IFRS

STAFF PAPER

IASB® Meeting

Project	**Goodwill and Impairment research project**
Paper topic	Setting objectives for the Board's follow-up work

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Purpose

1. This paper discusses what objectives the Board might seek to achieve in follow-up work, if any, that the Board may decide to undertake in the light of the key learnings from the Board's Goodwill and Impairment research project, and asks the Board to decide the objective(s) that it wishes to pursue.

2. The Board is not being asked to decide the form and content of the consultation document that should be issued as the next step in the research project. Depending on the objectives that the Board decides to seek to achieve in follow-up work, the next steps could be either to carry out new research, to continue the existing research, or to proceed with issuing a Discussion Paper or an Exposure Draft. The Board will be asked to decide the next steps at a future meeting.

Structure of the paper

3. The paper is structured as follows:

    (a) background and introduction (paragraphs 4–11)

    (b) key learnings from the Board's research so far (paragraphs 12–38)

    (c) possible objectives for follow-up (paragraphs 39–60)

    (d) questions to the Board

Background and introduction

4. On the basis of stakeholder feedback to the Board during and after the Post-implementation Review (PIR) of IFRS 3 *Business Combinations*, the Board set its research project the objective of investigating the following four research questions:

   (a) are there new conceptual arguments or new information to support reintroducing amortisation of goodwill?

   (b) could some identifiable intangible assets acquired in a business combination be included within goodwill without taking relevant information away from users of financial statements?

   (c) can better and more timely information about acquisitions, goodwill and impairment be provided through disclosures to users of financial statements without imposing costs that exceed the benefits?

   (d) can the application of the requirements in IAS 36 *Impairment of Assets* be improved by:

      (i) simplifying the test without making it less robust; and/or

      (ii) making the test more effective at timely recognition of impairments of goodwill?

5. See Agenda Paper 18A for the June 2018 education meeting of the Board and the US Financial Accounting Standards Board (FASB) for more background on the research project.[1]

6. In relation to stakeholder requests for reintroducing amortisation of goodwill, the Board has noted that the question of whether goodwill should be amortised was discussed and debated extensively when IFRS 3 (2004) was developed. Stakeholder views were polarised between those supporting amortising goodwill and those supporting only testing goodwill for any impairment, and perhaps will always remain polarised. Consequently, the Board observed that it would not be appropriate to change the accounting model unless significant new evidence has

[1] For convenience, the references we provide are to the most recent summaries we have developed, which were for that education meeting of the Board and the FASB. Those papers cross-refer to the original papers the Board discussed in reaching its tentative decisions.

emerged indicating that previous conclusions are no longer valid. Accordingly, the Board set its research project the objective of identifying whether any new conceptual arguments or new information support reintroducing amortisation of goodwill. Rather than focusing on whether to reintroduce amortisation of goodwill, the Board concluded that it was more important to focus on assessing whether the impairment testing of goodwill could be made more effective at timely recognition of impairment of goodwill and whether the test could be simplified without making it less robust.

7. The Board considered the following possible changes in seeking to answer the four research questions (see paragraph 4), and by the end of its meeting in April 2018 had reached the initial preferences summarised in the following table.

Objective	***Possible changes***	***The Board's initial preference***
Subsequent accounting for goodwill (Agenda Paper 18C for the June 2018 meeting of the Board and the FASB)	Amortisation of goodwill	No
	Immediate write-off of goodwill on initial recognition	No
	Componentising goodwill and accounting for the components separately	No
Allowing some identifiable intangible assets to be included within goodwill (Agenda Paper 18D for the June 2018 meeting of the Board and the FASB)	Allowing specified intangible assets such as customer relationships, brands and non-competition agreements to be included within goodwill	No
	Requiring recognition of only those intangible assets that have been recognised in the acquired entity's financial statements	No
	Allowing or requiring to be included in goodwill those identifiable intangible assets that would not have been recognised in financial statements if generated internally	No
	Allowing all identifiable intangible assets that do not meet the contractual-legal criterion to be included within goodwill	No
	Categorising intangible assets into wasting assets and organically-replaced intangible assets and in a business combination requiring recognition of only wasting assets	No

