# STAFF PAPER

**February 2016**

**IASB Meeting**

| **Project** | **Goodwill and impairment project** |
| --- | --- |
| Paper topic | Improving the impairment requirements for goodwill and other non-current, non-financial assets |

CONTACT(S) Michelle Fisher mfisher@ifrs.org +44(0)20 7246 6918

This paper has been prepared for discussion at a public meeting of the International Accounting Standards Board (the "Board") and does not represent the views of the Board or any individual member of the Board. Comments on the application of IFRS Standards do not purport to set out acceptable or unacceptable application of IFRS Standards. Technical decisions are made in public and reported in IASB *Update*.

## Objective of this paper

1. The purpose of this agenda paper is to help Board members to:

   (a) continue their discussions from October and November 2015 and further develop their views about the ways in which we could improve the impairment requirements in IAS 36 *Impairment of Assets*; and

   (b) decide which approaches they think the staff should develop further.

Significant changes to this paper from October 2015 Agenda Paper 18B:

- updating the objective of looking at improving the impairment requirements (paragraph 7);
- removal of discussion about simplifying value in use calculation and on guidance on allocating goodwill to cash generating units (paragraph 9(c));
- additional analysis about the implications of revisiting the methodology in determining impairment (paragraphs 15-17);
- updated staff analysis and view for Area I2 (paragraphs 33-49);
- new section Area I3 incorporating user outreach paper from November 2015 (paragraphs 50-62);
- revised staff recommendation (paragraph 63); and

The IASB is the independent standard-setting body of the IFRS Foundation, a not-for-profit corporation promoting the adoption of IFRSs. For more information visit www.ifrs.org

- additional explanation of the changes expected to be proposed by the FASB to their impairment model and details about the qualitative screen introduced in 2011 (see Appendix A).

## Structure of this paper

2. This paper includes the following sections:
   (a) Feedback from the Post-implementation Review (PIR) of IFRS 3 *Business Combinations*
   (b) Staff analysis
      (i) Overall objective
      (ii) Areas for possible improvement
         Area I1: Moving from a two-model approach to a single-model approach in determining impairment
            Method 1 Fair value less costs of disposal
            Method 2 Value in use
            Method 3 Expected manner of recovery
         Area I2: Relief from the annual impairment test requirement
         Area I3: Addressing investors' concerns about the current information provided
   (c) Staff recommendations and questions for the Board
   (d) Appendix: High level comparison of US GAAP and IFRS Standards for impairment of non-financial assets

## Summary of feedback on the PIR (see Appendix A of October Agenda Paper 18A for comment letter analysis)

3. The Board'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. 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.

5. 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.

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

    (a) the overall costs involved in performing the impairment test, including the requirement to perform it annually;

    (b) limitations of the VIU calculation, including the prohibition on including expansion capital expenditures in cash flow projections and the requirement to use a pre-tax discount rate; and

    (c) the high degree of subjectivity in the assumptions used in the impairment test, including allocating goodwill to cash-generating units (CGUs) for impairment testing purposes, and reallocating that goodwill if a restructuring occurs.

## Staff analysis

### *Overall objective of looking at improving the impairment test*

7. The staff think there are two objectives:

   (a) Consider whether the impairment test could be simplified and its application improved without loss of information for investors, for example by addressing the challenges in applying the current impairment requirements in paragraph 6.

   (b) Consider whether information can be improved for investors without imposing costs that would exceed the benefits provided by the improvements.

8. 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.

### *Areas the staff have identified for the Board to consider*

9. On the basis of the feedback we have received during the PIR, the Board's reasoning for its current impairment requirements and the work of the FASB and the EFRAG/OIC/ASBJ Research Group[1] the staff think the Board should consider the following four areas when looking at ways the impairment test could be simplified and improved:

   (a) revisiting the methodology in the calculation of impairment, in particular moving from a two-model approach to a single model approach;

[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).

