STAFF PAPER

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IASB Meeting

Project	**Goodwill and impairment project**		
Paper topic	Improving the disclosure requirements for goodwill and impairment		
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Objective of this paper

1. The purpose of this agenda paper is to help Board members to:
   - (a) continue their discussions and further develop their views about the ways in which we could make the disclosure requirements about goodwill and impairment more effective to users of financial statements; and
   - (b) decide which approaches they think the staff should develop further.

Structure of this paper

2. This paper includes the following sections:
   - (a) Feedback received from stakeholders on the goodwill and impairment requirements
   - (b) Objectives of improving the impairment requirements in IAS 36
   - (c) Approaches we could consider to make the disclosures about goodwill and impairment more effective for users:

     D1: Disclosure of why management paid a premium and the key performance targets

     D2: Disclosure of why management paid a premium, the key performance targets and a basic comparison with actual performance

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D3: Disclosure of breakdown of goodwill by acquisition

D4: Disclosure about recoverability of goodwill

D5: Disclosure of the payback period of the investment

D6: Consider ways to improve application of existing disclosures

(d) Staff recommendation and questions for the Board

Feedback received from stakeholders about impairment requirements

3. The Board's report and feedback statement on the Post-implementation Review (PIR) of IFRS 3 *Business Combinations* provided the following next steps to address impairment of goodwill:

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. The following are the key messages we heard from users of financial statements about the current information provided about goodwill and impairment (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 current information is useful because it provides confirmatory value about the performance of the acquisition and about the stewardship of management. However some users say the current information has limitations for the following main reasons:

      (i) impairment losses are recognised too late.

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

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

(iv) insufficient information to help them understand the subsequent performance of the acquired business and whether main targets/synergies of the acquisition are met, which are considered key to their analysis.

(b) Some users focus more on the timing of the impairment write-down and its overall magnitude rather than the specific amount of impairment recognised.

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

(a) what management thought were the key drivers that justified the valuation of the acquisition (and hence the amount of goodwill);

(b) assessing whether an acquisition has been successful; and

(c) assessing the accountability of management.

Objectives of improving the impairment requirements in IAS 36

7. The staff think there are two objectives:

(a) Considering whether the impairment test can be made less burdensome for preparers without a loss of information for users of financial statements.

(b) Consider whether better, more timely, information can be provided to users whilst still achieving an appropriate cost-benefit balance.

Agenda Paper 18B (this paper) and Agenda Paper 18C for this meeting focus on the second objective (b).

8. The staff do not think the objective of making the impairment test less burdensome for preparers conflicts with the objective of providing better, more timely information for investors. This is because even if we identify ways to improve the impairment test, impairment testing will still require management to make estimates about the entity's future activity and about the market conditions that are inevitably and inherently subjective. Consequently the staff think both preparers and users may be served better by the following:

   (a) Making the impairment test less burdensome to apply overall, for example by simplifying the mechanics of the calculation and/or introducing an indicator-only impairment test for goodwill, rather than a required annual test. This could provide relief for preparers on one hand whilst maintaining the information value for users.

   (b) Improving the disclosure requirements about goodwill and impairment to respond better to the needs of users expressed in paragraph 6. This would include consideration of whether some existing disclosures could be removed in light of the new disclosures.

   In Agenda Paper 18C the staff ask Board members to consider a possible modification to the impairment test to address users' concerns about late recognition of impairment losses and overstatement of goodwill. The staff does not think this modification would add significant complexity to the impairment test (and this complexity could be balanced by (a) above).

D1: Disclosure of why management paid a premium and the key performance targets

Description

9. Add a requirement for entities to disclose why a premium over the fair value of the net identifiable assets was paid together with disclosure of the key performance assumptions or targets ('targets') supporting the purchase price paid (and hence supporting the amount of goodwill recognised). The staff envisage this would necessitate a quantitative, as well as qualitative, explanation for the purchase price paid.