Objective	***Possible changes***	***The Board's initial preference***
	Allowing some indefinite-lived intangible assets to be included within goodwill	No
Additional disclosures (Agenda Paper 18F for the December 2017 Board meeting)	Each year, information about the headroom in a cash-generating unit (or groups of units) to which goodwill is allocated for impairment testing	Yes
	Each year, a breakdown of goodwill by past business combination, explaining why the carrying amount of goodwill is recoverable	Yes
	In the year in which a business combination occurs, the reasons for paying a premium that exceeds the value of the net identifiable assets acquired in a business combination, together with key assumptions or targets supporting the purchase consideration; and subsequently each year, a comparison of actual performance with those assumptions or targets	Yes
	Disclosure of the payback period of an investment in a business combination	No
Simplify the impairment test (Agenda Paper 18E for the December 2017 Board meeting; Agenda Paper 18A and Agenda Paper 18B for the January 2018 Board meeting)	Providing relief from the mandatory annual quantitative impairment testing of goodwill	No
	Removing the requirement for an entity to exclude from the value in use calculation cash flows resulting from a future restructuring or a future enhancement.	Yes
	Removing the explicit requirement to use pre-tax inputs to calculate value in use and to disclose the pre-tax discount rates used. Instead, an entity would be required: a. to use internally consistent assumptions about cash flows and discount rates; and b. to disclose the discount rate(s) actually used	Yes
	Allowing goodwill to be tested for impairment at the entity-level or at the level of reportable segments	No
Improving effectiveness of impairment testing	Changing the current requirement of using higher of value in use and fair value less costs of disposal to using a single method as the sole basis for determining the recoverable amount of an asset (or a cash−generating unit)	No

Objective	***Possible changes***	***The Board's initial preference***
(Agenda Paper 18C for the December 2017 Board meeting)	Using the unrecognised headroom of a cash-generating unit (or groups of units) as an additional input in the impairment testing of goodwill (the headroom approach)	Yes

8. Having reached the initial preferences, the Board subsequently:

   (a) assessed whether and how a change that would contribute to improving an area targeted by one research question would also contribute to improving an area targeted by other research questions;

   (b) attempted to identify a balanced package of possible changes to respond to stakeholder feedback during and after the PIR; and

   (c) explored the form and content of the consultation document that should be issued as the next step in the research project.

9. In that process, the Board observed that introducing the headroom approach would be a more significant change than the other changes. Having assessed the costs and benefits of applying the headroom approach and having discussed the headroom approach with some of the Board's consultative bodies, the Board became concerned that:

   (a) many stakeholders might not consider the headroom approach feasible; and

   (b) consequently, any follow-up by the Board that includes the headroom approach as the only significant improvement might not be considered by stakeholders as appropriate in the light of the feedback during and after the PIR of IFRS 3.

10. Furthermore, at the April 2018 meeting of the Accounting Standards Advisory Forum (ASAF), some ASAF members advised the Board to specify what the intended objective of improving the impairment test is—for example, whether the objective is that goodwill should not remain on an entity's statement of financial position for ever. Those ASAF members stated that reintroducing amortisation of

goodwill would be a less costly way of achieving that objective than introducing the headroom approach.

11. In the light of feedback from the ASAF and from the Board's other consultative bodies, the Board tentatively decided, at its May 2018 meeting, not to develop a document that would seek feedback solely about the headroom approach. At that meeting, several Board members thought that there is a need:

    (a) to define the objective(s) the Board should be achieving through its follow-up work in the light of the key learnings of the research so far.

    (b) to then review the Board's initial preferences (see table in paragraph 7) in the light of the defined objective(s).

Key learnings from the Board's research so far

12. One of the Board's considerations in adding the Goodwill and Impairment project to its research agenda was that more research was required:

    (a) to understand the reasons for stakeholders' concerns, especially whether the concerns arose because of problems with the existing requirements; and

    (b) to assess if there are ways of resolving those problems.

13. At a high level, the feedback to the Board during and after the PIR of IFRS 3 was that:

    (a) the requirements in IFRS 3 and IAS 36 on accounting for intangible assets acquired in a business combination and for acquired goodwill do not always produce useful information to the users of financial statements, and consequently, impose costs that exceed the benefits.

    (b) there is insufficient information in financial statements to help investors understand the subsequent performance of the acquired business.

14. The research so far has provided a better understanding of stakeholders' concerns and the problems with the existing requirements. Paragraphs 16–38 summarise the concerns and the key learnings from the research work. Those paragraphs are structured as follows:

(a) identifiable intangible assets acquired in a business combination (paragraphs 16–24).

(b) acquired goodwill (paragraphs 25–38)

(i) accounting for goodwill (paragraphs 29–32); and

(ii) impairment testing of goodwill (paragraphs 33–38).

15. The key learnings represent the staff conclusions drawn from the following research activities:

(a) analysis of stakeholder feedback during and after the PIR of IFRS 3;

(b) outreach with the Board's advisory and consultative bodies;

(c) consideration of work of national standard-setters, academics etc; and

(d) critical analysis of the requirements in current IFRS Standards in the light of the activities listed in (a)–(c).

Identifiable intangible assets acquired in a business combination

16. Agenda Paper 18D for the June 2018 meeting of the Board and the FASB sets out the feedback to the Board and the staff analysis of that feedback in detail.

17. Investors have mixed views about usefulness of information provided by recognising all identifiable intangible assets acquired in a business combination.

(a) a few investors supported the current requirement in IFRS 3 to recognise all identifiable intangible assets.

