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STAFF PAPER

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Project	**Goodwill and Impairment**
Paper topic	Effectiveness of the impairment test

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This paper is unchanged from Agenda Paper 18E to the Board's April 2021 meeting except for some minor editorial changes in paragraphs 21, 33(a) and 34. These changes have been underlined.

Purpose and structure of this paper

1. This paper provides the International Accounting Standards Board (Board) with a summary of the feedback received on improving the effectiveness of the impairment test of cash-generating units (CGUs) containing goodwill.

2. This paper does not ask the Board for any decisions.

3. The paper contains:

   (a) Key messages (paragraph 4);

   (b) Summary of the Board's preliminary views expressed in the Discussion Paper (paragraphs 5–13);

   (c) Questions asked (paragraph 14); and

   (d) Feedback received (paragraphs 15–75), including:

      (i) What causes possible delays in recognising impairment losses on goodwill? (paragraphs 19–33);

      (ii) Is it possible to design a different impairment test? (paragraphs 34–53);

      (iii) Are there ways to improve the application of the impairment test in IAS 36 *Impairment of Assets*? (paragraphs 54–67);

(iv) Other aspects of IAS 36 (paragraphs 68–75); and

(e) Question for the Board

Key messages

4. Most respondents agreed with the Board's preliminary view that it is not feasible to design a different impairment test that is significantly more effective than the impairment test of CGUs containing goodwill in IAS 36 at a reasonable cost. However, many of those respondents suggested how the Board could improve the application of the impairment test in IAS 36. In particular, many respondents suggested ideas for additional disclosure requirements to combat management over-optimism and suggested the Board develop additional guidance to improve the level at which goodwill is allocated to CGUs to reduce the 'shielding' effect described in the Discussion Paper.

Summary of the Board's preliminary views

5. Many stakeholders told the Board that impairment losses on goodwill are sometimes recognised too late, long after the events that caused those losses. They urged the Board to make the impairment test more effective at recognising impairment losses on goodwill on a timely basis.

6. The Board identified two broad reasons for concerns about the possible delay in recognising impairment losses on goodwill:

   (a) management over-optimism—some stakeholders have concerns that management may sometimes be too optimistic in making the assumptions 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 group of CGUs, containing goodwill. These typically contain headroom (see paragraph 10). This headroom shields acquired goodwill against the recognition of impairment losses.

7. Concerns about the possible delay in recognising impairment losses on goodwill may also be because some stakeholders believe the impairment test directly tests goodwill, or that it should test goodwill directly.

8. The Board considered the risk of over-optimism to be unavoidable, given the nature of the estimates required. If estimates of cash flows are sometimes too optimistic in practice, the Board considered that this is best addressed by auditors and regulators, not by changing IFRS Standards.

9. To address shielding, the Board considered whether it could incorporate the estimate of headroom into the design of the impairment test of CGUs containing goodwill, the 'headroom approach'.

10. Headroom is made up of items not recognised on the balance sheet: internally generated goodwill, unrecognised assets, and unrecognised differences between the carrying amount of recognised assets and liabilities and their recoverable amounts. Headroom can arise from:

    (a) items that are already present in a business at the date it acquires another business if goodwill is allocated to the combined business.

    (b) items generated after the acquisition. Moreover, if the acquired business has been combined with the acquirer's business for impairment testing, headroom could be generated by the acquired business, the acquirer's business or both.

11. The 'headroom approach' would compare:

    (a) the recoverable amount of the CGUs; with

    (b) the sum of:

        (i) the carrying amount of the recognised assets and liabilities of the CGUs; and

        (ii) the headroom of the CGUs at the previous impairment testing date.

12. The Board concluded that the 'headroom approach' would reduce shielding but not eliminate it. Moreover, the 'headroom approach' could result in recognising

impairments that are, in some circumstances, difficult to understand and the approach would add cost.

13. Therefore, the Board's preliminary view was that it is not feasible to design a different impairment test that is significantly more effective than the impairment test in IAS 36 at recognising impairment losses on goodwill on a timely basis at a reasonable cost.

