Staff paper

Agenda reference: 18

IASB® Meeting

Date	**May 2023**
Project	**Business Combinations—Disclosures, Goodwill and Impairment**
Topic	**Cover paper**
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Purpose and structure

1. In December 2022 the International Accounting Standards Board (IASB) added the Business Combinations—Disclosures, Goodwill and Impairment project to its standard-setting work plan. The project's objective is to provide users of financial statements with more useful information about the business combinations entities make, at a reasonable cost. To meet this objective, the IASB is considering:

   (a) the disclosure requirements about business combinations; and

   (b) the subsequent accounting for goodwill—in particular, potential changes to the impairment test of cash-generating units (CGUs) containing goodwill in IAS 36 *Impairment of Assets* (impairment test). The IASB is considering:

      (i) the feasibility of improving the effectiveness of the impairment test; and

      (ii) changes to reduce the cost and complexity of the impairment test without making it significantly less robust.

2. The Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment* included the IASB's preliminary views.

3. Following on from the IASB's discussions at its March 2023 meeting about some of its preliminary views on reducing cost and complexity of the impairment test, we ask the IASB to make a tentative decision about its preliminary view to develop proposals to remove the requirement to perform a quantitative impairment test every year.

4. At this meeting, we will also discuss considerations about improving the effectiveness of the impairment test. In particular, we plan to:

   (a) ask the IASB to make a tentative decision about its preliminary view on the feasibility of designing 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.

   (b) discuss suggestions from respondents to the Discussion Paper to improve the application of the impairment test. However, we are not asking the IASB to make tentative decisions on these suggestions at this meeting.

5. Following the Third Agenda Consultation, the IASB added to the maintenance project pipeline a narrow-scope project on Climate-related Risks in the Financial Statements. As part of that project, the IASB might consider whether and, if so, what narrow-scope actions might be needed to improve the application of IAS 36 in relation to such risks. Hence it is possible that IASB members might revisit the discussions in this project as part of the climate-related risks project and discuss further suggestions for improvements to the impairment test.

6. This paper summarises:

   (a) Papers for this meeting (paragraph 7–18);

   (b) Next steps (paragraphs 19–20); and

   (c) Preliminary views, feedback and tentative decisions to date (Appendix).

Papers for this meeting

7. There are four papers for this meeting:

   (a) Agenda Paper 18A—Reducing cost and complexity—removing the annual quantitative impairment test;

   (b) Agenda Paper 18B—Effectiveness of impairment test—feasibility of designing a different impairment test;

   (c) Agenda Paper 18C—Effectiveness of impairment test—criteria and application; and

   (d) Agenda Paper 18D—Effectiveness of impairment test—suggestions from respondents.

Reducing cost and complexity (Agenda Paper 18A)

8. To respond to feedback from the Post-implementation Review (PIR) of IFRS 3 *Business Combinations* that the impairment test is costly and complex, the IASB's preliminary views included:

   (a) removing the requirement for an entity to perform an annual quantitative impairment test for CGUs containing goodwill if there is no indication that the CGU may be impaired.

   (b) removing the restrictions on cash flows associated with future restructurings or enhancements.

   (c) removing the explicit requirement to use pre-tax discount rates and pre-tax cash flows in estimating value in use (VIU). Instead, an entity would be required to use internally consistent assumptions for cash flows and discount rates regardless of whether VIU is estimated on a pre-tax or post-tax basis.

(d) not pursuing other ideas to reduce the cost and complexity of the impairment test. These included:

(i) not adding more guidance on the difference between entity-specific inputs used in VIU and market-participant inputs used in fair value less costs of disposal (FVLCD);

(ii) not mandating a single method (either VIU or FVLCD) for estimating the recoverable amount of an asset, or requiring an entity to select the method that reflects the way the entity expects to recover an asset;

(iii) not allowing an entity to test goodwill at the entity level or at the level of reportable segments; and

(iv) not providing more guidance on identifying CGUs and on allocating goodwill to CGUs.