(b) providing relief from the annual impairment testing requirements, including consideration of an annual qualitative assessment and more robust impairment indicators;

(c) other less significant changes to IAS 36 (to be deferred and discussed at a future meeting):

(i) simplifying and providing guidance on the VIU calculation, including looking at the discount rate and the limitations placed on the cash flow estimates; and

(ii) guidance on identifying CGUs and allocating/reallocating goodwill to CGUs, including consideration of whether goodwill should be allocated to individual CGUs, rather than groups of CGUs, which may in some cases avoid the reallocation issue if an entity reorganises its reporting structure.

10. The staff think we also need to consider whether information can be improved for investors without imposing costs that would exceed the benefits provided by the improvements.

11. The staff have analysed the areas in paragraphs 9(a), 9(b) and 10 below. The staff have only provided an outline of their suggested approaches in paragraphs 9(b) and 10 at this meeting. However, if Board members support these approaches the staff will bring a more developed recommendation to a future meeting.

## *Area I1 Moving from a two-model approach to a single model approach in determining impairment*

### *Description*

12. The objective of IAS 36 is to prescribe the procedures that an entity applies to ensure that its assets are carried at no more than their recoverable amount. IAS 36 defines recoverable amount as the higher of an asset’s (or CGU’s) fair value less costs of disposal (FVLCD) and its value in use (VIU). Consequently, 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).

(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.

13. 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. We had some feedback that requiring entities to look at a single method (single calculation), rather than the higher of two methods, might reduce complexity without a loss of information for users of financial statements.

### *Staff analysis*

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

(a) Method 1: Fair value less costs of disposal (FVLCD)

(b) Method 2: Value in Use (VIU)

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

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

(ii) VIU if the entity expects to recover the asset principally through use.

Applying 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 at only one of these.

15. The staff think a single model might help to reduce some concerns about the complexity and subjectivity of the current model. For example, a more straightforward impairment test using one model should be easier to apply and understand, and could also reduce concerns that the complexity in the current model makes it easier to conceal impairment losses. A single model would also result in earlier recognition of impairment losses in some cases.

16. However, the staff note that changing to a single method would be more than just a potential simplification; it could also open the question about whether we should change the objective of the impairment test in IAS 36. For example, US GAAP uses a single model (fair value) and so the impairment test aims to ensure that the carrying amount of an asset does not exceed its fair value. Hence, the assessment considers assumptions market participants make when pricing an asset. Our objective in IAS 36 is to make sure assets are carried at no more than their recoverable amount (ie higher of FVLCD and VIU). Consequently, the IAS 36 test considers both the expected outcome from selling the asset (FVLCD) and the expected outcome from continuing to use the asset (VIU). This means it requires both the assumptions market participants make when pricing the asset and the effects of any factors that may be specific to the entity using the asset to be considered.

17. The staff agree with the approach in IAS 36 because, on discovering that an asset is impaired, a rational entity would normally sell that asset if the net proceeds from the sale exceed the benefits from continuing to use the asset. Similarly, a rational entity would normally keep an asset if the benefits from continuing to use it exceed the net proceeds from sale, even if its service potential is lower than originally expected. Consequently, the staff support the current objective in IAS 36 of making sure assets are carried at no more than their recoverable amount.

18. The staff support the reasons outlined by the IASC Board in paragraphs BCZ9-BCZ30 of the Basis for Conclusions accompanying IAS 36 for the current approach.[2] The staff have referred to the main arguments in these paragraphs in their analysis of the three methods below.

*Method 1: FVLCD*

19. 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.

---

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

(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.

20. Paragraph BCZ17 of IAS 36 provides the IASC's reasons for rejecting determining an asset's recoverable amount based only 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, 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.

21. The staff agree with the reasons in paragraph 20 and think that conceptually VIU should be considered in determining impairment, particularly if the entity plans to continue to use rather than sell an asset. However, the staff think there is a cost-benefit argument for determining impairment based only 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 Standards. 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 require the use of judgement, 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 a 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 some 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.

22. The staff also note that the FASB currently measures impairment based on fair value and so eliminating VIU would enhance convergence with US GAAP.

23. For the reasons in paragraph 21-22 (particularly paragraphs 21(a), 21(d) and 22) the staff would support determining impairment 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: VIU*

24. 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.