Questions asked

14. Question 6 in the Discussion Paper asked:

> As discussed in paragraphs 3.2–3.52 [of the Discussion Paper], the Board investigated whether it is feasible to make the impairment test for cash-generating units containing goodwill significantly more effective at recognising impairment losses on goodwill on a timely basis than the impairment test set out in IAS 36 *Impairment of Assets*. The Board's preliminary view is that this is not feasible.
>
> (a) Do you agree that it is not feasible to design an impairment test that is significantly more effective at the timely recognition of impairment losses on goodwill at a reasonable cost? Why or why not?
>
> (b) If you do not agree, how should the Board change the impairment test? How would those changes make the test significantly more effective? What cost would be required to implement those changes?
>
> (c) Paragraph 3.20 [of the Discussion Paper] discusses two reasons for the concerns that impairment losses on goodwill are not recognised on a timely basis: estimates that are too optimistic; and shielding. In your view, are these the main reasons for those concerns? Are there other main reasons for those concerns?
>
> (d) Should the Board consider any other aspects of IAS 36 in this project as a result of concerns raised in the Post-implementation Review (PIR) of IFRS 3?

Feedback received

15. 124 comments letters provided the Board with feedback on the effectiveness of the impairment test. In addition, the Board received feedback in outreach meetings with other stakeholders.

16. Most respondents agreed with the Board's preliminary view that it is not feasible to significantly improve the effectiveness of the impairment test of CGUs containing goodwill. In addition, most respondents agreed with the reasons for concerns about the timeliness of impairments losses on goodwill identified by the Board.

17. Many respondents, although agreeing that it is not feasible to design an impairment test that is significantly more effective than the impairment test in IAS 36 at the timely recognition of impairment losses on goodwill at a reasonable cost, suggested ways the Board could improve the application of the impairment test in IAS 36.

18. The remainder of this paper discusses:

    (a) what causes possible delays in recognising impairment losses on goodwill? (paragraphs 19–33);

    (b) is it possible to design a different impairment test? (paragraphs 34–53);

    (c) are there ways to improve the application of the impairment test in IAS 36? (paragraphs 54–67); and

    (d) other aspects of IAS 36 (paragraphs 68–75).

What causes possible delays in recognising impairment losses on goodwill?

19. The Board had identified two reasons for the concerns that impairment losses on goodwill are not recognised on a timely basis, and these were discussed further in the Discussion Paper:

    (a) estimates that are too optimistic; and

    (b) shielding.

20. Some respondents, many of which were preparers and many of which also agreed with the Board's preliminary view that it was not feasible to design a different impairment test that was more effective at recognising impairment losses on a timely

basis, were unconvinced there was a significant problem with the impairment test. In their view optimism is natural and oversight from auditors ensures proper implementation of the impairment test and IAS 36 has appropriate safeguards against optimism. They said shielding is inevitable, and is only inappropriate when goodwill is not properly allocated to CGUs.

21. One national standard-setter said that the test has limitations but meets its objective of ensuring that the combined assets, including goodwill, are carried at no more than their combined recoverable amount. One academic respondent said, in their view, there is no conclusive academic evidence that the impairment test is not effective since some evidence suggests the market reacts significantly to impairment losses. One consultant said, in their view, a premise that impairment losses can be recognised without any delay, as circumstances unfold, is unrealistic—an impairment is usually the result of a combination of factors that cumulatively lead to a negative outlook for a business, resulting in the loss of value for certain assets. One user representative group said that the test is not the problem but the application and lack of transparency on the methods and assumptions are. They said the new disclosures the Board is suggesting should help improve the impairment test (see Agenda Paper 18C to the Board's April meeting).

22. One consultant said that recent trends in goodwill impairment in Europe indicated that the impairment-only model is working effectively and as intended. This respondent highlighted that values of impairment increased significantly in the UK during 2019 as a result of uncertainty related to the UK's departure from the European Union (EU).

23. However, a few national standard-setters in Europe said in their view the level of impairment losses being recognised in recent years is too low and this indicates that the impairment test is not effective at recognising impairments of goodwill on a timely basis. Those respondents said that impairments resulting from covid-19 in interim financial statements or impairments resulting from uncertainty related to the UK's departure from the EU have not been as they expected.

24. Overall, most respondents agreed the impairment test has limitations and agreed that management over-optimism and shielding are the main reasons for these limitations. Some respondents put an emphasis on one reason over the other.

