IFRS

STAFF PAPER

June 2019

IASB® Meeting

Project	**Goodwill and Impairment**		
Paper topic	Preliminary views		
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Purpose of this paper

1. The purpose of this paper is to:
   (a) set out the staff recommendation for the Board's preliminary views to include in the Discussion Paper on the various ideas being explored in this project in accordance with the project objectives set by the Board in July 2018;
   (b) explain how those recommended preliminary views are aligned with those project objectives; and
   (c) compare and contrast those recommended preliminary views to other packages of preliminary views that the Board could include in the Discussion Paper, and the extent to which those other packages are aligned with the project objectives.

Structure of the paper

2. This paper is structured as follows:
   (a) Project objectives (paragraphs 3–5);
   (b) Summary of staff recommendations for preliminary views from accompanying Agenda Papers (paragraphs 6–20);

(c) Analysis of possible packages of preliminary views (paragraphs 21–35);

(d) Questions for the Board; and

(e) Appendix A—AASB – improving the impairment testing model in IAS 36

Project objectives

3. In the July 2018 Board meeting, on the basis of the findings from the research project, the Board made the following tentative decisions:

   (a) to pursue the objective of exploring whether disclosures could be improved to enable investors to assess more effectively whether a business combination was a good investment decision and whether the acquired business is performing after the acquisition as was expected at the time of the acquisition;

   (b) to pursue the objective of simplifying the accounting for goodwill by exploring whether to:

      (i) reintroduce amortisation; and/or

      (ii) provide relief from the mandatory annual quantitative impairment testing of goodwill;

   (c) to pursue the objective of improving the calculation of value in use (VIU) by removing from IAS 36 *Impairment of Assets*:

      (i) the restriction that excludes from the calculation those cash flows that are expected to result from a future restructuring or from a future enhancement; and

      (ii) the requirement to use pre-tax inputs in the calculation.

4. In addition, the Board tentatively decided to retain the existing model for impairment testing in IAS 36. This was in response to a previous objective of exploring whether to improve the effectiveness of the impairment test for goodwill. The Board had been considering that previous objective, following feedback from the Post-implementation review (PIR) of IFRS 3 *Business Combinations* that impairment losses are often recognised ‘too late’. Based on the

work performed in the project, the Board concluded that it was not possible to make significant improvements to the impairment test nor possible to design an impairment test that would target the acquired goodwill in isolation. However, many stakeholders still have concerns that the recognition of impairment losses is not timely; the ideas being explored to meet the project's objectives could have some interaction with these concerns about the possible lack of timeliness. Hence, this issue of lack of timeliness will be considered as part of the Board's overall response to the feedback from the PIR of IFRS 3 in this paper.

5. In a previous Board meeting (April 2018), the Board tentatively decided not to consider allowing any identifiable intangible assets acquired in a business combination to be included within goodwill. That was another objective the project had been exploring, following feedback from the PIR of IFRS 3 that the separate recognition and measurement requirements of particular intangible assets is challenging. This issue will not be considered further in this paper since it is unrelated to the remaining objectives of the project. However, this issue is intended to be included in the Discussion Paper, explaining the reasons for the Board's decision and allowing stakeholders to respond with their views.

Summary of staff recommendations for preliminary views from accompanying Agenda Papers

Agenda Paper 18A Better disclosures for business combinations

6. In relation to the objective of exploring whether disclosures could be improved to help investors to assess more effectively whether a business combination was a good investment decision and whether the acquired business is performing after the acquisition as was expected at the time of the acquisition, the staff recommended improvements to:

   (a) the disclosure objectives of IFRS 3 to:

      (i) clarify some existing disclosure requirements; and

      (ii) result in entities providing new information, thus helping users of the financial statements (users) to assess the subsequent performance of the acquired business, or combined business;

(b) add disclosure requirements for entities to provide information that will help users to assess whether the key objectives of the business combination are being achieved; and

(c) make targeted improvements to existing disclosure requirements of IFRS 3 that are not leading entities to provide the information the Board expected. Those improvements would require entities to disclose:

(i) the amount, or range of amounts, of expected synergies;

(ii) separately any liabilities arising from financing activities and defined benefit pension obligations assumed;

(iii) the amounts of the acquiree's revenue, operating profit or loss[1], and cash flow from operating activities since the acquisition date; and

(iv) a 'catch-all' requirement to ensure the disclosures provided are sufficient to meet the disclosure objectives of IFRS 3.

