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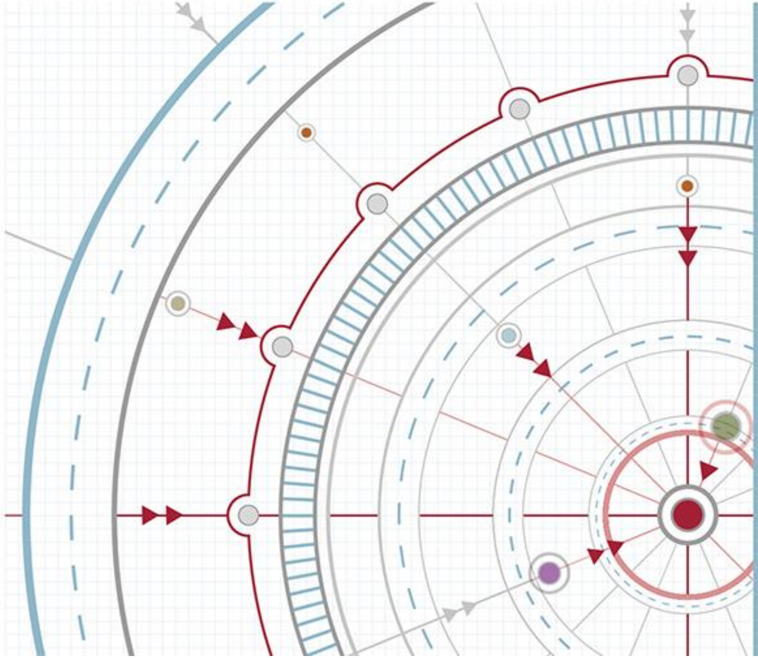

CMAC meeting, 2 March 2018

Agenda Paper 4

Goodwill and Impairment

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Objective of the meeting

To seek views about:

- an approach to the impairment testing of goodwill that considers movements in headroom [headroom is the excess of the recoverable amount of a cash-generating unit (or group of units) over the carrying amount of that unit]; and
- the requirement in IFRS 3 *Business Combinations* to recognise identifiable intangible assets acquired in a business combination.

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The staff's preference of time allocation is as follows:

Headroom approach <= **20 minutes**

Intangible assets acquired in a business combination >= **40 minutes**

The staff is seeking feedback from GPF on the same topics at its meeting on 6 March 2018.

Contents of the paper

Brief background

Brief background (1/3)

2009

Entities started implementing revised version of IFRS 3 *Business Combinations*

2013

The Board sought stakeholder feedback on specified matters as part of the Post-implementation Review of IFRS 3

2015

Having reviewed the stakeholders' feedback and academic research, the Board identified issues/topics for further research and follow-up (see pages 6–7)

2017

The Board made tentative decisions on some topics (see pages 6–7)

2018

The Board will soon decide the next stage of the research project

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Background on the project

Goodwill is an asset representing the future economic benefits produced by assets acquired in a merger or acquisition that are not individually recognised. Whether goodwill is impaired is assessed each year.

Some companies that have been applying IFRS 3 *Business Combinations* since 2009 say that the requirements in IAS 36 *Impairment of Assets* for testing impairment of goodwill are overly complex, time-consuming and expensive. Many companies also find it difficult to identify sufficiently reliable and observable data for measuring specified intangible assets that should be recognised separately from goodwill acquired in a business combination.

Some investors say that the information provided about goodwill and impairment is insufficient, and that impairment of goodwill is not recognised in a timely fashion. Some investors also question the usefulness of recognising specified intangible assets separately from goodwill acquired in a business combination.

As part of the research project, the International Accounting Standards Board is analysing the reasons for the concerns and considering whether any changes to the existing requirements of IFRS 3 and IAS 36 are needed to improve the way these Standards are applied.

Brief background (2/3)

Feedback received	Topic for research	Current status of Board's research
Entities are delaying recognition of impairments of goodwill.	**Topic 1**—Can the impairment testing model for goodwill be improved? *(Focus of this CMAC meeting)*	The Board tentatively decided to consider using the unrecognised headroom as an additional input in the impairment testing of goodwill. Headroom is the excess of the recoverable amount of a cash-generating unit (or group of units) over the carrying amount of the unit(s).[1]
Impairment testing of goodwill is a costly process.	**Topic 2**—Can impairment testing be simplified without making it less robust?	The Board tentatively decided to consider simplifying the value in use calculation.[2]
Financial statements do not include information to assess performance of an acquired business.	**Topic 3**—Can the quality of information provided to the users of financial statements be improved without imposing costs for preparers that outweigh the benefits?	The Board tentatively decided to consider requiring entities to disclose: (a) the unrecognised headroom; (b) breakdown of goodwill by past acquisition; and (c) information about value creation from new acquisitions.[1]

1. Members may refer to Agenda Papers 18C and 18F for the December 2017 Board meeting for more information.
2. Members may refer to Agenda Papers 18–18B for the January 2018 Board meeting for more information.

