value of goodwill ('Step 2') only if the fair value of the reporting unit is lower than its carrying amount ('Step 1').
27. In terms of differences to IFRS, US GAAP's Step 1 compares the carrying amount of the *reporting unit* to its *fair value*, whereas IAS 36 compares the carrying amount of a *CGU* to its *recoverable amount*. Step 2 exists only in US GAAP and requires the calculation of the implied fair value of goodwill. As a consequence, if an entity needs to take that extra step, the full impairment test under US GAAP is likely to be more costly than an impairment test under IAS 36. The difference in the underlying impairment test suggests that cost savings under US GAAP and IFRS may not be identical although, as Step 0 only saves costs where a quantitative test is not required, the additional costs of Step 2 should not be a factor in this difference in cost savings. Nevertheless, the staff think that the cost savings experienced through the use of optional qualitative test in US GAAP can provide useful insights for the Board to consider.
28. During the course of the project we have also heard comments that an assessment for indicators of impairment and the accumulation of the evidence for a robust application of the qualitative test can be more costly than a quantitative impairment test under certain circumstances. That said, staff think that the indicator-only impairment model is intended to identify when a quantitative test is required rather than obstruct an entity from performing a quantitative test in practice if they would so prefer, and will therefore not put an additional burden on entities in most circumstances.

⁴ In January 2017, FASB issued ASU 2017-04, which eliminates Step 2 of the current goodwill impairment test under ASC Topic 350, *Intangibles — Goodwill and Other*. Under the simplified model, a goodwill impairment is calculated based on the difference between the carrying amount of the reporting unit and its fair value, but not to exceed the carrying amount of goodwill allocated to that reporting unit. The application of ASU is not yet required, with early applications permitted.

29. Paragraph 99 of IAS 36 allows an entity to carry forward from the previous period its calculation of the recoverable amount of a CGU to which goodwill has been allocated for the purpose of impairment testing if specified conditions are met. According to paragraph BC177 in the Basis for Conclusions on IAS 36, the option was intended as a cost relief to preparers. In order to apply the cost relief, an entity would need to meet the following criteria:

- (a) the assets and liabilities making up the unit have not changed significantly since the most recent recoverable amount calculation;
- (b) the most recent recoverable amount calculation resulted in an amount that exceeded the carrying amount of the unit by a substantial margin; and
- (c) based on an analysis of events that have occurred and circumstances that have changed since the most recent recoverable amount calculation, the likelihood that a current recoverable amount determination would be less than the current carrying amount of the unit is remote.

Some respondents to the PIR of IFRS 3 thought the requirement to perform the test annually in the absence of impairment indicators was costly despite the cost relief contained in paragraph 99 of IAS 36. The staff note that these conditions, in particular conditions (a) and (b), are more stringent than would be required under an indicator-only impairment model. Therefore, the staff think that an indicator-only impairment model will likely provide more cost relief to preparers than is available under paragraph 99 of IAS 36.

30. Overall, the evidence on cost savings is mixed. Some stakeholders believe an indicator-only approach would save cost whereas others think it would not or think the costs it saves are limited. It is possible that stakeholders' views depend on the type of industry they operate in, the complexity of their business and how their assets and CGUs are organised. The Discussion Paper would explore whether stakeholders do consider an indicator-only approach provides more cost relief than paragraph 99 of IAS 36.

Alignment of impairment models

31. Goodwill is currently tested for impairment as part of a CGU (or group of CGUs), and as a result, the quantitative impairment test is designed to assess the recoverable amount of the CGU as a whole (including the goodwill), rather than the recoverable amount of the goodwill itself. IAS 36 currently requires a quantitative impairment test to be performed at least annually for a CGU that contains goodwill (and some identifiable intangible assets, see paragraphs 54–62 below). For other CGUs, the quantitative impairment test is required only when there is an indication that the CGU (or a particular asset within the CGU) may be impaired.
32. Since the same logic underpins impairment tests for all CGUs, the staff think that the frequency of the impairment test should not depend on whether the CGU contains goodwill. Adopting an indicator-only approach for goodwill impairment would allow entities to apply the same impairment tests for a CGU (or group of CGUs) that contains goodwill as CGU(s) that do not contain goodwill.

Disadvantages of indicator-only impairment model

33. In the staff’s view, an indicator-only model could:
- (a) make the impairment test marginally less robust (paragraphs 34–39);
 - (b) result in some limited loss of information that users of financial statements might find useful (paragraphs 40–43); and
 - (c) slightly weaken governance over impairment tests (paragraphs 44–45).

