STAFF PAPER

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Prepared for joint Capital Markets Advisory Committee and Global Preparers Forum meeting

Project	**Impairment testing of goodwill**		
Paper topic	Appendices accompanying Agenda Paper 5A *(for reference only)*		
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Contents of this Agenda Paper

1. This paper contains the following Appendices for reference when reading Agenda Paper 5A:

   (a) Appendix 1—Summary of Agenda Paper 18D of the May 2017 Board meeting; and

   (b) Appendix 2—Extracts from IAS 36 *Impairment of Assets*.

Information about the Capital Markets Advisory Committee (CMAC) is available at http://www.ifrs.org/The-organisation/Advisory-bodies/CMAC/Pages/CMAC.aspx

Information about the Global Preparers Forum (GPF) is available at http://www.ifrs.org/The+organisation/Advisory+bodies/GPF/

Appendix 1
Summary of [Agenda Paper 18D](http://www.ifrs.org/Meetings/MeetingDocs/IASB/2017/May/AP18D-Goodwill-Impairment.pdf) of the May 2017 Board meeting

The paper can also be accessed using the URL http://www.ifrs.org/Meetings/MeetingDocs/IASB/2017/May/AP18D-Goodwill-Impairment.pdf

The Board's objective of considering possible improvements to the disclosure requirements is to determine whether better and more timely information about goodwill and impairment can be provided to users of financial statements without imposing costs on preparers that exceed the benefits.

The staff is assessing whether the following approaches will improve disclosures:

About the approach	***Staff current thoughts***

Requiring an entity to disclose:
• the reasons for payment of premium over and above the value of the net identifiable assets acquired in an acquisition
• key performance assumptions or targets underlying the premium; and
• actual performance vis-à-vis the targets for a number of years following the acquisition
	• Key performance targets might include, for example, expected revenue of the acquired entity, specified level of increase in revenue of an existing business segment, increased operating margins, identified cost savings etc.
	• The acquirer would also identify the period over which it expects to achieve the targets and disclose the comparison of actual performance vis-à-vis the targets for that period.
	• The information required for this disclosure should be readily available in most cases.
	  ○ for large acquisitions, management is often subject to legal or regulatory requirement to seek shareholders' approval;
	  ○ in the documents seeking that approval, managements usually explain the basis for paying the premium and identify the key performance targets;
	  ○ it is probably a common practice to also include this information in management commentary.
	• A requirement to disclose this information in the financial statements would encourage entities to prepare information more rigorously so that it stands up to scrutiny by the auditors.

Requiring an entity to disclose breakdown of the carrying amount of goodwill by past acquisition, with an explanation for each combination, of why management considers that the goodwill is recoverable	• This disclosure was suggested by CMAC. • The disaggregation would highlight goodwill acquired in acquisitions; investors may consider some of those as unsuccessful acquisitions. • There may be some pressure on the entity to justify why that goodwill is recoverable and to perform more rigorous impairment test.

About the approach	***Staff current thoughts***
	• This disclosure together with the disclosure described above would help investors make their own assessment of whether goodwill is recoverable. • This information might not be readily available because IAS 36 currently does not require tracking of goodwill by past acquisition; however, information about goodwill acquired in past acquisitions of foreign operations may be readily available. • To explain why goodwill is still recoverable, the entity would be required to consider whether there is evidence that synergies from a past acquisition still exist and can be identified; gathering such evidence could be costly.
Reviewing current disclosure requirements in IAS 36 *Impairment of Assets* to determine whether any of those requirements should be modified or removed	• Feedback from the Post-Implementation Review of IFRS 3 *Business Combinations* provided some evidence that the current disclosure requirements in IAS 36 are not being well applied. • There is some external evidence, such as reports of regulators or publications of large accounting firms, that identify common errors when applying the disclosure requirements. • Reviewing the current disclosure requirements in IAS 36 could help in identifying improvements to assist better application or to remove redundant disclosures.

