Staff paper

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IASB® Meeting

Date	**May 2023**
Project	**Business Combinations—Disclosures, Goodwill and Impairment**
Topic	**Reducing cost and complexity—removing the annual quantitative impairment test**
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Purpose and structure

1. This paper includes our analysis and recommendations on the IASB's preliminary view to develop a proposal to remove the requirement to perform a quantitative impairment test of cash-generating units (CGUs) containing goodwill (impairment test) annually.

2. This paper is structured as follows:
   (a) Background (paragraphs 3–11);
   (b) Analysis (paragraphs 12–20);
   (c) Alternatives (paragraphs 21–38);
   (d) Summary of staff recommendations (paragraphs 39–40); and
   (e) Appendix—Additional feedback on paragraph 99 of IAS 36.

Background

Preliminary view

3. In the Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment*, the International Accounting Standards Board (IASB) included its preliminary views aimed at reducing the cost and complexity of the impairment test, including a preliminary view to remove the requirement to perform a quantitative impairment test of CGUs containing goodwill annually (annual testing requirement). As explained in paragraph 4.31 of the Discussion Paper, that preliminary view would also apply to intangible assets with indefinite useful lives and intangible assets not yet available for use.

4. Paragraphs 4.12–4.34 of the Discussion Paper set out the preliminary view and the IASB's considerations in reaching the preliminary view. In particular, the IASB considered:

   (a) the cost savings from providing that relief;

   (b) whether that relief would make the impairment test less robust;

   (c) other factors; and

   (d) whether the same relief should apply for intangible assets with indefinite useful lives and intangible assets not yet available for use.

5. IASB members had different views on how much cost such a change would save, and on how much it might reduce the robustness of the impairment test. Some IASB members' conclusion on this question was linked to their conclusion on the amortisation of goodwill—some IASB members might have been prepared to remove the annual testing requirement, but only if the IASB also reintroduced amortisation of goodwill. In their view, reintroducing amortisation would decrease reliance on the impairment test and justify removing the annual testing requirement.

6. A narrow majority (eight out of 14 IASB members) favoured removing the annual testing requirement, even though the IASB's preliminary view was that it should not

reintroduce amortisation of goodwill. They agreed that removing the annual testing requirement would make the impairment test marginally less robust. However, they also considered that when an entity has no indicator of impairment the benefits of testing for impairment are minimal and do not justify the cost.

7. Applying the preliminary view, although an entity would not be required to perform a quantitative impairment test each year, it would still need to assess whether there is an indication that the CGU or group of CGUs containing goodwill might be impaired and perform a quantitative impairment test if there is an indication that the CGU(s) may be impaired.

Summary of feedback

8. The IASB discussed feedback on the preliminary view at its May 2021 meeting. Paragraphs 19–42 of Agenda Paper 18D to that meeting summarises the feedback.

9. Many respondents disagreed with the preliminary view, although many of those respondents said the annual testing requirement could be removed if the IASB decides to reintroduce amortisation of goodwill.

10. Respondents disagreed for various reasons, including:

(a) reduction in the effectiveness and robustness of the impairment test;

(b) difficulty in enforcing an indicator-only impairment test;

(c) limited reductions in cost savings; and

(d) loss of useful information, because information required applying paragraph 134 of IAS 36—for example, information on key assumptions, the discount rates applied and sensitivity analysis—might not be disclosed when the impairment test is not performed.

11. Some respondents agreed with the preliminary view, and said:

    (a) the preliminary view would reduce costs without reducing the impairment test's robustness; and

    (b) the benefits of performing an impairment test when there are no indicators of impairment are minimal.

Analysis

12. The objective of removing the annual testing requirement was to reduce the cost and complexity of the impairment test, without significantly reducing its robustness. The vote for the preliminary view was close (eight of 14 IASB members voted in favour). Many respondents to the Discussion Paper did not support the preliminary view.

13. Although we continue to think that it is unlikely a quantitative impairment test would identify an impairment if there were no indicators of impairment, feedback casts some doubt on the IASB's effects analysis of the preliminary view (see paragraph 6).