Management over-optimism

25. Many respondents agreed that management over-optimism is part of the reason why the impairment test might not meet some stakeholder’s expectations and some respondents said that management over-optimism is the main reason why impairment losses on goodwill are recognised too late.

26. Respondents said management over-optimism occurs because:

    (a) of management bias;

    (b) of uncertainties in cash flow forecasts even when management are neutral;

    (c) financial plans and budgets that estimates are based upon are also used to incentivise management;

    (d) the impairment test is too subjective and very difficult to audit and to enforce, facilitating earnings management; and

    (e) of the reluctance of management to accept a decision to acquire a business was wrong.

27. A few respondents highlighted academic evidence that an entity’s management uses discretion in recognising impairment in ways that are potentially favourable to themselves.

28. However, a few preparers disagreed that management over-optimism is a reason for impairments being recognised too late. They said optimism is an essential trait of management. In their view, management should take a realistic long-term view of economic conditions and that the economic conditions at the balance sheet date should not be assumed to exist in the long term. In other words, management should have an expectation that they can improve the performance of the business when initially faced with challenging economic conditions.

Shielding

29. Many respondents agreed that shielding is part of the reason why the impairment test might not meet some stakeholder’s expectations and some respondents said that shielding is the main cause of impairments being recognised too late.

30. A few national standard-setters and accounting firms said that the concept of shielding is part of the design of the impairment test. In other words, the impairment test is a test of the carrying value of CGUs containing goodwill rather than a test of goodwill, and therefore shielding cannot be avoided. This is because goodwill does not generate independent cash flows on its own. One national standard-setter said that shielding was inevitable because businesses were being combined. A few respondents said there might be an ‘expectation gap’ whereby stakeholders expect the performance of the impairment test to be different.

31. Shielding was why a few respondents said that it would not be feasible to design a different impairment test that is significantly more effective unless the Board undertook a fundamental review of IAS 36, including the concept of CGUs (see paragraph 36).

32. Some respondents said that the shielding effect of goodwill can be exacerbated by the level at which an entity tests CGUs containing goodwill. Some respondents said that in practice many entities identify the testing level as a segment or a large group of CGUs. For example, one auditor group said that, in its view, the major reason for the shielding effect is the way IAS 36 defines the level for impairment testing of goodwill, being the lowest level goodwill is monitored for internal management purposes but no larger than an operating segment. In many cases entities use the upper limit of an operating segment because, as an accounting residual, goodwill is not monitored by management.

Other reasons

33. A few respondents highlighted possible other reasons why an entity might recognise impairment losses on goodwill later than the event that gave rise to the impairment, for example:

    (a) Goodwill is a residual—on initial recognition the value of goodwill recognised by an entity is a residual amount. Acquired goodwill cannot be measured directly nor can it be separated from internally generated goodwill, therefore it is not possible to identify impairments on a timely basis.

(b) Indicators of impairment—indicators of impairment in IAS 36 are very broad and focus too much on external factors which may contribute to impairments on goodwill not being recognised on a timely basis.

(c) Tax shielding—the tax effects of the acquisition can also shield goodwill from impairment.

(d) Test cannot react as quickly as the market—market, industry, and entity-specific factors disclosed or observed through other means is not a failing of the goodwill impairment model, but simply a practical reality that a periodic test cannot react as quickly as capital markets.

Is it possible to design a different impairment test?

34. Most respondents agreed with the Board's preliminary view that it is not feasible to design a different impairment test, at a reasonable cost. Many of these respondents went on to say that, for this reason, the Board should reintroduce amortisation (see Agenda Paper 18C). In addition, a regulator said that if the Board concludes that it cannot significantly improve the impairment test then the Board should reintroduce amortisation of goodwill. Those respondents said that the test is not robust and the reintroduction of amortisation of goodwill is needed to respond to the limitations of the impairment test.

35. Respondents agreeing with the Board's preliminary view agreed that the 'headroom approach' only reduced shielding rather than eliminating it, and would increase the complexity and cost of the impairment test without significantly improving the effectiveness of the test. They said the Board's work demonstrated that it was difficult to design a different test that was significantly more effective. Any alternative approach would always have limitations because of the nature of goodwill—a residual that is not able to be directly measured.