(b) some investors think that recognising at fair value all identifiable assets acquired, and all liabilities assumed, in a business combination does not provide useful information, and distorts their projections of expected cash flows.

(c) other investors questioned the usefulness of information provided by recognising some intangible assets, such as brands and customer relationships, because of concerns about:

(i) credibility of fair value measurement of those intangible assets;

(ii) usefulness of information provided by amortisation of those intangible assets; and

(iii) differences between accounting requirements for internally-generated intangible assets and those for intangible assets acquired in a business combination.

18. Preparers have mixed views about the implementation challenges in recognising and measuring intangible assets acquired in a business combination.

(a) members of the Global Preparers Forum (GPF) said that valuing identifiable intangible assets acquired in a business combination is not costly because it is a one-off activity and companies have access to valuation service providers and valuation models.

(b) however, many preparer participants in the PIR of IFRS 3 raised many concerns about the costs and complexity involved in identifying and measuring some intangible assets, such as brands and customer relationships.

19. The staff observed from the feedback from investors that many investors would support recognising *some, but not all,* identifiable intangible assets acquired in a business combination. Having said that, the analysis of investors' feedback leads the staff to conclude that most concerns of investors, including the concern highlighted in paragraph 17(c)(iii) about lack of comparability between entities growing by acquisition (and thus having intangible assets acquired in business combinations) and entities growing without acquisitions (and thus having only internally-generated intangible assets), are:

(a) not of the nature of fundamental disagreement with the principles underlying the requirement in IFRS 3; and instead are

(b) mainly about non-availability of the following information in financial statements for periods after a business combination:

(i) disaggregation of amortisation recognised in profit or loss by each class of intangible assets; and

(ii) carrying amount at the end of a reporting period of assets acquired in past business combinations.

20. Some investors view a business combination as a different type of transaction from a purchase of assets. Because the reasons for that view were not clear, that feedback did not provide a basis or reason for the staff to question the principles underlying the requirement in IFRS 3 for an acquirer to recognise all identifiable assets acquired and liabilities assumed in a business combination.

21. The staff think that investors generally raise concerns about lack of comparability between entities growing by acquisition and entities that grow without acquisitions because of the difficulty in deriving comparable measures of earnings. Paragraph 19(b) sets out the information that an investor is likely to require in deriving comparable measure of earnings of an entity that has grown through business combinations. In deriving a comparable measure of earnings, an investor may want to add back amortisation of some intangible assets acquired in a business combination, especially those intangible assets that an entity would not have capitalised had those assets been generated internally. In the absence of information about amortisation for each class of intangible assets, the investor might add back all of the amortisation for the period, which investors would say is not an ideal outcome.

22. The staff noted that information about amortisation for each class of intangible assets should be available in the financial statements. Paragraph 118 of IAS 38 requires an entity to disclose a reconciliation of the carrying amount at the beginning and end of the period for each class of intangible assets, and one of the items of reconciliation is the amortisation recognised during the period. However, the staff understand that data aggregators probably do not capture this information in their databases. One possible reason why they do not capture that information is that it is not disclosed in financial statements of entities that are not using IFRS Standards. Consequently, it is not clear whether the Board could take any action that would change the information reported by data aggregators.

23. In relation to the carrying amount at the end of a reporting period of assets acquired in past business combinations, investors might need this information if they choose not to model potential future business combinations in projecting expected future cash flows of the entity. However, it is not clear if this information is required only for intangible assets acquired in a business combination or also for other assets acquired in the business combination. The

Board might want to consider requiring disclosure of carrying amounts of assets acquired in past business combinations. However, preparers are likely to raise concerns that this information may not always be available, especially for some assets.

24. Preparers and auditors raised concerns about identifying and measuring some intangible assets such as customer relationships and brands, and consequently questioned the use of that information. Their concerns seem to be mainly about costs involved in the process of identifying and measuring those assets. However, if feedback from GPF is considered representative of the current view of preparers generally, it appears that practice has moved on and the concerns raised during the PIR may no longer exist. Consequently, if that is the case, there is no need for the Board to take any action on the recognition of intangible assets acquired in a business combination. Having said that, some preparers may still have concerns about the process of identifying and valuing intangible assets acquired in a business combination.

Acquired goodwill

25. During and after the PIR of IFRS 3, stakeholders raised concerns about:

    (a) whether goodwill is an asset and whether goodwill should be amortised;

    (b) the effectiveness of the impairment testing model for goodwill in IAS 36; and

    (c) the costs and complexity of performing the impairment test.

26. Agenda Paper 18C for the June 2018 meeting of the Board and the FASB sets out the feedback to the Board about subsequent accounting for goodwill and the staff analysis of that feedback in detail.

27. Agenda Paper 18C for the December 2017 Board meeting sets out the feedback to the Board about effectiveness of the impairment testing model for goodwill and the staff analysis of that feedback in detail.

