IFRS Accounting

Staff paper

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IASB® meeting

Date	**December 2022**
Project	**Goodwill and Impairment**
Topic	**Other topics**
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Purpose and structure

1. Agenda Paper 18E to the International Accounting Standards Board's (IASB) May 2021 meeting summarised suggestions from respondents to the Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment* for additional topics to be considered in the Goodwill and Impairment project. This paper provides the IASB with our analysis and recommendation on those suggestions.

2. The paper is structured as:
   (a) summary of our recommendations;
   (b) question for the IASB;
   (c) Appendix A—Topics relating to IFRS 3 *Business Combinations*; and
   (d) Appendix B—Topics relating to other IFRS Accounting Standards.

Summary of staff recommendations

3. We recommend the IASB does not include additional topics suggested by respondents in the Goodwill and Impairment project except to consider the following topics when deliberating possible improvements to the effectiveness of the impairment test of cash-generating units (CGU) containing goodwill:
   (a) requiring an entity to disclose goodwill by reportable segment; and
   (b) how the requirements in IAS 21 *The Effects of Changes in Foreign Exchange Rates* relating to the level at which goodwill balances are translated interacts with the level at which goodwill is tested for impairment applying IAS 36 *Impairment of Assets*.

Question for the IASB
Do you agree with our recommendation in paragraph 3?

Appendix A—Topics relating to IFRS 3

A1. The table below summaries topics suggested by respondents relating to IFRS 3 and provides our analysis and recommendation on those topics.

Feedback	Staff analysis	Staff recommendation
Initial measurement of non-controlling interests Paragraph 19 of IFRS 3 allows entities a choice in how to measure non-controlling interests. A few respondents said: • it is unclear whether paragraph 19 of IFRS 3 was intended to limit the application of the 'proportionate share of net assets' approach in measuring non-controlling interests, or was intended as a requirement on how that approach should be applied. • the financial results of entities initially measuring non-controlling interests using the 'proportionate share of net assets' approach are not comparable with the financial results of entities using the fair value approach. • goodwill attributable to non-controlling interests is not an asset of the reporting entity, and entities should therefore not be allowed to recognise such an asset when measuring non-controlling interests applying the fair value approach.	Paragraphs BC205–BC221A of IFRS 3 explain the IASB's reasons for permitting a measurement choice for some components of non-controlling interest. In particular, paragraphs BC217–BC218 highlight that the IASB was aware that permitting a measurement choice would result in differences between entities using the different measurement options. Some respondents also raised these questions in the Post-implementation Review (PIR) of IFRS 3. In the Report and Feedback Statement of the PIR of IFRS 3 the IASB concluded that the measurement of non-controlling interests is a low priority area. However, the IASB noted that if respondents raised this topic in the 2015 Agenda Consultation the IASB could start work on this topic. In both the 2015 Agenda Consultation and the Third Agenda Consultation the IASB did not identify the measurement of non-controlling interests as a priority area of focus.	We recommend not adding this topic to the Goodwill and Impairment project.

<table>
<tr><th>Feedback</th><th>Staff analysis</th><th>Staff recommendation</th></tr>
<tr><td><u>Accounting for non-controlling interests after a business combination</u>

A few respondents said:
There is a lack of guidance on how to account for equity transactions with non-controlling interests that do not result in a loss of control, especially when the non-controlling interest was initially measured using the ‘proportionate share of net assets’ approach. A few respondents said that, in their view, those transactions may overstate goodwill or could result in greater headroom that ‘shields’ goodwill from impairment losses.
It is unclear how entities should account for settlement of pre-existing relationships with non-controlling interests if those entities have initially measured the non-controlling interests using the ‘proportionate share of net assets’ approach.
An entity’s goodwill balance should be adjusted for subsequent changes in the ownership interests in a subsidiary that do not result in loss of control.
It is unclear how to allocate impairment losses between non-controlling interests and owners of the parent entity if the CGU giving rise to the impairment loss includes both</td><td>The IASB received comments during the PIR of IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements and IFRS 12 Disclosure of Interests in Other Entities about transactions that change the relationship between an investor and investee, including the effect of those transactions on non-controlling interest.

In the <u>Project Report and Feedback Statement</u> on the PIR of IFRS 10, IFRS 11 and IFRS 12, the IASB assessed these matters as low priority and said it would explore these matters if they are identified as a priority in the next agenda consultation.

