Staff paper

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Project	**Business Combinations—Disclosures, Goodwill and Impairment**
Topic	**Other IAS 36 proposals**
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Purpose and structure

1. As Agenda Paper 18 explains, this paper provides the International Accounting Standards Board (IASB) with our analysis of feedback on proposals in the Exposure Draft *Business Combinations—Disclosures, Goodwill and Impairment* (Exposure Draft):
   (a) to require an entity to disclose in which reportable segment a cash-generating unit (CGU) or group of CGUs containing goodwill is included (reportable segment disclosure); and
   (b) to remove the requirement to calculate value in use (VIU) using pre-tax cash flows and a pre-tax discount rate but add a requirement to disclose whether the discount rate used is pre-tax or post-tax (allowing use of post-tax discount rate).

2. This paper asks if the IASB agrees with our recommendations to retain both of these proposals. This paper also analyses suggestions for other changes to IAS 36 *Impairment of Assets*.

3. This paper is structured as follows:
   (a) reportable segment disclosure:

(i) background (paragraphs 4–5);

(ii) key messages from feedback (paragraph 6);

(iii) analysis (paragraphs 7–18);

(iv) staff recommendation (paragraph 19); and

(v) question 1 for the IASB; and

(b) allowing use of post-tax discount rate:

(i) background (paragraphs 20–21);

(ii) key messages from feedback (paragraphs 22–23);

(iii) analysis (paragraphs 24–31);

(iv) staff recommendation (paragraph 32); and

(v) question 2 for the IASB; and

(c) other feedback and question 3 for the IASB (paragraph 33).

Reportable segment disclosure

Background

4. Paragraph BC188 of the Basis for Conclusions on the Exposure Draft (Basis for Conclusions) identifies management over-optimism as one of two broad reasons for stakeholder concerns about possible delays in recognising impairment losses on goodwill. Paragraph BC189(c) of the Basis for Conclusions notes the IASB's observation that 'overly optimistic estimates of cash flows are best addressed by auditors and regulators, instead of by changing IFRS Accounting Standards'.

5. Nonetheless, the Exposure Draft proposed requiring entities to disclose in which reportable segment a CGU (or group of CGUs) containing goodwill is included. Paragraph BC202 of the Basis for Conclusions states:

> …The proposal has been developed because:

(a) in the IASB's view, this information would help users better assess the reasonableness of assumptions used in the impairment test and thereby help reduce management over-optimism. Users would be able to compare these assumptions with the information they receive about reportable segments and with their own assumptions about the future performance of those reportable segments.

(b) the IASB's research suggests that disclosing this information would not result in significant costs—entities are likely already to have this information. A few stakeholders said some entities already disclose this information.

(c) knowing to which reportable segment goodwill has been allocated would provide users with information that, together with other information disclosed in accordance with IFRS 3, could help them assess the decision of an entity's management to acquire a business and integrate it with the entity's other businesses. This outcome would align with the project's objective of providing better information about business combinations.

Key messages from feedback

6. As paragraphs 8–12 of Agenda Paper 18D to the IASB's January 2025 meeting (January agenda paper) notes:

(a) most respondents agreed with the proposal for reasons considered by the IASB.

(b) some respondents disagreed. A few of them disagreed that management over-optimism is a problem and/or that overly optimistic estimates of cash flows is best addressed by auditors and regulators. These respondents say, for example:

(i) management and those charged with governance—and not external parties such as auditors and regulators—have primary responsibility for the reasonableness of assumptions and estimates;

(ii) robust standard-setting—not enforcement mechanisms—should address these matters;

(iii) established management processes and regular auditor challenges already address potential over-optimism; and

(iv) IAS 36 sufficiently safeguards against management over-optimism by requiring entities to disclose key assumption and sensitivity analysis.

(c) a few other respondents said the disclosure might not be as useful as the IASB intends (paragraph 11 explains their reasons).