7. These suggested improvements were in response to feedback from the PIR of IFRS 3 that insufficient information is provided to help users understand the subsequent performance of the acquired business and whether the main targets and expected synergies of the acquisition are being achieved. Other feedback indicated that some of the existing requirements of IFRS 3 were not providing the information that was expected.

Agenda Paper 18B Reintroduction of amortisation of goodwill

8. The staff recommended the Board include a preliminary view in the Discussion Paper that the Board should retain the existing impairment-only model for the subsequent accounting for goodwill.

9. The staff acknowledged there are arguments to support the reintroduction of amortisation, but they observed there are also arguments to retain the existing

[1] The meaning of operating profit or loss would follow the definition by the *Primary Financial Statements* project, but be adjusted to exclude any acquisition-related transaction or integration costs.

impairment-only approach. On balance, the staff did not believe there is strong enough evidence to justify reintroducing amortisation.

10. In particular, the staff thought that amortisation is not an appropriate response to the ‘too late’ issue. The existing impairment test, if operating correctly, ensures the carrying amount of goodwill does not exceed the amount recoverable from the cash flows jointly generated by the goodwill and other assets of the cash-generating unit(s) (CGU(s)). If the impairment test is not being operated correctly, amortisation does not solve that issue. The recommended improvements to disclosures on subsequent performance would enable users of financial statements to assess for themselves whether the business combination has been a success and whether the benefits the goodwill related to still remain. The staff thought this provides more useful information than an arbitrary amortisation charge. Overall, the staff concluded that a desire to reduce the carrying amount of goodwill is not a strong enough argument to reintroduce amortisation.

Agenda Paper 18D Relief from mandatory annual impairment test

11. The staff recommended the Board include a preliminary view in the Discussion Paper to remove the requirement to carry out an annual quantitative impairment test for goodwill when no indicator of impairment exists. The staff also recommended that the Board apply the same relief for intangible assets with indefinite useful lives and intangible assets not yet available for use.

12. This relief was one of the ideas being explored to address the feedback from the PIR of IFRS 3 that the impairment test was costly and complex.

13. The staff thought that providing entities with relief from the mandatory quantitative annual impairment test could result in cost-savings for preparers and result in a uniform impairment model for all CGUs. The staff thought the loss in robustness of the impairment test and the loss of some information generated by the impairment test would not be significant enough to justify retaining the quantitative annual impairment test.

Agenda Paper 18E Value in use–cash flows from a future restructuring or a future enhancement

14. The staff recommended the Board include a preliminary view in the Discussion Paper to remove the restriction that excludes from the estimation of VIU of an asset (or a CGU) cash flows expected to arise from a future restructuring or a future enhancement.

15. This would help reduce the costs and complexity of the impairment test. It would also capture the value of the existing potential of an asset, helping to make the unit of account adopted for estimating VIU the same as that adopted for measuring fair value less costs of disposal. Both estimates would then capture this value.

16. To address concerns about the inclusion of unjustifiably optimistic cash flows in the estimation of VIU as a result of removing this restriction, the staff recommended:

    (a) a ‘more likely than not’ threshold be set for the inclusion of cash flows from future restructurings or future enhancements; and

    (b) requiring qualitative disclosures about future restructurings to which an entity is not yet committed or about future enhancements of an asset which are yet to occur.

Agenda Paper 18F Value in use–use of post-tax inputs

17. The staff recommended the Board include a preliminary view in the Discussion Paper to remove the requirement to use pre-tax inputs and a pre-tax discount rate to calculate VIU and to require entities to use internally consistent assumptions about cash flows and discount rates, and disclose the discount rate(s) used in the estimation of VIU.

18. This would also help with the cost and complexity of the impairment test and make the test more understandable—stakeholders told us in the feedback from the PIR of IFRS 3 that, in practice, post-tax inputs are used to estimate VIU as pre-tax discount rates are not observable.

19. The Discussion Paper would explore whether there is a need for further guidance on how to ensure that there is no ‘double counting’ of tax cash flows in estimates of VIU.

