STAFF PAPER

October 2015

IASB Meeting

Project	**Goodwill and impairment project**
Paper topic	Improving the impairment test

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Accounting Standards Advisory Forum, December 2015, Agenda paper 5C

Objective of this paper

1. The purpose of this agenda paper is:
   (a) to consider the ways we could improve the impairment test in IAS 36 *Impairment of Assets* following the September joint meeting with the US Financial Accounting Standards Board (FASB); and
   (b) ask what additional information IASB members need before considering the staff's suggestions in this paper.

Structure of this paper

2. This paper includes the following sections:
   (a) Introduction to this agenda paper
   (b) What do we need to address?
      (i) Feedback from the Post-implementation Review (PIR) of IFRS 3 *Business Combinations*
      (ii) Areas being considered by others
      (iii) Areas the staff have identified for the IASB to consider
   (c) Staff analysis
      (i) Overall objective

(ii) Four areas for possible improvement/simplification

Area 1: Revisiting the methodology in the calculation of recoverable amount

Area 2: Relief from the annual impairment test

Area 3: Simplifying/clarifying the value in use calculation

Area 4: Adding guidance on identifying cash generating units (CGUs) and allocating goodwill to CGUs

(iii) Addressing investors' concerns about the current information provided

(d) Summary of staff recommendations and questions for the IASB

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

Introduction to this agenda paper

3. The IASB's report and feedback statement on the PIR of IFRS 3 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.

4. In this agenda paper the staff have provided their initial analysis on possible ways of improving the impairment test based on feedback during the PIR, the IASB's reasoning for its current impairment requirements and the work of the FASB and the EFRAG/OIC/ASBJ Research Group[1] (see paragraphs 13-17 of Agenda Paper 18). Appendix A of Agenda Paper 18A provides a summary of what we have heard during the PIR on subsequent accounting for goodwill and impairment.

[1] A research group consisting of individuals from the European Financial Reporting Advisory Group (EFRAG), the Organismo Italiano di Contabilità (OIC), and the Accounting Standards Board of Japan (ASBJ) (referred to as the EFRAG/OIC/ASBJ Research Group for the purpose of this agenda paper).

5. The staff is asking IASB members to have only an initial discussion on the ways of improving the impairment test at this meeting, rather than making decisions, for the following reasons:

    (a) The different ways of improving the impairment test set out in this paper are interrelated. Consequently, views on one way of improving the impairment test may affect views on another area of potential improvement. Consequently, it is likely that once the IASB has discussed the four areas in this paper, the staff will need to bring back further analysis on some of their suggestions.

    (b) The staff think that the IASB should work with the FASB to benefit from each other’s work on improving the impairment test and also see if there is an opportunity to create further convergence in this area. The IASB and FASB do not have converged impairment standards. Consequently the staff think trying to work towards convergence at this stage would be difficult because of our two different starting points. Nevertheless, both Boards are looking at improving their impairment requirements and there is overlap in the areas that both Boards are considering. Consequently the staff recommend that the IASB discuss the possible approaches jointly with the FASB before making decisions about potential amendments to IAS 36. However, because the FASB has already discussed improvements to its impairment model at several meetings, the staff think the IASB should have their own discussions initially before starting discussions with the FASB.

    (c) As explained in paragraph 6(b) of Agenda Paper 18A, the staff plan to bring an agenda paper to the November 2015 IASB meeting with proposals on recognising and measuring intangible assets acquired in a business combination. Any views of IASB members on recognising and measuring intangible assets in a business combination may affect their views on the issues being considered at this meeting because the topics are interrelated.

What areas do we need to address?

Summary of feedback in the PIR (see Appendix A of Agenda Paper 18A for more detail)

6. 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 in IAS 36.

7. Many investors have told us that the information provided by the impairment test is useful because it provides confirmatory value about the performance of the acquisition and about the stewardship of the management. However, they note that impairment losses are often recognised too late (ie the information does not have predictive value). They have also expressed concerns about the subjectivity of some of the assumptions used in the impairment test, particularly in the value in use calculations.

8. 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) difficulties in determining a pre-tax discount rate for the value in use (VIU) calculation.

   (c) limitations of the VIU calculation, for example the prohibition on including expansion capital expenditures in cash flow projections.

   (d) the high degree of subjectivity in the assumptions used in the impairment test, particularly in the VIU calculations.

   (e) difficulties (and subjectivity involved) in allocating goodwill to cash generating units (CGUs) for impairment testing purposes, and reallocating that goodwill when restructuring occurs.