10. Key performance targets might include, for example, the level of expected sales of the acquiree (if the acquiree is not integrated), specified increases in revenue for an existing operating segment affected by the acquisition as a result of access to new markets, increased operating margins on a product line through removing a competitor from the market, and specific cost savings through economies of scale etc. 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). The staff would expect the key performance targets to follow from management's own assessment which it performs when determining whether to undertake the acquisition and which is communicated to investors in support of the acquisition.

Staff analysis

11. IFRS 3 already contains the following disclosure requirement in paragraph B64(e):

> a qualitative description of the factors that make up the goodwill recognised, such as expected synergies from combining operations of the acquiree and the acquirer, intangible assets that do not qualify for separate recognition or other factors.

12. Paragraph B64(d) of IFRS 3 also requires disclosure of the primary reasons for the business combination. We have received feedback during the PIR that in practice some entities provide limited information or disclose boilerplate information when applying the requirements in paragraphs B64(d) and (e) of IFRS 3. Users say these disclosures lack insight on the real economic reasons for the acquisition and the key drivers that justified the valuation of the acquisition. Consequently, the staff think we should replace paragraph B64(e) with a more specific requirement, like paragraph 9, so that entities will provide more specific, quantified information that is tailored to its own circumstances.

13. The staff note that disclosure of key performance targets supporting the purchase price paid 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.'

14. The staff think that disclosure of the entity's expectations about the consequences of an acquisition, in the form of the key performance targets that it expected to achieve as a result of that acquisition, provides relevant information about the goodwill asset and its measurement.

15. The staff think that in most cases management will already be identifying the key performance targets for its own performance monitoring purposes and also communicating the information to stakeholders, for example to obtain support for the acquisition. Communication about the business combination would include direct communication with shareholders, documentation and filings supporting the acquisition, and management commentary in the financial statements. Nevertheless, the staff think requiring specific information to be provided in the financial statements may improve the information prepared by entities and mean that the information provided is more consistent, and hence more comparable, with other acquisitions and other entities.

16. **Benefits of Disclosure D1:**

    (a) Helping users to understand what management thought were the key drivers that justified the valuation of the acquisition (an information need identified in paragraph 6(a)).

    (b) Providing users with more objective benchmarks that they can use to make their own assessments of whether the level of goodwill is reasonable and whether the acquisition is successful going forward (an information need identified in paragraph 6(b)).

    (c) Requiring disclosure of the key performance targets may encourage more careful determination of those targets and help to reduce over-optimistic assumptions. It may also improve comparability between entities and between acquisitions made by the same entity.

17. **Costs of Disclosure D1:**

    (a) Management may already be identifying and communicating the key performance targets supporting the purchase price paid. However, if

management are required to disclose this information in the financial statements they may need to spend additional time and cost to ensure that the estimates are sufficiently precise. This is because of the additional scrutiny from disclosing them in the audited financial statements.

(b) Auditors may have concerns about requirements to disclose management's key performance targets in audited financial statements. For example, they may be concerned about the need to clarify that they have not expressed an opinion on the reasonableness of the projections.

Staff view

18. The staff think we should replace paragraph B64(e) of IFRS 3 with the requirement in paragraph 9. However, if the Board wishes to pursue such disclosures as part of this project, the staff suggest that field testing or other outreach should be performed with preparers, including speaking to Global Preparers Forum (GPF) members, and auditors. This would help us understand what information would be both meaningful, and possible to prepare, and identify any potential audit issues.

D2: Disclosure of why management paid a premium, key performance targets and a basic comparison with actual performance

Description

19. Add a requirement for entities to:

(a) disclose why a premium over the fair value of the net identifiable assets was paid together with disclosure of the key performance targets supporting the purchase price paid ((a) is the same as Disclosure D1 as explained in paragraphs 9-10).

(b) an annual comparison of actual performance against the key performance targets for a number of years following the acquisition. The staff think the number of years should be driven by the time horizon used by management when determining the key performance targets in (a). The Board may want to also consider requiring a minimum period, for example three years.

Staff analysis

20. Information about the subsequent performance of the acquired business was determined to be of medium significance in the Report and Feedback Statement on the PIR of IFRS 3 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 19(b) separately, outside of this project.