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

26. The staff agree with the reasons in paragraph 25. 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 under Method 1).

*Method 3: Method depends on how the entity expects to recover the asset as follows*

27. 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. This could increase concerns that it is easy to conceal impairment losses.

(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 as explained above. That would be the case unless FVLCD would

be used whenever there is a plan to sell the asset, even if there was a long period of 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 composed 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.

#### *Staff view*

28. The staff think that the current approach in IAS 36 is conceptually the best approach and do not recommend moving to a one model approach. However, if the Board decide to consider a one-model approach, out of the three methods assessed above, the staff think there is a stronger cost-benefit argument for determining impairment based only on FVLCD.

### *Area I2 Testing for impairment only upon the occurrence of a triggering event rather than annually*

#### *Description*

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

30. 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.

31. 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 (‘indicator-only approach’). This would also be consistent with the approach for finite life assets in the scope of IAS 36.

32. IAS 36 requires an entity to assess at the end of each reporting period whether there is any indication that an asset may be impaired. If such an indication exists, the entity is

required to estimate the recoverable amount of the asset. IAS 36 provides a list of internal and external indicators that an asset may be impaired. These indicators are required to be considered as a minimum. The staff interpret the requirements in IAS 36 as requiring an active assessment of whether any indicators are present, rather than a passive assessment of whether any indicators have been noticed.

### *Staff analysis*

33. The Board 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).

34. During the PIR we received feedback from investors that impairment losses are often recognised too late (even with an annual impairment test). The staff think that without a required annual test, concerns may arise that recognition of impairment losses could be delayed even further. This could reduce investors' confidence in the value of goodwill and lead to enhanced concerns that it may be overstated.

#### *Indicator-only approach*

35. Nevertheless the staff think we could reduce the concerns in paragraph 34 if we make the impairment indicators in IAS 36 more robust. The staff suggest adding the following two impairment indicators to the indicators in paragraph 12 in IAS 36. These indicators would only be applicable to CGUs to which goodwill is allocated (either one or both of the following indicators could be considered by the Board):

    (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; and

    (b) an impairment indicator that incorporates an assessment of whether actual performance of the acquisition was worse than its expected performance during the first few years following an acquisition, for example 3 years.

36. These indicators are explained further in paragraphs 37-42.

*Qualitative assessment (paragraph 35(a))*

37. The staff have introduced this suggestion based on a similar qualitative assessment introduced into US GAAP in 2011.

38. Because of concerns about the cost and complexity of the annual goodwill impairment test, the FASB developed an optional qualitative 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. Because it is a relatively recent change, there is relatively limited feedback so far on how well it is working in practice. The FASB staff provided some information on use of the qualitative assessment in September 2015 IASB Agenda Paper 13E. The staff have provided more information about the mechanics of the qualitative screen in Appendix A. The staff think if Board members would like to consider incorporating a similar qualitative assessment, we should further discuss the feedback received with the FASB on how it is working in practice.

39. Including a qualitative assessment would make the indicators more rigorous because it would include further qualitative factors to consider at a minimum in addition to the indicators in paragraph 12 of IAS 36 (these factors are listed in paragraph A8 in the Appendix). Furthermore, it would also require a comparison of the carrying value with the fair value of the CGU (which would be lower than recoverable amount if VIU is greater than FVLCD).

40. The staff think we should also consider whether we should make this assessment more robust, for example:

    (a) using a stricter wording than ‘more likely than not’ in paragraph 35(a), such as ‘reasonable chance’; and/or

    (b) incorporating a consideration of the magnitude of the possible difference between fair value and carrying amount, rather than merely having a probability criterion.

*Assessment of actual performance with expected performance (paragraph 35 (b))*

41. The staff envisage that this indicator would require an entity to consider whether the acquisition has met the key performance assumptions or targets (‘targets’) supporting

the purchase price paid for the acquiree. Key performance targets might include, for example, specified increases in revenue for a particular operating segment as a result of access to new markets, increased operating margins on a product line through removing a competitor form the market and cost savings through economies of scale etc. If these key targets are not met then this indicator would trigger a requirement to measure the recoverable amount of the CGU. The staff envisage this indicator would only operate over the first few years following an acquisition, for example 3 years.

