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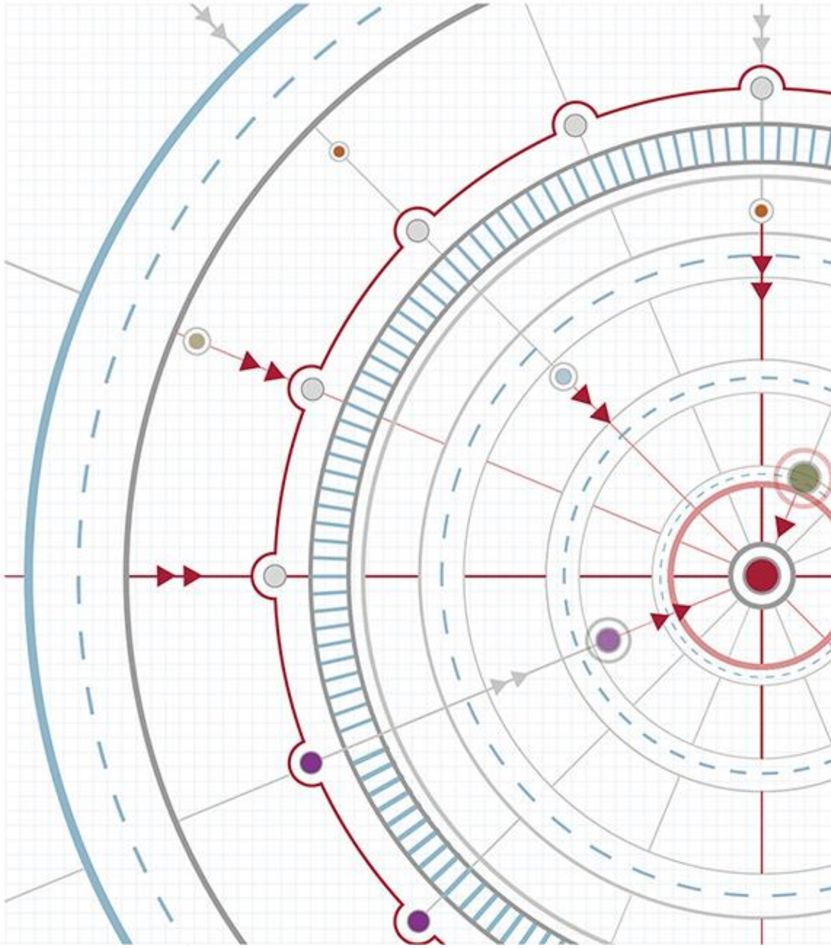

# Impairment testing of goodwill

Accounting Standards Advisory Forum meeting
July 2017

ASAF agenda paper 3B

# Questions to ASAF



| Page | Question |
|---|---|
| 16 | • Do you think the feedback that we received from GPF and CMAC members (pages 12 to 14) is broadly consistent with preparers' and investors' views in your jurisdiction? |
| 22 | • Do you think using a single method, ie either FVLCD or VIU, to determine recoverable amount could improve the effectiveness of impairment test?<br>• In most of the situations, do you think fair value and VIU measurements produce significantly different values? If so, why? |
| 27 | • Should the Board consider any of the relief approaches on page 23? If yes, which one(s) and why?<br>• Could you suggest any indicators that could be added to the list in IAS 36, especially indicators of overpayment?<br>• The existing internal reporting indicators (see page 26) are financial indicators. Do you think there could be non-financial indicators of impairment? |

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# Introduction

Goodwill and impairment research project

# Objectives of the research project



**Whether it is possible to:**

- Improve the quality of information provided to users without imposing costs that outweigh benefits
- Simplify and improve application of impairment test without loss of information to investors
- Simplify separation of specified identifiable intangible assets from goodwill in a business combination

# Objective of this session



Improve the quality of information provided to users without imposing costs that outweigh benefits

Simplify and improve application of impairment test without loss of information to investors

Simplify separation of specified identifiable intangible assets from goodwill in a business combination

# Why simplify the impairment test?



### IAS 36 requirements

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

### Preparers' concerns

- Performing the test annually is costly
- See pages 7–10

### Ongoing research

- Relief from mandatory annual quantitative test
- Calculating recoverable amount when there are indicators of impairment
- Using a single method to determine recoverable amount

* Recoverable amount is higher of fair value less costs of disposal (FVLCD) and value in use (VIU)