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

22. **Benefits of Disclosure D2** are the same as Disclosure D1 and also include:

    (a) Providing users with information about the subsequent performance of the acquired business and whether the key targets of the acquisition were met, which some users say is key to their analysis (an information need identified in paragraphs 5(a)(iv) and 6(b)).

    (b) It may add rigour and transparency to the impairment test, because the assumptions used by the entity why applying the impairment test in IAS 36 would need to be consistent with the comparison with the key performance targets.

23. **Costs of Disclosure D2** are the same as Disclosure D1 and also include:

    (a) The staff expect that management will already be monitoring the subsequent performance of acquisitions against the key targets of the acquisitions for internal purposes and for the purposes of assessing staff performance and reporting to investors and other stakeholders. However, if management are required to disclose this information in the financial statements, they may need to spend additional time and cost to ensure that

the information is sufficiently precise. This is because of the additional scrutiny from disclosing the information in the audited financial statements.

(b) Acquired entities are often integrated into the acquirer's existing business. There may be concerns that it would be complex and subjective to isolate data on the effect of an acquisition in subsequent periods. However the staff would expect that the fact the entity is to be integrated would be considered in identifying the key performance targets and determining the amount to be paid for the acquisition. The staff would envisage that the key performance targets in both Disclosures D1 and D2 would relate to the parts of the business affected by the acquisition, rather than just the acquiree (unless the acquiree is not integrated). Consequently the staff think it would usually be possible to monitor the performance of the acquisition against the key targets.

(c) The more acquisitions an entity undertakes and the longer information is required to be tracked, the more difficult it might be to monitor the performance of an individual acquisition.

Staff view

24. 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. Furthermore, 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 paid; and

(b) a basic comparison of actual performance against the expected targets for a period of time following acquisition.

25. Nevertheless, as noted in paragraph 18, the staff think if the Board wishes to pursue such disclosures as part of this project, field testing or other outreach should be performed with preparers, including speaking to GPF members, and auditors. This would help us understand what information would be both meaningful, and possible to prepare, and identify any potential audit issues.

D3: Breakdown of goodwill by acquisition

Description

26. Add a requirement for entities to disclose a breakdown of the amount of goodwill at the reporting date into the contributing past acquisitions.

Staff analysis

27. This disclosure was suggested by CMAC members at the November 2015 meeting and by users during our outreach on the PIR.

28. Currently goodwill is not required to be tracked by individual acquisition. For the purpose of impairment testing, goodwill acquired in a business combination is allocated to cash-generating units (CGUs), or groups of CGUs, expected to benefit from the synergies of the combination. Consequently if a CGU, or group of CGUs contains goodwill allocated from different acquisitions, the goodwill in that CGU, or group of CGUs, will be treated as a single asset for impairment testing.

29. The staff note that if goodwill was subject to amortisation (supported by some respondents to the PIR), tracking of goodwill by acquisition would be required. For example, if goodwill arising from several different acquisitions was allocated to a particular group of CGUs for the purposes of impairment testing, the goodwill in that group would have arisen at different times. Consequently it would be amortised over different remaining useful lives, and possibly using different amortisation methods. If an impairment loss arose in the group of CGUs, the impairment loss would need to be allocated to goodwill from each acquisition in order to determine the effect on amortisation going forward (see paragraphs 87-88 of February 2016 Agenda Paper 18B for further analysis).

30. **Benefits of Disclosure D3:**

    (a) Providing users with information about how and when the goodwill arose. This would help users to make their own assessments of whether goodwill from a particular acquisition is recoverable. For example if this approach is combined with Disclosure D1, users could assess the goodwill from a past

acquisition against the key performance targets supporting the goodwill at the time it was recognised.

(b) Requiring this type of disclosure would help to highlight goodwill remaining from poorly performing acquisitions or old acquisitions. Consequently it may increase pressure on management to justify why goodwill is recoverable and add rigour to the impairment test. This may help to address concerns about overstatement of goodwill resulting from its accumulation over time.