14. Most respondents who commented on the potential effect of removing the annual testing requirement, said doing so would reduce the test's effectiveness and result in further delays in recognising impairment losses on goodwill.

15. A few respondents (including many regulators) said removing the annual testing requirement would make it more difficult for auditors and regulators to enforce the impairment test. For example, if the quantitative impairment test is not performed annually, auditors and regulators might not have comparative information from impairment tests performed in previous years. This may undermine the ability of auditors and regulators to assess the reasonableness of assumptions used.

16. On the other hand, a few respondents said removing the annual testing requirement would not reduce the robustness of the impairment test. Academic evidence[1] from the United States shows that entities performing a qualitative assessment (Step Zero) applying US generally accepted accounting principles, exhibit no reduction in the timeliness of impairment loss recognition. This suggests that not performing the quantitative impairment test annually would not affect the robustness of the test, although Step Zero is not the same as an indicator-only approach.

17. Feedback suggests the disclosures from the annual quantitative impairment test are useful. Some respondents said removing the requirement to perform the annual quantitative impairment test might result in loss of information that could help users understand whether an impairment could occur in the future—for example, information required by paragraph 134 of IAS 36. Several stakeholders discussing some of the suggestions for improvements to the impairment test (see Agenda Paper 18D) said those suggested improvements are not required because some of the requirements in IAS 36 are sufficient to ensure the robustness of the impairment test—disclosure of key assumptions as required by paragraph 134 of IAS 36 was one of the requirements mentioned.

18. Feedback on the extent of cost reduction that would result from removing the annual testing requirement was mixed. Some respondents said performing a qualitative assessment of indicators of impairment would be less costly than performing a quantitative impairment test annually because entities would not be required to estimate future cash flows for each CGU. However, some respondents disagreed.

19. For example, a few respondents said any cost reduction would be relatively marginal because entities would likely continue to perform the test annually, even if not required to do so. This could be because it is easier to perform a quantitative impairment test than to assess whether a quantitative test is required, or because

[1] Black, D. E., Krupa, J., and Minutti-Meza, M. (2019), 'The Optional Qualitative Assessment in Impairment Tests', *SSRN Electronic Journal* and Adame, K. (2019), 'Step Zero: Determinants and Implications of Reliance on the Qualitative Goodwill Impairment Assessment', *SSRN Electronic Journal*.

performing a quantitative impairment test is part of their annual governance process. We heard similar feedback in our outreach discussing stakeholder suggestions for other changes to the impairment test (see paragraph A4 and Agenda Paper 18D). However, one preparer from a European preparer group, that we also spoke with, said they preferred an indicator-only approach. An entity could still perform a quantitative impairment test annually if that was their policy, but this should not prevent those entities who would prefer to apply an indicator-only approach from doing so.

20. On balance, we recommend that the IASB not proceed with its preliminary view—that is, we recommend the IASB retain the annual testing requirement. In particular we think:

   (a) removing the annual testing requirement risks reducing the robustness of the impairment test and the loss of useful information for users; and

   (b) proceeding with the preliminary view might not result in a significant reduction in the cost and complexity of the impairment test.

Alternatives

21. Stakeholders suggested the following alternatives to removing the annual testing requirement:

   (a) making paragraph 99 of IAS 36 easier to apply (paragraphs 22–31);

   (b) requiring a quantitative impairment test to be performed periodically (paragraphs 32–36); and

   (c) making the requirement for performing a quantitative impairment test annually an accounting policy choice (paragraphs 37–38).

Paragraph 99 of IAS 36

Background

22. A few respondents, mainly accounting firms and national standard-setters, suggested that instead of removing the annual testing requirement, the IASB explore whether the relief from estimating the recoverable amount of a CGU containing goodwill set out in paragraph 99 of IAS 36 could be made easier to apply.

23. Paragraph 99 of IAS 36 says:

> 99 The most recent detailed calculation made in a preceding period of the recoverable amount of a cash-generating unit to which goodwill has been allocated may be used in the impairment test of that unit in the current period provided all of the following criteria are met:
>
> (a) the assets and liabilities making up the unit have not changed significantly since the most recent recoverable amount calculation;
>
> (b) the most recent recoverable amount calculation resulted in an amount that exceeded the carrying amount of the unit by a substantial margin; and
>
> (c) based on an analysis of events that have occurred and circumstances that have changed since the most recent recoverable amount calculation, the likelihood that a current recoverable amount determination would be less than the current carrying amount of the unit is remote.

