IFRS

STAFF PAPER

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FASB | IASB Meeting

Project	Goodwill and Impairment
Paper topic	Summary of the IASB's research project

CONTACTS Tim Craig tcraig@ifrs.org +44 (0)20 7246 6921

Purpose of this paper

1. This paper sets out a summary of the current status of the IASB's research project, of the tentative decisions made by the IASB in its June 2019 Board meeting and of the next steps in the research project. A link to the detailed supporting papers for the June 2019 Board meeting is also provided.

Structure of the paper

2. The paper is structured as follows:

    (a) Background (paragraphs 3–10);

    (b) Preliminary view of the IASB (paragraphs 11–45); and

    (c) Next steps (paragraphs 46–47).

Background

3. The IASB issued a revised version of IFRS 3 *Business Combinations* in 2008 and required entities to apply the revised Standard for annual reporting periods beginning on or after 1 July 2009.

4. As part of its due process, the IASB is required to conduct a Post-implementation Review (PIR) once a new Standard or major amendment has been applied internationally for at least two years. The purpose of a PIR is to ensure that the new Standard or major amendment is working as intended. There is no presumption that a PIR will lead to any changes to a Standard. Depending upon the nature of findings, the IASB may consider

making minor amendments to the Standard or prepare an agenda proposal for a broader revision of the Standard.

5. The PIR of IFRS 3[1] began in 2013, about three years after entities started applying IFRS 3. As part of the PIR of IFRS 3, the IASB sought feedback on specified questions about:

   (a) the definition of business;

   (b) fair value measurement in a business combination;

   (c) the recognition of intangible assets separately from goodwill;

   (d) accounting for negative goodwill;

   (e) impairment of goodwill and indefinite-lived intangible assets;

   (f) accounting for non-controlling interests;

   (g) accounting for step acquisitions and loss of control; and

   (h) disclosures.

6. See Request for Information (issued in January 2014) for more information about the questions asked.

7. After reviewing the results of the Request for Information, feedback from outreach activities and academic research, the IASB assessed some of the topics listed in paragraph 5 as requiring further follow-up. The IASB concluded the PIR of IFRS 3 by:

   (a) publishing a Report and Feedback Statement in June 2015;

   (b) adding to its work plan a maintenance project on the definition of business[2]; and

[1] The scope of the PIR covered the whole Business Combinations project, which resulted in IFRS 3 (2004), IFRS 3 (2008) and consequential amendments to IAS 27 *Consolidated and Separate Financial Statements*, IAS 36 *Impairment of Assets* and IAS 38 *Intangible Assets*.

[2] In October 2018, the Board amended IFRS 3 by issuing *Definition of a Business* (Amendments to IFRS 3).

(c) adding to its work plan the Goodwill and Impairment research project.

8. The purpose of a research project is to determine whether there is a need for standard-setting activity.

9. The feedback to the PIR of IFRS 3 highlighted the following concerns:

    (a) it is often hard to assess the subsequent performance of the acquired business;

    (b) goodwill impairment losses are often not recognised on a timely basis;

    (c) the impairment test for goodwill is costly and complex;

    (d) many respondents suggested an amortisation and impairment approach; and

    (e) the separate recognition of some identifiable intangible assets is challenging.

10. Research was performed to understand the reasons for these concerns and to assess whether there were ways of resolving these concerns. The IASB set the project the following research questions:

    (a) 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?

    (b) Can the impairment test be made more effective at timely recognition of impairments of goodwill?

    (c) Can the application of the requirements in IAS 36 be improved by simplifying the test without making it less robust?

    (d) Are there new conceptual arguments or new information to support reintroducing amortisation of goodwill?

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

Preliminary view of the IASB

11. The research findings, in response to the questions in paragraph 10, were considered by the IASB, and tentative decisions were made by the IASB on its preliminary view of proposals it should develop with the aim of helping to resolve stakeholders' concerns. This preliminary view is summarised in this section of the paper.