Areas being considered by others

9. At the September 2015 meeting of the International Forum of Accounting Standard Setters (IFASS), the EFRAG/OIC/ASBJ Research Group presented a paper which said that the group is now focussing its effort on discussing possible improvements in the following aspects of the impairment model[2]:

   (a) Frequency of testing, including if the annual impairment test should be mandatory.

   (b) Methodology of calculating recoverable amount, including if the Standards could require only one estimate of the recoverable amount.

   (c) Discount rate, including the use of a pre-tax rate.

   (d) Clarifying the notion and ways of identification of CGUs.

   (e) Association of goodwill to relevant CGUs and reallocation at the time of restructuring.

10. In September 2015 IASB Agenda Paper 13E the FASB staff identified four potential simplifications to consider for the impairment test in US GAAP:

    (a) Testing for impairment at the entity, operating segment, or reportable segment level rather than the reporting unit level.

    (b) Using a one-step test rather than a two-step test (note, IFRS does not require a two-step test).

    (c) Testing for impairment only upon the occurrence of a triggering event rather than annually.

    (d) The ability to change the date the impairment test is performed rather than a requirement to test at the same time every year.

    The staff have provided a comparison between the impairment requirements in IFRS and US GAAP in the appendix to this agenda paper.

[2] The EFRAG/OIC/ASBJ Research Group have also being focusing on assessing how to apply annual amortisation to goodwill (see paragraph 16 of Agenda Paper 18).

Areas the staff have identified for the IASB to consider

11. Based on the feedback we have received and the areas being considered by the FASB and the EFRAG/OIC/ASBJ Research Group the staff think the IASB should consider the following four areas when looking at ways to improve/simplify the impairment test:

    (a) Revisiting the methodology in the calculation of recoverable amount, in particular considering determining recoverable amount based on one model.

    (b) Providing relief from the annual impairment testing requirements, including consideration of an annual qualitative assessment.

    (c) Simplifying and providing guidance on the VIU calculation, including looking at the discount rate and the limitations on the cash flows.

    (d) Guidance on identifying CGUs and allocating/reallocating goodwill to CGUs.

    The staff have analysed these four areas below.

Staff analysis

Overall objective of looking at improving the impairment test

12. The staff think the main objective is to consider whether the impairment test could be simplified and improved without loss of information for investors. The staff think we should also consider whether information can be improved for investors without imposing costs that would exceed the benefits provided by the improvements.

13. In practice, many of the complexities regarding impairment testing relate to goodwill. However some concerns raised about the existing impairment test for goodwill during the PIR of IFRS 3 are also general concerns about the impairment model in IAS 36 and how it applies to other non-current, non-financial assets. Consequently, considering whether changes should be made to the existing impairment test for goodwill may best be done in parallel with considering changes to the overall impairment model.

Area 1 Revisiting the methodology in the calculation of recoverable amount

Description

14. IAS 36 defines recoverable amount as the higher of an asset's (or CGU's) fair value less costs of disposal (FVLCD) and its value in use (VIU):

15. When determining recoverable amount, management needs to estimate and compare two different amounts under the two different models. This often requires management to perform two different calculations (unless the first calculation is greater than carrying amount).

16. Also, in practice, many entities determine FVLCD using a discounted cash flow calculation because CGUs are not usually traded in active markets. Some think that it is confusing to use different inputs for VIU and FVLCD when both are estimated using discounted cash flow calculations:

    (a) FVLCD reflects the market's expectation of the present value of the future cash flows to be derived from the asset.

    (b) VIU is the entity's estimate of the present value of the future cash flows to be derived from continuing use and disposal of the asset.

17. We had some feedback that requiring entities to look at a single method (single calculation) rather than the higher of two methods may reduce complexity.

Staff analysis

18. The staff think there are three possibilities for a single method:

    (a) Method 1: Recoverable amount based on FVLCD

    (b) Method 2: Recoverable amount based on VIU

    (c) Method 3: Recoverable amount based on how the entity expects to recover the asset as follows:

        (i) determined based on FVLCD if the entity expects to sell the asset; and

        (ii) determined based on VIU if the entity expects to recover the asset through use.

Basing recoverable amount on a single method in (a)-(c) could lead to the recognition of higher or earlier impairment charges because the entity would not be looking at the higher of VIU and FVLCD, but rather only one of these.

19. The staff think that the current approach in IAS 36 is conceptually the best approach for the reasons outlined by the IASC[3] in paragraphs BCZ9-BCZ30 of the Basis for Conclusions accompanying IAS 36. The staff have referred to the main arguments in these paragraphs in their analysis of the three methods below.