(d) a few respondents suggested providing guidance on how to calculate terminal value or introducing other disclosure requirements, either instead of, or in addition to the proposal. Paragraphs 13–18 explain these suggestions.

Analysis

7. We analyse below:

(a) feedback on the proposed disclosure requirement (paragraphs 8–12); and

(b) alternative suggestions (paragraphs 13–18).

Proposed disclosure requirement

8. We continue to agree with paragraph BC188 of the Basis for Conclusions that management over-optimism is one of two broad reasons for stakeholder concerns about possible delays in recognising impairment losses on goodwill. While some respondents to the Exposure Draft questioned whether management over-optimism is a problem and said existing requirements adequately address management over-optimism, other respondents commenting on the proposal did not. In feedback to the Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment*,

many respondents said management over-optimism is part of the reason for possible delays in recognising impairment losses on goodwill and some respondents said management over-optimism is the main reason for possible delays in recognising impairment losses on goodwill.

9. For reasons previously considered by the IASB (see paragraph BC189(c) of the Basis for Conclusions), we also continue to agree with the IASB's observation that changing IFRS Accounting Standards is not the best way to address overly optimistic estimates of cash flows.

10. Notwithstanding our view in paragraph 9, we continue to agree with the proposal to require entities to disclose in which reportable segment a CGU (or group of CGUs) containing goodwill is included for reasons considered by the IASB (see paragraph 5). Most respondents agreed with the proposals for the same reasons.

11. We acknowledge the view of a few respondents who disagreed and said the disclosure might not be as useful as intended because:

    (a) it will be difficult for a user to reconcile CGU-level assumptions and segment-level information when a reportable segment contains multiple CGUs; and

    (b) the disclosure will only be provided by entities applying IFRS 8 and not all entities applying IFRS Accounting Standards.

12. Nonetheless, we think:

    (a) the disclosure would provide a helpful reference point for users and a reconciliation between CGU-level information and reportable segment information is unnecessary and could be unduly costly; and

    (b) requiring entities not applying IFRS 8 to disclose the information required applying this proposal would impose unreasonable costs on those entities.

Alternative suggestions

13. As paragraph 6 notes, a few respondents provided alternative suggestions. As the IASB noted when developing the Exposure Draft and considering suggestions from stakeholders to improve the effectiveness of the impairment test[1]:

    (a) this project was not established to conduct a full review of IAS 36—it is not a post-implementation review (PIR) of IAS 36. Instead, this project was established to respond to feedback on the PIR of IFRS 3 *Business Combinations*. Hence, considering whether the suggestions would respond to the feedback on the PIR of IFRS 3 about the impairment test was a key factor in identifying suggestions that could be explored further within the scope of this project.

    (b) to identify suggestions that could be explored further as part of this project, the IASB considered only those suggestions that:

        (i) could mitigate either of the two main reasons the IASB identified for possible delays in recognising impairment losses on goodwill—management over-optimism and shielding; and

        (ii) can be implemented at a reasonable cost.

14. We continue to apply the same criteria in assessing respondents' suggestions.

Terminal value guidance

15. A few respondents suggested providing guidance for terminal value calculations. The IASB considered this in developing the Exposure Draft (see paragraph A1 of Agenda Paper 18C to the IASB's May 2023 meeting). Respondents have not provided new evidence that changes our view of this suggestion—we continue to think providing such guidance would require a broader change to IAS 36 which would go beyond the scope of this project.

[1] See paragraphs 14–15 and paragraphs 24–25 of Agenda Paper 18C to the IASB's May 2023 meeting.

Comparison of previous assumptions to actual results

16. A few respondents suggested requiring entities to disclose a comparison of the assumptions used in the impairment test which had been disclosed in previous reporting periods to actual results in the current period. The IASB considered and consulted on this suggestion when developing the Exposure Draft. As paragraphs 38–50 of Agenda Paper 18D of the IASB's May 2023 meeting explain:

    (a) the disclosure might not provide useful information to help reduce management over-optimism; and

    (b) the disclosure might be costly (including preparing the information, explaining differences or disclosing commercially sensitive information).