36. A few respondents, mainly accounting firms and accounting bodies, said that it would not be feasible to design a different impairment test that is significantly more effective unless the Board undertook a fundamental review of IAS 36, including the concept of CGUs, and suggested the Board conduct such a review.

37. Some respondents disagreed with the Board's preliminary view. Those respondents said that there are ways to improve the impairment test. They proposed:

(a) pursuing the 'headroom approach' (paragraphs 38–43);

(b) an 'implied goodwill' impairment test (paragraphs 44–46);

(c) a 'direct value' comparison (paragraphs 47–50); and

(d) other suggestions (paragraphs 51–53).

The 'headroom approach'

38. Some accounting bodies, academics and national standard-setters suggested the Board reconsider the headroom approach described in the paragraph 11 of this paper. They said shielding is a problem and anything that can reduce the effect of shielding should be explored.

39. A few respondents (an accounting body, a valuations standard-setter and an academic) suggested the Board reconsider a variant of the 'headroom approach' that the Board discussed during the development of the Discussion Paper—the 'pre-acquisition headroom approach', or something similar to that approach. In the IVSC's article *Opportunities for Enhancing the Goodwill Impairment Framework* this is described as the 'step-up approach'.

40. Unlike the headroom approach, the pre-acquisition headroom approach would require an entity to calculate the headroom only once—at the date of acquisition. Therefore, the respondents suggesting this approach said it is easier and less costly to apply in practice.

41. The 'pre-acquisition headroom approach' would compare:

(a) the recoverable amount of the CGUs; with

(b) the sum of:

(i) the carrying amount of the recognised assets and liabilities of the CGUs; and

(ii) the headroom of the CGUs at the date of acquisition.

42. One academic provided research that compared the pattern of the reduction in goodwill using the existing impairment-only approach, amortisation of goodwill, and an impairment-only approach using the 'pre-acquisition headroom' impairment test. This research compared the pattern of reduction in goodwill to an estimate of the economic usage of the goodwill.

43. The academic's research identified that the 'pre-acquisition headroom approach' most aligned with their estimate of the economic decline of goodwill. Accordingly, the academics suggested the Board reconsider this approach.

'Implied goodwill' impairment test

44. A few respondents suggested the Board consider an 'implied goodwill' approach to replace the impairment test in IAS 36. One preparer group suggested an approach similar to that previously used in FRS 11 *Impairment of Fixed Assets and Goodwill* in UK generally accepted accounting principles (GAAP), which is similar to the 'pre-acquisition headroom approach' described in paragraphs 40–41, since this could mitigate internally generated goodwill masking true performance. A national standard-setter suggested an 'implied goodwill' approach similar to the impairment test in German GAAP, GAS 23 *Accounting for Subsidiaries in Consolidated Financial Statements*.

45. The approach in German GAAP requires an entity to compare:

    (a) the fair value of the investment in the subsidiary; with

    (b) the sum of:

        (i) the total of the carrying amount of the net assets of the subsidiary in the consolidated financial statements; and

        (ii) the net carrying amount of goodwill.

46. In addition, an entity is encouraged to examine whether material unrecognised reserves and liabilities that require a change in the amount of the write-down have arisen since the date of initial consolidation.

'Direct value' comparison

47. In 2020, the International Valuation Standards Council (IVSC) published a series of articles on goodwill. A few respondents referred to an approach described by the IVSC in its final article, *Opportunities for Enhancing the Goodwill Impairment Framework*[1].

48. In a direct value comparison model, an entity would be required to compare the fair value of a CGU containing goodwill at the date of the impairment test with the fair value of the same CGU at the time of the acquisition.

49. If the fair value of the CGU has declined below the value at the time of acquisition, the entity would recognise an impairment of goodwill equal to the amount of the difference between the values.

50. The IVSC said that this approach is also simpler than the existing impairment test in IAS 36 and therefore could also reduce costs for preparers. In particular, the IVSC said:

    (a) An entity would no longer need to determine the carrying amount of the CGU at each testing date; and

    (b) The allocation of goodwill to CGUs at the time of acquisition may be easier because it might allow an entity to consider where synergies are expected to arise as a result of the acquisition.