Appendix 2
Extracts from IAS 36 *Impairment of Assets*

Identifying an asset that may be impaired

7 Paragraphs 8–17 specify when recoverable amount shall be determined. These requirements use the term 'an asset' but apply equally to an individual asset or a cash-generating unit. The remainder of this Standard is structured as follows:

(a) …

8 An asset is impaired when its carrying amount exceeds its recoverable amount. Paragraphs 12–14 describe some indications that an impairment loss may have occurred. If any of those indications is present, an entity is required to make a formal estimate of recoverable amount. Except as described in paragraph 10, this Standard does not require an entity to make a formal estimate of recoverable amount if no indication of an impairment loss is present.

9 An entity shall assess at the end of each reporting period whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset.

10 Irrespective of whether there is any indication of impairment, an entity shall also:

(a) test an intangible asset with an indefinite useful life or an intangible asset not yet available for use for impairment annually by comparing its carrying amount with its recoverable amount. This impairment test may be performed at any time during an annual period, provided it is performed at the same time every year. Different intangible assets may be tested for impairment at different times. However, if such an intangible asset was initially recognised during the current annual period, that intangible asset shall be tested for impairment before the end of the current annual period.

(b) test goodwill acquired in a business combination for impairment annually in accordance with paragraphs 80–99.

11 The ability of an intangible asset to generate sufficient future economic benefits to recover its carrying amount is usually subject to greater uncertainty before the asset is available for use than after it is available for use. Therefore, this Standard requires an entity to test for impairment, at least annually, the carrying amount of an intangible asset that is not yet available for use.

12 In assessing whether there is any indication that an asset may be impaired, an entity shall consider, as a minimum, the following indications:

External Sources of information

(a) there are observable indications that the asset's value has declined during the period significantly more than would be expected as a result of the passage of time or normal use.

(b) significant changes with an adverse effect on the entity have taken place during the period, or will take place in the near future, in the

technological, market, economic or legal environment in which the entity operates or in the market to which an asset is dedicated.

(c) market interest rates or other market rates of return on investments have increased during the period, and those increases are likely to affect the discount rate used in calculating an asset's value in use and decrease the asset's recoverable amount materially.

(d) the carrying amount of the net assets of the entity is more than its market capitalisation.

Internal sources of information

(e) evidence is available of obsolescence or physical damage of an asset.

(f) significant changes with an adverse effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, an asset is used or is expected to be used. These changes include the asset becoming idle, plans to discontinue or restructure the operation to which an asset belongs, plans to dispose of an asset before the previously expected date, and reassessing the useful life of an asset as finite rather than indefinite. [2]

2 Once an asset meets the criteria to be classified as held for sale (or is included in a disposal group that is classified as held for sale), it is excluded from the scope of this Standard and is accounted for in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.

(g) evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected.

Dividend from a subsidiary, joint venture or associate

(h) for an investment in a subsidiary, joint venture or associate, the investor recognises a dividend from the investment and evidence is available that:

(i) the carrying amount of the investment in the separate financial statements exceeds the carrying amounts in the consolidated financial statements of the investee's net assets, including associated goodwill; or

(ii) the dividend exceeds the total comprehensive income of the subsidiary, joint venture or associate in the period the dividend is declared.

13 The list in paragraph 12 is not exhaustive. An entity may identify other indications that an asset may be impaired and these would also require the entity to determine the asset's recoverable amount or, in the case of goodwill, perform an impairment test in accordance with paragraphs 80–99.

14 Evidence from internal reporting that indicates that an asset may be impaired includes the existence of:

(a) cash flows for acquiring the asset, or subsequent cash needs for operating or maintaining it, that are significantly higher than those originally budgeted;

(b) actual net cash flows or operating profit or loss flowing from the asset that are significantly worse than those budgeted;

(c) a significant decline in budgeted net cash flows or operating profit, or a significant increase in budgeted loss, flowing from the asset; or

(d) operating losses or net cash outflows for the asset, when current period amounts are aggregated with budgeted amounts for the future.