42. The staff envisage the indicator in paragraph 35(b) operating as follows:

(a) On acquisition an entity would disclose the key performance targets supporting the purchase price paid for the acquiree. These would need to be specific to the effects of the acquisition (and hence support the goodwill figure) and measurable. For example, a key performance target might be the level of expected sales of the acquiree (if the acquiree is not integrated) or the expected increase in sales or cost reduction for a specific part of the business benefiting from the synergies of the acquisition (if the acquiree is integrated). The entity would also identify the periods over which it expects to achieve these targets (for example an increase in revenue at 5 per cent per year for 3 years).

(b) At the end of the first reporting period after the acquisition the entity would assess whether the targets were met. If those targets have not been met for CGUs to which goodwill was allocated, then this would trigger a requirement to measure the recoverable amount of those CGUs.

(c) The entity would also update the key targets at each reporting period to reflect any changes in management’s forecasts. The revised key targets at the end of one reporting period would be used as the basis for the impairment indicator in the following reporting period (for example, management may determine it should revise the expected increase in revenue from 5 per cent to 4 per cent per year).

(d) At the end of the second reporting period, the entity would assess whether the revised key targets are met. If those key targets have not been met, then this indicator would trigger a requirement to measure the recoverable

amount of the CGU. Again management would consider whether it needs to update its key targets going forward.

43. The staff note that they are still developing the approach in paragraph 42 and can present a more developed recommendation at a future meeting if Board members support the underlying approach.

44. The staff note that this indicator is also linked to the staff's recommendation in Area I3 about additional disclosure requirements (see paragraphs 50-62). The staff also note that the assumptions used in the measurement of recoverable amount should be consistent with the revised key targets set at each reporting date.

*Requirement for an annual test in the first three years*

45. 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.

46. Consequently, the staff think we could also consider whether we should couple the indicator-only approach 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 two annual periods, that unit (group of units) must be tested for impairment in the current period. In other words, there would be no relief from the annual impairment test in the first three years.

47. The staff think if we introduce more rigorous impairment indicators as suggested in paragraph 35 then this additional safeguard in the first three years would not be necessary. Nevertheless, if an annual test in the first three years is considered, the staff think it should only be required for units to which a significant amount of goodwill was allocated from that business combination.

### *Staff view*

48. The staff think we should require an indicator-only approach for CGUs to which goodwill is allocated, rather than an annual impairment test, but with the following additional impairment indicators:

(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; and

(b) for the first three years, an impairment indicator that incorporates an assessment of whether actual performance of the acquisition during the reporting period was worse than its expected performance.

49. The staff think that this approach should be coupled with the disclosure recommended by the staff in Area I3.

## Area I3: Addressing investors' concerns about the current information provided

### *Description*

50. The staff think the following are the key messages we have heard from users about the information provided by the current impairment requirements (taken from the staff analysis in November Agenda Paper 18B *Feedback from users of financial statements about information on goodwill and impairment*):

(a) Some users say the information provided by the current requirements is useful because it provides confirmatory value about the performance of the acquisition and about the stewardship of management. However some users say the information has limitations for the following main reasons:

(i) impairment losses are recognised too late.

(ii) impairment calculations are inherently very judgemental and the assumptions used in the calculations are subjective.

(iii) disclosures are not sufficient to assess whether the main inputs/assumptions are reasonable. However some users said that some of the current disclosures are useful; these included discount rates used, long-term growth rates, profit and capital expenditure assumptions and sensitivities.

(iv) insufficient information to help them understand the subsequent performance of the acquired business and whether

main targets/synergies of the acquisition are met, which are considered key to their analysis.

Some users focus more on the timing of the impairment write-down and the overall magnitude rather than the actual amount of impairment recognised.

(b) Users appear to be particularly interested in understanding what management thought were the key drivers that justified the valuation of the acquisition (and hence the additional amount of goodwill), assessing whether an acquisition has been successful and assessing the accountability of management.