9. In March 2023 the IASB tentatively decided:

(a) to maintain the preliminary views described in paragraphs 8(b) and 8(c).

(b) not to pursue the suggestions described in 8(d)(i) and 8(d)(ii).

10. In this meeting, the IASB will discuss feedback and analysis on the preliminary view to remove the requirement to perform an annual quantitative impairment test (paragraph 8(a))—Agenda Paper 18A.

11. The preliminary views in paragraphs 8(d)(iii) and 8(d)(iv) will be discussed at a future meeting when we analyse suggestions from respondents to the Discussion Paper to improve the application of the impairment test. This is because they are linked to some of those suggestions.

Effectiveness of impairment test (Agenda Papers 18B–18D)

12. During the PIR of IFRS 3, 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 IASB to make the test more effective at recognising impairment losses on goodwill on a timelier basis.

13. As discussed in the Discussion Paper, the IASB 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. These typically contain headroom.[1] This headroom can shield acquired goodwill against the recognition of impairment losses.

14. The IASB considered the risk of over-optimism to be unavoidable, given the nature of the estimates required. IAS 36 contains requirements that reduce the risk that cash flow forecasts could be too optimistic. If estimates of cash flows are sometimes too optimistic, the IASB considered that this is best addressed by auditors and regulators, not by changing IFRS Accounting Standards.

15. To address shielding, the IASB considered whether it could design a different impairment test. In particular, the IASB considered an impairment test of CGUs containing goodwill in which at least a portion of any reduction in the recoverable amount of a CGU would be attributed to the acquired goodwill, rather than allocating it first to the unrecognised headroom (headroom approach).

16. However, the IASB'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 a reasonable cost.

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[1] The headroom of a CGU is the amount by which its recoverable amount exceeds the carrying amount of its recognised net assets—including goodwill. 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.

17. Further details about this preliminary view and the feedback and analysis on the preliminary view, are included in Agenda Paper 18B.

18. Although most respondents to the Discussion Paper commenting on the preliminary view in paragraph 16 agreed with that view, many suggested ways to improve the application, and hence the effectiveness of, the impairment test. These suggestions, and feedback from the IASB's consultative groups and the IFRS Interpretations Committee on the suggestions, are included in Agenda Papers 18C and 18D.

Next steps

19. In the coming months we plan to ask the IASB to tentatively decide on:

    (a) whether to pursue respondents' suggestions to improve the application of the impairment test discussed in Agenda Papers 18C and 18D; and

    (b) the remaining aspects of the package of disclosure requirements—for example the scope of entities subject to the proposed disclosure requirements about the subsequent performance of business combinations.

20. Once the IASB has made tentative decisions on all aspects of the project, we will ask the IASB whether the package as a whole meets the project objective and whether it would like to publish an exposure draft setting out its proposals.

Appendix—Summary of preliminary views, feedback and tentative decisions

Topic	Summary of the IASB's preliminary view	Summary of feedback	Tentative decisions
Objective and scope	The project's objective is to explore whether an entity can, at a reasonable cost, provide users of financial statements (users) with more useful information about the business combinations those entities make.	See Agenda Paper 18A to the IASB's March 2021 meeting. Most respondents who commented on the project's objective agreed. However, some respondents, notably in Germany and Japan, disagreed. Many respondents commenting on the scope agreed with it. However, many respondents commenting on the project's scope said that they did not view the IASB's preliminary views as a package of views with a unifying objective. Many of those respondents suggested considering disclosures separately from the subsequent accounting for goodwill.	June 2021 The IASB tentatively decided to leave the objective of the project unchanged from that described in the Discussion Paper and to make no changes to the project's scope at this stage. December 2022 The IASB decided not to consider additional topics suggested by respondents in this project, except for two topics related to possible improvements to the effectiveness of the impairment test of cash-generating units containing goodwill.