17. Respondents have not provided new evidence that changes our view of this suggestion since the IASB previously considered it and therefore we think the IASB should not explore this suggestion further.

Comparison with market parameters

18. A few respondents suggested requiring entities to disclose a comparison of the assumptions used in the impairment test with market parameters. We understand that users generally have access to market parameters and can and usually do make these comparisons as part of their analysis. For reasons similar to those in paragraph 16(a) and 16(b) above, we think the IASB should not explore this suggestion further.

Staff recommendation

19. We recommend:

    (a) retaining the proposals to require an entity to disclose in which reportable segment a CGU or group of CGUs containing goodwill in included; and

    (b) not exploring further any of the other suggestions made by respondents in relation to management over-optimism.

Question 1 for the IASB
Does the IASB agree with our recommendation in paragraph 19?

Allowing use of post-tax discount rate

Background

20. As paragraph BC215 of the Basis for Conclusions explains, in calculating VIU, IAS 36 requires an entity to use pre-tax cash flows and discount them using pre-tax discount rates. To reduce the cost and complexity of the impairment test, the IASB proposed to remove this requirement. Consequently, an entity would be able to use either pre-tax or post-tax cash flows and discount rates to calculate VIU. The IASB also proposed to require an entity to disclose whether the discount rate used is pre-tax or post-tax.

21. Paragraphs BC215–BC222 of the Basis for Conclusions explain the IASB's rationale for this proposal. As paragraph BC219 notes, in the IASB's view this proposal would:

    (a) make the impairment test easier to understand by aligning it with valuation practice.

    (b) not require entities to calculate pre-tax discount rates solely to satisfy the disclosure requirements in IAS 36.

    (c) provide users with more useful information.

    (d) better align the value in use calculation in IAS 36 with fair value in IFRS 13 *Fair Value Measurement*. IFRS 13 does not specify whether an entity is required to use pre-tax or post-tax cash flows and discount rates to measure fair value using a present value technique. Instead, IFRS 13 requires an entity to use internally consistent assumptions about cash flows and discount rates.

Key messages from feedback

22. Almost all respondents agreed with the proposal for reasons consistent with those considered by the IASB. A few respondents disagreed and said the proposal could lead to diversity unless the IASB provides additional guidance (see paragraph 23).

23. In developing the proposals, the IASB considered requests from stakeholders to provide further guidance and illustrative examples to help entities calculate VIU using post-tax cash flows and discount rates. Paragraph BC220 of the Basis for Conclusions explains why the IASB decided not to do so. Nonetheless, as paragraph 17 of the January agenda paper notes, many respondents to the Exposure Draft requested further guidance and illustrative examples. Respondents requested:

    (a) additional guidance for, and/or disclosures of, tax effects (see paragraph 17(a) of the January agenda paper for details);

    (b) clarifying whether the choice between calculating VIU on a pre-tax or a post-tax basis is an accounting policy choice requiring consistent application;

    (c) guidance on how to transition from using pre-tax cash flows and pre-tax discount rates to using post-tax cash flows and post-tax discount rates; and

    (d) guidance on the use of post-tax cash flows and discount rates for specific industries or situations.

Analysis

24. For reasons previously considered by the IASB (see paragraph 21), we think the IASB should retain its proposals to:

    (a) remove the requirement to calculate VIU using pre-tax cash flows and a pre-tax discount rate; and

    (b) require an entity to disclose whether the discount rate used is pre-tax or post-tax.

25. Almost all respondents agreed with the proposals. Respondents that disagreed did not disagree with the IASB's rationale for the proposals but instead requested further guidance which we consider below.