Brief background (3/3)

Issue identified	Topic for research	Current status of Board's research
Testing goodwill only for impairment without amortising it is not appropriate.	**Topic 4**—Are there any new conceptual arguments or new information in support of amortising goodwill?	The Board tentatively decided not to consider reintroducing amortisation of goodwill.[3]
Valuing some intangible assets on an acquisition is a costly process and does not provide useful information to investors.	**Topic 5**—Can an entity be allowed to include some acquired identifiable intangible assets within goodwill arising on an acquisition? *(Focus of this CMAC meeting)*	• No decisions made • This topic is scheduled for discussion at the March/April 2018 Board meeting

3. Members may refer to Agenda Paper 18B for the December 2017 Board meeting for more information.

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IASB Update December 2017

Goodwill and Impairment (Agenda Paper 18)

The Board met on 14 December 2017 to discuss whether there are ways to improve the application of IAS 36 *Impairment of Assets*.

The Board tentatively decided to consider improving the application of IAS 36 by using the unrecognised headroom (the excess of the recoverable amount over the carrying amount) of a cash-generating unit (or groups of units) as an additional input in the impairment testing of goodwill. Eleven Board members agreed and three disagreed with this decision.

The Board tentatively decided to consider introducing requirements for the entity to disclose:

a. each year, information about the headroom in a cash-generating unit (or groups of units) to which goodwill is allocated for impairment testing;

b. a breakdown of goodwill by past business combination, explaining why the carrying amount of goodwill is recoverable; and

c. the reasons for paying a premium that exceeds the value of the net identifiable assets acquired in a business combination, key assumptions or targets supporting the purchase consideration and a comparison of actual performance with those assumptions or targets.

Twelve Board members agreed and two disagreed with this decision.

The Board tentatively decided against pursuing the following approaches, which it had considered in past meetings:

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

b. allowing goodwill to be tested for impairment at the entity-level or at the level of reportable segments;

c. requiring disclosure of the payback period of an investment in a business combination; and

d. 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).

Eleven Board members agreed and three disagreed with this decision.

The Board tentatively decided that the following possible approaches are outside the scope of the goodwill and impairment research project:

a. requiring disclosure of a measure of total assets and liabilities for each reportable segment; and

b. reviewing the drafting of the disclosure requirements in IFRS 3 *Business Combinations*.

Thirteen Board members agreed and one disagreed with this decision.

The Board tentatively decided not to consider reintroducing amortisation of goodwill. Eleven Board members agreed and three disagreed with this decision.

Next steps

At future meetings, the Board will:

a. decide whether the output of the project should be a discussion paper or an exposure draft;

b. discuss whether to consider subsuming some intangible assets within goodwill in a business combination;

c. continue to discuss whether to simplify the calculation of value in use by removing:

    i. the explicit requirement to use pre-tax inputs; and

    ii. the prohibition on including estimated cash flows from uncommitted future restructuring and from improving or enhancing an asset's performance.

IASB Update January 2018

Goodwill and Impairment (Agenda Paper 18)

The Board met on 25 January 2018 to discuss whether it can simplify the value in use calculation without making the impairment test in IAS 36 *Impairment of Assets* less robust.

The Board tentatively decided to consider 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.

Thirteen Board members agreed and one disagreed with this decision.

The Board also tentatively decided to consider 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.

All 14 Board members agreed with this decision.

Next Steps

At future meetings, the Board will:

a. discuss whether to consider subsuming some intangible assets within goodwill acquired in a business combination; and

b. decide whether the next stage in the project should be a discussion paper or an exposure draft.

Improving effectiveness of impairment testing of goodwill using headroom approach

In this section of the presentation, we present a proposed new approach to improve the effectiveness of impairment testing of goodwill using the headroom approach.

We discussed this approach with CMAC members in a series of 1:1 conference calls in November/December 2017, and are grateful for your participation. We summarised the feedback on page 19.

The objective of including this topic for this meeting is to summarise the feedback received from those members to the full CMAC and to seek views from new CMAC members and those members that did not participate.

Frequently used terms

For the benefit of members, terms frequently used in this section of the paper are summarised and defined below.

Cash-generating unit (unit)	Smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. References to a 'unit' should also be read as referring to groups of units.
Recoverable amount (RA) of a unit	Recoverable amount is higher of fair value less costs of disposal (FVLCD) and value in use (VIU).
Carrying amount (CA) of a unit	Carrying amount includes the carrying amount of only those assets that can be attributed directly, or allocated on a reasonable and consistent basis, to the unit. This also includes carrying amount of acquired goodwill allocated to the unit.
Unrecognised headroom (UH)	Difference between the recoverable amount of a unit and its carrying amount. This difference mainly comprises internally generated goodwill and unrecognised intangible assets, if any.
Total headroom (TH)	Sum of the unrecognised headroom of a unit and the carrying amount of acquired goodwill allocated to that unit.