Topic	Summary of the IASB's preliminary view	Summary of feedback	Tentative decisions
		Paragraphs 34–45 of Agenda Paper 18E to the IASB's May 2021 meeting includes other topics respondents suggested the IASB consider within this project.	
Disclosure on the subsequent performance of business combinations	The IASB's preliminary view is that it should develop proposals to: a. amend IFRS 3 *Business Combinations* to replace the requirement to disclose the primary reasons for a business combination with a requirement for an entity to disclose the strategic rationale for undertaking a business combination and management's objectives for the business combination. b. add a requirement for companies to disclose in the year in which a business combination occurs, the metrics that	See Agenda Paper 18C to the IASB's April 2021 meeting. Many respondents, including almost all users, agreed that an entity should be required to provide additional information about the subsequent performance of business combinations and with basing that information on what an entity's management review. However, many respondents, including many preparers, had concerns about the cost of providing this information.	October 2021 The IASB tentatively decided that, based on the Conceptual Framework for Financial Reporting, information can be required in financial statements about the benefits an entity's management expects from a business combination and the extent to which management's objectives are being met—such as information about the subsequent performance of a business combination, and quantitative information about expected synergies. September 2022 The IASB tentatively decided to propose:

Topic	Summary of the IASB's preliminary view	Summary of feedback	Tentative decisions
	management will use to monitor whether its objectives are being met and in subsequent years the extent to which management's objectives are being met using those metrics.	In addition, many respondents said information about the performance of business combinations should be provided in an entity's management commentary rather than financial statements.	a. replacing the requirement in IFRS 3 for an entity to disclose the 'primary reasons for the business combination' in paragraph B64(d) of IFRS 3 with a requirement to disclose the 'strategic rationale for undertaking the business combination'. b. adding to IFRS 3 a requirement for an entity to disclose, for 'strategically important' business combinations, (i) information about management's objectives for a business combination and the metrics and targets management will use to monitor whether the objectives for the business combination are being met and (ii) actual performance in subsequent periods. c. providing an exemption in specific circumstances that would permit an entity not to disclose information about management's objectives for a business combination and the metrics and targets management will use to monitor whether the objectives for the business combination are being met.

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			January 2023 The IASB tentatively decided on the design of the exemption. February 2023 The IASB tentatively decided to: a. identify the information the entity is required to disclose about the subsequent performance of business combinations using the key management personnel of the reporting entity, as defined in IAS 24 *Related Party Disclosures*; b. maintain its preliminary view that an entity be required to disclose information about the subsequent performance of a business combination for as long as the entity's management continues to monitor whether the objectives of the business combination are being met (subject to additional disclosure requirements when an entity's management is not or stops monitoring the performance of a business combination); and

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			c. clarify some details of the disclosure requirements, for example that an entity would be permitted to disclose information about its targets for a business combination as a range or a point estimate.
Improvements to existing IFRS 3 disclosure requirements	The IASB's preliminary view is that it should develop proposals to add additional disclosure objectives to IFRS 3.	See Agenda Paper 18D to the IASB's April 2021 meeting. Of the IASB's other preliminary views on disclosures, the requirement to disclose additional quantitative information about synergies attracted most comment. The IASB received mixed feedback on this preliminary view. Respondents generally agreed with the IASB's preliminary views that it should	October 2021 The IASB tentatively decided that, based on the Conceptual Framework for Financial Reporting, information can be required in financial statements about the benefits an entity's management expects from a business combination and the extent to which management's objectives are being met—such as information about the subsequent performance of a business combination, and quantitative information about expected synergies. September 2022

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		add new disclosure objectives and a requirement to disclose debt and pension liabilities obtained in a business combination.	The IASB tentatively decided to propose adding the disclosure objectives described in the Discussion Paper to IFRS 3.
Improvements to existing IFRS 3 disclosure requirements	The IASB's preliminary view is that it should develop proposals to amend paragraph B64(e) of IFRS 3 to require a company to disclose the estimated amount or range of amounts of expected synergies arising from the business combination.	There was mixed feedback on the IASB's preliminary views on information about the contribution of the acquired business.	October 2021 The IASB tentatively decided that, based on the Conceptual Framework for Financial Reporting, information can be required in financial statements about the benefits an entity's management expects from a business combination and the extent to which management's objectives are being met—such as information about the subsequent performance of a business combination, and quantitative information about expected synergies. November 2021 The IASB tentatively decided: a. not to define 'synergies'.