Better disclosures for business combinations

12. In the feedback received in the PIR of IFRS 3, investors commented that it is often hard to assess the subsequent performance of an acquisition. Although, during the course of the research project the IASB had decided not to perform a comprehensive review of the disclosure requirements of IFRS 3 or IAS 36, in its April, May and June 2019 Board meetings, the IASB subsequently considered proposals to provide better disclosures for business combinations (see **Agenda Paper 18A for the June 2019** Board meeting).

13. The IASB considered:

    (a) improvements to the disclosure objectives of IFRS 3, with the aim of making them more specific and helping users of financial statements assess the subsequent performance of an acquisition;

    (b) additional disclosure requirements to produce information that will help users to assess whether the key objectives of the business combination are being achieved; and

    (c) targeted improvements to existing disclosure requirements of IFRS 3.

14. Given the diversity of business combinations, the IASB concluded that it was unlikely that a single measure could be prescribed that would provide users of financial statements with sufficient information on the subsequent

performance of an acquisition in all cases. The IASB therefore considered a 'management approach', whereby information on subsequent performance would be based on how an entity's management monitors and measures in its internal reporting whether the key objectives of the business combination are being achieved.

15. During the course of its outreach with its consultative groups (the Accounting Standards Advisory Forum (ASAF), the Capital Markets Advisory Committee (CMAC) and the Global Preparers Forum (GPF)), the IASB heard a number of concerns over the proposed disclosures relating to subsequent performance, including:

    (a) integration;

    (b) commercial sensitivity;

    (c) forward-looking information; and

    (d) how should an entity determine which business combinations the disclosures should be provided for?

16. The IASB intends to explore these issues further in a discussion paper. From a joint meeting of CMAC and GPF, initial indications were that combined information about the integrated business could still be useful and information may not need to be highly detailed, which could alleviate concerns regarding commercial sensitivity. The IASB also intends to seek feedback from regulators on possible concerns about forward-looking information.

17. The IASB has considered defining management as the Chief Operating Decision Maker (CODM), as defined in IFRS 8 *Operating Segments*. Following that approach, the information on subsequent performance would be based on how the CODM monitors and measures whether the key objectives of a business combination are being achieved. This approach could provide a reasonable balance between meeting the needs of users and making it feasible for preparers to produce the information at a cost that

is justified by the benefits to users, since it is likely the CODM will review the most significant business combinations.

18. There was some debate whether this could mean information on material business combinations may not always be provided. There was also debate whether some minimum prescribed information should be provided if the entity concludes that the information is material to users regardless of whether the entity's management monitor a business combination. These issues are likely to be discussed further in the discussion paper.

19. In its June 2019 Board meeting, the IASB reached a preliminary view that it should develop proposals to improve the disclosure objectives and disclosure requirements of IFRS 3 based on the recommendations in **Agenda Paper 18A for the June 2019** Board meeting, with the exception of a proposal to replace the disclosure requirement in paragraph B64(q)(ii) relating to pro forma information.

Improving the effectiveness of the impairment test

20. Feedback from the PIR of IFRS 3 had highlighted that goodwill impairment losses were not always recognised on a timely basis. The IASB concluded this could be due to:

    (a) management optimism; and

    (b) shielding by unrecognised headroom of a cash-generating unit or units to which goodwill is allocated.

21. Since management optimism is largely an application issue, the main focus of the IASB's research has been on whether the shielding effect of unrecognised headroom could be diminished, and the acquired goodwill targeted better.

22. A number of approaches were investigated by the IASB and these are discussed in **Agenda Paper 18C for the December 2017** Board meeting. In particular the IASB investigated the 'updated headroom approach' which incorporated the unrecognised headroom into the design of the impairment test.

23. However, the test would still not target the acquired goodwill in isolation. The test would estimate a reduction in the total headroom of a cash-generating unit, but it would not identify whether the cause was a reduction in the value of the acquired goodwill or a reduction in another element contributing to the headroom within the cash-generating unit. In addition, members of the IASB's consultative groups, ASAF and GPF, reported concerns in relation to the cost of the approach.

24. The IASB therefore concluded that it was not possible to make significant improvements to the impairment test, nor to design an impairment test that would target the acquired goodwill. In its July 2018 Board meeting, the IASB decided not to pursue any further this objective of attempting to make the impairment test more effective.