Why improve the impairment test? (1/2)

IAS 36 requirements

- Goodwill tested for impairment at the level of a unit to which goodwill relates
- RA of the unit to be measured every year
- No impairment if RA > CA

Investors' concerns

- Entity-specific nature of VIU gives scope for management's optimism to creep into impairment test to avoid recognising any impairment
- Impairments of goodwill are not recognised at the right time and in the right amounts

Staff research

Likely causes—

- Unwarranted management optimism
- Shielding effect of internally generated goodwill

Why improve the impairment test? (2/2)

What is the shielding effect?	Is it possible to remove the shielding effect?
• In the current model, RA of a unit is compared with its CA. • Impairment of goodwill is recognised only if RA < CA • If there is a decrease in RA for reasons such as an acquisition not giving rise to synergies as expected, such decrease is not reflected in performance so long as RA of the unit is higher than its CA • This is because, *the unrecognised headroom ([RA - CA] which mainly comprises internally generated goodwill)* absorbs the first layer of decreases in RA, Thus, it shields the acquired goodwill.	• A possible simple solution would be to make a rebuttable presumption that the first layer of decreases in RA is attributable to acquired goodwill • For this purpose, an entity may be required to specifically consider the headroom information when testing goodwill for impairment as explained and illustrated in pages 12–17

How to improve the impairment test?

Current requirement	Headroom approach
Compare recoverable amount (RA) of a unit with its carrying amount (CA) at the current impairment testing date T1	Compare total headroom of a unit at the current impairment testing date T1 (ie TH_{T1}) with the total headroom of the unit at the immediately preceding impairment testing date T0 (ie TH_{T0})
Goodwill is impaired only if recoverable amount of the unit is less than its carrying amount (ie $RA_{T1} < CA_{T1}$)	If the total headroom decreases (ie $TH_{T1} < TH_{T0}$), it is presumed that there is an impairment of acquired goodwill amounting to $TH_{T1} – TH_{T0}$ unless that presumption is rebutted.
	If the entity rebuts that presumption, it should disclose the reasons why part or all of the decrease should not be attributed to acquired goodwill.

Members may refer to Agenda Paper 18C for the December 2017 Board meeting for detailed analysis of the headroom approach.

Headroom approach (1/5)

Consider the following facts

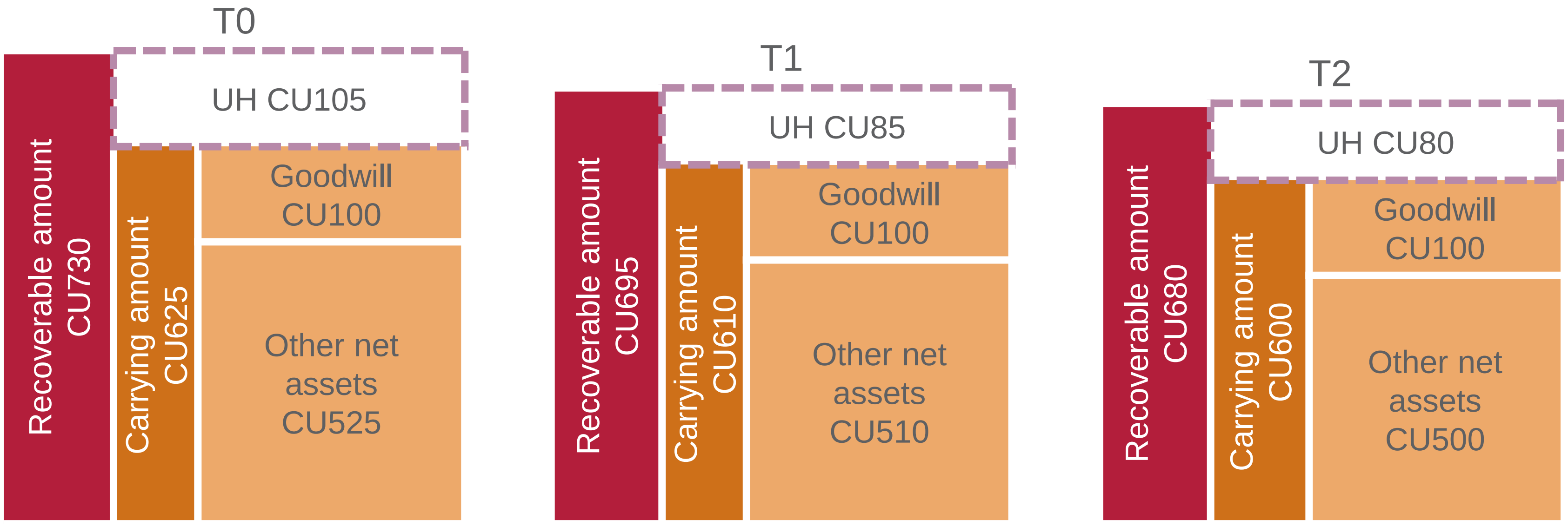
- Company X tests goodwill for impairment regularly at the annual reporting date
- Company X has a cash-generating unit Z that includes acquired goodwill from a recent past acquisition
- See table for the recoverable amount and the carrying amount of unit Z at three reporting dates T0, T1 and T2
- Assume that there is no change in the level of business activity
- Monetary amounts are denominated in ‘currency units (CU)’