31. **Costs of Disclosure D3:**

(a) Additional requirement to track goodwill by acquisition to enable the amount of goodwill existing at the reporting date to be disaggregated by past acquisition.

Staff view

32. The staff think Disclosure D3 would provide helpful information for users, particularly if coupled with Disclosure D1 as explained in paragraph 30(a). Furthermore, the staff does not envisage that tracking goodwill by acquisition would be complex for most entities.

D4: Disclosure of recoverability of goodwill

Description

33. Add a requirement for entities to:

(a) disclose a breakdown of the amount of goodwill at the reporting date into the contributing past acquisitions ((a) is the same as Disclosure D3 in paragraph 26).

(b) for each significant acquisition in the breakdown in (a), provide an explanation to justify why the amount of goodwill is recoverable. For example management would be required to consider what evidence there is that synergies and going concern remain from a previous acquisition.

Staff analysis

34. **Benefits of Disclosure D4** are the same as Disclosure D3 and also include providing users with information about whether management thinks the goodwill from a particular acquisition is recoverable.

35. **Costs of Disclosure D4** are the same as Disclosure D3 and also include the need to track the ongoing effect of an acquisition whilst goodwill from that acquisition remains.

Staff view

36. The staff do not think the cost of providing this disclosure would justify the benefits to users. In the years following the acquisition the staff think that Disclosure D2 would provide better information about whether an acquisition is successful, and hence whether goodwill is recoverable. In later years, if an acquired business is integrated within other parts of the acquirer's business, and further acquisitions and reallocations of CGUs occur, it may become very difficult to provide objective quantitative information to justify the separate recoverability of the goodwill that arises from individual acquisitions made many years earlier. Consequently the staff are concerned that the disclosure in paragraph 33(b) might end up being addressed by boilerplate information and would not be very useful to users.

D5: Information about the payback period

Description

37. Add a requirement for entities to disclose the expected payback period of the investment in a business combination, ie the expected time to recover the purchase price paid for an acquisition (either with or without considering the effect of discounting).

Staff analysis

38. In 2015 the Accounting Standards Board of Japan (ASBJ) staff published a research paper on amortisation of goodwill. As part of the work performed in developing the research paper the ASBJ staff surveyed and held discussions with financial statement users in Japan. In the research paper the ASBJ staff noted:

> "As shown in the survey result, Japanese users' views were mixed as to whether they prefer the impairment-only approach or the amortisation and impairment approach. However, the result showed that the majority of users expressed support for the amortisation and impairment approach. In order to deepen our understanding, we reached out to Japanese users to seek their rationale. During the discussion, some explained that financial information is richer under the amortisation and impairment approach, for example, because it would provide some indication about management views on the expected payback period for investments."[1]

39. In its 2014 Discussion Paper, the EFRAG/OIC/ASBJ Research Group stated that an entity would normally consider "the expected payback period of the investment on a business combination, which is normally estimated at the time when the business combination takes place." in determining the amortisation period. However, the EFRAG/OIC/ASBJ Research Group noted that "the payback period itself would not meet the definition of an amortisation period, and an entity would need to make the appropriate adjustments in determining the amortisation period".[2]

40. The staff do not think the expected payback period would normally correspond with an appropriate amortisation period for goodwill. Consequently, an amortisation model for goodwill would be unlikely to provide information about the payback period to users. However, the staff note that if users are interested in this information we could consider adding a requirement to disclose the payback period.

41. In our user outreach during the PIR we did not receive any requests for information about the payback period of the investment. However, it was referred to in three comment letters by non-users, including the ASBJ. None of these letters provided a definition of what they considered to be the payback period.

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[1] The information in this paragraph is taken from paragraphs 44 and 45 of the research paper.

[2] The information in this paragraph is taken from paragraph 84(c) of the discussion paper

Staff view

42. The staff does not recommend adding a disclosure requirement about the payback period. The staff think Disclosure D1 would provide more relevant information to users. Nevertheless, the staff note that an entity might disclose information about the payback period if it was one of the key performance targets supporting the premium paid.