15 As indicated in paragraph 10, this Standard requires an intangible asset with an indefinite useful life or not yet available for use and goodwill to be tested for impairment, at least annually. Apart from when the requirements in paragraph 10 apply, the concept of materiality applies in identifying whether the recoverable amount of an asset needs to be estimated. For example, if previous calculations show that an asset's recoverable amount is significantly greater than its carrying amount, the entity need not re-estimate the asset's recoverable amount if no events have occurred that would eliminate that difference. Similarly, previous analysis may show that an asset's recoverable amount is not sensitive to one (or more) of the indications listed in paragraph 12.

16 As an illustration of paragraph 15, if market interest rates or other market rates of return on investments have increased during the period, an entity is not required to make a formal estimate of an asset's recoverable amount in the following cases:

(a) if the discount rate used in calculating the asset's value in use is unlikely to be affected by the increase in these market rates. For example, increases in short-term interest rates may not have a material effect on the discount rate used for an asset that has a long remaining useful life.

(b) if the discount rate used in calculating the asset's value in use is likely to be affected by the increase in these market rates but previous sensitivity analysis of recoverable amount shows that:

  (i) it is unlikely that there will be a material decrease in recoverable amount because future cash flows are also likely to increase (eg in some cases, an entity may be able to demonstrate that it adjusts its revenues to compensate for any increase in market rates); or

  (ii) the decrease in recoverable amount is unlikely to result in a material impairment loss.

17 If there is an indication that an asset may be impaired, this may indicate that the remaining useful life, the depreciation (amortisation) method or the residual value for the asset needs to be reviewed and adjusted in accordance with the Standard applicable to the asset, even if no impairment loss is recognised for the asset.

…

Estimates used to measure recoverable amounts of cash-generating units containing goodwill or intangible assets with indefinite useful lives

134 An entity shall disclose the information required by (a)–(f) for each cash-generating unit (group of units) for which the carrying amount of goodwill or intangible assets with indefinite useful lives allocated to that unit (group of units) is significant in comparison with the entity's total carrying amount of goodwill or intangible assets with indefinite useful lives:

(a) the carrying amount of goodwill allocated to the unit (group of units).

(b) the carrying amount of intangible assets with indefinite useful lives allocated to the unit (group of units).

(c) the basis on which the unit's (group of units') recoverable amount has been determined (ie value in use or fair value less costs of disposal).

(d) if the unit's (group of units') recoverable amount is based on value in use:

(i) each key assumption on which management has based its cash flow projections for the period covered by the most recent budgets/forecasts. Key assumptions are those to which the unit's (group of units') recoverable amount is most sensitive.

(ii) a description of management's approach to determining the value(s) assigned to each key assumption, whether those value(s) reflect past experience or, if appropriate, are consistent with external sources of information, and, if not, how and why they differ from past experience or external sources of information.

(iii) the period over which management has projected cash flows based on financial budgets/forecasts approved by management and, when a period greater than five years is used for a cash-generating unit (group of units), an explanation of why that longer period is justified.

(iv) the growth rate used to extrapolate cash flow projections beyond the period covered by the most recent budgets/forecasts, and the justification for using any growth rate that exceeds the long-term average growth rate for the products, industries, or country or countries in which the entity operates, or for the market to which the unit (group of units) is dedicated.

(v) the discount rate(s) applied to the cash flow projections.

(e) if the unit's (group of units') recoverable amount is based on fair value less costs of disposal, the valuation technique(s) used to measure fair value less costs of disposal. An entity is not required to provide the disclosures required by IFRS 13. If fair value less costs of disposal is not measured using a quoted price for an identical unit (group of units), an entity shall disclose the following information:

(i) each key assumption on which management has based its determination of fair value less costs of disposal. Key assumptions are those to which the unit's (group of units') recoverable amount is most sensitive.

(ii) a description of management's approach to determining the value (or values) assigned to each key assumption, whether those values reflect past experience or, if appropriate, are consistent with external sources of information, and, if not, how

and why they differ from past experience or external sources of information.

(iiA) the level of the fair value hierarchy (see IFRS 13) within which the fair value measurement is categorised in its entirety (without giving regard to the observability of 'costs of disposal').

(iiB) if there has been a change in valuation technique, the change and the reason(s) for making it.