Unit Z	T0 CU	T1 CU	T2 CU
Carrying amount			
– acquired goodwill	*100	#100	#100
– other recognised assets, less liabilities	525	510	500
Recoverable amount	730	695	680

* after recognising impairment loss, if any, at T0
# before recognising impairment loss at T1 and T2

Headroom approach (2/5)

Impairment testing of unit Z applying the current requirements in IAS 36



No impairment of goodwill	No impairment of goodwill	No impairment of goodwill
$RA_{T0} > CA_{T0}$	$RA_{T1} > CA_{T1}$	$RA_{T2} > CA_{T2}$

The unrecognised headroom (UH) is currently disclosed in financial statements only if a reasonably possible change in a key assumption used in measuring RA would cause CA to exceed RA

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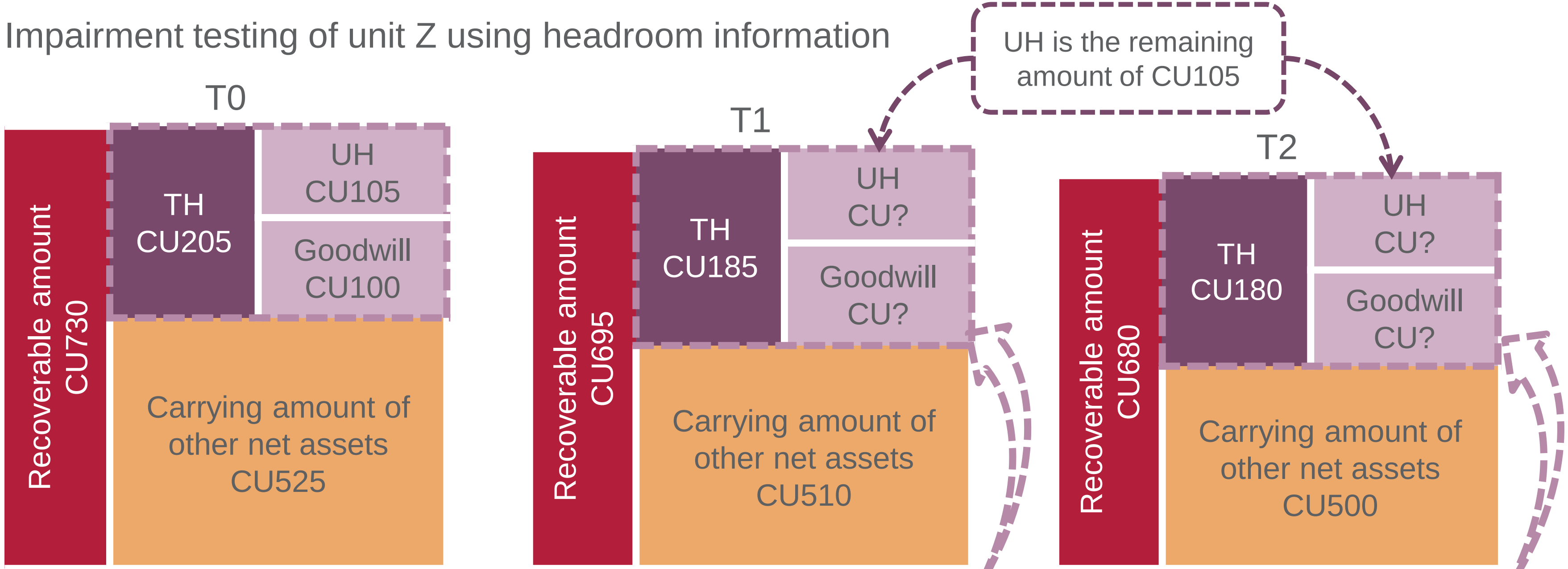
Case Study applying the current requirements in IAS 36

- At time T0, the cash-generating unit Z is assessed to have a Recoverable Amount of CU730, which exceeds the Carrying Amount of CU625. Therefore, there is no need to impair goodwill.
- At T1, the Recoverable Amount of unit Z has declined relative to T0. Similarly, the Recoverable Amount at T2 has declined relative to T1. But the declines do not pass the threshold required to trigger an impairment of goodwill.
- This illustrates how the Unrecognised Headroom (UH) can act as a shield, that delays recognition of goodwill impairment especially if the decrease in Recoverable Amount is for reasons such as the acquisition not giving rise to synergies as expected.