D6: Consider ways to improve application of existing disclosures in IAS 36

Description

43. During the PIR, users expressed general concerns that disclosures are not sufficient or transparent enough to assess whether the main inputs/assumptions used in the impairment calculations are reasonable. However, users generally did not provide specific details about their concerns about individual disclosures. The feedback from the PIR on IFRS 3 also provided some evidence that the current disclosure requirements in IAS 36 are not being well applied.

Staff analysis

44. In 2013 the European Securities and Markets Authority (ESMA) published a review of 2011 IFRS financial statements related to impairment testing of goodwill and other intangible assets. The review looked into the accounting practices of a sample of 235 European issuers from 23 countries. The ESMA noted that although the major disclosures related to goodwill impairment testing were generally provided, in many cases these were of the boilerplate variety and not entity-specific. The ESMA made the following recommendations to issuers to improve their disclosures:

    (a) better specify the key assumptions used in the impairment test;

    (b) include sensitivity analyses with sufficient detail and transparency, especially in situations when indicators are present that impairment might have occurred;

(c) determine the growth rates used to extrapolate cash flows projections based on budgets and forecasts; and

(d) disclose specific discount rates for each material cash-generating unit rather than average discount rates.

45. The staff note that some of the big accounting firms have also issued publications that identify common errors when applying the disclosure requirements in IAS 36. For example over aggregating or not disclosing assumptions, or not disclosing all reasonably possible changes in key assumptions.

46. On the basis of the findings in paragraph 44-45 and feedback received during the PIR, the staff think that the concerns in paragraph 43 are primarily because some entities were not complying with the disclosure requirements as intended or were using boilerplate disclosures. The findings of the ESMA and the big accounting firms are based on relatively old data and the staff acknowledge application may have improved over recent years. Nevertheless, the staff think we could also consider whether we can improve any of the disclosure requirements in IAS 36 or add guidance to ensure they are better understood and applied.

47. The staff think we should also consider whether some existing disclosures should be removed if they are either not meeting the needs of users or become unnecessary in light of the new disclosure being considered under Disclosures D1-D4.

Staff view

48. The staff think as part of this project we should review the existing disclosure requirements in IAS 36 to see if we can improve them to assist better application or remove them if they are no longer necessary in light of the new disclosures we are considering to respond to the needs of users. The staff think this kind of overall assessment of the disclosures in IAS 36 would best be performed after we have considered ways to improve the impairment test and other ways of improving the information provided for users.

Staff recommendation and questions

49. The staff recommend that we consider disclosures D1, D2 and D3 as part of this project. These disclosures are:

    (a) explain why a premium over the fair value of net identifiable assets was paid together with identifying the key performance targets supporting the purchase price paid;

    (b) provide a basic comparison of actual performance against the key performance targets for a few years following the acquisition; and

    (c) provide a breakdown of goodwill by acquisition.

50. The staff would expect that the analysis in paragraphs 49(a) and (b) would follow management's own internal assessment which it performs for the purposes of its own performance monitoring and communication with stakeholders about the acquisition, so would not result in significant additional cost or complexity. However, as a first step, the staff recommend that field testing or other outreach should be performed with preparers, including speaking to GPF members, and auditors. This would help us understand what information would be both meaningful, and possible to prepare, and identify any potential audit issues.

51. The staff think that even if the Board wishes to consider the disclosure in paragraph 49(b) separately, outside of this project (as explained in paragraph 20), the disclosures in paragraph 49(a) and (c) would still provide a significant improvement in the existing information provided to users. This is because they would provide users with the ability to identify which past acquisitions the goodwill relates to and assess it against the key performance targets supporting the goodwill at the time it was recognised. Consequently it would enable users to make their own assessments of whether they think the goodwill from a particular acquisition is recoverable.

52. 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 review 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.

Questions
(1) Which of Disclosures D1-D6 would Board members like to consider as part of this project? (2) Do Board members think there are any other ways of improving the disclosure requirements that we should consider? (3) Do Board members have any comments on field testing these disclosures?