IFRS

STAFF PAPER

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Project	**Goodwill and Impairment**		
Paper topic	Effectiveness of impairment test—Improving the application of the impairment test		
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Purpose and structure of this paper

1. The purpose of this paper is to assist the International Accounting Standards Board (Board) make a decision about reintroducing amortisation of goodwill and whether that decision is conditional on the feasibility of improving the effectiveness of the impairment test of cash-generating units (CGUs) containing goodwill (impairment test). In particular, this paper provides the Board with staff analysis on feedback about improving the application of the impairment test.

2. The paper is structured as follows:

   (a) key messages from feedback (paragraphs 3–7);

   (b) staff analysis of feedback on management over-optimism (paragraphs 8–35), including:

      (i) improving the disclosure requirements associated with the impairment test of CGUs containing goodwill (paragraphs 9–28); and

      (ii) providing additional guidance about the assumptions used (paragraphs 29–35);

   (c) staff analysis of feedback on shielding effect (paragraphs 36–47);

   (d) staff analysis of feedback on other aspects of IAS 36 *Impairment of Assets* (paragraphs 48–56).

Key messages from feedback

3. During the Post-implementation Review (PIR) of IFRS 3 *Business Combinations*, many stakeholders expressed concerns about the effectiveness of the impairment test. They said impairment losses on goodwill are often recognised too late, long after the events that caused those losses. Stakeholders urged the Board to make the test more effective at recognising impairment losses on goodwill on a timelier basis.

4. As discussed in the Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment* (Discussion Paper), the Board identified two broad reasons for concerns about the possible delays in recognising impairment losses on goodwill:

    (a) management over-optimism—some stakeholders said management may sometimes be too optimistic in making assumptions for the cash flow forecasts needed to carry out the impairment test.

    (b) shielding—goodwill does not generate cash flows independently and therefore cannot be measured directly. The impairment test therefore focuses on testing a CGU, or a group of CGUs, containing goodwill[1]. These typically contain headroom[2]. This headroom shields acquired goodwill against the recognition of impairment losses.

5. As discussed in Agenda Paper 18B to this meeting, most respondents agreed with the Board that it is not feasible to design a different impairment test that is significantly more effective than the existing impairment test at a reasonable cost. Nevertheless, many respondents said the application of the impairment test can be improved with some clarifications and targeted changes to IAS 36 directed at reducing:

    (a) management over-optimism, either by clarifying requirements or providing guidance to help improve the reasonableness of assumptions used or through requiring additional disclosures that might improve management

[1] For ease of reference, the paper sometimes refers to the impairment test as applying to a CGU but the discussion applies equally to impairment test performed at the level of a group of CGUs.

[2] Headroom in a CGU comprises unrecognised assets and liabilities within a CGU, such as internally generated goodwill, and unrecognised differences between the carrying amount of recognised assets and liabilities and their recoverable amounts.

accountability and enforceability of the impairment test. Paragraphs 8–35 discuss these suggestions.

(b) shielding, with targeted improvements to prevent the allocation of goodwill to CGUs at a higher level than necessary and aligning the level at which goodwill is tested with the level at which management monitors operations. Paragraphs 36–47 discuss these suggestions.

6. Finally, a few respondents suggested considering other aspects of IAS 36 in order to improve the effectiveness of the test. Paragraphs 48–56 discuss these suggestions.

7. In the staff's view, the extent of feedback suggests there may be ways to reduce the limitations of the impairment test and to improve its effectiveness. The staff think some targeted improvements to the impairment test, combined with the Board's preliminary views on disclosures about business combinations, could be an appropriate response to feedback on the PIR of IFRS 3 and could help auditors and regulators enforce the requirements of IAS 36 more easily. The rest of this paper provides the staff's analysis of respondents suggestions.

Management over-optimism

8. Many accounting firms and regulators and some national standard-setters and accounting bodies disagreed with the Board's preliminary view that management over-optimism is best addressed by auditors and regulators rather than through standard-setting. Some respondents suggested possible amendments to IFRS Standards that, in their view, would help address management over-optimism and improve the impairment test, including:

   (a) improving the disclosure requirements associated with the impairment test (paragraphs 9–28); and

   (b) providing additional guidance about the assumptions used (paragraphs 29–35).