Less robust impairment test

34. In paragraph BC162 of the Basis for Conclusions on IAS 36, the Board concluded that the non-amortisation of goodwill increases the reliance that must be placed on impairment tests to ensure the carrying amount of goodwill does not exceed its recoverable amount and for that reason decided that a quantitative impairment test of goodwill should be performed annually.
35. Feedback from investors during the PIR of IFRS 3 indicated that impairment losses are often not recognised on a timely basis and those impairment losses recognised are often not adequate. Some stakeholders are therefore concerned that adopting an indicator-only approach would exacerbate the problem of delayed and inadequate

recognition of impairment losses of goodwill (paragraph 10). This could be due to entities not performing the test annually or due to an additional layer of judgement being introduced into the test, namely deciding whether there is an indicator of impairment.

36. Since the impairment test does not directly measure the recoverable amount of the goodwill, to the extent the ineffectiveness in the existing impairment model for goodwill is caused by the “shielding effect”, the Board’s original strategy—to rely on more frequent (ie annual) impairment tests when it removed the requirement to amortise goodwill so as to ensure recoverability of goodwill—is somewhat less effective than the Board had expected. The delayed and inadequate recognition of goodwill impairment is due to factors other than the frequency of the impairment test, and hence cannot be mitigated by performing the test more frequently (ie annually). Therefore, the staff do not expect the adoption of an indicator-only approach would significantly reduce the robustness of the test.
37. The indicator-only approach relies on management identifying the existence of an indicator of impairment. In the staff’s view, although indicators may be somewhat less sensitive at capturing instances of impairment than are quantitative tests, it is unlikely that a material decrease in the recoverable amount of a CGU could occur without management identifying the existence of a qualitative indicator of impairment. Thus, if properly applied, an indicator-only impairment model is unlikely to be significantly less robust than a mandatory annual impairment test.

38. One particular concern about an indicator-only impairment model is that it would require greater management judgement and that entities could potentially behave opportunistically to avoid recognising an impairment loss on goodwill. Although academic evidence is mixed on this subject, the 2017 study performed by Duff and Phelps⁵ on the optional qualitative test in the US suggests that entities adopting Step 0 are more likely to recognise an impairment loss than entities which did not adopt Step 0. Therefore, there is some evidence that entities are not using the optional test in US GAAP opportunistically to avoid recognising impairment losses.

⁵ Duff & Phelps. (2017). *2017 U.S. Goodwill Impairment Study*. Financial Executives Research Foundation, Inc.

39. Another concern regarding an indicator-only impairment model is that by not requiring entities to perform an impairment test on an annual basis, the entity's expertise in performing the test could be lost, resulting in the test being less robust when it is eventually required to be performed. The staff acknowledged this risk. However, on the other hand, requiring an entity to perform an impairment test annually could, in some cases, result in entities using the same impairment model that has been used in previous years without necessarily reviewing whether the model is still fit for purpose.

Loss of useful disclosures

40. IAS 36 requires an entity to disclose information about the estimates used to measure the recoverable amounts of CGUs containing goodwill. Due to the requirement for a mandatory annual quantitative impairment test, entities need to disclose this information every year, even if no impairment loss has been recognised for the CGU.
41. During the PIR of IFRS 3, some investors commented that these disclosures are useful. In particular, disclosures relating to the discount rates, long-term growth rates, profit and capital expenditure assumptions and sensitivities were highlighted as relevant information for users of financial statements. If the requirement to perform the annual quantitative impairment test is removed, an entity may only be required to disclose this information when the quantitative test is performed (ie when there are indicators of possible impairment that trigger a quantitative impairment test).
42. On the other hand, a few preparers commented that the assessment of recoverable amount utilises similar valuation techniques and requires similar estimates for both CGUs that contain goodwill and CGUs that do not. These preparers do not see a need to disclose valuation inputs more frequently just because a CGU contains goodwill.
43. The effects of losing such information may be partly mitigated by potential disclosure enhancements proposed in this project (see **Agenda Paper 18A Better disclosures for business combinations**), such as the disclosure of management's objectives for the acquisition and whether these objectives are subsequently being achieved which may, in some circumstances, provide similar information.