Method 1: Recoverable amount based on FVLCD

20. Paragraph BCZ16 of IAS 36 notes that some think that FVLCD is the only appropriate measurement for recoverable amount. The main arguments are:

    (a) VIU is subjective and could be abused. Observable market prices that reflect the judgement of the marketplace are a more reliable measurement.

    (b) If an asset is expected to generate greater net cash inflows for the entity than for other participants, the superior returns are almost always generated by internally generated goodwill from the synergy of the business and its management team.

21. Paragraph BCZ17 of IAS 36 provides the IASC's reasons for rejecting determining an asset's recoverable amount only based on FVLCD. These are summarised as:

    (a) No preference should be given to the market's expectation. An entity may have superior information about future cash flows.

    (b) If an entity can generate greater cash flows by using an asset than selling it would be misleading to base recoverable amount on the market price because a rational entity would not be willing to sell.

    (c) It is the amount that an entity expects to recover from an asset, including the effect of synergies with other assets, which is relevant.

22. The staff agree with the reasons in paragraph 21 and think conceptually VIU should be considered in determining recoverable amount, particularly if the entity plans to continue to use rather than sell an asset. However, the staff think there is a cost-

[3] The IASB was preceded by the Board of International Accounting Standards Committee (IASC).

benefit argument for considering determining recoverable amount based on FVLCD for the following reasons:

(a) An entity would only have to use one set of assumptions (and only be familiar with one calculation). These would be assumptions from the market participants' perspective, which may be easier for investors to understand. Entities are required to determine the fair value of assets under other IFRS. However, the concept of VIU is only used in IAS 36. Consequently entities only need to understand and apply VIU calculations for the purposes of IAS 36.

(b) Investors have expressed concerns about the subjectivity of the assumptions used by preparers, particularly in determining VIU. Although both methods are judgemental, FVLCD is sometimes considered more reliable than VIU because it is based less on management judgement and more on external evidence for some assets (although there is rarely external evidence for CGUs of an entity). Some have expressed preference for recoverable amount to be determined based on the more easily verifiable and objective FVLCD.

(c) More concerns raised by preparers about the complexity of the impairment test relate to the VIU calculations. However the staff acknowledge that in many cases the FVLCD calculations can be equally complex. The staff also note that there is currently no need to estimate FVLCD when VIU is known to be higher than FVLCD, because in that case recoverable amount equals VIU. Consequently, if the use of VIU were eliminated, it would become necessary to estimate FVLCD in those cases. It is possible that some of the complications arising in estimating VIU could then also arise in estimating FVLCD.

(d) Some think that VIU is an artificial figure and so is not a good input to the impairment test. They state that this is because there are artificial restrictions on the cash flows that can be used in a VIU calculation and that there are inconsistencies in the model, for example the determination of the discount rate is based partially on a market participant's perspective. The staff have considered ways to mitigate some of these concerns later in this paper (see paragraphs 47-60)

23. The staff also notes that FASB currently determines recoverable amount based on fair value and so eliminating VIU would enhance convergence with US GAAP.

24. For the reasons in paragraph 22-23 (particularly paragraphs 22(a), 22(d) and 23) the staff would support determining recoverable amount based on FVLCD rather than VIU if only one method is used. However the staff acknowledge that many concerns about the VIU method are equally applicable if FVLCD is determined by a discounted cash flow calculation (but arguably to a slightly lesser extent).

Method 2: Recoverable amount based on VIU

25. Paragraph BCZ21 of IAS 36 notes that some think VIU is the only appropriate measurement for the recoverable amount of an asset because:

    (a) Financial statements are prepared under a going concern assumption. No consideration should be given to an alternative measurement that reflects a disposal, unless this reflects the entity's intentions.

    (b) Assets should not be carried at amounts higher than their service potential from use by the entity. A market value does not necessarily reflect the service potential of an asset.

26. Paragraph BCZ22 of IAS 36 provides the IASC's reasons for rejecting determining an asset's recoverable amount only based on VIU:

    (a) If an asset's FVLCD is higher than its VIU, a rational entity will dispose of the asset. In this situation, it is logical to base recoverable amount on the asset's FVLCD to avoid recognising an impairment loss that is unrelated to economic reality.

    (b) If an asset's FVLCD is greater than its VIU, but management decides to keep the asset, the extra loss (the difference between FVLCD and VIU) properly falls in later periods because it results from management's decision in these later periods to keep the asset.

27. The staff agree with the reasons in paragraph 26. However, the staff think there is a slightly stronger argument for choosing to eliminate VIU rather than FVLCD if one model is used to determine recoverable amount (as explained in paragraph 22-24).