# What we heard…

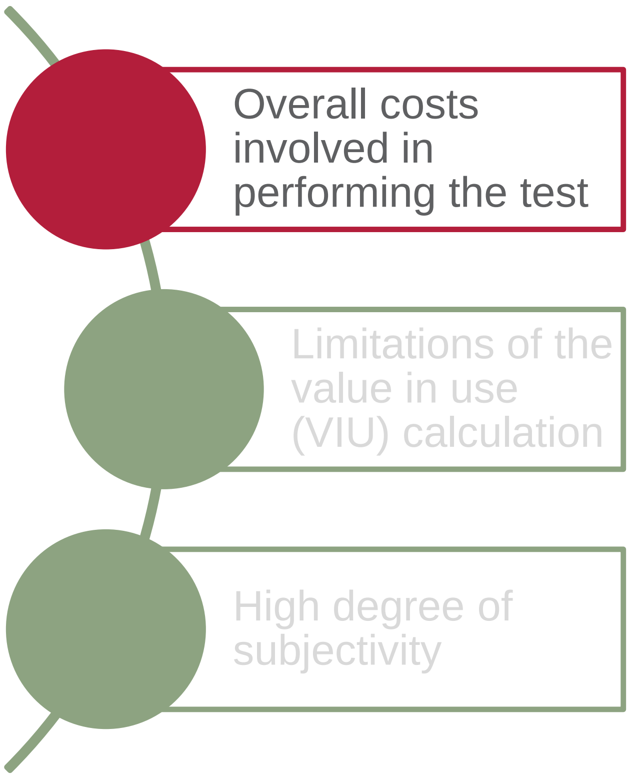


Feedback received from

- Post-implementation Review of IFRS 3
- 2015 Agenda Consultation

- Overall costs involved in performing the test
- Limitations of the VIU calculation
- High degree of subjectivity

# What we heard…




- Complex and time-consuming
- Need to calculate both VIU and fair value less costs of disposal (FVLCD)
- Requirement to perform the test annually in the absence of indicators

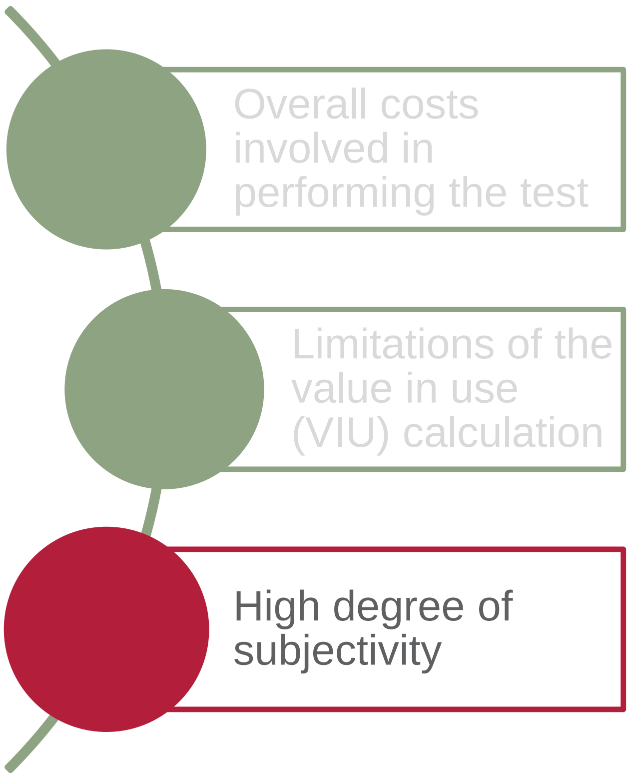
# What we heard…

- Overall costs involved in performing the test
- Limitations of the value in use (VIU) calculation
- High degree of subjectivity

- Difficulties in determining a pre-tax discount rate
- Prohibition on including expansion capital expenditure in projections

# What we heard…






- High degree of subjectivity in the assumptions used in VIU calculation
- Difficulties in allocating goodwill to CGUs for testing purposes, and reallocating when restructuring

# Feedback from consultative groups

# Feedback from CMAC



| Month | Questions asked | Summary of feedback |
|---|---|---|
| November 2015 (link to the agenda paper) | Do you make any ‘non-GAAP’ adjustments to goodwill or impairment for your analysis? | • Impairment charge generally added back only for determining cash flows<br>• That does not mean that analysts disregard impairment charge or consider that information unhelpful |
| | Would amortisation of goodwill help or hinder you analysis? | • Mixed feedback about amortisation of goodwill<br>• Current impairment test provides useful information<br>• Impairment test should be made robust rather than introducing other approaches |
| | Is there any other information that you need for your analysis? | • Additional disclosures to help investors understand the key drivers that justified the purchase consideration<br>• Breakdown of carrying amount of goodwill by past acquisitions |
| | | Click the links for full meeting summary and recording. |