Improving existing disclosure requirements

Feedback

9. The most common disclosure improvements suggested by respondents as a response to the problem of management over-optimism include:

   (a) Accuracy of past forecasts—a comparison of forecasts prepared for the impairment test in prior years with actual cash flows. Some respondents said this disclosure could help assess management's ability to forecast accurately and, would eventually, introduce additional discipline in the test.

   (b) Assumptions used—some respondents said better disclosure of the assumptions used in the impairment test would help assess the reasonableness of the entity's approach. These could include, for example, better sensitivity analysis, disclosure of why key assumptions have changed since the previous reporting period and disclosure of growth rates used in other periods of the cash flow forecast, not only in the period used to estimate the terminal value.

   (c) 'Close-call'—a few respondents suggested requiring disclosure of additional information about why no impairment loss was recognised and how close the entity was to recognising an impairment loss in 'close-call' situations in which there is little headroom.

   (d) Terminal value—a few respondents suggested providing better disclosures about terminal value which often makes up a large portion of the recoverable amount of a CGU.

Staff analysis

10. The staff generally agree that improving existing disclosure requirements might reduce the risk of management over-optimism. Academic evidence (see Agenda Paper 18F to the Board's May 2021 meeting) shows that disclosures associated with the impairment test are useful[3]. There is also some evidence suggesting that higher quality

[3] André, P., Dionysiou, D., and Tsalavoutas, I. (2017), 'Mandated Disclosures under IAS 36 Impairment of Assets and IAS 38 Intangible Assets: Value Relevance and Impact on Analysts' Forecasts', *Applied Economics*, 50 (7), 707-25.

disclosures are associated with reduced uncertainty and lower cost of capital[4]. However, there are costs associated with introducing new disclosure requirements and these costs would need further investigation.

11. This section analyses disclosure suggestions regarding:
    (a) accuracy of past forecasts (paragraphs 12–17);
    (b) assumptions used in the impairment test (paragraphs 18–21);
    (c) close-call situations (paragraphs 22–23); and
    (d) terminal value (paragraphs 24–25).

Accuracy of past forecasts

12. Some respondents suggested requiring entities to disclose a comparison of the cash flow forecast used for the impairment test in a specified number of prior periods with actual cash flows. The staff agrees with comments made by some Board members in previous meetings that such disclosure could add discipline and incentivise management to ensure assumptions used are reasonable and supportable.

13. Providing such information might not be excessively costly. Paragraph 34 of IAS 36 already requires management to assess the reasonableness of the assumptions on which its current cash flow projections are based by examining the causes of differences between past cash flow projections and actual cash flows. Accordingly, entities should already have performed analysis that could provide the basis for such a disclosure.

14. However, the staff have not yet undertaken research into how entities apply the requirement in paragraph 34 of IAS 36 or undertaken research into how readily available actual cash flow information would be for a CGU or group of CGUs. There might be incremental costs to gather the information needed to prepare the suggested disclosure, if, for example, the cash flow information needed for a CGU or group of CGUs that are tested for impairment does not exactly match how the entity's internal reporting systems provide that cash flow information. The extent of the cost would also depend on the period of time the Board would require entities to provide such a

[4] Paugam, L. and Ramond, O. (2015), 'Effect of Impairment-Testing Disclosures on the Cost of Equity Capital', *Journal of Business Finance & Accounting*, 42 (5-6), 583-618.

comparison for—the shorter the period the less costly the information would be to prepare, but this would affect how useful the information would be (see paragraph 16(a)).

15. As discussed in Agenda Paper 18B to this meeting, the Board considered whether to include a subsequent cash flow test in the Exposure Draft of Proposed Amendments to IAS 36 in 2002. Although the Board considered such an approach from the perspective of designing a different impairment test and not from a disclosure perspective, the process and costs involved in providing the information would not differ. One of the reasons the Board rejected this test were concerns about the cost and that it would be burdensome to apply.

16. In addition, the usefulness of the information provided by this disclosure would need to be further explored. For example, the staff think:

    (a) requiring entities to provide this information for a relatively short time-period might not (i) provide sufficient information about the accuracy of cash flow forecasts; or (ii) help reduce management over-optimism. This is because shorter time-frames might be more likely to be distorted by timing differences and it's generally forecasts for later periods that might be subject to greater uncertainty and management over-optimism. Forecasts for later periods are also more likely to influence the terminal value and the terminal value generally represents a significant portion of the recoverable amount of a CGU.