28. Agenda Paper 18E for the December 2017 Board meeting, and Agenda Paper 18A and Agenda Paper 18B for the January 2018 Board meeting set out the feedback

to the Board about the costs and complexity of performing impairment testing of goodwill and the analysis of that feedback in detail.

Accounting for goodwill

29. Paragraphs BC313–BC323 of the Basis for Conclusions on IFRS 3 [paragraphs B313–B323 of the Basis for Conclusions on FASB Statement No. 141 (revised 2007), *Business Combinations*] explain the boards' considerations in concluding that goodwill acquired in a business combination qualifies as an asset. In reaching that conclusion, the boards observed that goodwill acquired in a business combination is composed of:

    (a) the going concern element of the acquired business; and

    (b) the expected synergies and other benefits from combining the acquirer's businesses with the acquired businesses.

    The boards described these components collectively as core goodwill.

30. In developing and finalising the 2018 *Conceptual Framework*, the IASB did not reconsider the conclusions in paragraphs BC313–BC323 of the Basis for Conclusions on IFRS 3. During the development of the 2018 *Conceptual Framework*, the staff applied the proposed definition of an asset to goodwill and concluded that core goodwill met the proposed definition. (See Example 1.1 of Agenda Paper 10C for the October 2016 meeting.)

31. When replacing IAS 22 (revised 1998) *Business Combinations* with IFRS 3, the Board concluded that goodwill should not be amortised and instead should be tested for impairment annually, or more frequently if events or changes in circumstances indicate that it might be impaired. The Board's considerations are explained in paragraphs BC131A–BC136 of the Basis for Conclusions on IAS 36. The Board's main consideration (as explained in paragraph BC131E of the Basis for Conclusions on IAS 36) was that assessing goodwill annually for impairment provides better information than an allocation of the cost through an amortisation charge. The amount of amortisation depends on factors that are generally not possible to predict, such as the useful life of the acquired goodwill and the pattern in which it diminishes. Furthermore, the Board was doubtful about the usefulness

of an amortisation charge that reflects the consumption of acquired goodwill, when the internally-generated goodwill replacing it is not recognised.

32. The research so far has not provided any new evidence for the staff to doubt whether goodwill is an asset or whether goodwill should be amortised. On the other hand, the staff gained a better understanding of stakeholders' concerns. The following are the key learnings from the research on this topic:

(a) some stakeholders make the criticism that goodwill is not an asset but instead is a residual or a plug. The reason for that criticism is that those stakeholders focus on the amount determined by measuring goodwill as a residual, not on the economic resources (or the rights) that constitute goodwill. A business is generally considered to have the ability to reinvest and generate returns for an indefinite period of time, if not to perpetuity. A part of the purchase consideration is clearly attributable to that ability. The ability to reinvest and generate returns for an indefinite period of time arises from the rights an entity has to carry on its business for an indefinite period of time. While none of the individual identifiable assets with finite life would carry rights beyond that finite life, goodwill, and possibly some other intangible assets with indefinite life, capture the rights that give the business the ability to reinvest and generate returns for an indefinite period of time. The fact that goodwill is measured as a residual does not prevent it from being an asset. The Board concluded that there was no easier way to measure goodwill other than the residual measurement. The Board also acknowledged that one consequence of that measurement as a residual is that any overpayment for the acquired business is subsumed in the measurement of goodwill.

(b) the going concern element of a business, which is a component of core goodwill, could also include *growth options* (sometimes also known as real options) that cannot be captured as part of the fair value of the acquired identifiable assets. Some stakeholders said that in some situations goodwill may represent a bet on a new technology. While it was unclear whether those stakeholders disagree with recognising that bet as part of goodwill, the bet represents a growth option that an acquirer paid for, and unless the growth option is a component of an individual identifiable asset acquired in the business combination, it is intuitive that goodwill includes the growth option. It is most likely that most growth options to grow and develop the business are just an inherent component of the right to carry on the business and to benefit from it.

(c) the question whether acquired goodwill should be amortised or not is to some extent a question about the unit of account for goodwill. As explained in paragraph 31, one of the considerations in removing the requirement to amortise goodwill was that the Board was doubtful about the usefulness of an amortisation charge that reflects the consumption of acquired goodwill, when the internally-generated goodwill replacing it is not recognised. This implies that (i) the Board probably considered goodwill, both acquired and internally-generated, and relating to the same business, as one unit of account; and (ii) the focus of the Board was on the economic resources (or the rights) that constitute goodwill. However, if the amount of acquired goodwill and the amount of internally-generated goodwill relating to the same business were considered to be two separate units of account, acquired goodwill would likely be a wasting asset. Having said that, the period over which the acquired goodwill is consumed is likely to be indefinite because of the nature of the components of core goodwill (ie the nature of the economic resources or the rights that constitute goodwill). The going concern element of the acquired business is typically expected to have an indefinite life. Furthermore, synergies would generally be available to the acquirer for an indefinite period. Similarly, growth options are not expected to have a finite life. Consequently, amortisation of goodwill might not be possible because it is generally not possible to predict the useful life.