Method 3: Recoverable amount based on expected manner of recovery

28. The staff do not support requiring recoverable amount to be determined based on how the entity expects to recover the asset for the following reasons:

(a) There would still be two different types of methods/calculations to understand and apply in IAS 36. The staff think one of the main benefits from moving to a single model would be removing the need to understand the differences between the inputs into the FVLCD and VIU calculations.

(b) This approach could result in additional subjectivity, for example how to decide which model to use for an asset that is held for a period of time before being sold.

(c) The staff think this method is more likely to result in the model in IAS 36 being based on VIU (which staff think is the slightly less supportable method for the reasons given in paragraph 22-24). That is unless FVLCD would be used whenever there is a plan to sell the asset, even if there was a long time before expected sale. The staff also think if an asset is expected to be sold in the near future, VIU is likely to be mainly comprised of the present value of the expected disposal proceeds. Consequently it might reasonably be expected that there should be little difference between VIU and FVLCD in these circumstances.

29. The staff observes that IFRS 5 *Non-current Assets Held For Sale and Discontinued Operations* requires an entity to measure a non-current asset (or disposal group) classified as held for sale at the lower of its carrying amount and fair value less costs to sell. To qualify for classification as held for sale, the sale of a non-current asset (or disposal group) must be highly probable. The staff think that if recoverable amount is based on the expected manner of recovery of an asset a consequence would effectively be a relaxation of the IFRS 5 requirement for a sale to be highly probable. For example, if an entity expects to sell an asset, that asset would be measured at the lower of its cost and recoverable amount (which would be based on sale—FVLCD in

accordance with Method 3), but the sale may not meet the criteria in IFRS 5 to be highly probable.

Staff view

30. The staff think that the current approach in IAS 36 is conceptually the best approach. However, out of the three possibilities assessed, the staff think if we move to a single method there is a stronger cost-benefit argument for determining recoverable amount based only on FVLCD.

Area 2 Testing for impairment only upon the occurrence of a triggering event rather than annually

Description

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

32. The annual impairment test for a CGU to which goodwill has been allocated 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. However, if some or all of the goodwill allocated to a unit (group of units) was acquired in a business combination during the current annual period, that unit (group of units) must be tested for impairment before the end of the current annual period.

33. We have had some feedback that requiring an impairment test only if impairment indicators are present for goodwill and other indefinite life intangible assets may reduce complexity (ie an explicit impairment test would be required only if there is some indication of a possible impairment).

Staff analysis

34. The IASB required an annual amortisation test for goodwill and indefinite life intangible assets because it determined that non-amortisation of an intangible asset increases the reliance that must be placed on impairment reviews of that asset to ensure that its carrying amount does not exceed its recoverable amount (see paragraphs BC121 and BC162 of the Basis for Conclusions accompanying IAS 36).

35. During the PIR we received feedback from investors that impairment losses are often recognised too late (even with an annual impairment test). The staff have concerns that without a required annual test, recognition of impairment losses could be delayed even further unless we do more to support more rigorous application of the indicator-only approach.

36. If goodwill is not amortised and an annual test is not required, this could reduce investors' confidence in the value of goodwill and lead to concerns about the possibility that it may be overstated. Consequently, not having an annual test could increase pressure on management to prove that indicators of impairment have not occurred, which could limit some of the relief provided by removing the annual requirement.

Indicator only approach, including consideration of a qualitative assessment

37. Nevertheless the staff think we should consider whether we can eliminate the annual impairment test requirement for CGUs to which goodwill is allocated if we make the impairment indicators in IAS 36 more robust. The staff suggest considering the following two impairment indicators in addition to the indicators in IAS 36 (either one or both could be considered):

    (a) A qualitative assessment of whether it is more likely than not that the fair value of a CGU (or group of CGUs) to which goodwill is allocated is less than its carrying amount. The staff have introduced this suggestion based on a similar qualitative assessment introduced into US GAAP in 2011 (see paragraph 42). The staff think we should also consider whether we should make this assessment more robust, for example using a stricter wording than 'more likely than not' and/or incorporating a consideration of the magnitude of the difference between fair value and carrying amount, rather than just having a probability criterion.

    (b) An impairment indicator that incorporates some kind of assessment of whether actual performance of the acquiree was worse than its original expected performance.

38. An entity would be required to assess at the end of each reporting period whether there is any indication that a CGU to which goodwill is allocated may be impaired, including considering the indicators in IAS 36 and in paragraphs 37(a) and (b).