    (b) differences between the forecasts and actual cash flows could result from facts and circumstances beyond management's control—even when reasonable and supportable cash flow forecasts are used, there are likely to be variances and these variances are likely to increase the longer the time period the analysis is provided for because it becomes harder to predict what will happen further in the future.

    (c) the information might be less relevant if management have changed in the period in question. There is a greater risk of management changes when this disclosure covers a longer time period.

(d) significant events such as the COVID-19 pandemic or a significant acquisition could make trend analysis meaningless, especially in situations in which the analysis covers a longer time period.

17. Hence, although this suggestion could reduce management over-optimism and improve forecasting discipline, the Board would need to carefully consider the costs and benefits of such a proposal.

Assumptions used

18. Although respondents requested better information about assumptions used in impairment tests to assess the reasonableness of the entity's approach, it is possible this request could be indicative of problems in applying the existing disclosure requirements in IAS 36 rather than a need to add to those requirements.

19. In particular, paragraph 134 of IAS 36 already requires disclosure of each key assumption on which management has based its cash flow projections for the period covered by the most recent budget/forecasts. Key assumptions are those to which the CGU's recoverable amount is most sensitive. In addition, if a reasonably possible change in a key assumption could cause the CGU's carrying amount to exceed its recoverable amount an entity is required to disclose:

(a) the amount by which the CGU's recoverable amount exceeds its carrying amount;

(b) the value assigned to the key assumption; and

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

20. One regulator suggested strengthening the disclosure requirements in paragraph 134 of IAS 36, for example by clarifying that these requirements are linked to the key metrics used by management to monitor the subsequent performance of business combinations. One national standard-setter suggested changing the disclosure about a reasonably possible change in key assumptions to also require disclosure about any reasonably possible changes and the effect of those changes on the recoverable amount regardless of whether those changes could cause the CGU's carrying amount

to exceed its recoverable amount. The national standard-setter said this would give users a better understanding of the sensitivities in the valuation of the goodwill balance. One user suggested requiring entities to justify any material change in discount and growth rate assumptions used compared to the prior period.

21. The staff think that:

    (a) if a reasonably possible change in a key assumption would not give rise to an impairment loss on goodwill, the effect of disclosing this information on helping deter management over-optimism would be limited even if the additional information is useful.

    (b) having to justify when there has been a material change in the discount or growth rate used (or any key assumption used) could help deter management over-optimism. In addition, providing this information should not be unduly costly because entities should already have this information given that management should have considered this in selecting the assumptions to use. The Board could explore this suggestion further.

Close-call situations

22. Although acknowledging the disclosure requirements in paragraph 134, one regulator suggested requiring disclosures about the facts and circumstances of how close an entity was to recognising an impairment loss because, in their view, it is important, but difficult for users to understand how close an entity was to recognising an impairment loss and why goodwill was not impaired.

23. The staff think information about how close an entity was at recognising an impairment loss on goodwill should, in 'close call' situations, already be disclosed applying paragraph 134. The staff acknowledge that having to disclose reasons for why no impairment was recognised in such situations, which a few respondents suggested, might help deter management over-optimism, particularly for example, if the justification as to why there is no impairment loss depends on forecasts that are over-optimistic and have a greater chance of not being met in subsequent reporting periods. Similar to paragraph 21(b), the entity should have this information because management should have considered this in assessing there is no impairment loss to recognise.

Terminal value

24. The staff agree that management over-optimism could be reduced by requiring disclosure on how the terminal value has been calculated. The staff understands that although the terminal value often makes up a large portion of a recoverable amount measured using a discounted cash flows model, little disclosure is provided on growth rates and other assumptions used in the periods leading up to the period from which the terminal value is extrapolated from. Assumptions in these periods are likely to significantly affect the terminal value. The staff think the Board would need to understand why such information is not provided because it might be considered to be a key assumption.

25. One national standard-setter said entities say disclosure of the growth rate during the budgeting period could be commercially sensitive. If the Board explored this suggestion further, such practical concerns would also need to be considered.