(d) when revising IAS 36 in 2004, the Board acknowledged that overpayments are possible and, in concept, an overpayment should lead to the acquirer's recognition of an expense (or loss) in the period of the acquisition. The Board explained its considerations in paragraph BC382 of the Basis for Conclusions on IAS 36 in concluding that it is typically not feasible to identify and quantify an overpayment. The research so far did not provide a reason or a basis to question those considerations.

Impairment testing of goodwill

33. For impairment testing, an entity is required to allocate, from the acquisition date, the goodwill acquired in a business combination to each of its cash-generating units, or groups of units, that is expected to benefit from the synergies of the combination.[2] A unit containing acquired goodwill is tested annually for any impairment by comparing the recoverable amount of the unit with its carrying amount. The carrying amount of the unit includes, in addition to the allocated goodwill, the carrying amount of those assets that can be attributed directly, or allocated on a reasonable and consistent basis, to the unit.

34. Each unit to which the goodwill is so allocated should:

    (a) represent the lowest level within the entity at which the goodwill is monitored for internal management purposes; and

    (b) not be larger than an operating segment as defined by paragraph 5 of IFRS 8 *Operating Segments* before aggregation.

35. As explained in the Basis for Conclusions on IAS 36, the Board required an annual quantitative impairment test for intangible assets with indefinite useful life and goodwill. This is because not amortising those assets increases the reliance that must be placed on impairment reviews to ensure that their carrying amounts do not exceed their recoverable amounts.

36. For goodwill, the existence of a rigorous and operational impairment test was seen as a precondition for removing the requirement to amortise it in all cases. The Board introduced the requirement to carry out an annual quantitative impairment test for goodwill and intangible assets with indefinite life at the same time as it replaced the amortisation-model with the impairment-only model.

[2] In the context of impairment testing of goodwill, any reference to a unit should be read as referring also to a group of units.

37. The staff note that when the revised IAS 36 was issued in 2004, three members of the Board dissented from IAS 36, questioning the robustness of the impairment testing model for goodwill. Two of the three members thought that a much more rigorous effort must be made to determine the recoverable amount of goodwill, than the current impairment test. The other member thought that the current impairment test fails to eliminate the shield from impairment provided by the internally-generated goodwill of the acquiring entity at acquisition. (See paragraphs DO4, DO6–DO7 of the Dissent of Anthony T Cope, James J Leisenring and Geoffrey Whittington accompanying IAS 36.)

38. The research so far has provided some evidence to question the Board's conclusion that an annual quantitative impairment test would provide sufficient rigour in testing the carrying amount of goodwill for any impairment. The following are the key learnings from the research on this topic:

    (a) IAS 36 requires a unit, or group of units, to be tested for impairment. Though the objective of the impairment test is not to provide information directly about performance of a unit, the test together with the disclosures provide some information indirectly about performance of the unit. Having said that, the current impairment testing model does not always provide information about performance of the acquired business. This is because, (i) depending on facts and circumstances, the acquired business may or may not be a separate unit for impairment testing purposes; and (ii) the test provides information to users only if an impairment loss is recognised or if a near miss results in disclosure of unrecognised headroom (paragraph 134(f)(i) and paragraph 135(e)(i) of IAS 36).

    (b) because goodwill is currently tested for impairment as part of a unit, the focus of the test, in reality, is not to assess whether the carrying amount of goodwill is overstated but to assess whether the carrying amount of net assets of the unit (that includes goodwill) is overstated. This argument is strengthened by the fact that IAS 36 requires the same impairment testing model—ie comparison of the recoverable amount of the unit with its carrying amount—whether or not it contains acquired goodwill. If the focus of the test is not to assess whether the carrying amount of goodwill is overstated:

(i) it should not matter whether or not goodwill is amortised.

(ii) it is unclear why the requirements for the frequency of the quantitative impairment test depend on whether the unit contains goodwill. To be consistent with the focus of the current testing model, it would always be sufficient to test a unit only when there is an indication that the unit may be impaired—regardless of whether the unit includes goodwill. (IAS 36 currently specifies that for a unit that contains goodwill, the impairment test must be performed annually; but for a unit that does not include goodwill, the test is required only when there is an indication that the unit may be impaired.)

(c) although the Board had expected when revising IAS 36 in 2004 that impairment testing would identify overpayments, the current impairment testing model does not identify overpayments as effectively as the Board had expected. As explained in paragraph 33, IAS 36 requires an entity to allocate, from the acquisition date, the acquired goodwill to each of its units that is expected to benefit from the synergies of the combination. Acquired goodwill allocated to a unit could be shielded from impairment by any pre-existing unrecognised headroom in the unit. (The unrecognised headroom is the excess of the recoverable amount of the unit over its carrying amount; it comprises internally-generated goodwill, any unrecognised intangible assets and the difference between current value and carrying amount of net assets not measured at current value.) Consequently, the current impairment testing model may not identify overpayments.