If fair value less costs of disposal is measured using discounted cash flow projections, an entity shall disclose the following information:

(iii) the period over which management has projected cash flows.

(iv) the growth rate used to extrapolate cash flow projections.

(v) the discount rate(s) applied to the cash flow projections.

(f) if a reasonably possible change in a key assumption on which management has based its determination of the unit's (group of units') recoverable amount would cause the unit's (group of units') carrying amount to exceed its recoverable amount:

(i) the amount by which the unit's (group of units') recoverable amount exceeds its carrying amount.

(ii) the value assigned to the key assumption.

(iii) the amount by which the value assigned to the key assumption must change, after incorporating any consequential effects of that change on the other variables used to measure recoverable amount, in order for the unit's (group of units') recoverable amount to be equal to its carrying amount.

135 If some or all of the carrying amount of goodwill or intangible assets with indefinite useful lives is allocated across multiple cash-generating units (groups of units), and the amount so allocated to each unit (group of units) is not significant in comparison with the entity's total carrying amount of goodwill or intangible assets with indefinite useful lives, that fact shall be disclosed, together with the aggregate carrying amount of goodwill or intangible assets with indefinite useful lives allocated to those units (groups of units). In addition, if the recoverable amounts of any of those units (groups of units) are based on the same key assumption(s) and the aggregate carrying amount of goodwill or intangible assets with indefinite useful lives allocated to them is significant in comparison with the entity's total carrying amount of goodwill or intangible assets with indefinite useful lives, an entity shall disclose that fact, together with:

(a) the aggregate carrying amount of goodwill allocated to those units (groups of units).

(b) the aggregate carrying amount of intangible assets with indefinite useful lives allocated to those units (groups of units).

(c) a description of the key assumption(s).

(d) a description of management's approach to determining the value(s) assigned to the key assumption(s), whether those value(s) reflect past experience or, if appropriate, are consistent with external sources of information, and, if not, how and why they differ from past experience or external sources of information.

(e) if a reasonably possible change in the key assumption(s) would cause the aggregate of the units' (groups of units') carrying amounts to exceed the aggregate of their recoverable amounts:

(i) the amount by which the aggregate of the units' (groups of units') recoverable amounts exceeds the aggregate of their carrying amounts.

(ii) the value(s) assigned to the key assumption(s).

(iii) the amount by which the value(s) assigned to the key assumption(s) must change, after incorporating any consequential effects of the change on the other variables used to measure recoverable amount, in order for the aggregate of the units' (groups of units') recoverable amounts to be equal to the aggregate of their carrying amounts.

136 The most recent detailed calculation made in a preceding period of the recoverable amount of a cash-generating unit (group of units) may, in accordance with paragraph 24 or 99, be carried forward and used in the impairment test for that unit (group of units) in the current period provided specified criteria are met. When this is the case, the information for that unit (group of units) that is incorporated into the disclosures required by paragraphs 134 and 135 relate to the carried forward calculation of recoverable amount.

137 Illustrative Example 9 illustrates the disclosures required by paragraphs 134 and 135.

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IAS 36 *Impairment of Assets*
Illustrative examples

…

Example 9 Disclosures about cash-generating units with goodwill or intangible assets with indefinite useful lives

The purpose of this example is to illustrate the disclosures required by paragraphs 134 and 135 of IAS 36.

Background

IE80 Entity M is a multinational manufacturing firm that uses geographical segments for reporting segment information. M's three reportable segments are Europe, North America and Asia. Goodwill has been allocated for impairment testing purposes to three individual cash-generating units—two in Europe (units A and B) and one in North America (unit C)—and to one group of cash-generating units (comprising operation XYZ) in Asia. Units A, B and C and operation XYZ each represent the lowest level within M at which the goodwill is monitored for internal management purposes.

IE81 M acquired unit C, a manufacturing operation in North America, in December 20X2. Unlike M's other North American operations, C operates in an industry with high margins and high growth rates, and with the benefit of a 10-year patent on its primary product. The patent was granted to C just before M's acquisition of C. As part of accounting for the acquisition of C, M recognised, in addition to the patent, goodwill of CU3,000 and a brand name of CU1,000. M's management has determined that the brand name has an indefinite useful life. M has no other intangible assets with indefinite useful lives.