Other considerations

26. When the Board revised IAS 36 in 2004, it considered the costs of providing disclosures to assist users in evaluating the reliability of the impairment test. Specifically, in deciding disclosure requirements, the Board considered two interrelated issues:

    (a) what information should be disclosed so that users have sufficient information for evaluating the reliability of impairment tests; and

    (b) the level at which this information should be presented so that there is an appropriate balance of the benefits and costs of providing that information.

27. The staff acknowledges that the additional disclosure discussed in paragraphs 12–25, if implemented, would increase costs for preparers. However, in the staff's view those incremental costs could be marginal:

    (a) if the Board decides to not also change the level of aggregation and the granularity of disclosure; and

    (b) as mentioned earlier, entities should already have some of this information.

28. The staff also think that if the Board explored these suggestions further, it should first assess how much of the feedback requesting additional disclosures about assumptions,

close call situations and terminal values is indicative of a problem in how entities apply existing requirements rather than a need to improve existing requirements. If it is indicative of a problem in applying the existing requirements, the Board could consider clarifying how entities should apply the existing requirement.

Guidance about the assumptions used

Feedback summary

29. Paragraph 33 of IAS 36 states:

> In measuring value in use an entity shall:
>
> (a) base cash flow projections on reasonable and supportable assumptions that represent management's best estimate of the range of economic conditions that will exist over the remaining useful life of the asset. Greater weight shall be given to external evidence.
>
> (b) base cash flow projections on the most recent financial budgets/ forecasts approved by management, but shall exclude any estimated future cash inflows or outflows expected to arise from future restructurings or from improving or enhancing the asset's performance. Projections based on these budgets/forecasts shall cover a maximum period of five years, unless a longer period can be justified.
>
> (c) estimate cash flow projections beyond the period covered by the most recent budgets/forecasts by extrapolating the projections based on the budgets/forecasts using a steady or declining growth rate for subsequent years, unless an increasing rate can be justified. This growth rate shall not exceed the long‑term average growth rate for the products, industries, or country or countries in which the entity operates, or for the market in which the asset is used, unless a higher rate can be justified.

30. Some respondents suggested providing additional guidance or illustrative examples on the application of this paragraph, particularly regarding:

(a) the interaction between the requirement to base cash flow forecasts on (i) reasonable and supportable assumptions; and (ii) budgets or forecasts approved by management which may, by nature, be over-optimistic because they are also used to incentivise management.

(b) consistency of assumptions used with external evidence and/or other assumptions (for example, clarifying that a forecasted growth in revenues be supported by a proportionate increase in capital expenditures or requiring entities to reconcile the recoverable amount of CGUs and the market capitalisation of an entity).

(c) how to factor in less optimistic scenarios in cash flow forecasts.

(d) how to estimate the terminal value—respondents said the terminal value often makes up a large portion of the recoverable amount measured using discounted cash flows. However, IAS 36 provides little guidance on how cash flows are extrapolated beyond the period covered by the most recent budgets/forecasts.

(e) how to appropriately reflect risks in the discount rate.

Staff analysis

31. Paragraphs 3.26–3.28 of the Discussion Paper state:

> 3.26 IAS 36 already contains several requirements to reduce the risk that cash flow forecasts used by management could be too optimistic. IAS 36 requires companies to use reasonable and supportable assumptions that represent management's best estimate of the range of economic conditions that will exist over the remaining useful life of the asset, with greater weight given to external evidence. The assumptions are required to be based on the most recent financial budgets or forecasts approved by management (paragraphs 33(a) and 33(b) of IAS 36). Paragraph 38 of IAS 36 requires companies to consider whether the information from financial budgets or forecasts reflects reasonable and supportable assumptions and represents management's best estimate of the set of economic

> conditions that will exist over the remaining useful life of the asset.
>
> 3.27 Paragraph 34 of IAS 36 requires management to assess the reasonableness of those assumptions by examining the causes of differences between past cash flow projections and actual cash flows.
>
> 3.28 Paragraph BCZ20 of the Basis for Conclusions on IAS 36 explains that the Board's predecessor, the International Accounting Standards Committee (IASC), considered that these requirements were sufficient to prevent a company from using assumptions that were different from the market without justification.