(d) the application of the current impairment testing model may not necessarily result in an entity recognising impairment of goodwill for impairment events, such as the acquirer not being able to realise expected synergies from an acquisition, if there is sufficient headroom in the unit because of internally-generated goodwill and intangible assets. The application of the current model would most likely result in recognition of impairment of goodwill when there are major impairment events affecting not just the acquired goodwill but all assets of the unit, ie events affecting the business in general.

(e) the headroom approach would provide rigour or robustness if it makes an entity analyse the reasons for a decrease in the total headroom and identify the factors affecting acquired goodwill. The entity's management would be discouraged from making over-optimistic projections of cash flows because any difficulty in maintaining the over-optimism year after year reduces the total headroom, potentially resulting in the recognition of an impairment loss on acquired goodwill. Some members of ASAF and the Board's other consultative bodies were mainly concerned about the rebuttable presumption that all of a decrease in total headroom should be attributed first to acquired goodwill. They thought that if an entity were to be unable to gather evidence to rebut the presumption or decided not to seek such evidence, the presumption would lead to a decrease in total headroom being attributed to acquired goodwill even if the decrease was caused by reasons not connected to the acquired goodwill. In the view of those members, recognising the resulting impairment loss may not provide useful information to investors. However, the concerns could be resolved by changing the rebuttable presumption so that any decrease in total headroom would be allocated pro-rata to both acquired goodwill and the unrecognised headroom. In situations in which an entity rebuts the presumption, investors are likely to benefit from the disclosure of the basis used for attributing the decrease in total headroom. This information is not available to investors in the current impairment test.

(f) instead of the headroom approach, impairment testing of goodwill could be made effective by requiring goodwill to be tested at the lowest possible levels of units without grouping the units. The staff understand from various informal discussions with stakeholders that there are different views about what the lowest level is within the entity at which acquired goodwill is monitored for internal management purposes and that entities tend to test goodwill at the level of an operating segment. However, to be able to test goodwill for impairment at the lowest possible levels of units without grouping the units, an entity would need to further componentise goodwill, especially to identify the synergies paid for, and allocate the synergies on a reasonable basis to the individual units that benefit from the synergies. A possible criticism of such a requirement could be that the impairment testing of goodwill would then become even more costly, and perhaps arbitrary depending on how goodwill is componentised.

Possible objectives for follow-up

39. On the basis of the key learnings from the research so far and the possible changes considered by the Board in response to stakeholder feedback during and after the PIR of IFRS 3, the staff suggest that the Board could seek to achieve one or more of the following objectives through its follow-up work:

(a) *Objective A*—better disclosures that would enable investors to assess more effectively whether a business combination is a good investment decision and whether the acquired business is performing after the combination as expected.

(b) *Objective B*—make targeted changes to the value in use calculation.

(c) *Objective C*—change the impairment testing model to focus on assessing whether the carrying amount of acquired goodwill is recoverable.

(d) *Objective D*—retain the current impairment testing model and simplify the requirements for accounting for goodwill.

(e) *Objective E*—remove the differences between accounting requirements for internally-generated intangible assets and those for intangible assets acquired in a business combination.

Objective A—better disclosures

40. When revising IAS 36 in 2004, the Board concluded that it is typically not feasible to identify and quantify any overpayments that are included in goodwill

as a result of it being measured as a residual. The research so far did not provide a reason or a basis to question that conclusion. Furthermore, although the Board had expected when revising IAS 36 in 2004 that impairment testing would identify overpayments, the current impairment testing model does not identify overpayments as effectively as the Board had expected (see paragraph 38(c)). Having said that, the Board could explore if there is scope for more disclosures to help users assess overpayments.

41. As explained in paragraph 38(a), the objective of the impairment test is not to provide information directly about the performance of a unit; the test together with the disclosures provide some information indirectly about the performance of the unit. The current impairment testing model does not always provide information about the performance of an acquired business. Furthermore, there is no specific requirement in any applicable IFRS Standard for an entity to disclose information about whether an acquired business is performing after the acquisition as expected at the time of acquisition. Consequently, there appears to be some scope for improving disclosures.

42. The staff recommends that the Board should seek to achieve Objective A whether or not it seeks to achieve the other objectives. Agenda Paper 18F for the June 2018 meeting of the Board and the FASB sets out in detail the feedback to the Board and the possible new disclosures the Board considered in the research project so far. The staff is seeking advice from ASAF in July 2018 about possible improvements to the current disclosure requirements and possible new disclosures. At a future meeting, the Board would be presented with more analysis of whether it is possible, and if so how, to achieve this objective.