Should amortisation of goodwill be reintroduced?

25. The IASB had decided at an earlier stage in the research project not to reintroduce amortisation based on the staff's research, which concluded there were no new arguments to support the reintroduction of amortisation of goodwill.

26. However, having concluded it was not possible to make significant improvements to the impairment test, the IASB decided in its July 2018 Board meeting to reconsider whether amortisation of goodwill should be reintroduced.

27. Amortisation of goodwill could:

    (a) provide a simple mechanism for reducing the carrying amount of acquired goodwill and thus address concerns of those stakeholders who believe that the carrying amount of acquired goodwill may tend to be overstated; and

    (b) take some pressure off from the impairment test, which may make the impairment test easier to apply.

28. The question the IASB was considering was not whether amortisation of goodwill was preferable to an impairment-only approach. Instead, the

question was whether the findings of the research project had provided compelling evidence that the Board should reintroduce amortisation.

29. The arguments for reintroducing amortisation were:

(a) the feedback from the PIR of IFRS 3 was that the impairment test does not always recognise impairment losses on a timely basis—they are recognised 'too late'— and that the test is costly and complex. This calls into question the conclusions of the IASB, when IFRS 3 was issued, that the impairment test was rigorous and operational—a pre-requisite for the IASB's decision to remove the amortisation of goodwill;

(b) the research performed has demonstrated how the shielding effect of unrecognised headroom can contribute to 'late' recognition of impairment losses. The IASB has concluded it is not possible to make significant improvements to the impairment test and amortisation is a simple mechanism to reduce the carrying amount of goodwill to respond to the lack of timely recognition of impairment losses; and

(c) the retention of acquired goodwill on the statement of financial position may mislead users into thinking the business combination continues to be a success in cases when it may actually have failed.

30. The arguments for retaining the impairment-only model were:

(a) although the information from the impairment test is sometimes only confirmatory, the impairment test still provides more useful information than amortisation;

(b) the IASB was aware of the shielding effect when it issued IFRS 3, but still considered the impairment test rigorous and operational enough. By design, the impairment test tests that the carrying amount of acquired goodwill is recoverable from the cash flows of the cash-generating unit it jointly contributes to generating. This design is appropriate for an asset that does not generate independent cash inflows;

(c) it is not possible to estimate the pattern in which goodwill diminishes and any amortisation charge would therefore be arbitrary. An arbitrary reduction in the carrying amount of goodwill would not necessarily depict the original benefits from the business combination significantly better than an impairment-only approach; and

(d) informing users whether a business combination has been a success is not the purpose of the impairment test. The IASB is exploring disclosure requirements to provide users with information on the subsequent performance of an acquisition which will enable users of financial statements to assess for themselves whether a business combination has been a success (see paragraphs 12–19).

31. **Agenda Paper 18B for the June 2019** Board meeting provides further details of these arguments. In addition, the staff believed both models had their issues but overall the reintroduction of amortisation of goodwill did not result in a significant enough improvement in financial reporting to justify a change.

32. The IASB decided in its June 2019 Board meeting, by a small majority (eight to six), that its preliminary view was to retain the impairment-only model. However, due to the small majority, the IASB will present both arguments in a discussion paper and ask stakeholders whether they can provide further evidence to help the IASB find a more conclusive answer to this question. In particular, the IASB intends to use the discussion paper to explain clearly to stakeholders the design of the impairment test and to explore further the 'too late' issue and the basis of stakeholders' concerns.

33. In its June 2019 Board meeting, the IASB also decided upon a preliminary view that it should develop a proposal for a subtotal of total equity before

goodwill to be presented on the statement of financial position. Given the inevitable limitations of any impairment test of acquired goodwill and the unique nature of goodwill, a presentation of this subtotal could be helpful to users of the financial statements. Further details are provided in **Agenda Paper 18C for the June 2019** Board meeting.

Can the impairment test be simplified?