Annual impairment test as governance mechanism

44. A few members of the Board’s consultative groups have stated that they view the annual quantitative impairment test as a valuable governance mechanism that holds management accountable for its investment decisions and prompts management to thoroughly assess the value creation and cash generation processes within the business, thus helping users of financial statements to monitor management’s stewardship. The removal of the mandatory annual impairment test would take away this governance mechanism.
45. Nevertheless, in the staff’s view:
- (a) the effectiveness of such a governance mechanism is hampered by the inherently limited effectiveness of the impairment test itself;
 - (b) this project is exploring enhanced disclosures on the subsequent performance of an acquired business that could mitigate the concerns of some stakeholders about the loss of this governance mechanism; and
 - (c) it is not clear why this governance mechanism should be required for CGUs that contain goodwill but not for CGUs that do not contain goodwill.

Staff recommendation

46. On the basis of the analysis above, the staff thinks that providing entities with relief from the mandatory quantitative annual impairment test could result in cost-savings for preparers and result in a uniform impairment model for all CGUs. This would help to achieve the Board’s objective of simplifying the accounting for goodwill. Nevertheless, such a change may result in a less robust impairment test under limited circumstances, as well as the loss of certain information and a governance mechanism that some stakeholders may find valuable. However, the staff think that the potential loss in the robustness of the test is not expected to be significant, and that the enhanced disclosure requirements could mitigate some of the other concerns. Hence, the benefits of performing a quantitative impairment test annually are limited compared to the costs of performing the quantitative test annually.

47. As noted in paragraph 38, empirical evidence from the optional qualitative test in US GAAP does not suggest that entities are using Step 0 opportunistically to avoid

recognising goodwill impairment, supporting the staff's view that any potential loss in robustness of the test is likely to be limited. Although, as noted in paragraphs 20–30, there are mixed views of the extent of potential cost savings, the staff think that the cost saving can be significant.

48. Although the relief from a mandatory quantitative annual impairment test would not improve the effectiveness of goodwill impairment test, the staff think that it can be an important element in the overall package of proposals helping to achieve an overall cost-benefit balance which is further discussed in **Agenda Paper 18G Preliminary views**.

Effect of a decision to reintroduce goodwill amortisation on relief from mandatory annual impairment test

49. The previous arguments for removing the requirement to perform a quantitative impairment test annually apply whether amortisation of goodwill is reintroduced or not. If amortisation of goodwill was reintroduced an additional argument would exist.
50. As noted in paragraph 34, in revising IAS 36 in 2004, the Board believed that the non-amortisation of goodwill placed greater reliance on the impairment test to ensure the recoverability of goodwill, and accordingly the Board introduced a requirement for an annual quantitative impairment test. Reintroducing goodwill amortisation would remove this concern.
51. Accordingly, if the Board reintroduces amortisation of goodwill, the staff think that it would be appropriate to remove the requirement for a quantitative annual test **when there is no indicator of impairment**.
52. Nevertheless, the staff think that removing the requirement for a quantitative annual test is appropriate even if the Board does not reintroduce amortisation of goodwill. In the staff's view, for reasons summarised in paragraphs 46–48, the benefits of retaining the quantitative annual test are only marginal and do not justify the additional costs of requiring such a test annually.
53. Accordingly, the staff **recommend that** the Board **include** a preliminary view **in the Discussion Paper** to remove the requirement to carry out an annual quantitative

impairment test for goodwill when no indicator of impairment exists, whether or not amortisation of goodwill is reintroduced.

Intangible assets

54. The requirement in IAS 36 to perform a mandatory annual quantitative impairment test applies not only to goodwill but also, for similar reasons, to intangible assets with indefinite useful lives and intangible assets not yet available for use.
55. During the PIR of IFRS 3, although the feedback on the ineffectiveness of the impairment test largely focused on goodwill, stakeholders did raise similar concerns over the impairment test for indefinite-lived intangible assets although it was not clear whether the shielding effect was also an issue for these assets. The staff think that there are arguments both for and against applying any relief that the Board may propose for goodwill to such intangible assets as well.
56. On one hand, the staff think that there are two key differences between impairment tests for goodwill and impairment tests for intangible assets which could support an argument against applying the same relief to intangible assets with indefinite useful lives and intangible assets not yet available for use:
 - (a) Intangible assets within the scope of IAS 38 differ from goodwill as these intangible assets are identifiable (as defined by paragraph 12 of IAS 38) whereas goodwill is not. Although goodwill does not generate cash flows independently of other assets, some indefinite-lived intangible assets and some intangible assets not yet available for use may be able to generate independent cashflows. To the extent that these intangible assets generate independent cashflows and are tested for impairment as individual assets, impairment tests for intangible assets experience less ‘shielding effect’ than do impairment tests for goodwill.
 - (b) To the extent that these intangible assets are tested as part of a CGU, the identifiable nature of these assets suggest that these assets may sometimes be allocated to a CGU at a lower level than the CGU(s) to which goodwill is allocated. This allocation to CGUs at a lower level may also reduce the

‘shielding effect’ that could affect the impairment tests for these intangible assets.