Headroom approach (3/5)

Impairment testing of unit Z using headroom information



Comparing TH at two dates	$TH_{T1} < TH_{T0}$ by CU20 (205-185)	$TH_{T2} < TH_{T1}$ by CU5 (185-180)
Recognised as goodwill impairment	CU20	CU5
Goodwill, less impairment	CU80 (100-20)	CU75 (80 - 5)

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These visual aids illustrate how the proposed approach of impairment testing using the headroom information would produce a more timely recognition of goodwill impairment.

In this example, the Recoverable Amounts and Carrying Amounts are identical to those on the previous slide. However, under this model the trigger for recognising goodwill impairment is as follows:

- If Total Headroom (TH) at T1 is < TH at T0, then a goodwill impairment gets recognised.
- At T1, we observe that TH decreased by CU20 (205 – 185), which is recognised as a goodwill impairment.
- At T2, the goodwill impairment trigger is benchmarked from the TH at T1. In this instance, the decrease in TH of CU5 (185 – 180) gets recognised as a goodwill impairment.

This example illustrates how the headroom information approach could produce a timelier recognition of goodwill impairment than under the current requirements (illustrated on page 14).

Headroom approach (4/5)

Attribution of loss to acquired goodwill and (or) unrecognised headroom

- In the current impairment testing model, the first layer of decreases in total headroom is all absorbed by the unrecognised headroom
  - In the example on page 14, the decrease in total headroom of CU20 from T0 to T1 is absorbed by unrecognised headroom
  - Similarly, the decrease in total headroom of CU5 from T1 to T2 is absorbed by unrecognised headroom
- This might not reflect the economics especially if the decrease in total headroom is for reasons such as the entity not being able to realise the expected synergies from an acquisition etc
- Consequently, in the headroom approach, there is a rebuttable presumption that any decrease in total headroom is attributed first to acquired goodwill (as illustrated on page 15)
- The decrease in total headroom attributed to acquired goodwill is recognised as impairment loss in the entity's financial statements.

(continued)

Headroom approach (5/5)

Attribution of loss to acquired goodwill and (or) unrecognised headroom

- However, an entity may rebut the presumption on the basis of specific evidence that all or part of the decrease in total headroom is not attributable to acquired goodwill
- The presumption could be rebutted if the decrease in total headroom is for reasons such as:
  - increase in risk-free component of discount rate; or
  - significant decline in the current value of the unit's asset that is measured in the financial statements on historical cost basis
- In such a situation, the entity would attribute the decrease in total headroom either to the unrecognised headroom or pro-rata to acquired goodwill and the unrecognised headroom depending upon the reason for the decrease
- The decrease in total headroom attributed to the unrecognised headroom is NOT recognised in the entity's financial statements
- However, the entity would disclose the basis of attribution of decrease in total headroom

Pros and cons of the headroom approach

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- Shielding effect of internally generated goodwill is removed
- Entities would need to think carefully about factors affecting acquired goodwill
- Management is discouraged from making over-optimistic projections of cash flows because any difficulty in maintaining the over-optimism year after year negatively effects the total headroom, potentially resulting in impairment of acquired goodwill
- Timing of recognition of impairments of goodwill may improve
- Investors benefit from the disclosure of basis used for attributing decrease in total headroom

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- Costs of applying the impairment testing model would increase because of the need for:
  - precise measurement of recoverable amount; and
  - application of the rebuttable presumption

Summary of feedback from some CMAC members

- Staff had calls with 11 CMAC members in November/December 2017 to discuss the headroom approach
- A good majority of those CMAC members supported the headroom approach
  - Some members highlighted the importance of the accompanying narrative that a company should be required to disclose in its financial statements
  - Some members indicated a preference for disclosure of headroom instead of using the headroom approach for impairment testing—however, they thought that entities are likely to apply a disclosure-only requirement less rigorously than having to use the headroom for impairment testing purposes
- Other feedback
  - A couple of members supported amortisation of goodwill
  - One member supported componentising goodwill on initial recognition and then, depending on the nature of the component, either amortising the component, writing it off against equity or only testing it for impairment

Question to CMAC

1. Do you have any further comments or feedback about the headroom approach to testing goodwill for impairment?

IFRS Foundation

Separate recognition of identifiable intangible assets acquired in a business combination

Feedback from Post-implementation Review of IFRS 3

Feedback from investors			Feedback from preparers and auditors		
Separate recognition of acquired intangibles is of limited (if any) utility except if there is a market for the intangibles			Valuation of intangible assets such as brands and customer relationships is costly and complex		
Significant arbitrage opportunities in accounting for an acquisition	Little credence placed on value of intangible assets such as brands or customer lists	Amortisation of some intangible assets conveys no useful information about potential replacement cost	Lack of sufficient reliable and observable data	Highly subjective and high level of judgement required	Arbitrary allocation of future cash flows