24. Paragraph BC177 of the Basis for Conclusions on IAS 36 notes the IASB's view that, in applying paragraph 99 of IAS 36, many entities should be able to conclude that the recoverable amount of a CGU to which goodwill has been allocated is greater than its carrying amount without actually recomputing recoverable amount. The IASB

concluded that permitting an entity to use a prior calculation of the recoverable amount only if it met the conditions in paragraph 99 of IAS 36 would significantly reduce the costs of applying the impairment test, without compromising its integrity.

25. Respondents to the Discussion Paper said paragraph 99 is applied infrequently because of a perceived lack of clarity on some of the criteria. They said it can be difficult to provide sufficient evidence to auditors and regulators to support the application of the paragraph. Several respondents said clarifying the meaning of terms such as ‘substantial margin’ and ‘remote’ could increase the frequency at which paragraph 99 is applied.

26. We discussed the suggestion to clarify the criteria in paragraph 99 with the IASB’s consultative groups and the IFRS Interpretations Committee (Committee). Feedback from those discussions is summarised in the Appendix.

Analysis

27. In both the responses to the Discussion Paper and our subsequent outreach there was limited support to make changes to paragraph 99.

28. In subsequent outreach, stakeholders highlighted concerns with making the paragraph easier to apply and the effect that doing so might have on the robustness of the impairment test.

29. We agree that the criteria to be able to use this relief need to be stringent. We therefore think the criteria should remain unchanged.

30. We also think it would be difficult to provide guidance on how to apply the criteria—for example, on what constitutes a significant change or a substantial margin—within a principles-based approach.

31. However, there is merit in the suggestions to increase the awareness of this relief and remind stakeholders of its purpose. We agree doing so could help increase its use in

appropriate circumstances. We will consider ways to increase the awareness of this relief.

Periodic impairment test

32. In developing its preliminary view to remove the annual testing requirement, the IASB explored requiring entities to perform a quantitative impairment test, even if there is no indication of impairment, only in some years and to follow an indicator-only approach in the intervening periods (for example to perform a quantitative impairment test once every three years).

33. Although such an approach may be marginally more robust than an indicator-only impairment test, the IASB did not pursue this because setting the period when an entity would be required to perform a quantitative impairment test would be arbitrary and would add complexity—for example, if goodwill from different business combinations is allocated to the same CGU.

34. A few respondents to the Discussion Paper suggested reducing the frequency of performing a mandatory quantitative impairment test because doing so would reduce costs but maintain more rigour in the impairment test than an indicator-only impairment test.

35. In our outreach one preparer also suggested reducing the frequency of performing a quantitative impairment test based on the risk of impairment as a potential alternative to removing the annual testing requirement.

36. However, we think the feedback does not provide new arguments that the IASB did not consider when developing its preliminary view and therefore we think the IASB should not explore a periodic impairment test.

Accounting policy choice

37. A few respondents to the Discussion Paper suggested making the annual testing requirement an accounting policy choice, because entities might have different opinions on whether an annual quantitative test provides better governance or whether an indicator-only approach is more cost efficient.

38. Although making the annual testing requirement an accounting policy choice might allow entities to adjust the frequency of performing a quantitative impairment test to fit their facts and circumstances, we think it would also reduce the comparability of financial statements. Therefore, we think the IASB should not pursue making the annual testing requirement an accounting policy choice.

Summary of staff recommendations

39. For the reasons set out in paragraphs 12–20, we recommend that the IASB not proceed with its preliminary view—that is, we recommend the IASB retain the requirement in IAS 36 for an entity to perform a quantitative impairment test of CGUs containing goodwill annually.

40. For the reasons set out in paragraphs 27–38, we recommend that the IASB not pursue any of the alternatives to an annual quantitative impairment test suggested by respondents to the Discussion Paper.

Question for the IASB
Does the IASB agree with the staff recommendations in paragraph 39 and 40?