34. During the PIR of IFRS 3, many stakeholders commented that the impairment test was costly and complex. In view of the main challenges identified by stakeholders, the IASB decided in its July 2018 Board meeting to explore whether to:

    (a) provide relief from the mandatory annual quantitative impairment test;

    (b) remove the requirement to exclude cash flows from a future restructuring or a future enhancement of an asset in estimating value in use; and

    (c) permit the use of post-tax inputs and a post-tax discount rate in the estimation of value in use.

Relief from the mandatory annual quantitative impairment test

35. The IASB reached a preliminary view in its June 2019 Board meeting that it should develop a proposal to provide relief from the mandatory annual quantitative test and to require an impairment test of goodwill where there is an indicator of impairment. The same relief would also be applied to intangible assets with indefinite useful lives and for intangible assets not yet ready for use.

36. The removal of the requirement to perform a quantitative impairment test annually even in the absence of any indicator of impairment should reduce costs for preparers of financial statements, although there were some doubts how substantial these cost savings would be.

37. The majority for this decision was also small (eight to six) and the main concern was the impact on the robustness of the impairment test, which had

already been shown to be challenged. However, the evidence suggests that the delayed recognition of goodwill impairment losses was due to factors other than the frequency of the impairment test and hence this delay could not be resolved by performing the test more frequently. Therefore, some IASB members thought the benefits from the annual test did not justify the costs. These cost savings would also help to balance the costs of the overall package of proposals.

38. **Agenda Paper 18D for the June 2019** Board meeting provides more details.

Targeted improvements to value in use

39. The IASB reached a preliminary view in its June 2019 Board meeting that it should develop proposals to remove the requirement to exclude cash flows from a future restructuring or a future enhancement of an asset in estimating value in use and permit the use of post-tax inputs and a post-tax discount rate in the estimation of value in use.

40. Both of the improvements to the estimation of value in use help reduce the cost and complexity of the test. In particular:

    (a) eliminating an inconsistency in IAS 36 and adopting the same unit of account for value in use as is used for fair value less costs of disposal, where the existing potential to restructure or enhance an asset is available to a potential buyer of the asset as well as the current holder of the asset; and

    (b) permitting estimates of value in use to be calculated on a post-tax basis, which is how in practice entities perform these calculations.

41. There were concerns regarding the inclusion of cash flows from future restructurings and future enhancements of assets and the possibility of unjustifiably optimistic cash flows being included. The IASB considered setting a threshold for the inclusion of these cash flow projections and requiring additional disclosures about future restructurings to which an entity is not yet committed and future enhancements of an asset which are yet to

occur but, in its June 2019 Board meeting, the IASB decided tentatively not to develop these proposals.

42. **Agenda Papers 18E and 18F for the June 2019** Board meeting provide further details.

Including some identifiable intangible assets in goodwill

43. The IASB considered several approaches to including some identifiable intangible assets in goodwill. The staff had recommended that the IASB should pursue allowing indefinite-lived intangible assets acquired in a business combination to be included within goodwill, if those assets were not already generating cash inflows from continuing use that were largely independent of those from other assets or groups of assets (see **Agenda Paper 18A for the April 2018** Board meeting).

44. The IASB did not support the staff recommendation for the reasons set out in paragraph 65 of that paper and in addition:

    (a) there was no compelling evidence that allowing some intangible assets with indefinite useful lives 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 the effectiveness of impairment testing.

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

Other Agenda Papers for the June 2019 Board meeting

45. For completeness, in addition to the Agenda Papers linked above, we mention that there was also a Cover Paper (**Agenda Paper 18 for the June 2019** Board meeting) and a summary paper considering the preliminary views (**Agenda Paper 18G for the June 2019** Board meeting).

Next steps

46. In its July 2019 Board meeting, the IASB will be asked to confirm that the next stage in the Goodwill and Impairment project should be to issue a discussion paper. The staff will also request permission to begin the balloting process for the discussion paper.

47. In addition to the preliminary view reached by the IASB in its June 2019 Board meeting on the proposals to develop, it is intended the discussion paper includes brief sections on the IASB's attempts to improve the impairment test and its decisions relating to including some intangible assets in goodwill.