After reviewing academic research and feedback from other outreach activities, the Board decided to consider whether some intangible assets could be included within goodwill acquired in a business combination

Possible approaches for Board's consideration (1/5)

Retain current requirements of IFRS 3 (Approach A)

Require disclosures similar to those in IFRS 13 *Fair Value Measurement* for intangible assets acquired in a business combination (Approach B)

Allow indefinite-lived intangible assets to be included within goodwill (Approach C)

Segregate intangible assets into wasting assets and organically-replaced assets and require only wasting assets to be recognised separately from goodwill (Approach D)

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The staff plan to discuss these approaches with the Board in March/April 2018. The staff will consider feedback from cmac in thinking about, and analysing, the possible approaches.

Possible approaches for Board's consideration (2/5)

Approach A— Retain current requirements of IFRS 3	Usefulness of financial statements would be enhanced if intangibles acquired in a business combination were separated from goodwill
	To have predictive value, financial information should be segregated into reasonably homogenous groups—many intangibles have characteristics that distinguish them from goodwill
	Some academic research establishes value relevance of separate recognition of intangible assets acquired in a business combination
	The requirement to account for intangible assets separately encourages management of an entity to better analyse the acquisitions

Possible approaches for Board's consideration (3/5)

Approach B— Requiring disclosures similar to those in IFRS 13 for intangible assets acquired in a business combination	Investors question the credibility of value of recognised intangibles. One possible reason for those questions is concern about inadequate disclosures about the valuation techniques and inputs used in measuring fair value of those intangibles
	Some investors requested the Board to consider expanding the scope of the disclosure requirements in IFRS 13 to include information about fair value of intangible assets recognised in a business combination
	Together with the disclosures, separate recognition of intangible assets would provide decision useful information to investors

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The staff could ask the Board to consider requiring the following disclosures for intangible assets recognised in a business combination, which are along the lines of the disclosure requirements in IFRS 13:

a. The level of fair value hierarchy within which the fair value measurements are categorised in their entirety (Level 1, 2 or 3).

b. For fair value measurements categorised within Level 2 and Level 3 of the fair value hierarchy, a description of the valuation technique(s) and the inputs used in the fair value measurement.

c. For fair value measurements categorised within Level 3 of the fair value hierarchy:

    i. quantitative information about the significant unobservable inputs used in the fair value measurement.

    ii. a narrative description of the sensitivity of the fair value measurement to changes in unobservable inputs if a change in those inputs to a different amount might result in a significantly higher or lower fair value measurement.

    iii. if there are interrelationships between the significant unobservable inputs and other unobservable inputs used in the fair value measurement, a description of those interrelationships and of how they might magnify or mitigate the effect of changes in the unobservable inputs on the fair value measurement.

Level 1 inputs are quoted prices in active markets for identical assets or liabilities that the entity can access at the measurement date.

Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3 inputs are unobservable inputs.

Possible approaches for Board's consideration (4/5)

Approach C— Allow indefinite-lived intangible assets to be included within goodwill	The easiest possible course of action
	This is not a fundamental change in accounting for those assets because subsequent accounting for indefinite-lived intangible assets and goodwill is similar
	Likely to reduce the cost of applying IFRS 3
	May not provide useful information especially if any of the acquired indefinite-lived intangible assets are already generating independent cash flows, say by way of licensing income

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Extracts from IAS 38 *Intangible Assets* of requirements about accounting for indefinite-lived intangible assets

Useful life

88 **An entity shall assess whether the useful life of an intangible asset is finite or indefinite and, if finite, the length of, or number of production or similar units constituting, that useful life. An intangible asset shall be regarded by the entity as having an indefinite useful life when, based on an analysis of all of the relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity.**

89 The accounting for an intangible asset is based on its useful life. An intangible asset with a finite useful life is amortised (see paragraphs 97–106), and an intangible asset with an indefinite useful life is not (see paragraphs 107–110). The Illustrative Examples accompanying this Standard illustrate the determination of useful life for different intangible assets, and the subsequent accounting for those assets based on the useful life determinations.

90 Many factors are considered in determining the useful life of an intangible asset, including:

(a) the expected usage of the asset by the entity and whether the asset could be managed efficiently by another management team;

(b) typical product life cycles for the asset and public information on estimates of useful lives of similar assets that are used in a similar way;

(c) technical, technological, commercial or other types of obsolescence;

(d) the stability of the industry in which the asset operates and changes in the market demand for the products or services output from the asset;

(e) expected actions by competitors or potential competitors;

(f) the level of maintenance expenditure required to obtain the expected future economic benefits from the asset and the entity's ability and intention to reach such a level;

(g) the period of control over the asset and legal or similar limits on the use of the asset, such as the expiry dates of related leases; and

(h) whether the useful life of the asset is dependent on the useful life of other assets of the entity.