39. As for the qualitative assessment under US GAAP, guidance could be included on the qualitative factors to consider when making the qualitative assessment. Such factors could include a deterioration in general economic conditions, deterioration in the industry or environment in which an entity operates, increases in costs, a decrease in financial performance, changes in management and a sustained decrease in share price etc.

Requirement for an annual test in the first two or three years

40. The staff also suggest that we should consider whether we want the indicator-only approach to be coupled with a requirement that if some or all of the goodwill allocated to a unit (group of units) was acquired in a business combination during the current annual period or the previous annual period, that unit (group of units) must be tested for impairment in the current period. In other words no relief from the annual impairment test in the first two years. The staff suggest this should apply only to units to which a material amount of goodwill was allocated from that business combination.

41. The staff think that often investors are most concerned about whether or not an acquisition performs as expected in the few years following acquisition. The staff also think that if management realise they have overpaid or a business combination is unsuccessful, this is often identified relatively soon after the acquisition. The staff further suggest that we could consider extending the annual test to three years after a business combination, rather than two. This extension may address possible concerns that in the period following an acquisition a unit may be considered not to be impaired if the acquisition price of the acquiree is considered to be a recent market price.

Consideration of the work of the FASB

42. Due to concerns about the cost and complexity of the annual goodwill impairment test, the FASB developed an optional qualitative impairment assessment as a screen for companies to assess whether it is more likely than not that goodwill is impaired before performing the quantitative impairment test. The qualitative assessment was

introduced in 2011 (with early adoption permitted)[4]. Because it is a recent change, there is limited feedback so far on how well it is working in practice. The FASB provided some information on use of the qualitative assessment in its September 2015 IASB Agenda Paper 13E. The staff think if IASB members would like to consider incorporating a similar qualitative assessment, we should consider the ongoing research by the FASB on how it is working in practice.

43. The staff also note that the FASB is currently considering the frequency of impairment testing as part of its work on considering ways to improve and simplify its impairment test. In particular it is considering:

(a) whether to test for impairment on the occurrence of a triggering event rather than annually; and

(b) whether to relax the requirement for the test to be performed at the same time every year.

44. Consequently the staff think that we could discuss this area with the FASB before deciding what types of simplification may be appropriate.

Staff view

45. The staff suggest considering an indicator-only approach for CGUs with goodwill and adding the following additional indicators to IAS 36:

(a) A qualitative assessment of whether it is more likely than not that the fair value of a CGU (or group of CGUs) to which goodwill is allocated is less than its carrying amount. The staff have provided suggestions on how we could make this indicator stricter in paragraph 37(a).

(b) An impairment indicator that incorporates some kind of assessment of whether actual performance of the acquiree was worse than its original expected performance.

46. The staff also suggest considering adding a requirement that if a material amount of goodwill was allocated to a unit from a business combination during the current

[4] originally in the amendments in FASB Accounting Standards Update No. 2011-08, *Intangibles—Goodwill and Other (Topic 350): Testing Goodwill for Impairment;* now in Subtopic 350-20, Intangibles—Goodwill and Other—Goodwill

annual period or the previous annual period, that unit must be tested for impairment in the current period.

Area 3 Simplifying/clarifying the value in use calculation

Description

47. Most of the concerns raised by preparers about the complexity of the impairment test relate to the VIU calculations. Based on responses to the PIR the staff think the following are the main concerns by preparers that are specific to the VIU model:

(a) Requirement to use pre-tax discount rates: the requirement to use a pre-tax discount rate when equity returns are always post-tax (meaning there are not observable market inputs for a pre-tax cost of equity). Practically, this means that the test is usually conducted on a post-tax basis with an additional iteration performed simply to derive a pre-tax discount rate

(b) Artificial restrictions on VIU cash flows: the current limitations on what can be included in VIU cash flows, in particular the prohibition on including expansion capital expenditures in cash flow projections. This means that management have to adjust their financial budgets/forecasts.

(c) Lack of guidance in other areas making the assumptions used very subjective: examples include the difference between the market perspective (FVLCD) and the entity perspective (VIU) and on the growth rate used for extrapolating the projections based on the budgets/forecasts.

Staff analysis

Discount rate

(more detail in paragraphs 207-220 in September IASB Agenda Paper 15B on discount rates)

48. IAS 36 requires the use of pre-tax rates when determining VIU. Cash flows used in VIU calculations are typically available on a pre-tax basis and can be used without any adjustment (as all inputs have to be consistent, ie on a pre-tax basis). However, entities usually use weighted average cost of capital (WACC) as a starting point for

determining the discount rate, in accordance with the guidance in IAS 36. WACC is usually a post-tax rate, from the entity's perspective.