Summary

20. The staff recommend that the Board include a preliminary view in the Discussion Paper to:

    (a) provide better disclosures for business combinations, particularly on the subsequent performance of the acquired business, or combined business;

    (b) not to reintroduce amortisation of goodwill;

    (c) provide relief from the mandatory annual quantitative impairment test of goodwill;

    (d) permit the inclusion of cash flows from future restructurings or future enhancements in estimates of VIU; and

    (e) permit the use of post-tax inputs in estimates of VIU.

Analysis of possible packages of preliminary views

21. The key elements of feedback from the PIR of IFRS 3 that the objectives, and consequently the ideas explored, seek to address are:

    (a) impairment losses are recognised ‘too late’;

    (b) the impairment test is costly and complex to perform;

    (c) many respondents preferred the reintroduction of the amortisation of goodwill; and

    (d) insufficient information is provided to help users understand the subsequent performance of the acquired business.

22. The overall aims that the objectives seek to achieve are:

    (a) provide better information for users; and

(b) reduce cost and complexity by simplifying the accounting for goodwill and the impairment test.

23. As discussed in paragraph 4, the staff's analysis also considers the implications of the packages of preliminary views for the effectiveness of the impairment test.

24. Since the objectives are interrelated and can conflict with or complement one another, the package of preliminary views needs to strike the appropriate balance between the different objectives.

25. Table 1 analyses the staff recommendation for the Board's preliminary views to include in the Discussion Paper against the overall aims of the project objectives. The staff recommendation of preliminary views is based on the staff recommendations in the individual Agenda Papers for this meeting, as summarised in paragraph 20.

26. To summarise another possible package of preliminary views, Table 2 analyses a package of preliminary views that is the same as the staff recommendation except that it includes a preliminary view to reintroduce amortisation rather than retain the impairment-only model.

27. After Table 2, the staff discuss briefly some other possible variants on the staff's recommendations.

Table 1 Staff recommendation for Board's preliminary views

Idea being explored	Staff recommendation	Aims achieved	Aims hindered
Better disclosures for business combinations	Provide better disclosures for business combinations, particularly on subsequent performance of the acquired business, and targeted improvements to existing requirements	• Provides better information for users • Addresses feedback from PIR of IFRS 3 that users need information on subsequent performance of acquired business	• Additional costs for preparers to provide additional disclosures • Additional costs limited by use of chief operating decision maker threshold and removing pro forma information requirement, but less information provided as a consequence • Further deletions could further offset the additional costs
Reintroduction of amortisation	Retain an impairment-only model and not reintroduce amortisation of goodwill	• Better information from impairment test retained • Purpose of impairment test clarified for stakeholders	• Was not possible to amend impairment test to target acquired goodwill in isolation • Consumption may be mislabelled as impairment loss

Idea being explored	Staff recommendation	Aims achieved	Aims hindered
		• Avoids disruption when there is, at best, a marginal case for change	
Relief from the mandatory annual impairment test	Remove the requirement for a mandatory annual quantitative test of goodwill and some intangible assets	• Reduces the costs associated with the impairment test (performing test/providing disclosures)	• Change in frequency of performing test should result in only limited reduction in robustness of test • Loss of disclosures generated by goodwill impairment tests
Removing requirement to use pre-tax inputs in calculating VIU	Permit the use of post-tax inputs and a post-tax discount rate to estimate VIU	• Permits disclosure of post-tax discount rates, which are likely to be more useful information • Makes test more understandable	

Idea being explored	**Staff recommendation**	**Aims achieved**	**Aims hindered**
Removing restrictions on cash flow projections used in calculating VIU	Permit the inclusion of cash flows from future restructurings or future enhancements in estimates of VIU	• Reduces cost and complexity of performing test • Improves effectiveness as cash flow forecasts used are not just produced for financial reporting purposes	• Might impact robustness of test by permitting inclusion of unjustifiably optimistic cash flows

Table 2 Preliminary views including reintroduction of amortisation

Idea being explored	**Alternative recommendation**	**Aims achieved**	**Aims hindered**
Better disclosures for business combinations	Provide better disclosures for business combinations, particularly on subsequent performance of the acquired business, and targeted improvements to existing requirements	• Provides better information for users • Addresses feedback from PIR of IFRS 3 that users need information on subsequent performance of acquired business	• Additional costs for preparers to provide additional disclosures • Additional costs limited by use of chief operating decision maker threshold and removing pro forma information requirement, but less information provided as a consequence • Further deletions could further offset the additional costs
Reintroduction of amortisation	Reintroduce amortisation	• Provide cost savings for preparers, reducing pressure on the impairment test • Help reduce the carrying amount of goodwill, which the	• Reduction in information provided since amortisation charge, at best, arbitrary and risks pre-empting impairment test,