Other suggestions

51. A few respondents suggested approaches whereby the original expectations of management at the date of acquisition were tested against the current expectations of management, and any targets not met would trigger an impairment.

52. One accounting body also suggested an approach similar to an approach in FRS 11 in UK GAAP whereby an entity would be required to perform a subsequent cash flow test to confirm, ex post, the cash flow projections used to measure a CGU's value in use. If the actual cash flows were lower than those forecast and would have required

[1] https://www.ivsc.org/news/article/opportunities-for-enhancing-the-goodwill-impairment-framework

the recognition of an impairment loss, the original impairment calculations would have to be reperformed using the actual cash flows.

53. One preparer group said the problem was not with the test but with the accounting for goodwill, there being relatively few complaints about IAS 36 when testing other assets. They encouraged the Board, as part of a wider project on intangible assets, to reopen the accounting treatment of goodwill, including consideration of whether goodwill should be recognised on the balance sheet in the first place, and if so, how should it be subsequently treated.

Are there ways to improve the application of the impairment test in IAS 36?

54. Most respondents agreed that it is not feasible to design a different impairment test that would significantly improve the recognition of impairment losses on goodwill on a more timely basis compared to the impairment test of CGUs containing goodwill in IAS 36. Nevertheless, many respondents said that the application of the impairment test in IAS 36 can be improved.

55. Respondents suggested ideas for improving the effectiveness of the impairment test in IAS 36 that address:

    (a) Management over-optimism (paragraphs 56–61); and

    (b) Shielding (paragraphs 62–67).

Management over-optimism

56. A few preparers and national standard-setters agreed with the Board’s view that management over-optimism is best addressed by auditors and regulators rather than through standard-setting.

57. However, many accounting firms and regulators and some national standard-setters and accounting bodies disagreed with the Board’s preliminary view. Some respondents said that over-optimism is best addressed:

    (a) by management of companies, who are ultimately responsible for the financial statements; or by

(b) the Board, who should ensure that IFRS Standards are robust and enforceable in practice.

58. Accounting firms and regulators said that it is difficult for them to challenge the assumptions used by management in an impairment test because management have better knowledge of the business and industry than the auditor or regulator has. They said they can only make adjustments when there are obvious inconsistencies or technical errors.

59. Some respondents suggested possible amendments to IFRS Standards that in their view would help to address management over-optimism and improve the impairment test in IAS 36. Suggestions for how to reduce management over-optimism in the impairment test typically address either:

(a) the assumptions used in the impairment test (paragraph 60); or

(b) additional disclosure requirements (paragraph 61).

Assumptions used

60. Some respondents suggested the Board consider ways to improve the assumptions used in the impairment test to help reduce the risk of over-optimistic estimates:

(a) Reasonable and supportable cash flows—a few respondents (regulators, national standard-setters and accounting firms) said that the Board could provide more guidance on the requirement in paragraph 33 of IAS 36 for an entity to '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.' For example, respondents suggested the Board should consider providing guidance on the expected internal consistency between assumptions used (for example that increases in revenue are supported by committed increases in capital expenditure) or consistency between an entity's assumptions and external evidence, with a few respondents suggesting the Board re-emphasise placing greater weight on external evidence. As mentioned in paragraph 26(c) management budgets may be over-optimistic because they are being used to incentivise management. IAS 36 requires management to base cash flow projections on reasonable and supportable assumptions (paragraph 33(a) of IAS 36), and also to base cash flows projections on budgets or forecasts approved by management (paragraph 33(b) of IAS 36). A few respondents suggested the Board put more emphasis on the requirement around reasonable and supportable assumptions. One national standard-setter suggested the Board base guidance on what is reasonable and supportable on the guidance in appendix B of IFRS 9 *Financial Instruments* on the measurement of expected credit losses.

(b) Scenario analysis—a few respondents suggested that the Board consider requiring estimates to be based on multi scenario models in order to include less optimistic scenarios in cash flow predictions and help reduce the use of over-optimistic estimates. For example, the weighted average of the cash flow estimates for three scenarios based on how likely those cash flows are to be incurred (best case, base case and worse case).