49. Because IAS 36 requires entities to use a pre-tax rate, the post-tax rate is translated into the pre-tax rate. In theory, discounting post-tax cash flows at a post-tax discount rate and discounting pre-tax cash flows at a pre-tax discount rate should give the same result, as long as the pre-tax discount rate is the post-tax discount rate adjusted to reflect the specific amount and timing of the future tax cash flows (see paragraph BCZ85 of the Basis for Conclusions accompanying IAS 36). This is usually done by using a simple formula of dividing a post-tax rate by (1-tax rate), which features in many accounting manuals. However, this formula only works in the very simple scenario of perpetual returns with no growth.

50. As a result, many academics and valuation professionals recommend using the post-tax rates available and converting pre-tax cash flows to post-tax cash flows. This has led to divergence in practice. Some companies use post-tax rates and post-tax cash flows, whereas others convert post-tax rates to pre-tax rates and apply these to pre-tax cash flows. Some disclose pre-tax rates, post-tax rates, or both. Regulatory practice also differs; some regulators state that they now accept calculations on a post-tax basis, whereas others have taken regulatory action to require companies to use and disclose pre-tax discount rates[5].

51. The difference in the way that a post-tax rate is adjusted to arrive at a pre-tax rate can for example mean the difference between impairment and no impairment in IAS 36. This can make a big difference to investors' analysis.

52. The staff thinks that mandating the use of the pre-tax rate adds to complexity for the preparer, because, often, the starting point for the calculation is the post-tax rate. Consequently the staff recommend not requiring the pre-tax rate to be used in the VIU calculation. This would be consistent with the requirements in IFRS 13 *Fair Value Measurement* for determining FVLCD. The staff note that this issue is currently being considered for possible inclusion in the IASB's research project on discount rates.

[5] Based on information provided to IASB staff by IOSCO's Committee 1 on Issuer Accounting, Audit and Disclosure, which comprises 28 members.

VIU cash flows

53. IAS 36 requires that future cash flows used in the VIU calculations are estimated for an asset/unit in its current condition. Consequently estimates of future cash flows are not permitted to include estimated future cash inflows or outflows that are expected to arise from a future restructuring to which an entity is not yet committed or from improving or enhancing the asset's performance.

54. The IASB acknowledges in paragraph BC69 of the Basis for Conclusions accompanying IAS 36 that if the unit’s fair value less costs to sell were to be estimated, it would also reflect the market’s assessment of the expected net benefits any acquirer would be able to derive from restructuring the unit or from future capital expenditure on the unit. Nevertheless in paragraph BC72 the IASB concluded that allowing these cash flows to be included in VIU would be a significant change to the concept that VIU is assessed for a unit in its current condition. The IASB decided such a change should only be considered when it considers and resolves the broader question of the appropriate measurement objectives in accounting.

55. The staff note that the IASB has considered measurement objectives as part of its Conceptual Framework project. The VIU calculation in IAS 36 is an application of the VIU measurement base described in the Exposure Draft *Conceptual Framework of Financial Reporting*. That Exposure Draft does not specify that an application of the VIU measurement base would require the asset to be measured in its current condition.

56. The staff think that future cash flows should be included in VIU even if those cash flows are expected to arise from a future restructuring to which an entity is not yet committed or from improving or enhancing the asset's performance. This would be consistent with the requirements for FVLCD. It would also mean that management do not need to adjust financial budgets/forecasts for the purposes of the calculation, for example to separate forecast capital expenditures between maintenance capital expenditures and expansionary capital expenditures.

57. Nevertheless the staff note that if a future restructuring is significant and changes the composition of the entity’s CGUs, this could create difficulties in terms of identifying CGUs to be tested. Furthermore if restructurings are expected far in the future or take

a number of years to complete, there is a risk that plans could change. This could make assumptions regarding the cash flows even more subjective. To lessen this problem the IASB could consider only permitting the inclusion of restructurings meeting certain criteria, for example only those for which there is a formal plan. However, the staff do not support such criteria as again it would create another artificial restriction.

Lack of guidance in other areas

58. The staff think it would also be helpful to consider whether education material could be developed to address other areas of difficulty such as difference between the market perspective (FVLCD) and the entity perspective (VIU), determining the terminal value (growth rate) etc.

Staff view

59. The staff think the following improvements to the VIU calculations should be considered:

(a) Removing the requirement to use pre-tax rates because post-tax rates are the rates that can be observed and therefore are often used in practice.

(b) Not requiring management to make adjustment to their financial budgets/forecasts to exclude estimated future cash inflows or outflows that are expected to arise from a future restructuring to which an entity is not yet committed or improving or enhancing the asset's performance.