32. Staff agree that the use of reasonable and supportable assumptions in estimating a CGU's VIU can be challenging and it can be difficult to enforce for auditors and regulators. Although some of the concerns might result from application issues, the staff think the Board could consider whether additional requirements or more clarity about the existing requirements could help resolve these challenges.

33. One of the areas a few respondents suggested clarifying was the interaction of the requirement to base cash flow projections on the most recent financial budgets/forecasts and the requirement to base cash flow projections on reasonable and supportable assumptions. The staff think that to help the application of IAS 36 and reduce the risk of management over-optimism, the Board could clarify that the requirements do not conflict and even if cash flow projections are based on the most recent financial budgets/forecasts approved by management (paragraph 33(b) of IAS 36), these cash flow projections need to be based on reasonable and supportable assumptions (paragraph 33(a) of IAS 36). For example, any 'stretch target' used to incentivise management in budgets or forecasts might not always be reasonable and supportable and in that situation should be excluded from the cash flow forecasts used to calculate the recoverable amount.

34. The staff have the following observations about some of the other suggestions:

    (a) Different scenarios in cash flows forecasts—Appendix A of IAS 36 highlights that there are different ways in which entities might compute present value and contrasts two approaches, the 'traditional' approach and an expected cash flow approach. The appendix also discusses the effect each approach has on how risk is reflected in the discount rate. A multi-scenario model that incorporates less optimistic scenarios would, in the staff's view, be a variant of the expected cash flow approach. Requiring entities to use such a model would be a significant change to IAS 36 and could have wider implications on impairment testing.

(b) How to appropriately reflect risks in the discount rate—Appendix A of IAS 36 also discusses the factors and types of risks that should be reflected in the discount rate. One regulator said this should be clarified asking whether, for example, execution risk premium should be included. Although the staff think this might help in specific circumstances, it could require developing extensive detailed guidance rather than broad principles. There was also a suggestion to update and align the guidance on discount rates with IFRS 13 *Fair Value Measurement.* The staff think this would be outside the scope of this project.

(c) How to estimate the terminal value—The request for guidance on calculating terminal values seems to be more concerned with the cash flow forecast that the extrapolation is based on rather than the growth rate. This appears to be more of an application issue because IAS 36 already requires the cash flow forecast to be based on reasonable and supportable assumptions and on the most recent financial budgets/forecasts approved by management.

35. Several of the suggestions were provided by regulators which implies that additional requirements or clarity in these areas would help better enforce the application of the impairment test. However, the staff think further work would need to be performed to understand what additional specific requirements or guidance the Board can provide compared to that already in IAS 36 and whether that requirement or guidance can be suitably broad to apply to all entities and not risk a rules-based approach to the impairment test. Additionally, the staff think it is important to remember that this project was not established to conduct a full review of IAS 36 but to respond to feedback on the impairment test of CGUs containing goodwill in the PIR of IFRS 3.

Shielding

Feedback summary

36. In developing its preliminary views, the Board considered whether to provide additional guidance on identifying CGUs and on allocating goodwill to CGUs. Its preliminary view was that it should not develop such guidance because it would be difficult to provide guidance that could apply to all entities.

37. Many respondents agreed with the Board's preliminary view. However, many disagreed and suggested providing guidance on how to allocate (and reallocate) goodwill to CGUs and reconsidering the level at which the test is performed.

38. Respondents said entities often allocate and test goodwill for impairment at the operating segment level and not necessarily at the lowest level at which the goodwill is monitored for internal management purposes[5]. Many respondents said a lack of clarity in IAS 36 contributes to this problem—in particular, the requirement to allocate goodwill at the lowest level within the entity at which goodwill is monitored for internal management purposes is not clear or well understood in practice. For example, many accounting firms and some national standard-setters who commented said an entity's management often does not monitor goodwill but instead monitors the overall business and in these situations, entities test goodwill for impairment at the operating segment level.

39. To help reduce the effect of shielding, a few respondents also suggested:

    (a) providing additional guidance on the reallocation and disposal of goodwill. In their experience, some entities reallocate goodwill opportunistically to avoid recognising an impairment loss;

    (b) providing guidance on what 'largely independent' cash inflows means; and

    (c) requiring entities to disclose the amount of headroom in material CGUs containing goodwill at acquisition and for a few years afterwards.