(c) Terminal values—a few national standard-setters and regulators said the Board should provide additional guidance for how an entity estimates the terminal value, since it often has a significant impact on the estimate of value in use.

(d) Guidance on discount rate—a few respondents said that the Board should provide more guidance on how to appropriately reflect risk in the discount rate—one respondent suggested this should be based on the illustrative examples accompanying IFRS 13, published in 2013.

(e) Reconciliation of recoverable amount and market capitalisation—a few respondents said that requiring an entity to reconcile the recoverable amount of its CGUs and the market capitalisation of the entity might help to highlight management over-optimism and act as a reasonableness test, especially where the market capitalisation is lower than the book value of equity. Similarly some of those respondents suggested that entities should reconcile multiples implied by the recoverable amounts of CGUs to market multiples and explain any variance.

Disclosure requirements

61. Some respondents suggested the Board improve the disclosure requirements associated with the impairment test of CGUs containing goodwill to help reduce the risk of over-optimistic estimates. Suggestions for improving disclosures in this area included:

(a) Back-testing disclosures—some respondents (accounting firms, accounting bodies and national standard-setters) suggested the Board require an entity disclose a comparison of forecasts prepared for the impairment test in prior years with actual cash flows. Those respondents said that this disclosure would enable users of financial statements to assess how accurate an entity's management is in estimating cash flow forecasts for use in the impairment test.

(b) Better disclosures on assumptions—some users, regulators, accounting bodies and national standard-setters suggested the Board consider improving the disclosures an entity is required to make about the assumptions in the impairment test. For example, a few respondents suggested better sensitivity analysis on key assumptions would help users of financial statements assess the reliability of the impairment test. Users of financial statements said better disclosures on the assumptions and on the methods used would enable them to assess whether the entity is taking a realistic approach. In addition, a few respondents said the Board should require an entity to disclose why key assumptions like growth rate or discount rate have changed since the previous reporting period and to disclose growth rates used in other periods of the cash flow forecast, not only in estimating the terminal value.

(c) 'Close call' disclosures—a few respondents suggested entities provide additional information about why no impairment loss was recognised and how close the entity was to recognising an impairment loss in so-called 'close call' cases where there is little headroom in a CGU.

(d) Disclosures about the terminal value—which a few respondents said usually makes up a large proportion of the recoverable amount of a CGU.

Shielding

62. To address shielding of goodwill in the impairment test, respondents suggested the Board could:

    (a) Address the expectation gap—making it clearer to stakeholders that the objective of the test is to ensure that the carrying value of CGUs including goodwill are recoverable rather than being a direct test of goodwill for impairment that provides information about the performance of the business combination.

    (b) Require additional disclosures, for example, of the amount of headroom in material CGUs containing goodwill at acquisition and for a few years afterwards.

    (c) Consider the level at which the impairment test is performed. In particular, to give more guidance on how to identify CGUs and allocate goodwill to those units (paragraphs 63–67).

63. Many respondents commented on the level at which an entity performs the impairment test. Respondents said that entities often test goodwill for impairment at the operating segment level rather than lower-level CGUs. Accordingly, many respondents suggested the Board consider providing additional guidance on identifying and allocating goodwill to CGUs which, in their view, would help reduce the effect of shielding.

64. In terms of identifying CGUs, a few respondents said that the Board should provide more guidance on:

    (a) What 'largely independent' cash flows means—for example, one respondent said it is not clear whether the cash flows of a retail store are largely independent from an online channel when the issuer has a multichannel approach and customers are influenced by the information on the website in their final purchase. Another respondent said that focusing on largely independent cash inflows rather than cash flows did not reflect economic substance.

(b) A few respondents suggested the Board require entities to disclosure how CGUs have been identified and where shielding in a group of CGUs is likely to be high.

65. Paragraph 80 of IAS 36 sets out the requirements for how an entity allocates goodwill to CGUs for the purpose of the impairment test:

> For the purpose of impairment testing, goodwill acquired in a business combination shall, from the acquisition date, be allocated to each of the acquirer's cash-generating units, or groups of cash-generating units, that is expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units or groups of units. Each unit or group of units to which the goodwill is so allocated shall:
>
> (a) represent the lowest level within the entity at which the goodwill is monitored for internal management purposes; and
>
> (b) not be larger than an operating segment as defined by paragraph 5 of IFRS 8 *Operating Segments* before aggregation.