60. The staff think it would also be helpful to consider whether education material could be developed to address concerns about the lack of guidance in other areas.

Area 4 Guidance on identifying CGUs and allocating goodwill to CGUs

Description

61. For the purpose of impairment testing, IAS 36 requires that goodwill must be allocated from the acquisition date to each of the acquirer's CGUs or groups of CGUs that are expected to benefit from the synergies of the combination irrespective of

whether other assets or liabilities of the acquiree are assigned to those units. Each CGU, or group of CGUs, represents the lowest level within the entity at which the goodwill is monitored for internal management purposes and must not be larger than an operating segment.

62. The PIR identified that one of the main challenges of the current impairment test is the allocation of goodwill to CGUs for impairment testing, which can be judgemental and difficult to apply in practice. After the initial allocation, the carrying value of the goodwill is tested for impairment as part of the respective CGUs (or groups of CGUs), which might be merged or restructured in subsequent years to a degree that they have little or no similarities to the originally acquired business. Furthermore, the impairment test is performed on the basis of the most recent approved budgets, which over time can be substantially different from the business plans at the acquisition date. Some respondents also said it is not clear what constitutes 'the lowest level within the entity at which the goodwill is monitored for internal management purposes'.

63. We have had some feedback that IAS 36 does not provide sufficient guidance in this area and leads to diversity in practice.

Staff analysis

Clarification or education material

64. The staff think we should consider whether we can provide helpful clarification in IAS 36 or separate education material in the following areas:

(a) Identifying cash-generating units (CGUs), for example further illustrative examples addressing common scenarios.

(b) Allocating goodwill to CGUs, for example guidance on how to identify whether a CGU has synergies from the business combination.

(c) Reallocating goodwill if an entity later reorganises its reporting structure, for example guidance on what we mean by relative values.

(d) Addressing the practical difficulties related to the testing of a CGU for impairment when part of the recoverable amount is attributable to non-controlling interests (NCI).

65. The staff support the current requirement in IAS 36 for allocating goodwill to CGUs because it provides information about goodwill impairment losses to investors at the lowest level at which it is available to management. However the staff agree that IAS 36 provides limited guidance on identifying CGUs and allocation of goodwill. The staff think education material or other guidance could help preparers understand how to apply the requirements and thereby improve information provided for investors. For example the guidance could illustrate more clearly that because there is a link between the level at which goodwill is tested for impairment and the way an entity manages its operations, an entity is not required to develop new reporting systems to perform the test or perform arbitrary allocations (as described in paragraph BC140 of the Basis for Conclusions accompanying IAS 36).

Simplifying the current approach

66. The staff have not identified ways of simplifying or changing the requirements for identifying CGUs or allocating and reallocating goodwill that would not risk a loss of information for investors. The size and composition of the CGUs to which goodwill is allocated has a significant impact on the recognition and measurement of impairment losses. The staff think that if the requirements were relaxed it would be likely to lead to concerns that it is easy to avoid impairment losses.

Consideration of the work of the FASB

67. One of the possible simplifications identified by the FASB staff in September 2015 IASB Agenda Paper 13E was testing for impairment at the entity, operating segment, or reportable segment level rather than the reporting unit level. IAS 36 requires that each CGU or group of CGUs to which goodwill is allocated should not be larger than an operating segment determined in accordance with IFRS 8 *Operating Segments*.

68. The staff do not think that there should be an option to test goodwill at the entity or operating segment level because it could lead to loss of information about impairment. For example, if goodwill impairment exists at the lower level at which the goodwill is monitored, that impairment might not be recognised if CGUs/group of CGUs are aggregated with other CGUs/groups of CGUs that contain sufficient headroom to offset the impairment loss.

Staff view

69. The staff think we should consider education material to address the practical concerns.

Addressing investors' concerns about the current information provided

70. In addition to focusing on simplifying the existing impairment model for preparers, the staff think we should also consider how can we address investors' concerns that impairment losses of non-financial assets, including goodwill, are being recognised too late under the requirements in IAS 36 and the lack of information about the actual performance of an acquiree compared to the expected performance. The staff think there are two ways to do this

    (a) Consider more robust impairment indicators, including an indicator that compares actual performance with original expected performance (see paragraph 31-46)

    (b) Consider how we can improve disclosures (see paragraph 71)

71. As part of our work on impairment the staff think we should consider ways of improving the disclosure requirements in IAS 36. The staff suggest considering the following:

    (a) Developing a clear objective for impairment disclosures to help the IASB to determine appropriate disclosure requirements and help preparers apply the requirements.