IE82 The carrying amounts of goodwill and intangible assets with indefinite useful lives allocated to units A, B and C and to operation XYZ are as follows:

	Goodwill	*Intangible assets with indefinite useful lives*
	CU	**CU**
A	350	
B	450	
C	3,000	1,000
XYZ	1,200	
Total	5,000	1,000

IE83 During the year ending 31 December 20X3, M determines that there is no impairment of any of its cash-generating units or group of cash-generating units containing goodwill or intangible assets with indefinite useful lives. The recoverable amounts (ie higher of value in use and fair value less costs of disposal) of those units and group of units are determined on the basis of value in

use calculations. M has determined that the recoverable amount calculations are most sensitive to changes in the following assumptions:

Units A and B	***Unit C***	***Operation XYZ***
Gross margin during the budget period (budget period is 4 years)	5-year US government bond rate during the budget period (budget period is 5 years)	Gross margin during the budget period (budget period is 5 years)
Raw materials price inflation during the budget period	Raw materials price inflation during the budget period	Japanese yen/US dollar exchange rate during the budget period
Market share during the budget period	Market share during the budget period	Market share during the budget period
Growth rate used to extrapolate cash flows beyond the budget period	Growth rate used to extrapolate cash flows beyond the budget period	Growth rate used to extrapolate cash flows beyond the budget period

IE84 Gross margins during the budget period for A, B and XYZ are estimated by M based on average gross margins achieved in the period immediately before the start of the budget period, increased by 5 per cent per year for anticipated efficiency improvements. A and B produce complementary products and are operated by M to achieve the same gross margins.

IE85 Market shares during the budget period are estimated by M based on average market shares achieved in the period immediately before the start of the budget period, adjusted each year for any anticipated growth or decline in market shares. M anticipates that:

(a) market shares for A and B will differ, but will each grow during the budget period by 3 per cent per year as a result of ongoing improvements in product quality.

(b) C's market share will grow during the budget period by 6 per cent per year as a result of increased advertising expenditure and the benefits from the protection of the 10-year patent on its primary product.

(c) XYZ's market share will remain unchanged during the budget period as a result of the combination of ongoing improvements in product quality and an anticipated increase in competition.

IE86 A and B purchase raw materials from the same European suppliers, whereas C's raw materials are purchased from various North American suppliers. Raw materials price inflation during the budget period is estimated by M to be consistent with forecast consumer price indices published by government agencies in the relevant European and North American countries.

IE87 The 5-year US government bond rate during the budget period is estimated by M to be consistent with the yield on such bonds at the beginning of the budget period. The Japanese yen/US dollar exchange rate is estimated by M to be consistent with the average market forward exchange rate over the budget period.

IE88 M uses steady growth rates to extrapolate beyond the budget period cash flows for A, B, C and XYX. The growth rates for A, B and XYZ are estimated by M to be consistent with publicly available information about the long-term average growth rates for the markets in which A, B and XYZ operate. However, the growth rate for C exceeds the long-term average growth rate for the market in which C operates. M's management is of the opinion that this is reasonable in the light of the protection of the 10-year patent on C's primary product.

IE89 M includes the following disclosure in the notes to its financial statements for the year ending 31 December 20X3.

Impairment Tests for Goodwill and Intangible Assets with Indefinite Lives

Goodwill has been allocated for impairment testing purposes to three individual cash-generating units—two in Europe (units A and B) and one in North America (unit C)—and to one group of cash-generating units (comprising operation XYZ) in Asia. The carrying amount of goodwill allocated to unit C and operation XYZ is significant in comparison with the total carrying amount of goodwill, but the carrying amount of goodwill allocated to each of units A and B is not. Nevertheless, the recoverable amounts of units A and B are based on some of the same key assumptions, and the aggregate carrying amount of goodwill allocated to those units is significant.