66. Some respondents highlighted aspects of this requirement that, in their view, sometimes result in an entity allocating goodwill to too high a level for impairment testing purposes, often an operating segment level, and this increases the shielding of goodwill in the impairment test. Respondents said the Board should provide more guidance on the requirements in IAS 36 to lower the level goodwill is tested for impairment. For example:

(a) Provide guidance to better align to how management monitor. Many of the accounting firms and some national standard-setters who commented, said that an entity's management does not monitor goodwill but instead monitors the overall business. As a consequence, they said entities often test goodwill for impairment at a segment level because management do not monitor goodwill. A few respondents said that the Board should replace 'goodwill is monitored' with 'the acquired business is monitored'. A few respondents said the Board should clarify what is meant by 'monitoring'.

(b) Some respondents said that the guidance on the level goodwill is tested for impairment could be linked to the Board's suggestions for new disclosures on the subsequent performance of the business combination or to where the synergies are expected to arise.

(c) Amend the reference to operating segments. A few respondents said that the Board should remove the reference to operating segments, while another respondent said that the Board should include a rebuttable presumption that goodwill should be allocated to a CGU or group of CGUs below segment level.

(d) Provide guidance as to what 'expected to benefit from the synergies of the combination' means. A few respondents said that the Board could link this to its preliminary view for additional disclosures about expected synergies.

(e) A few respondents said the Board should provide more guidance on reallocation and disposals of goodwill. In their experience, some entities reallocate goodwill opportunistically to avoid recognising an impairment of goodwill.

67. However, many respondents agreed with the Board's preliminary view not to provide additional guidance on identifying CGUs and on allocating goodwill to CGUs, agreeing with the Board that it would be difficult to provide guidance that could apply to all entities.

Other aspects of IAS 36

68. A few respondents highlighted other aspects of IAS 36 that the Board could consider in order to improve the effectiveness of the impairment test.

(a) Permitting an entity to reverse an impairment loss on goodwill (paragraphs 69–74); and

(b) Indicators of impairment (paragraph 75).

Reversal of impairment losses on goodwill

69. IAS 36 requires an entity to reverse an impairment loss recognised in prior periods for an asset other than goodwill in particular situations. However, paragraph 124 of IAS 36 states that an impairment loss recognised for goodwill shall not be reversed in a subsequent period.

70. Paragraphs BC187–BC191 of IAS 36 explain that the Board prohibits the reversal of goodwill impairments because even if the specific external event that caused the recognition of the impairment loss is reversed, it will 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.

71. A few respondents, notably in France, said the Board should reconsider whether to require an entity to recognise a reversal of a previously recognised impairment of goodwill in specific circumstances.

72. Those respondents said that not being able to reverse an impairment of goodwill might contribute to impairments of goodwill being recognised ‘too late’ because an entity’s management may be more willing to recognise an impairment loss on a timely basis if the entity is able to reverse that impairment loss if circumstances change. In particular, one respondent said that a recent example is the covid-19 pandemic—entities might be unwilling to recognise an impairment loss in their interim results because they would be unable to reverse these impairment losses in subsequent periods, even if the economic situation improved.

73. The respondents suggested the Board permit an entity to reverse a previously recognised impairment of goodwill when the circumstances giving rise to the potential reversal occur soon after the initial recognition of the impairment loss. For example, those respondents say the Board could set a time period of before the end of the following reporting period.

74. 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. In addition, a few respondents also said that the Board should not permit an entity to reverse previously recognised impairments of goodwill.

Indicators of impairment

75. Some respondents suggested the Board should improve the indicators of impairment listed in IAS 36 which a few respondents identified as one of the reasons impairment losses on goodwill are not recognised on a timely basis. For example, some respondents said the Board should use the information provided by an entity applying its preliminary views about disclosures on subsequent performance of acquisitions as an indicator of impairment. If the performance of a business combination falls below management's target that could be an indicator that goodwill is impaired.

Question for the Board
Does the Board have any comments or questions on the feedback discussed in this paper?