    (b) There is criticism that IFRS 3 and IAS 36 already require extensive disclosures. We could assess whether existing requirements are still relevant or justified from a cost-benefit perspective and also by considering them against the objective in (a).

    (c) Requiring some kind of disclosure about how the actual performance of an acquiree compared to the expected performance in the early years (for example, in the first three years post-acquisition). This is a disclosure investors often say is important and is missing. However, the staff note that such a disclosure may be difficult if the acquiree is integrated and restructured into the group within these first few years.

(d) Investors express concerns that the assumptions used in impairment calculations are subjective, particularly in the VIU calculations. We could do further outreach to assess if these concerns are caused primarily by deficiencies in IAS 36, or because some entities are not complying with the disclosure requirements or are using boilerplate disclosures.

Staff recommendations and questions for the IASB

72. The staff recommend the following ways of improving and simplifying the existing impairment requirements should be considered. The staff note that if some suggestions are adopted it may affect views on whether to consider/reject others:

(a) Consider whether recoverable amount should be determined based only on FVTCD.

(b) Consider an indicator-only approach for CGUs to which goodwill is allocated, rather than an annual impairment test but with the following additional impairment indicators:

(i) A qualitative assessment of whether it is more likely than not that the fair value of a CGU (or group of CGUs) to which goodwill is allocated is less than its carrying amount.

(ii) An impairment indicator that incorporates some kind of assessment of whether actual performance of the acquiree was worse than its original expected performance.

(c) In addition to (b) considering adding a requirement that if some or all of the goodwill allocated to a unit was acquired in a business combination during the current annual period or the previous annual period, that unit must be tested for impairment in the current period if allocated goodwill was material.

(d) Consider improving the VIU calculation as follows:

(i) Removing the requirement to use pre-tax rates because post-tax rates are the rates that can be observed and therefore are often used in practice.

(ii) Allowing management forecasts to be used without adjustments to eliminate cash flows that are expected to arise from a future restructuring to which an entity is not yet committed or from improving or enhancing the asset's performance.

(iii) Developing education material to address other areas that are considered complex or subjective, for example:

1. On the difference between the market perspective (FVLCD) and the entity perspective (VIU) and

2. On requirements for identifying CGUs and allocating/reallocation goodwill to CGUs.

(e) Consider requiring some kind of disclosure, at least in the first few years, about how the actual performance of an acquiree compared to its expected performance.

(f) Consider developing an objective for the impairment disclosures and in the light of this objective review the current disclosures in IAS 36 to see if they can be improved or removed.

73. The staff also think we should monitor the ongoing work of the EFRAG/OIC/ASBJ Research Group on looking at ways to improve the impairment requirements. We can consider their work to identify whether the suggestions in paragraph 72 are appropriate and whether other possible improvements should be considered.

74. The staff think that the IASB should work with the FASB to benefit from each other's work and see if there is an opportunity to create further convergence for impairment testing. Both Boards are looking at improving their impairment requirements and there is overlap in the areas that both Boards are considering.

Questions
1) Do IASB members need any further information on the suggestions in paragraph 72 before considering them further? 2) Do IASB members think there are any other ways of improving the current impairment requirements that we should consider?

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

A1. The staff have prepared the following summary of what we have identified as the main differences between the requirements in IFRS and US GAAP for impairment of non-financial assets that are relevant to our discussions at this meeting.

IFRS	US GAAP		
One-step impairment test. 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. The impairment loss is measured as the difference between carrying amount and recoverable amount.	Goodwill: Two-step impairment test. 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. 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. Optional qualitative assessment: An entity may first assess qualitative factors to determine whether the two-step goodwill impairment	Indefinite-lived intangible assets: One-step impairment test. The carrying amount of an asset is compared with its fair value. The impairment loss is recognised as the excess of the carrying amount over the fair value of the asset. 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 circumstances that an	Long-lived assets: Two-step impairment test. 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. 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.

	test is necessary. If the entity 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. An entity can bypass the qualitative assessment for any reporting unit in any period and proceed directly to Step one of the two-step test.	entity would need to consider in doing qualitative impairment test are provided. An entity can bypass the qualitative assessment for any asset in any period and proceed directly to the quantitative test	

IFRS	US GAAP
Impairment testing is required when there is an indication of impairment.	Similar requirement.
Annual impairment testing is required for goodwill, indefinite life intangibles and intangibles 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)
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 in 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 intangibles.
Reversals of impairment are recognised, other than for impairments of goodwill.	Reversals of impairments are prohibited.