57. Given these differences, impairment tests for intangible assets with indefinite useful lives and intangible assets not yet available for use may be more effective than impairment tests for goodwill. Thus, there is a greater likelihood that a quantitative test would detect an impairment—and hence a somewhat greater risk that moving to an indicator-only approach could fail to detect an impairment that a mandatory annual quantitative test would have otherwise revealed. The greater reduction in robustness may tilt the balance between the cost and benefit of providing relief for these intangible assets compared to goodwill.
58. On the other hand, since the logic underpinning the requirement for a mandatory annual quantitative impairment test is the same for intangible assets with indefinite useful lives and intangible assets not yet available for use as it is for goodwill, the staff think that the same impairment model should apply to all these assets.
59. Moreover, if relief from a mandatory annual quantitative impairment test is provided for goodwill, but not for intangible assets with indefinite useful lives and intangible assets not yet available for use, the resulting accounting treatment would require assets that are identifiable to be tested for impairment more frequently than an asset that is not identifiable. Such a difference in accounting treatment may be counterintuitive.
60. Also, if a different impairment model is applied to goodwill and other types of intangible assets, the difference in the subsequent accounting for these assets could create scope for accounting arbitrage that enables entities to achieve desired accounting outcomes through selective use of judgement in deciding whether to recognise intangible assets in a business combination and how to measure them.
61. Additionally, paragraph 55 of IAS 16 *Property, Plant and Equipment* states that depreciation of an asset begins when the asset is available for use. The non-depreciation of such fixed assets is similar in nature to the non-amortisation of intangible assets not yet available for use. However, IAS 36 requires a mandatory annual quantitative impairment test only for intangible assets that are not yet available for use, but not for their ‘tangible fixed assets under development’ counterparts. The

difference in accounting treatment that is based on the physical attributes of the asset may appear arbitrary.

62. On balance, the staff think that the reasons to apply the same impairment test for goodwill and intangible assets with indefinite useful lives and intangible assets not yet available for use are stronger than the reasons for applying different tests. Therefore, the staff think that any relief that the Board may propose for the impairment test for goodwill should be extended to such intangible assets as well.

Question for the Board

1. Do Board members agree with the staff’s recommendation to include a preliminary view in the Discussion Paper to:
 - (a) remove the requirement to carry out an annual quantitative impairment test for goodwill when no indicator of impairment exists; and
 - (b) for intangible assets with indefinite useful lives, and for intangible assets not yet available for use, apply the same relief as for goodwill?

Other issues for consideration

63. The following paragraphs summarise other detailed issues that the Board may wish to consider in due course if it decides to propose an indicator-only model for goodwill impairment testing. The staff is not requesting decisions on these issues at this point. These items would be included in the Discussion Paper for information and the Board could consider them more fully when it considers the feedback on the Discussion Paper.

Disclosure of events triggering a quantitative impairment test

64. Under the existing impairment model, an impairment test is a quantitative exercise and the recognition or reversal of an impairment loss triggers a requirement to

disclose the events and circumstances (paragraph 130(a) of IAS 36) that led to the impairment loss or reversal. The disclosure of such events is not required if no impairment loss or reversal is recognised.

65. Under an indicator-only model, an indicator of impairment that triggers a quantitative impairment test may not necessarily result in recognition of an impairment loss or its reversal. The Board may wish to consider requiring disclosure of the facts and circumstances triggering the impairment test, even if it did not eventually result in an impairment loss or reversal. During our outreach with stakeholders, some users commented that qualitative information relating to triggering events could be useful. Although the Board has previously decided not to perform a complete review of the disclosure requirements of IAS 36, this amendment could be considered by the Board when the feedback from the Discussion Paper has been received.

Timing of impairment tests

66. If the indicator-only impairment model were to be adopted for goodwill, the Board may need to consider the timing of impairment tests. Paragraph 96 of IAS 36 stipulates that a CGU to which goodwill has been allocated (and in the case of intangible assets with indefinite useful lives and intangible assets not yet available for use, paragraph 10(a) of IAS 36) can be tested for impairment any time during the year, provided that the test is performed at the same time every year.
67. If the Board proposes to remove the requirement to perform mandatory annual quantitative impairment tests, which may occur at times other than the end of the period, an impairment test, if any, performed by the entity would occur only at the end of the reporting period when an assessment for indicators of impairment is performed. Therefore, the option under paragraphs 10(a) and 96 of IAS 36, for entities to perform a quantitative impairment test at any time during the year, would no longer be applicable under an indicator-only approach.