Idea being explored	**Alternative recommendation**	**Aims achieved**	**Aims hindered**
		impairment test does not target in isolation	which would further reduce its limited (confirmatory) value
Relief from the mandatory annual impairment test	Remove the requirement for a mandatory annual quantitative test of goodwill and some intangible assets	• Reduces the costs associated with the impairment test (performing test/providing disclosures)	• Change in frequency of performing test should result in only limited reduction in robustness of test • Loss of disclosures generated by goodwill impairment tests
Removing requirement to use pre-tax inputs in calculating VIU	Permit the use of post-tax inputs and a post-tax discount rate to estimate VIU	• Permits disclosure of post-tax discount rates, which are likely to be more useful information • Makes test more understandable	

Idea being explored	**Alternative recommendation**	**Aims achieved**	**Aims hindered**
Removing restrictions on cash flow projections used in calculating VIU	Permit the inclusion of cash flows from future restructurings or future enhancements in estimates of VIU	• Reduces cost and complexity of performing test • Improves effectiveness as cash flow forecasts used are not just produced for financial reporting purposes	• Might impact robustness of test by permitting inclusion of unjustifiably optimistic cash flows

Summary of staff recommendation of preliminary views (Table 1)

28. Overall the package of preliminary views recommended by the staff:

(a) helps provide better information, in particular to enable investors to assess the subsequent performance of the acquisition. This adds to the information (although limited) that the impairment-only approach continues to provide (which has confirmatory value);

(b) helps reduce the cost and complexity of the impairment test by:

(i) removing the need to perform an annual quantitative test in the absence of an indicator of impairment; and

(ii) improving the understandability of the VIU calculation

which helps to reduce the additional costs to preparers of the overall package of preliminary views (with the main reduction in cost arising from the removal of the mandatory annual quantitative test);

(c) makes the impairment test slightly more effective by using cash flow forecasts that are used internally in VIU calculations, though this is offset by a minor reduction in robustness through removing the requirement for an annual quantitative test; and

(d) confirms the purpose of the impairment test of goodwill is appropriate, providing a response to the ‘too late’ issue and providing an understanding of what can be expected from the impairment test for stakeholders.

29. In addition, the staff recommendation for the Board’s preliminary views is also compared to the recommendations contained in the Australian Accounting Standards Board (AASB) Research Report 9 *Perspectives on IAS 36: A case for standard setting activity* that a representative of the AASB presented for discussion at the April 2019 meeting of the Accounting Standards Advisory Forum (ASAF) in Appendix A.

Summary of preliminary views with reintroduction of amortisation (Table 2)

30. Compared to the package of preliminary views recommended by the staff, the preliminary views analysed in Table 2, including the reintroduction of amortisation:

    (a) continues to help provide better information on business combinations, in particular to enable investors to assess the subsequent performance of the acquisition, but reduces the information provided by the impairment test;

    (b) helps reduce the cost and complexity of the impairment test, to a greater extent than the staff recommendation, by:

        (i) removing the need to perform an annual quantitative test in the absence of any indicators of impairment;

        (ii) improving the understandability of the VIU calculation; and

        (iii) reducing the likelihood that a quantitative impairment test is triggered under the indicator-only approach;

    (c) makes the impairment test slightly more effective, by using cash flow forecasts that are used internally in VIU calculations, though this is offset by a minor reduction in robustness through removing the requirement for an annual quantitative test; and

    (d) reduces the pressure on the impairment test (through amortisation) by reducing the carrying amount of goodwill, responding partly to the ‘too late’ issue.

31. Hence, in comparison to the staff recommendation, there is a slightly greater saving in cost and complexity, and the reduction in the carrying amount of goodwill takes some pressure off the impairment test, thus responding somewhat more to those concerned that recognition of impairment losses is ‘too late’. However, the information provided is less useful, due to the arbitrary amortisation charge.