Requests for additional guidance

Requests in paragraphs 23(a) and 23(d)

26. As paragraph 23(a) and 23(d) explain, respondents requested additional guidance for, and/or disclosures of, tax effects. The IASB considered such requests in developing its proposals in the Exposure Draft. Respondents also requested guidance on the use of post-tax cash flows and discount rates for specific industries or situations.

27. As paragraph BC220 of the Basis for Conclusions explains, the IASB did not propose to include further guidance and illustrative examples because:

    (a) stakeholders said entities already use post-tax cash flows and post-tax discount rates to estimate value in use.

    (b) entities using pre-tax cash flows and pre-tax discount rates already have to make similar judgements about tax effects.

    (c) the proposal is consistent with a similar amendment the IASB made to IAS 41 *Agriculture* in *Annual Improvements to IFRS Standards 2018–2020*.[2] The IASB did not provide such clarifications or guidance when it amended IAS 41.

28. We continue to think it is unnecessary to provide further guidance or illustrative examples for reasons previously considered by the IASB. Respondents have not provided new evidence that changes our view in this respect. We also think it is unnecessary to add a requirement for an entity to disclose the approach used for reflecting tax effects and an explanation of key assumptions related to tax consequences as requested by respondents. Applying the proposals, an entity would already be required to disclose whether the discount rate used is pre-tax or post-tax.

[2] The IASB amended IAS 41 as part of Annual Improvements to IFRS Standards 2018–2020 to remove the requirement to exclude taxation cash flows in measuring the fair value of biological assets.

Additionally, paragraph 134(d) of IAS 36 already requires disclosure of each key assumption, including management's approach to determining the values assigned.

Requests in paragraphs 23(b) and 23(c)

29. As paragraphs 23(b) and 23(c) note, respondents suggested:

(a) clarifying whether the choice between calculating VIU on a pre-tax or a post-tax basis is an accounting policy choice requiring consistent application; and

(b) providing guidance on how to transition from using pre-tax cash flows and pre-tax discount rates to using post-tax cash flows and post-tax discount rates.

30. Paragraph BCZ85 of IAS 36 states:

> 'In theory, discounting post-tax cash flows at a post-tax discount rate and discounting pre-tax cash flows at a pre-tax discount rate should give the same result…'.

31. Therefore, we think it is unnecessary for the IASB to specify whether such a choice is an accounting policy or to provide transition guidance. We note that the IASB did not provide similar clarifications or guidance when it made a similar amendment to IAS 41 (see paragraph 27(c)).

Staff recommendation

32. We recommend:

(a) retaining the proposals to:

(i) remove the requirement to calculate VIU using pre-tax cash flows and a pre-tax discount rate; and

(ii) require an entity to disclose whether the discount rate used is pre-tax or post-tax.

(b) not exploring further other suggestions made by respondents in relation to this proposal (summarised in paragraph 23).

Question 2 for the IASB
Does the IASB agree with our recommendation in paragraph 32?

Suggestions for other changes to IAS 36

33. As paragraphs 18–19 of the January agenda paper note:

    (a) some respondents said a more fundamental change to IAS 36 is required to address the concern about impairment losses sometimes being recognised too late, for example pursuing the headroom approach. The IASB considered this feedback (see paragraphs 33–36 of Agenda Paper 18 of the IASB's February 2025 meeting) when deciding whether to retain its approach to achieving the project objective. The IASB decided to consider only targeted improvements to the impairment test to mitigate management over-optimism and shielding.

    (b) one respondent suggested strengthening the requirements to use reasonable and supportable assumptions through application guidance. Another respondent suggested revisiting Example 9 of the Illustrative Examples accompanying IAS 36 to illustrate how an entity applies disclosure requirements related to assumptions in paragraph 134(d) of IAS 36—an existing disclosure requirement. We note these are isolated requests and think these suggestions go beyond scope of changes the IASB decided to consider (see paragraph 13(b)).

Question 3 for the IASB
Does the IASB have questions or comments on our analysis in paragraph 33?