Carrying forward a recoverable amount calculation

68. Paragraph 99 of IAS 36 allows an entity to carry forward from the previous period its calculation of the recoverable amount of a CGU to which goodwill has been allocated

for the purpose of impairment testing if specified conditions are met (paragraph 24 of IAS 36 allows a similar treatment for intangible assets with indefinite useful lives). According to paragraph BC177 in the Basis for Conclusions on IAS 36, the option was intended as a cost relief to preparers.

69. One of the conditions specified in paragraph 99 of IAS 36 is that there is only a remote likelihood that an up-to-date calculation would have led to the entity recognising an impairment loss. However, where the likelihood of impairment is remote, no quantitative impairment test needs to be performed under the indicator-only model. Therefore, the staff think that the approach in paragraph 99 of IAS 36 would become redundant under an indicator-only impairment model.

Review of indicators of impairment

70. In the May 2019 Board meeting, a few Board members highlighted the importance of having a robust set of indicators in ensuring an indicator-only impairment model for goodwill operates appropriately. This would also help enforcement of the Standard. This is important because, if the Board decides to propose an indicator-only model for goodwill impairment testing, greater reliance would be placed on these indicators to ensure the robustness of the test.
71. Paragraph 12 of IAS 36 sets out a non-exhaustive list of indicators that an asset may be impaired. The Board may wish to review this list to ensure that indicators relevant to the impairment of goodwill are included.
72. Possible additions might include:
- (a) a failure to meet the key objectives of the acquisition, as highlighted by the enhanced disclosures recommended in **Agenda Paper 18A Better disclosures for business combinations**.
 - (b) indicators of impairment suggested by other bodies. In September 2017, the European Financial Reporting Advisory Group (EFRAG) presented a discussion paper on ‘Goodwill Impairment Test: Can it be improved?’ to the Accounting Standards Advisory Forum. The paper suggested some potential indicators of impairment that could be included in IAS 36. The

Board could also consider the indicators of impairment that are currently used by the FASB for its optional qualitative assessment. Please refer to **Appendix A** for a list of those indicators.

73. Although the staff think that it is important to strengthen the indicators to ensure the robustness of an indicator-only impairment model, expanding the list excessively could promote a check-list approach towards impairment assessment and discourage necessary management judgement. Due to the wide range of facts and circumstances facing entities, the staff think that management judgement is required in identifying indicators of impairment and therefore care would need to be taken in developing a more detailed list of impairment indicators to ensure the appropriate balance is struck.

APPENDIX A – Potential indicators of impairment the Board may wish to considerIndicators of impairment suggested in EFRAG discussion paper

The introduction of a Step Zero would require more specific and adapted indicators for goodwill, which would build on those in IAS 36. In evaluating whether or not the likelihood of an impairment is remote, an entity would have to assess relevant events and circumstances that could include the following:

- (a) Macroeconomic conditions:
 - (i) a decline in general of economic conditions (eg equity and credit markets) or limitations on accessing capital;
 - (ii) industry and market considerations such as a deterioration in the environment in which an entity operates or increased competitive environment; and
 - (iii) cost factors such as significant increases in raw materials, labour, or other costs that have a negative effect on earnings and cash flows.
- (b) Conditions specific to the entity/CGU:
 - (i) observable prices for the CGU, such as prices paid by the acquirer or a third party to buy a non-controlling interest, vesting or non-vesting of performance-based options on non-controlling interest and the outcome of contingent consideration clauses;
 - (ii) significant decline in actual and planned earnings when compared with prior projections;
 - (iii) whether the reasons for undertaking the business combination have been met, for example in relation to expected technological innovation, access to markets or realisation of expected synergies from the combination;
 - (iv) information from previous impairment calculations, such as whether the most recent calculations have indicated that the recoverable amount of the CGU is significantly greater than its carrying amount and assets and liabilities composing the CGU have not changed significantly since then;

- (v) changes in the way the acquired business is managed or changes in plans, such as restructuring or discontinued operations of the business acquired;
- (vi) restructuring costs are significantly higher than initially expected; and
- (vii) other relevant entity-specific events such as changes in key personnel or customers, contemplation of bankruptcy or litigation.

Indicators of impairment used in FASB’s optional qualitative assessment (Paragraph 350-20-35-3C in the *FASB Accounting Standards Codification*)

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, labour, 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).