### ***Staff analysis***

51. The staff think that even if we identify ways to improve the impairment test and the test is better applied and disclosed, any impairment test of goodwill is likely to be inherently subjective. Consequently, the staff think that preparers and users may both be served better by the following:

    (a) Not reintroducing amortisation for goodwill, but focussing on making the impairment test less burdensome to apply (for example by introducing an indicator-only impairment test for goodwill and considering improvements like those noted in paragraph 9(c)) and trying to streamline the existing disclosure requirements. The staff think this could provide relief for preparers on the one hand without significant loss of information for users.

    (b) Requiring disclosure of the key performance assumptions or targets (‘targets’) supporting the purchase price, and hence supporting the amount of goodwill recognised, together with a basic comparison of actual performance against the key indicators for a few years following the acquisition, for example 3 years.

52. The staff note that the disclosures in paragraph 51(b) would also add rigour to the impairment test, because the assumptions used by the entity in the impairment test would need to be consistent with the disclosures in paragraph 51(b). The disclosures would also form the basis for the impairment indicator outlined in paragraph 35(b).

53. The staff think the disclosure in paragraph 51(b) will provide users with more objective information and support their information needs described in paragraph 50(b). It will also help to address users' concerns in paragraphs 49(i),(ii) and (iv). Such an approach might also help to reduce the likelihood of over-optimistic assumptions from management. On the basis of the feedback we have received during the PIR, the staff think that the concerns in paragraph 50(iii) are primarily because some entities are not complying with the disclosure requirements as intended or are using boilerplate disclosures. However, the staff think we should also consider whether any improvements or clarifications could be made to the existing disclosures to help to address the concerns.

54. The staff note that disclosure of key performance targets supporting the purchase price would involve disclosure of forward-looking information. In paragraph 7.4 of the Board's Exposure Draft proposing a revised *Conceptual Framework for Financial Reporting* the Board proposes that:

> 'Forward-looking information about likely or possible future transactions and events is included in the financial statements only if it provides relevant information about an entity's assets, liabilities and equity that existed at the end of, or during, the period (even if they are unrecognised) or income and expenses for the period. For example, if an asset or a liability is measured by estimating future cash flows, information about the estimates of those future cash flows may be needed in order to understand the reported measures.'

55. The staff think that disclosure of the key performance targets provides relevant information about the goodwill asset and how it is measured.

56. We have had feedback that the disclosure requirements in IFRS 3 and IAS 36 are already excessive. However, the staff think if we also consider ways to simplify the mechanics of the current impairment test and streamline the existing disclosures, adding this new disclosure may not lead to a net additional cost or complexity for preparers, while at the same time providing better information to users. Moreover, the staff think that as stewards of the entity, management is responsible for ensuring that the progress of an acquisition is measured and compared to the targets used to determine the price paid for it.

### *Field testing*

57. If the Board wishes to develop such disclosures as part of this project, and incorporate them into the indicators used to test for impairment, the staff suggest that field testing

or other outreach should be performed with preparers, including speaking to the Global Preparers Forum (GPF), and auditors. This would help us understand what information would be both meaningful, and possible to prepare, and identify any potential audit issues. For example the staff think we may want to consider the following issues:

(a) Considering the cost-benefits balance:

   (i) While one would expect management to identify and record the key performance targets supporting the purchase price for an acquisition, and also compare the subsequent performance of the acquisition against these targets, this process will involve significant judgement. The staff think if management are required to disclose this information in the financial statements, they would need to spend additional time and cost to ensure that the estimates are as precise as possible. This is because of the additional scrutiny from disclosing them in the financial statements.

   (ii) There may be concerns that an acquired entity is often fully integrated into the acquirer's existing business and it would be complex and subjective to isolate data on the effect of an acquisition. Nevertheless the staff think that the fact the entity would be integrated should be considered in identifying the key performance targets. Consequently, the staff would envisage that the key targets would relate to the parts of the business affected by the acquisition, rather than the acquiree.