Objective B—targeted changes to the value in use calculation

43. At the April 2018 and May 2018 meetings of the Board, the staff analysed the following changes to the value in use calculation and concluded that they are relatively straightforward improvements that the Board could consider proposing to IAS 36:

    (a) amending the calculation of value in use of an asset (or a unit) by removing the requirement to exclude from the calculation of value in use those cash flows that would result from a future restructuring or from a future enhancement.

(b) removing the explicit requirement to use pre-tax inputs in calculating value in use, and to disclose pre-tax discount rates used. Instead, an entity would be required to use internally consistent assumptions about cash flows and discount rates, and to disclose the discount rate(s) actually used.

44. The staff recommend that the Board should pursue making those changes to the value in use calculation, whether or not the Board seeks to achieve the other objectives. Those changes pose no obstacle to considering any changes to the accounting requirements for goodwill or changes to the impairment testing model to focus on goodwill.

Objective C—change the impairment testing model to focus on goodwill

45. Acquired goodwill is recognised only at the time of a business combination. Consequently, there would be a reasonable expectation that the carrying amount of acquired goodwill should provide some information about the business combination in which that goodwill arose, such as whether an overpayment was identifiable at the date of the acquisition or whether the entity has subsequently been able to achieve the expected synergies.

46. However, for reasons explained in paragraph 38, the current impairment testing model does not always provide such information. Although the Board explained in paragraph BC135 of the Basis for Conclusions on IAS 36 that the objective of the impairment test for goodwill is to ensure that the carrying amount of goodwill is recoverable, the mechanics of the current model are such that the test focuses on assessing whether the carrying amount of net assets of the unit (that includes goodwill) is recoverable. Consequently, the Board could consider changing the impairment testing model to instead focus on the carrying amount of goodwill.

47. In seeking to achieve this objective, the Board could:

(a) further pursue the headroom approach with a rebuttable presumption that all of a decrease in total headroom should be allocated pro-rata to both acquired goodwill and the unrecognised headroom; or

(b) pursue requiring impairment testing at the lowest possible levels of units without grouping the units as explained in paragraph 38(f).

Further research would be required if the Board seeks to achieve this objective.

48. In relation to the headroom approach, although benefits and costs of the approach were identified, more work is required to understand the extent of costs that are likely to be incurred in applying the headroom approach and to confirm that the expected benefits exceed the expected cost of applying the approach.

Objective D—simplify accounting for goodwill

49. In finalising the objective and the mechanics of the current impairment testing for goodwill in 2004, the Board observed that goodwill does not generate cash flows independently of other assets or group of assets. Therefore, goodwill cannot be tested for impairment separately and can only be tested together with the assets with which it generates cash flows. Consequently, the Board concluded that the objective of the impairment test should be to assess whether the carrying amount of the unit that includes goodwill is recoverable. Accordingly, the Board required an entity to compare the recoverable amount of the unit with its carrying amount. The Board also concluded that because it is not possible to measure separately goodwill generated internally after a business combination and to factor that measure into the impairment test for acquired goodwill, the carrying amount of goodwill will always be shielded from impairment by that internally-generated goodwill.

50. Having considered the research so far, the Board could reconfirm the conclusions reached by the Board when it revised IAS 36 in 2004 (see paragraph 49)—ie the Board could retain the objective and mechanics of the current impairment testing model for goodwill. Furthermore, the Board could consider better explaining that the focus of the test is not on the amount that is recognised as goodwill but on the economic resources or the rights that constitute goodwill that generate cash flows together with other assets.

51. Having retained the current impairment testing model, the Board could consider the following simplifications:

(a) providing relief from the mandatory annual quantitative impairment testing of goodwill.

(b) amortisation of goodwill.

Relief from the mandatory annual quantitative impairment testing of goodwill

52. For the reasons explained in paragraph 38, the research so far has helped conclude that the mandatory annual quantitative impairment testing of goodwill does not necessarily provide sufficient rigour in testing the carrying amount of goodwill for any impairment. As explained in paragraph 38(b)(ii), to be consistent with the focus of the current testing model, it would always be sufficient to test a unit only when there is an indication that the unit may be impaired—regardless of whether the unit includes goodwill. Consequently, the Board could reconsider requiring an entity to perform the quantitative impairment testing of goodwill only when there are indicators of possible impairment. This is likely to reduce the cost of impairment testing without losing the information provided by the impairment test. Agenda Paper 18E for the June 2018 meeting of the Board and the FASB sets out in detail the feedback to the Board and the analysis of possible relief from the mandatory annual quantitative impairment testing of goodwill.

Amortisation of goodwill

53. The Board could consider reintroducing amortisation of goodwill. Agenda Paper 18C for the June 2018 meeting of the Board and the FASB sets out the Board's discussions so far on amortisation of goodwill.