[5] Paragraph 80 of IAS 36 specifies that a CGU or group of CGUs to which goodwill is 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.

Staff analysis

Goodwill allocation and level of testing

40. The staff agree that management does not generally monitor goodwill directly, but rather monitors business activities. Therefore, the staff think that in deciding next steps, the Board could consider whether it is possible to replace 'goodwill is monitored' with 'the acquired business is monitored' in paragraph 80 of IAS 36, as suggested by some respondents. Alternatively, the Board could clarify the meaning of 'monitored'. This might be a relatively simple change to make and could prevent entities defaulting to testing goodwill for impairment at an operating segment level only because management does not specifically monitor goodwill.

41. The staff also agree with respondents who suggested incorporating information from applying the Board's preliminary view on disclosures on the subsequent performance of business combinations—for example how a business combination is monitored and what metrics are used to monitor that performance—into any guidance the Board might provide on the level at which goodwill is tested for impairment. The disclosures on expected synergies could also be incorporated and could be used to provide guidance on what is meant by 'expected to benefit from the synergies of the combination' when allocating goodwill to CGUs.

42. The Board considered testing goodwill for impairment at an operating segment level as a safeguard to prevent goodwill being tested at too high a level, for example at the entity level (see paragraphs BC137–BC150 of the Basis for Conclusions on IAS 36). The staff think this safeguard is still necessary, and therefore do not agree with respondents' suggestions to remove the reference to operating segment, because there is a risk that entities might then perform the test at an entity level. However, the staff think clarifying the purpose of the reference to the operating segment in paragraph 80 of IAS 36 and clarifying the emphasis of the requirements on how the business is monitored internally, together with the clarifications on what is meant by monitoring discussed in paragraph 40 could help the application of IAS 36 and reduce the shielding effect due to testing goodwill at too high a level.

Reallocation and disposal of goodwill

43. Paragraph 86 of IAS 36 requires that when an entity disposes of an operation within a CGU to which goodwill has been allocated, the goodwill associated with the disposed operation should be measured on the basis of the relative values of the operation disposed of and the portion of the CGU retained unless some other method better reflects the goodwill associated with the operation disposed of. Paragraph 87 of IAS 36 includes a similar requirement that applies when an entity reorganises its reporting structure in a way that changes the composition of CGUs to which goodwill has been allocated.

44. Paragraphs BC155–BC156 of the Basis for Conclusions on IAS 36 explain that the Board considered such a relative value approach appropriate because goodwill associated with disposed or reallocated operations cannot be identified or associated with an asset group at a lower level than a CGU, except arbitrarily.

45. The staff understand from feedback that entities may decide to reallocate goodwill opportunistically to avoid impairments of goodwill. For example, an entity may decide to reallocate an operation with a weak performance from a CGU that has a large amount of goodwill or merge different CGUs to shield goodwill of one CGU from impairment losses with internally generated goodwill of another CGU, claiming that the new reporting structure better reflects how goodwill is monitored.

46. Although no evidence has been provided that would change the Board’s conclusions on the relative value approach, the staff think the Board could consider additional requirements in order to prevent opportunistic reallocations. For example, the Board could explore whether reorganising the reporting structure for the purpose of impairment testing should be subject to specific criteria. As suggested by a few respondents, reallocation of goodwill could be allowed only if it is justified by a change in the cash flow structure. Alternatively, an entity could be required to perform an impairment test based on the previous reporting structure before reallocating goodwill to a different CGU.

Other suggestions

47. The staff think:

    (a) 'Largely independent' cash inflows is a fundamental principle of IAS 36 and the CGU concept and providing guidance on what this means could have wider implications than just the impairment test of CGUs containing goodwill.

    (b) Although disclosing the amount of headroom in material CGUs to which goodwill is allocated at acquisition and for a few years afterwards could help manage the expectation gap that unavoidable shielding in the impairment test might delay the recognition of impairment losses, the staff think there are only limited benefits from this suggestion since it would not reduce the shielding effect.

Other aspects of IAS 36

Reversal of impairment losses on goodwill

Feedback summary

48. A few respondents suggested permitting an entity to reverse impairment losses on goodwill. In their view, permitting an entity to reverse impairment losses on goodwill would provide management with less incentive to delay recognising an impairment loss which could help address management over-optimism and lead to earlier recognition of impairment losses.