   (iii) The more acquisitions an entity undertakes and the longer that information needs to be tracked, the more difficult it would be to segregate the performance of a particular acquisition from that of other operations. For example, it may be difficult to distinguish between the effects of different acquisitions, particularly if they shared similar key performance targets. Nevertheless, the staff think this type of information is important, for example so that the same cost saving is not used as a justification for more than one acquisition.

(b) Audit issues: the disclosure in paragraph 51(b) would require an entity to disclose more specific information about the primary reasons for the

business combination and the factors that make up the goodwill recognised than currently required by paragraphs B64(d) and (e) in IFRS 3. The staff note that users often say some entities currently provide only boilerplate information. The staff think auditors might have concerns about including specific disclosures about management's targets for the acquisition in audited financial statements because of the need to clarify that they have not expressed an opinion on the reasonableness of the projections.

*Scope of the goodwill and impairment project*

58. The staff note that considering information about the subsequent performance of the acquiree was listed in the PIR as of medium significance and has not yet been added to the Board's agenda. The Board decided that depending on the feedback received from the 2015 Agenda Consultation, we could investigate whether it would be practical to prepare this information, and for how many reporting periods it would be cost-beneficial. Consequently, Board members may want to consider the disclosure in paragraph 51(b) separately, outside of this project.

59. However subsequent information can take many forms, from requiring detailed financial information/financial statements to disclosures about key financial indicators. The staff has limited its consideration to the latter. The staff think that considering this type of disclosure as part of the project would provide us with more scope to simplify the current impairment test without loss of information for users of financial statements.

60. The staff note that there is strong support among preparers, and others, for the Board to reconsider an amortisation model for goodwill (see Agenda Paper 18B for this meeting). The staff think that the key performance targets supporting the purchase price are also likely to be the kinds of factors that would need to be considered, and hence disclosed, if an amortised model was used for goodwill. For example, if one of the key performance targets is improved operating margins of 5 per cent over 5 years this provides evidence that the useful life of goodwill might be 5 years.

## Staff view

61. The staff think that even in cases in which the acquiree is integrated into the acquirer's business it should be possible for the acquirer to disclose:

(a) the key performance targets supporting the purchase price and hence those targets supporting the goodwill figure; and

(b) a basic comparison of actual performance against the expected targets in the first three years following acquisition.

62. Nevertheless, as noted in paragraph 57, the staff think the first step should be to perform field testing/outreach with preparers and auditors to understand what disclosures would be feasible.

## Staff recommendation and questions

63. The staff recommend the following:

(a) not changing from a two-model approach to a one model approach for impairment and not reintroducing amortisation for goodwill.

(b) requiring 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; and

(ii) an impairment indicator that incorporates an assessment of whether actual performance of the acquisition during the reporting period was worse than its original expected performance at the start of the reporting period.

(c) requiring an entity to disclose the key performance targets of the acquisition and then disclosing a basic comparison of actual performance against the key targets in the first 3 years following acquisition.

(d) making the mechanics of the impairment test less burdensome to apply by considering the following (to be considered in more detail at a future meeting):

(i) simplifying and providing guidance on the VIU calculation, including looking at the discount rate and the limitations on the cash flows;

(ii) providing more guidance on identifying CGUs and allocating/reallocating goodwill to CGUs. This could include consideration of whether goodwill should be allocated to the individual CGU level. which could avoid the need for a reallocation if a restructuring of the business occurs; and

(iii) streamlining the existing disclosure requirements.

**Questions**

This paper covers the following approaches

Area I1: Moving from a two-model approach to a single-model approach in determining impairment

Method 1 Fair value less costs of disposal

Method 2 Value in use

Method 3 Expected manner of recovery

Area I2: Relief from the annual impairment test requirement

Indicator-only approach with enhanced indicators

Indicator-only approach with enhanced indicators and annual test in first three years

Area I3: Addressing investors' concerns about the current information provided

Additional disclosures.

Questions:

(1) Do Board members need any further information before developing views on which of the above approaches they would like the staff to develop further?

(2) Are there any approaches in this paper that Board members do not think we should consider further?