54. Amortisation of goodwill is a pragmatic solution that could help in resolving concerns that the current impairment testing model does not focus on assessing whether the carrying amount of goodwill is overstated. Allowing amortisation would reduce the costs to preparers in accounting for goodwill but would reduce the information provided by the impairment test. For reasons explained in paragraph 32(c), any research about the useful life of goodwill is not likely to produce any satisfactory evidence of an appropriate useful life of goodwill. If the Board wishes to consider reintroducing amortisation of goodwill, some more

research would be required to identify any consequential issues and possible ways of resolving the issues.

Immediate write-off of goodwill on initial recognition

55. Instead of considering retaining the current impairment test and reintroducing amortisation of goodwill, the Board could consider immediate write-off of goodwill on initial recognition. This change would reduce the costs to preparers in accounting for goodwill but would eliminate the information provided by the impairment test. *Appendix A* of Agenda Paper 18C for the June 2018 meeting of the Board and the FASB sets out the Board's discussions so far on immediate write-off of goodwill on initial recognition.

56. Immediate write-off of goodwill on initial recognition could help in resolving stakeholder concerns about items such as overpayments remaining in goodwill because of the residual measurement. However, this change would undermine the conclusion that goodwill is an asset. Part of the amount recognised as goodwill is clearly attributable to the core components of goodwill. This change would represent a significant change to the underlying principles of IFRS 3 and would involve substantial work. New research would be required to identify any consequential issues and possible ways of resolving those issues—especially the question whether the write-off should be through profit or loss, other comprehensive income or equity. The staff think that any research is not likely to produce acceptable solutions. If the Board pursues this approach, there is likely to be a demand from investors for the Board to consider requiring write-off of some identifiable intangible assets acquired in a business combination.

Objective E—aligning accounting for internally-generated intangible assets and intangibles acquired in a business combination

57. To respond to investors' concerns that the requirement in IFRS 3 for an acquirer to recognise all identifiable intangible assets makes it hard to compare the performance of an entity growing by acquisition with that of an entity growing without acquisitions, the Board could consider removing the differences between accounting requirements for internally-generated intangible assets and those for

intangible assets acquired in a business combination. The Board could do this by reconsidering the requirements in either IFRS 3 or IAS 38.

58. The staff do not recommend that the Board seek to achieve Objective E because the potential work would involve a fundamental reconsideration of accounting for intangible assets. As explained in paragraphs 16–24:

(a) the staff did not find any reason or basis to question the underlying principles of IFRS 3; and

(b) the main cause of investors’ concerns seems to be availability of information. Information about amortisation for each class of intangible assets that investors would need in order to derive comparable measure of earnings should be available in financial statements prepared applying IFRS Standards. Having said that, the staff understand that one possible reason why data aggregators may not be capturing that information is that it is not being disclosed in financial statements of entities that are not using IFRS Standards. The staff understand that there is no requirement in US GAAP to disclose a reconciliation of the carrying amount at the beginning and end of the period for each class of intangible assets other than goodwill.

59. At its May 2018 meeting, the Board considered whether some identifiable intangible assets acquired in a business could be included within goodwill without taking information away from users of financial statements. The Board decided not to consider allowing any identifiable intangible assets to be included within acquired goodwill mainly for the following reasons:

(a) there is no compelling evidence that allowing some intangible assets with indefinite useful life to be included within goodwill would generate cost savings.

(b) including intangible assets within goodwill would cause the carrying amount of goodwill to increase, thereby exacerbating stakeholder concerns about effectiveness of impairment testing.

(c) including intangible assets within goodwill would appear unhelpful in the light of current external research suggesting that the statement of financial position and the statement(s) of financial performance provide insufficient information about intangible assets.

60. At this stage, the staff do not see a reason for the Board to reconsider its tentative decision not to not to consider allowing any identifiable intangible assets acquired in a business combination to be included within goodwill.

Questions for the Board

1. Does the Board agree with the staff recommendation to pursue the objective of identifying better disclosures that would enable investors to assess more effectively whether a business combination is a good investment decision and whether the acquired business is performing after the combination as expected (Objective A)?
2. Does the Board agree with the staff recommendation to pursue the changes to the value in use calculation set out in paragraph 43 (Objective B)?
3. Does the Board wish to pursue the objective of changing the impairment testing model to focus on assessing whether the carrying amount of acquired goodwill is recoverable (Objective C)?
4. If the Board decides not to pursue Objective C—
   a. Does the Board wish to consider requiring an entity to immediately write-off goodwill on initial recognition?
   b. If the Board does not wish to consider immediate write-off of goodwill on initial recognition, does the Board wish to consider reintroducing amortisation of goodwill?
   c. Does the Board wish to reconsider pursuing possible relief from the mandatory annual quantitative impairment testing of goodwill?
5. Does the Board agree with the staff recommendation not to pursue the objective of removing the differences between accounting requirements for internally-generated intangible assets and those for intangible assets acquired in a business combination (Objective E)?