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			b. not to make changes to its preliminary view as a result of feedback on other specific aspects of its preliminary view. For the purpose of testing staff examples the IASB decided that the examples should illustrate disclosure of information about: a. total expected synergies disaggregated by nature; for example, total revenue, total cost and totals for other types of synergies; and b. when the benefits expected from the synergies are expected to start and how long they will last (which would require an entity to identify whether those synergies are expected to be one-off or recurring). September 2022 The IASB tentatively decided to propose: a. adding to IFRS 3 a requirement for an entity to disclose in the year of a business combination

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			quantitative information about expected synergies; and b. providing an exemption from disclosing that information in specific circumstances. January 2023 The IASB tentatively decided on the design of the exemption. The IASB also tentatively decided to require an entity: a. to disclose quantitative information about expected synergies by category (for example, total revenue synergies, total cost synergies and the total for each other type of synergy). b. to consider, for any case in which a disclosure of totals by category would qualify for an exemption, whether disclosure as a total for all categories could remove the reason for applying the exemption to the total by category. c. to describe the synergies by specifying each category of expected synergy.

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			d. to disclose when the benefits expected from the synergies are expected to start and how long they will last. This disclosure would require an entity to identify whether the synergies are expected to be finite or indefinite.
Improvements to existing IFRS 3 disclosure requirements	The IASB's preliminary view is that it should develop proposals to amend paragraph B64(i) of IFRS 3 to specify that liabilities arising from financing activities and defined benefit pension liabilities are major classes of liabilities.		November 2021 The IASB tentatively decided to achieve the objective of its preliminary view by not specifying that these liabilities are major classes of liabilities but instead by proposing to amend: a. paragraph B64(i) of IFRS 3 to remove the term 'major'; and b. paragraph IE72 of the Illustrative Examples accompanying IFRS 3 to illustrate liabilities arising from financing activities and defined benefit pension liabilities as classes of liabilities assumed.
Improvements to existing IFRS 3	The IASB's preliminary view is that it should retain the requirement for an entity to disclose information about the contribution		November 2021 The IASB tentatively decided:

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disclosure requirements	of the acquired business, with some amendments to the requirements.		a. to retain the requirement in paragraph B64(q) of IFRS 3. b. to explain the objective of the requirement in paragraph B64(q)(ii) of IFRS 3 but not to provide guidance on how the information required by paragraph B64(q)(ii) should be prepared. c. to specify in paragraph B64(q)(ii) of IFRS 3 that the basis that an entity applies in preparing the information required by that paragraph is an accounting policy. d. to replace the term 'profit or loss' in paragraph B64(q) of IFRS 3 with 'operating profit or loss'. 'Operating profit or loss' will be as defined in the IASB's Primary Financial Statements project. e. not to add a requirement to disclose information about cash flows arising from operating activities.
Improvements to existing IFRS 3 disclosure requirements	The IASB had no preliminary view on removing existing disclosure requirements. However, in the Discussion Paper the IASB noted that as a next step in this project, it	See Agenda Paper 18C to the IASB's March 2023 meeting.	March 2023 The IASB tentatively decided to remove from IFRS 3 requirements to disclose:

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	intended to investigate whether to remove any of the disclosure requirements from IFRS 3 without depriving users of material information.	Respondents provided some suggestions for disclosure requirements in IFRS 3 that could be removed.	a. information about acquired receivables (paragraph B64(h)); b. in the reconciliation between opening and closing goodwill balances, adjustments resulting from the subsequent recognition of deferred tax assets (paragraph B67(d)(iii)); and c. the amount and an explanation of any material gain or loss recognised in the current reporting period that relates to the identifiable assets acquired or liabilities assumed in a business combination that was effected in the current or previous reporting period (paragraph B67(e)).
Effectiveness of the impairment test	The IASB's preliminary view is that it is not feasible to design a different impairment test for cash-generating units containing goodwill that is significantly more effective than the impairment test in IAS 36 at recognising impairment losses on goodwill on a timely basis and at a reasonable cost.	See Agenda Paper 18B to the IASB's May 2021 meeting. Most respondents commenting on the topic, agreed with the IASB's preliminary view that it is not feasible to design a different impairment test that is significantly more effective than the	N/A