(3) Do Board members think there are any other ways of improving the current impairment requirements that we should consider?

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

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

| IFRS STANDARDS | US GAAP | | |
|---|---|---|---|
| One-step impairment test.<br><br>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.<br><br>The impairment loss is measured as the difference between carrying amount and recoverable amount. | Goodwill:<br><br>Two-step impairment test.<br><br>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.<br><br>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.<br><br>Optional qualitative assessment:<br><br>An entity may first assess qualitative factors to determine whether the two-step goodwill impairment | Indefinite-lived intangible assets:<br><br>One-step impairment test.<br><br>The carrying amount of an asset is compared with its fair value.<br><br>The impairment loss is recognised as the excess of the carrying amount over the fair value of the asset.<br><br>Optional qualitative assessment:<br><br>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:<br><br>Two-step impairment test.<br><br>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.<br><br>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.<br><br>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.<br><br>An entity can bypass the qualitative assessment for any asset in any period and proceed directly to the quantitative test. | |

| IFRS STANDARDS | US GAAP |
|---|---|
| Impairment testing is required when there is an indication of impairment. | Similar requirement. |
| Annual impairment testing is required for goodwill, indefinite life 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.<br>(Both may differ from a CGU under IFRS Standards.) |

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

### *Effect of FASB's proposed changes in 2015*

A2. In October 2015, the FASB decided to propose to simplify the impairment test for goodwill by removing Step 2 of the impairment model, ie the requirement to perform a hypothetical purchase price allocation to calculate the implied fair value of goodwill when the carrying value of a reporting unit exceeds its fair value.

A3. The FASB considered allowing entities an option to perform Step 2 but decided not to do so. Upon the removal of Step 2, the impairment charge recognised against goodwill would be the excess of the carrying amount over fair value of the reporting unit, limited to the carrying amount of goodwill.

### *Further information on the optional qualitative assessment*

A4. In 2011 the FASB issued Accounting Standards Update (ASU) 2011-08 *Intangibles—Goodwill and Other (Topic 350): Testing Goodwill for Impairment,* (now in Subtopic 350-20 *Intangibles—Goodwill and Other—Goodwill*).
ASU 2011-08 introduced an optional qualitative assessment for testing goodwill for impairment (qualitative screen). Under the qualitative screen, an entity has the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount.

A5. If, after assessing the totality of events or circumstances, an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the impairment test is unnecessary.

A6. However, if an entity concludes otherwise, then it is required to perform the first step of the two-step impairment test (calculating the fair value of the reporting unit and comparing the fair value with the carrying amount of the reporting unit). If the carrying amount of a reporting unit exceeds its fair value, then the entity is required to perform the second step of the goodwill impairment test to measure the amount of the impairment loss, if any.

A7. An entity has the option to bypass the qualitative assessment for any reporting unit in any period and proceed directly to performing the first step of the two-step goodwill impairment test. An entity may resume performing the qualitative assessment in any subsequent period.

A8. Examples of events and circumstances are provided that an entity should consider in evaluating whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. These are:

(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 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; and

(g) if applicable, a sustained decrease in share price (considered in both absolute terms and relative to peers).

A9. The examples of events and circumstances are not intended to be all-inclusive, and an entity may identify other relevant events or circumstances to consider in determining whether to perform the first step of the two-step impairment test.

A10. None of the individual examples of events and circumstances are intended to represent stand-alone events or circumstances that necessarily would require an entity to perform the first step of the goodwill impairment test.

A11. In reaching its conclusion about whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount, an entity should consider the extent to which each of the adverse events or circumstances identified could affect the comparison of a reporting unit's fair value with its carrying amount. An entity should place more weight on the events and circumstances that most affect a reporting unit's fair value or the carrying amount of its net assets. In addition, an entity should consider positive and mitigating events and circumstances that may affect its determination of whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount.

A12. If an entity has a recent fair value calculation for a reporting unit, it also should include as a factor in its consideration the difference between the fair value and the carrying amount in deciding whether the first step of the impairment test is necessary.