91 The term ‘indefinite’ does not mean ‘infinite’. The useful life of an intangible asset reflects only that level of future maintenance expenditure required to maintain the asset at its standard of performance assessed at the time of estimating the asset’s useful life, and the entity’s ability and intention to reach such a level. A conclusion that the useful life of an intangible asset is indefinite should not depend on planned future expenditure in excess of that required to maintain the asset at that standard of performance.

92 Given the history of rapid changes in technology, computer software and many other intangible assets are susceptible to technological obsolescence. Therefore, it will often be the case that their useful life is short. Expected future reductions in the selling price of an item that was produced using an intangible asset could indicate the expectation of technological or commercial obsolescence of the asset, which, in turn, might reflect a reduction of the future economic benefits embodied in the asset.

93 The useful life of an intangible asset may be very long or even indefinite. Uncertainty justifies estimating the useful life of an intangible asset on a prudent basis, but it does not justify choosing a life that is unrealistically short.

94 The useful life of an intangible asset that arises from contractual or other legal rights shall not exceed the period of the contractual or other legal rights, but may be shorter depending on the period over which the entity expects to use the asset. If the contractual or other legal rights are conveyed for a limited term that can be renewed, the useful life of the intangible asset shall include the renewal period(s) only if there is evidence to support renewal by the entity without significant cost. The useful life of a reacquired right recognised as an intangible asset in a business combination is the remaining contractual period of the contract in which the right was granted and shall not include renewal periods.

95 There may be both economic and legal factors influencing the useful life of an intangible asset. Economic factors determine the period over which future economic benefits will be received by the entity. Legal factors may restrict the period over which the entity controls access to these benefits. The useful life is the shorter of the periods determined by these factors.

96 Existence of the following factors, among others, indicates that an entity would be able to renew the contractual or other legal rights without significant cost:

(a) there is evidence, possibly based on experience, that the contractual or other legal rights will be renewed. If renewal is contingent upon the consent of a third party, this includes evidence that the third party will give its consent;

(b) there is evidence that any conditions necessary to obtain renewal will be satisfied; and

(c) the cost to the entity of renewal is not significant when compared with the future economic benefits expected to flow to the entity from renewal.

If the cost of renewal is significant when compared with the future economic benefits expected to flow to the entity from renewal, the 'renewal' cost represents, in substance, the cost to acquire a new intangible asset at the renewal date.

…

Intangible assets with indefinite useful lives

107 An intangible asset with an indefinite useful life shall not be amortised.

108 In accordance with IAS 36, an entity is required to test an intangible asset with an indefinite useful life for impairment by comparing its recoverable amount with its carrying amount

(a) annually, and

(b) whenever there is an indication that the intangible asset may be impaired.

Review of useful life assessment

109 The useful life of an intangible asset that is not being amortised shall be reviewed each period to determine whether events and circumstances continue to support an indefinite useful life assessment for that asset. If they do not, the change in the useful life assessment from indefinite to finite shall be accounted for as a change in an accounting estimate in accordance with IAS 8.

110 In accordance with IAS 36, reassessing the useful life of an intangible asset as finite rather than indefinite is an indicator that the asset may be impaired. As a result, the entity tests the asset for impairment by comparing its recoverable amount, determined in accordance with IAS 36, with its carrying amount, and recognising any excess of the carrying amount over the recoverable amount as an impairment loss.

Possible approaches for Board’s consideration (5/5)

Approach D— Segregating intangible assets into wasting assets and organically-replaced assets and requiring only wasting assets to be recognised separately from goodwill	Valuing wasting intangibles assets is less subjective than valuing organically-replaced intangible assets
	Amortisation of a wasting asset provides useful information about potential future cash outflows for replacing the asset
	A fundamental change to the relevant IFRS Standards
	Judgement required in assessing whether an intangible asset is a wasting asset or an organically-replaced asset; some assets may not neatly fall into one of the two categories

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The Accounting and Reporting Policy team of the UK's Financial Reporting Council carried out research to understand investor views on whether, from their perspective, the current requirements in IFRS Standards produce useful and reliable information. The results of the research were published in March 2014 in a report *Investor Views on Intangible Assets and their Amortisation*.

Extracts from the report

Intangible assets acquired in a business combination

1.9 More than half of the respondents expressed a preference for accounting treatments in the statement of financial position (52%) and in the income statement (59%) different from those currently required by IAS 38.