Staff analysis

49. Paragraphs BC187–BC191 of the Basis for Conclusions on IAS 36 explain that the Board prohibited the reversal of impairment losses on goodwill because even if the specific external event that caused the recognition of the impairment loss is reversed, it would seldom, if ever, be possible to determine that the effect of that reversal is a corresponding increase in the recoverable amount of the acquired goodwill rather than an increase in the internally generated goodwill within the CGU.

50. Based on the feedback, the staff have not identified any evidence suggesting it would be possible to determine that the effect of that reversal is a corresponding increase in the recoverable amount of the acquired goodwill rather than an increase in the internally generated goodwill within the CGU. The staff acknowledges that the risk of recognising internally generated goodwill may be reduced by allowing entities to reverse impairment loss of goodwill over only a short time period and only in limited circumstances. For example, the Board could permit an entity to reverse an impairment loss in annual financial statements that has been recognised in an interim period or permitting an entity to reverse an impairment loss if it was caused by a specific external event and subsequent external events have occurred that reversed the effect of that event.

51. However, in the staff's view feedback does not suggest strong support for such a change. In particular:

    (a) the staff discussed this topic at the joint Capital Markets Advisory Committee (CMAC) and Global Preparers Forum (GPF) meeting in October 2020. GPF and CMAC members said that the ability to reverse goodwill impairments would not provide useful information. GPF members also said that tracking and measuring reversals of impairment would be difficult and costly.

    (b) One national standard-setter who specifically disagreed with this suggestion said:

        (i) users in their jurisdiction did not think the ability to reverse impairment losses would result in more timely recognition of impairment losses on goodwill; and

        (ii) preparers indicated that the ability to reverse a previously recognised impairment loss would not affect when they recognise impairment losses.

52. The staff also questions how effective this suggestion would be because staff think entities are unlikely to want to reverse an impairment charge. Academic evidence[6]

[6] Amel-Zadeh, A., Glaum, M., and Sellhorn, T. (2020), 'Empirical Goodwill Research: Insights, Issues and Implications for Standard Setting and Future Research', *Working paper University of Oxford*.

shows that announcements of impairment losses on goodwill are associated with negative stock market reaction. By contrast, users might be more sceptical of an impairment loss reversal and the entity might not receive a corresponding positive stock market reaction. Reversing an impairment loss risks the entity needing to recognise a subsequent impairment loss in future, which could then provide a second negative stock market reaction.

53. Therefore, the staff think there is not sufficient compelling evidence for the Board to pursue permitting reversals of impairment losses further.

Indicators of impairment

Feedback summary

54. Some respondents suggested reviewing the list of indicators of impairment in paragraph 12 of IAS 36 and said the indicators listed could contribute to the delay in recognising impairment losses on goodwill.

Staff analysis

55. When the Board considered its preliminary views on providing relief from the mandatory annual quantitative impairment test in IAS 36 and moving to an indicator-based approach, the Board was aware that such a move would put more reliance on identifying indicators of impairment. The Board therefore already planned to assess whether it needed to update the list of indicators in IAS 36.

56. Based on feedback, the staff think the Board should consider updating these indicators regardless of whether it decides to provide relief from the requirement for an annual impairment test. In particular, the Board could consider the following suggestions provided by some respondents that commented on Board’s preliminary views on providing relief from the annual impairment test:

    (a) whether to develop a list of indicators specifically applying to goodwill.

    (b) whether to develop a list of indicators that should exist to presume goodwill is not impaired.

    (c) whether to give more prominence to internal indicators over external indicators.

(d) whether an indicator of impairment would automatically exist for goodwill relating to a contingent asset for which the contingency is subsequently resolved or when it has arisen on recognition of deferred tax liabilities and those liabilities are subsequently derecognised.

(e) whether information provided by an entity applying the Board's preliminary views on the disclosure of the subsequent performance of business combinations should be included as an indicator of impairment. For example, the performance of a business combination being below management's disclosed target could be an indicator.

Question for the Board
Does the Board have any comments or questions on the analysis presented in this paper? Are there areas on which the Board would like additional analysis to support its decision on the subsequent accounting for goodwill?