Appendix—Additional feedback on paragraph 99 of IAS 36

A1. We discussed whether to clarify or amend paragraph 99 of IAS 36 to make it easier to apply at the March 2023 meetings of:

(a) Global Preparers Forum (GPF);

(b) Capital Markets Advisory Committee (CMAC);

(c) IFRS Interpretations Committee (Committee); and

(d) Accounting Standards Advisory Forum (ASAF).

A2. We asked members of these groups:

(a) Whether paragraph 99 is applied frequently and if not, why not?

(b) How could (and should) the IASB make it easier to apply?

(c) Would paragraph 99 (if applied) significantly reduce cost and complexity of the impairment test without reducing its effectiveness?

(d) Whether an entity applying paragraph 99 should be required to disclose additional information.

(e) If changes were made to paragraph 99, should similar changes be made for intangible assets with indefinite useful lives for which paragraph 24 of IAS 36 provides similar relief?

A3. Feedback from these groups is summarised as follows:

(a) Current application of paragraph 99 (paragraphs A4–A6);

(b) Whether to make paragraph 99 easier to apply (paragraphs A7–A11);

(c) Other suggestions (paragraphs A12–A15); and

(d) Other comments (paragraphs A16–A17).

Current application

A4. Many preparers, auditors and national standard-setters said paragraph 99 is rarely applied. These stakeholders highlighted different reasons:

(a) the existence of the relief is not obvious because of its location in IAS 36;

(b) entities prefer to perform the impairment test annually for governance purposes (internal or external);

(c) auditors apply the criteria for the relief very stringently; and

(d) it is difficult to demonstrate that the criteria for the relief have been met—for example, it is difficult to demonstrate that the assets and liabilities of the CGU have not changed significantly since the most recent calculation of recoverable amount.

A5. One Committee member said they have seen paragraph 99 applied by sophisticated, well controlled entities with a comprehensive understanding of the drivers of recoverable amount and the sensitivity of key assumptions in their impairment tests.

A6. Some national standard-setters and one Committee member said paragraph 99 is used for interim reporting.

Whether to make changes to paragraph 99

A7. Some preparers said the wording of paragraph 99 is fine. One preparer said the criteria set a high hurdle, but in the rare circumstances they are met, entities should be allowed to perform a simplified version of the impairment test as permitted by paragraph 99.

A8. One user said it is not clear what difficulties entities have with the current requirement but that there would be no problem in clarifying the wording.

A9. One national standard-setter said additional guidance (for example, on what a significant change and a substantial margin are) would make paragraph 99 easier to apply.

A10. However, there were also some users concerned about making paragraph 99 easier to apply. One user said there needs to be clear and strong criteria and another user was concerned about reducing the robustness of the impairment test, given the IASB's decision to retain the impairment-only model.

A11. Similarly, some national standard-setters said the criteria for relief should be stringent, and they were concerned that application of paragraph 99 could result in impairment losses being recognised too late.

Other suggestions

A12. A few stakeholders said, in their view, a potential reason why paragraph 99 is not used frequently is because of where it is placed in the standard and it not being integrated with the other requirements in IAS 36. A few stakeholders suggested improving the awareness of the requirement which could increase its use.

A13. One preparer suggested providing relief from performing a quantitative impairment test in the year an acquisition is made because impairment is unlikely so soon after the acquisition.

A14. One preparer suggested changing to a periodic impairment test, with the frequency of performing a quantitative impairment test dependent on the risk of impairment. If that risk is high, a test should be performed annually, whereas where the risk is lower the test should be performed every three to five years.

A15. One auditor suggested introducing a 'backstop' to paragraph 99 whereby an entity would need to refresh the recoverable amount every two to three years because the recoverable amount determined in a prior test is likely to be viable for only a short period of time.

Other comments

A16. One national standard-setter and one auditor said an entity should be required to disclose how they met the criteria in paragraph 99 or that they had applied that paragraph.

A17. One national standard-setter and two auditors said if clarifications or amendments are made to paragraph 99, similar amendments should also be made to paragraph 24 of IAS 36 which provides similar relief for intangible assets with indefinite useful lives.