1.10 The majority of those preferring a different treatment in the statement of financial position (37% of the total population) explained a distinction they make between different types of intangible asset. The key distinguishing characteristics as explained by these respondents were as follows:

- "wasting" intangible assets – these are separable from the entity, have finite useful lives and lead to identifiable future revenue streams. Examples include wireless spectrum and patents; and
- "organically replaced" intangible assets – investors raise doubts about whether these intangible assets are capable of being separated from the entity, are likely to have reliably determined useful lives, or be a source of future economic benefits that could be distinguished from the business as a whole. They stated that such intangible assets are replenished on an ongoing basis through the marketing and promotional expenditure of the company. Examples of such assets include customer lists and brands.

1.11 Although these investors believe that "wasting" intangible assets should be separately identified and capitalised, they are opposed to the separation of "organically replaced" intangible assets from goodwill.

1.12 Respondents that expressed a preference for an accounting treatment subsequent to initial recognition other than that required by IAS 38 suggested either:

- An accounting treatment that reflected the same distinction as noted above; wasting intangible assets to be amortised over their useful lives but organically replaced intangible assets to be subject to annual impairment reviews rather than periodic amortisation (33% of the total population); or

- All intangible assets acquired in a business combination to be subject to annual impairment reviews rather than periodic amortisation (26% of the total population).

1.13 We note that, in respect of intangible assets acquired in a business combination, IAS 38 does not permit different accounting treatments in response to the characteristics noted by respondents because:

- An intangible asset is considered identifiable if it is separable or it arises from legal or contractual rights;
- The probability recognition criterion (that is, the requirement that, in order to be recognised, it must be probable that the asset will yield economic benefits) is always considered to be satisfied; and
- The reliability measurement criterion is always considered to be met, on the basis that there is sufficient information to enable the asset to be measured reliably.

1.14 A majority of all respondents (74%) also noted that they add back amortisation charges on intangible assets acquired in a business combination when considering Earnings Per Share (EPS) ratios in some or all cases.

Questions to CMAC

2. Do you think separate recognition of intangible assets acquired in a business combination provides useful information?
3. Do you agree with the feedback that valuing brands and customer relationships is costly and complex? Are you aware of any other intangible assets that are difficult to value?
4. Do you think that the concerns about credibility of fair value of recognised intangible assets are because of insufficient disclosures about the valuation methodology and inputs used in valuing the recognised intangible assets?
5. Do you have any comments or feedback on each of the possible approaches for the Board's consideration?

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Appendices

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Past discussions with CMAC and GPF

Appendix A

Past discussions with CMAC and GPF

- CMAC and GPF consulted in the past on:
  - simplifying impairment testing (Topic 2); and
  - additional disclosures (Topic 3)
- Feedback (see pages 32–35) considered in developing the approaches that the Board tentatively decided to consider

NOTES ON PAGE 31

The staff consulted both CMAC and Global Preparers Forum (GPF), either individually or jointly, on the same topics in the past. We included the feedback from GPF for the benefit of CMAC members.

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 • 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 • Current impairment test provides useful information • 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 • Breakdown of carrying amount of goodwill by past acquisitions
		Click the links for full meeting summary and recording.

Feedback from GPF (1/2)

Month	Question 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: – Disclosing sensitive key targets could give away an entity's competitive advantage – Some key targets may not be measurable and auditable, eg acquisition of human competencies – Disclosure of components of goodwill is already required and that information is sufficient • In respect of actual performance vis-à-vis the targets: – It is difficult to track actual performance when acquired business is integrated with existing business – Not meeting the targets does not necessarily mean that the acquisition is not successful
		Click the links for full meeting notes and recording.

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Feedback from GPF (2/2)

Month	Feedback sought on…	Summary of feedback
March 2017 (link to the agenda paper)	…the following possible simplifications to the impairment test of goodwill: • Using either fair value less costs of disposal (FVLCD) or value in use (VIU) as the sole basis for calculating recoverable amount • Relief from annual testing • Relaxing some restrictions on cash flows included in VIU calculation • Additional guidance on applying IAS 36 *Impairment of Assets*	• Several members favoured relief from annual testing and relaxing the restrictions on cash flows included in VIU calculation • 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 joint CMAC–GPF

Month	Feedback sought on…	Summary of feedback
June 2017 (link to the agenda paper)	• Possible relief from the mandatory annual quantitative impairment testing of goodwill	• GPF members generally supported the relief • Some GPF members suggested requiring quantitative testing less frequently than annually and some questioned the need for considering the relief • Very few CMAC members supported the relief
	• Possible additional disclosures about newly acquired businesses; and • Breakdown of goodwill by past acquisition	• CMAC members generally supported both the possible disclosures • GPF members expressed concerns about having to disclose commercially sensitive information; they also questioned use of breakdown of goodwill, especially long after an acquisition
	• Current disclosure requirements in IAS 36	• Disclosure of a pre-tax discount rate is not useful as that rate is not observable and is generally not used in valuation
		Click the links for full meeting notes and recordings (pre-breakout and post-breakout).

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