Operation XYZ

The recoverable amount of operation XYZ has been determined based on a value in use calculation. That calculation uses cash flow projections based on financial budgets approved by management covering a five-year period, and a discount rate of 8.4 per cent. Cash flows beyond that five-year period have been extrapolated using a steady 6.3 per cent growth rate. This growth rate does not exceed the long-term average growth rate for the market in which XYZ operates. Management believes that any reasonably possible change in the key assumptions on which XYZ's recoverable amount is based would not cause XYZ's carrying amount to exceed its recoverable amount.

Unit C

The recoverable amount of unit C has also been determined based on a value in use calculation. That calculation uses cash flow projections based on financial budgets approved by management covering a five-year period, and a discount rate of 9.2 per cent. C's cash flows beyond the five-year period are extrapolated using a steady 12 per cent growth rate. This growth rate exceeds by 4 percentage points the long-term average growth rate for the market in which C operates. However, C benefits from the protection of a 10-year patent on its primary product, granted in December 20X2. Management believes that a 12 per cent growth rate is reasonable in the light of that patent. Management also believes that any reasonably possible change in the key assumptions on which C's recoverable amount is based would not cause C's carrying amount to exceed its recoverable amount.

Units A and B

The recoverable amounts of units A and B have been determined on the basis of value in use calculations. Those units produce complementary products, and their recoverable amounts are based on some of the same key assumptions. Both value in use calculations use cash flow projections based on financial budgets approved by management covering a four-year period, and a discount rate of 7.9 per cent. Both sets of cash flows beyond the four-year period are extrapolated using a steady 5 per cent growth rate. This growth rate does not exceed the long-term average growth rate for the market in which A and B operate. Cash flow projections during the budget period for both A and B are also based on the same expected gross margins during the budget period and the same raw materials price inflation during the budget period. Management believes that any reasonably possible change in any of these key assumptions would not cause the aggregate carrying amount of A and B to exceed the aggregate recoverable amount of those units.

	Operation XYZ	*Unit C*	*Units A and B (in aggregate)*
Carrying amount of goodwill	CU1,200	CU3,000	CU800
Carrying amount of brand name with indefinite useful life	–	CU1,000	–
Key assumptions used in value in use calculations[(a)]			
Key assumption	Budgeted gross margins	5-year US government bond rate	Budgeted gross margins
Basis for determining value(s) assigned to key assumption	Average gross margins achieved in period immediately before the budget period, increased for expected efficiency improvements.	Yield on 5-year US government bonds at the beginning of the budget period.	Average gross margins achieved in period immediately before the budget period, increased for expected efficiency improvements.
	Values assigned to key assumption reflect past experience, except for efficiency improvements. Management believes improvements of 5% per year are reasonably achievable.	Value assigned to key assumption is consistent with external sources of information.	Values assigned to key assumption reflect past experience, except for efficiency improvements. Management believes improvements of 5% per year are reasonably achievable.

Key assumption	Japanese yen/US dollar exchange rate during the budget period	Raw materials price inflation	Raw materials price inflation
Basis for determining value(s) assigned to key assumption	Average market forward exchange rate over the budget period.	Forecast consumer price indices during the budget period for North American countries from which raw materials are purchased.	Forecast consumer price indices during the budget period for European countries from which raw materials are purchased.
	Value assigned to key assumption is consistent with external sources of information.	Value assigned to key assumption is consistent with external sources of information.	Value assigned to key assumption is consistent with external sources of information.
Key assumption	Budgeted market share	Budgeted market share	
Basis for determining value(s) assigned to key assumption	Average market share in period immediately before the budget period.	Average market share in period immediately before the budget period, increased each year for anticipated growth in market share.	
	Value assigned to key assumption reflects past experience. No change in market share expected as a result of ongoing product quality improvements coupled with anticipated increase in competition.	Management believes market share growth of 6% per year is reasonably achievable due to increased advertising expenditure, the benefits from the protection of the 10-year patent on C's primary product, and the expected synergies to be achieved from operating C as part of M's North American segment.	

(a) The key assumptions shown in this table for units A and B are only those that are used in the recoverable amount calculations for both units.