32. In addition to the preliminary views summarised in Tables 1 and 2, a presentation idea was explored in **Agenda Paper 18C Presentation of equity before goodwill**

subtotal, whereby a subtotal of equity before goodwill could be presented on the statement of financial position. This latter idea was not part of the staff recommended preliminary views, but the Board could choose to include this in the overall preliminary views package selected to further increase the prominence of acquired goodwill carrying amounts, given the nature of goodwill and the inevitable limitations of the impairment test. This could be a further response to the 'too late' feedback, with a limited impact on costs.

Other options

33. Instead of deciding to include in the Discussion Paper one of the packages of preliminary views in Table 1 or Table 2, the Board could modify the package in Table 1 by not providing relief from the annual quantitative impairment test. This modification would respond to concerns that, without reintroducing amortisation, providing this relief would reduce the robustness of the impairment test.

34. If the Board decides to propose not to reintroduce amortisation, and not to provide the relief from the quantitative annual impairment test, the Board could decide that the cost of the additional disclosure requirements is too high (and not sufficiently offset by the limited VIU changes), especially because preparers have indicated that because of, for example, commercial sensitivity, the benefits of some of the information may not be significant.

35. Under that scenario, the only changes that remain, the two limited VIU improvements, could then perhaps be addressed by an Exposure Draft or passed to the *Annual Improvement* project.

Questions for the Board

Questions for the Board
1. Does the Board agree with the package of preliminary views, as established by the indicative decisions the Board has made in the other Agenda Papers, for the Board to include in the Discussion Paper?
If not:

2.	Does the Board agree with the staff recommendation of preliminary views, as summarised in paragraph 20 and analysed in Table 1, for the Board to include in the Discussion Paper?

Appendix A—AASB – improving the impairment testing model in IAS 36

A1. A representative of the AASB presented the AASB Research Report 9 *Perspectives on IAS 36: A case for standard setting activity* for discussion at the April 2019 meeting of the ASAF. See **Agenda Paper 18 Cover paper** for the full minutes of the discussion that took place at that meeting. The recommendations of the report were as follows:

(a) Review IAS 36 in its entirety with a view to issuing a new standard that provides principles that enable users, preparers, auditors and regulators to develop a common understanding of the practical aspects of undertaking the procedures applied to ensure that assets are carried at no more than their recoverable amount.

(b) Clarify the purpose of the impairment testing requirements, and develop guidance explaining what the test is (and is not) intended to achieve.

(c) Develop a modified single model approach, including specific amendments to:

(i) remove the existing restrictions on VIU regarding future restructurings and asset enhancements and replace those restrictions with guidance on when it would be reasonable to include such cash flows in an impairment model;

(ii) reserve the use of a 'fair value less costs of disposal' model for assets expected to be disposed of within the following financial reporting period;

(iii) allow the use of a post-tax discount rate; and

(iv) specifically permit the use of market-based assumptions within the cash flow model, such as a forward curve for commodity prices and foreign exchange rates;

(d) Redraft the guidance as to what constitutes a CGU or a group of CGUs, to strengthen the linkage with how an entity's results are viewed and decisions are made internally; and

(e) Implement the following enhanced disclosure proposals:

(i) provide further guidance on the definition of a key assumption, being those to which the impairment model is most sensitive, to encourage more informative disclosure;

(ii) revise the disclosure requirements of IAS 36 to provide more coherent disclosure principles regardless of the method chosen to determine recoverable amount; and

(iii) incorporate an additional disclosure objective in IFRS 3 to provide information to help investors understand the subsequent performance of the acquired business, having regard to the commercially sensitive nature of the information.

A2. Although the AASB's proposals focus on IAS 36 in its entirety and not just in relation to the impairment testing of goodwill, the staff recommendation of preliminary views includes the AASB's recommendations in paragraphs A1(c)(i), A1(c)(iii) and A1(e)(iii). In addition, in establishing the preliminary view of whether to reintroduce amortisation or not, the purpose of the impairment test of goodwill has been clarified as recommended in paragraph A1(b). Most of the other recommendations have been considered by the Board at some point during the project.

A3. In response to the AASB's recommendation that there should be a fundamental review of IAS 36 in its entirety (paragraph A1(a)), the majority of ASAF members did not support the need for this review, with several ASAF members commenting that the issues experienced in practice relate primarily to implementation, rather than the principles of the Standard.

A4. The staff intend to summarise the ASAF meeting minutes and the AASB research for inclusion in the Discussion Paper.