# Feedback from GPF



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

# Feedback from GPF (continued)



| Month | Questions asked | Summary of feedback |
| --- | --- | --- |
| March 2017 (link to the agenda paper) | Feedback on the following possible simplifications to the impairment test of goodwill:<br>• Using either FVLCD or VIU as the sole basis for calculating recoverable amount<br>• Relief from annual testing<br>• Relaxing some restrictions on cash flows included in VIU calculations<br>• Additional guidance on applying IAS 36 | • Several members favoured relief from annual testing and relaxing the restrictions on cash flows included in VIU calculations<br>• In relation to using either FVLCD or VIU as the sole basis for calculating recoverable amount, some members indicated a preference for a model that uses VIU |
| | | Click the links for full meeting notes and recording. |

# Feedback from previous discussions with ASAF



| Month | Questions asked | Summary of feedback |
|---|---|---|
| December 2015 | ASAF members were asked for feedback on the Board's initial discussions and for any advice on the way forward with the project. | • Mixed views with some members supporting impairment only approach to goodwill whereas others supported amortisation and impairment of goodwill.<br>• Consider what information users want; focus on the benefits for users of the current information versus the costs to preparers of applying the requirements.<br>• Focus primarily on improving the impairment test, because such an improvement would be required regardless of the approach for accounting for goodwill.<br>• Some ASAF members thought it necessary to retain a robust impairment test if the impairment-only approach is maintained. |
| | | Click the links for full meeting summary and recording. |

# Questions to ASAF members



- Do you think the feedback that we received from GPF and CMAC members (pages 12 to 14) is broadly consistent with preparers’ and investors’ views in your jurisdiction?

# Possible approaches to simplify and improve goodwill impairment testing

# Staff current thoughts…



## One model approach

- only FVLCD or only VIU?

## Relief from annual impairment test

- indicator-only approach?

## Improving value in use (VIU) calculations

- pre-tax versus post-tax discount rate?
- relax restrictions on the cash flows to be included?

## Allocating goodwill to CGUs

- additional criteria/guidance on allocating goodwill to existing CGUs?

# Staff current thoughts—one model



Single method for determining recoverable amount instead of higher of the two

| | | | | |
|---|---|---|---|---|
| FVLCD as the sole basis | OR | VIU as the sole basis | OR | FVLCD or VIU depending on how an entity expects to recover the asset |

# Staff current thoughts—one model
(continued)



- Using a single method might improve effectiveness of the test and could:
  - make the test easier to apply and understand; and
  - reduce concerns that current model makes it easy to delay and (or) conceal impairment
- Feedback from CFA Society
  - concerned about entity-specific nature of VIU and scope for management to pass the impairment test
  - a fair value based impairment model would be more objective
- Feedback from a few preparers
  - VIU better reflects the fact that an entity holds the assets for continued use in the business
  - VIU is a reflection of range of economic conditions and not just the best case scenario

# Staff current thoughts—one model
**(continued)**



- Do VIU and FVLCD approximate each other?
  - FV generally based on Level 3 inputs and discounted cash flow techniques
  - Level 3 inputs might not be significantly different from management's best estimates
  - Cash flow projections for VIU based on reasonable and supportable assumptions and giving greater weight to external evidence
  - Same discount rate generally used for FV and VIU calculations

# Questions to ASAF members



- Do you think using a single method, ie FVLCD or VIU, to determine recoverable amount could improve the effectiveness of impairment test?
- In most of the situations, do you think fair value and VIU measurements produce significantly different values? If so, why?

# Staff current thoughts—indicator approach



Date of acquisition

*Approach 1*

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

*Approach 2*

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

*Approach 3*

Partial (more constrained) relief from annual testing—Mandatory quantitative test for the first few years after acquisition (perhaps 3–5 years) and indicator-based impairment test in later years

*Approach 4*

Partial (more constrained) relief from annual testing—Mandatory quantitative test, say every 3 years, and indicator-based impairment test in the intervening years

Year 1 | Year 2 | Year 3 | Year 4 | Year 5 | Year 6

# Staff current thoughts—indicator approach (continued)



## Indicators of impairment

- IAS 36 provides a list of indicators that an entity must consider as a minimum (see page 26).
- The following additional indicator could be added:
  - Actual performance not in line with the key performance assumptions or targets supporting the acquired goodwill

# Staff current thoughts—indicator approach (continued)



## Consequences of introducing indicator-only approach

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

# Indicators currently listed in IAS 36



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

# Questions to ASAF members



- Should the Board consider any of the relief approaches on page 23? If yes, which one(s) and why?
- Could you suggest any indicators that could be added to the list in IAS 36, especially indicators of overpayment?
- The existing internal reporting indicators (see page 26) are financial indicators. Do you think there could be non-financial indicators of impairment?

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