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		impairment test of cash-generating units containing goodwill in IAS 36 at a reasonable cost.	
		See Agenda Paper 18B to the IASB's May 2021 meeting. Many respondents to this preliminary view suggested how the IASB 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 IASB develop additional guidance to improve the level at which goodwill is allocated to cash-generating units to reduce the 'shielding' effect described in the Discussion Paper.	N/A

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Subsequent accounting for goodwill	By a small majority (eight out of 14 IASB members), the IASB reached a preliminary view that the IASB should retain the impairment-only model rather than reintroduce amortisation of goodwill.	See Agenda Paper 18C to the IASB's May 2021 meeting. Respondents remain divided on whether the IASB should reintroduce amortisation of goodwill. Many respondents agreed with the IASB's preliminary view to retain the impairment-only model but many other respondents disagreed with the IASB's preliminary view and instead advocated reintroducing amortisation of goodwill.	November 2022 The IASB tentatively decided to maintain its preliminary view to retain the impairment-only model for the subsequent accounting for goodwill.
Simplifying the impairment test	The IASB's preliminary view is that it should develop proposals to: a. reduce the cost and complexity of performing the impairment test by providing entities with relief from having to perform an annual quantitative impairment test for cash-generating units containing goodwill if	See Agenda Paper 18D to the IASB's May 2021 meeting. Many respondents, including some preparers, did not support the IASB's preliminary view that it should implement an indicator-only impairment test for goodwill. However,	March 2023 The IASB tentatively decided to maintain its preliminary view to reduce cost and complexity, and to provide more useful and understandable information by simplifying the requirements for estimating value in use.

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	there is no indication that an impairment may have occurred; and b. reduce cost and complexity, and to provide more useful and understandable information by simplifying the requirements for estimating value in use.	many of those who disagreed also said that the cost-benefit could be re-evaluated if the IASB decides to amortise goodwill. Respondents generally welcomed the IASB's preliminary views on simplifying and improving how value in use should be estimated.	
Presenting total equity excluding goodwill	In the IASB's preliminary view, it should develop a proposal to require an entity to present on its statement of financial position the amount of total equity excluding goodwill. This amount would likely be presented as a free-standing item, and not as a subtotal, or line item, within the structure of the statement of financial position.	See Agenda Paper 18E to the IASB's May 2021 meeting. Almost all respondents disagreed with the IASB's preliminary view that it should require an entity to present in its statement of financial position an amount representing total equity excluding goodwill. In their view, users can easily calculate that amount and	December 2022 The IASB tentatively decided against proceeding with its preliminary view and therefore tentatively decided not to require an entity to present the amount of total equity excluding goodwill as a separate line item on its statement of financial position.

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		presenting that amount could cast doubt on whether goodwill is an asset.	
Intangible assets acquired in a business combination	The IASB's preliminary view is that it should not change the recognition criteria for identifiable intangible assets that are acquired in a business combination.	See Agenda Paper 18E to the IASB's May 2021 meeting. Most respondents who commented on the question, including many users, agreed with the IASB's preliminary view not to develop such a proposal. In their view, goodwill and other intangible assets acquired in a business combination are different in nature and recognising these assets separately provides users with better and more useful information.	December 2022 The IASB tentatively decided to maintain its preliminary view and therefore to make no changes to the recognition criteria in IFRS 3 for identifiable intangible assets acquired in a business combination.

A1. In addition, we provided the IASB with a summary of feedback from users (Agenda Paper 18B to the IASB's April 2021 meeting) and a summary of academic evidence (Agenda Paper 18F to the IASB's May 2021 meeting).