In the Third Agenda Consultation, the IASB didn’t receive feedback asking for guidance on accounting for non-controlling interests after a business combination (see more details in <u>Feedback Statement: Third Agenda Consultation</u>).</td><td>We recommend not adding this topic to the Goodwill and Impairment project.</td></tr>
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Feedback	Staff analysis	Staff recommendation
subsidiaries with non-controlling interests and subsidiaries without non-controlling interests.		
<u>Recognising assets acquired and liabilities assumed in a business combination at their acquisition-date fair values</u> A few respondents said fair value adjustments made to assets acquired and liabilities assumed in a business combination affect the financial performance of the reporting entity in future periods. For example, if the inventory that an entity acquired in a business combination received an upward fair value adjustment during purchase price allocation, the inventory will have a higher cost basis in the consolidated financial statements. When the acquired inventory is eventually sold to an external party, the reporting entity would recognise a higher cost of goods sold, and correspondingly, a lower gross profit. In those respondents' view, the financial impact caused by fair value adjustments on acquisition distorts the operating margin reported by the entity post-acquisition. One respondent highlighted a conflict between the measurement principles in IFRS 3 (based on fair value) and in IFRS 15 *Revenue from Contracts with Customers* (based on the transaction price) that in its view should be addressed.	Paragraph BC203 of IFRS 3 explains why, in the IASB's view, recognising assets acquired and the liabilities assumed at their acquisition date fair values provides useful information. In particular, that paragraph notes the boards (the IASB and the US Financial Accounting Standards Board) concluded that: 1) measuring assets acquired or liabilities assumed at amounts other than their fair values at the acquisition date does not faithfully represent their economic values or the acquirer's economic circumstances resulting from the business combination; and 2) measurement at fair value enables users to make a better assessment of the cash-generating abilities of the identifiable net assets acquired in the business combination and the accountability of management for the resources entrusted to it. The IASB asked a question in the PIR of IFRS 3 about the extent to which the information derived from the fair value measurements is relevant and whether there are any deficiencies.	We recommend not adding this topic to the Goodwill and Impairment project.

Feedback	Staff analysis	Staff recommendation
	Some respondents to the PIR of IFRS 3 highlighted concerns that fair value information does not facilitate a comparison of trends between entities that grow organically and those that grow through acquisitions. In addition, some respondents said upward revaluations of acquired inventory to fair value reduce profitability in the first period following the business combination. In the Report and Feedback Statement on the PIR of IFRS 3 the IASB acknowledged the difficulties but, based on the comments received in the PIR of IFRS 3, concluded that fair value remains the best approach for measuring the assets acquired and the liabilities assumed in a business combination. The comments raised by respondents to the Discussion Paper do not highlight new information that would suggest the IASB reopens this question as part of its Goodwill and Impairment project.	
Specific components of goodwill A few respondents suggested the IASB should reconsider requiring entities to separate goodwill into components and accounting for the different components separately. In addition, a few respondents suggested exploring how to better account for 'technical goodwill' that results from deferred tax	When developing the Discussion Paper, the IASB rejected the approach of separating goodwill into components and accounting for the components separately because: 1) it would increase the complexity and subjectivity of the subsequent accounting for goodwill; and	We recommend not adding these topics to the Goodwill and Impairment project.

Feedback	Staff analysis	Staff recommendation
liabilities arising from fair value adjustments made to assets acquired and liabilities assumed in a business combination. A few of these respondents suggested requiring entities to derecognise such goodwill when the corresponding deferred tax liabilities are derecognised. One of these respondents said that if the IASB decides not to do so, the IASB should clarify that a component of goodwill that resulted from the recognition of a deferred tax liability should be tested for impairment at the level at which the deferred tax liability is recognised.	2) goodwill cannot be measured directly and, therefore, it is doubtful the different components of goodwill could be measured reliably. As noted in paragraph 9 of Agenda Paper 18B to the October 2022 IASB meeting we think convincing arguments to change the IASB's views in the Discussion Paper have not been provided.	
Acquisition of assets A few respondents said that there is misalignment between the accounting for business combinations and the accounting for the acquisition of assets that are similar in nature to business combinations.	Paragraph BC20 of IFRS 3 explains that when developing the revised IFRS 3, the IASB considered whether to expand the scope of IFRS 3 to all acquisition of groups of assets and decided not to do so because doing so would require further research and deliberation of additional issues and could delay the implementation of the revised IFRS 3's improvements. During the PIR of IFRS 3 the IASB asked if there are benefits of having separate accounting treatments for business combinations and asset acquisitions. As noted in the Report and Feedback Statement on the PIR of IFRS 3, respondents suggested revisiting whether the differences in the accounting treatment for some items (notably deferred tax) are justified, taking into consideration difficulties that arise from having to	We recommend not adding this topic to the Goodwill and Impairment project.

Feedback	Staff analysis	Staff recommendation
	determine whether a transaction represents an asset acquisition or a business combination. As a result of the feedback on the PIR, the IASB: 1) added a project to clarify the Definition of a Business to its workplan. 2) said it would consider differences in deferred tax accounting in this area in its then existing project on Income Taxes. The IASB issued amendments to IFRS 3 on the definition of a business in October 2018. As a result of feedback on the IASB's 2015 Agenda Consultation the IASB decided not to carry out further research into income taxes. In our view feedback to the Discussion Paper does not identify convincing arguments to reconsider the difference between the accounting for business combinations and acquisition of assets.	
<u>Measurement of the consideration transferred</u> A few respondents highlighted that if the consideration for the business combination includes equity financial instruments, there is often a difference between the goodwill measured on acquisition	Paragraph BC338–BC342 of IFRS 3 discussed the reason the IASB decided that the fair value of equity securities issued as	We recommend not adding this topic to the Goodwill and Impairment project.

Feedback	Staff analysis	Staff recommendation
date and the goodwill if it were measured at the date of the acquisition agreement due to changes in fair value of those instruments between those dates. In their view, the amount of goodwill recognised in financial statements is misstated because it does not represent the amount management intended to pay to acquire the business and therefore does not help to hold management to account for their acquisition decisions. One respondent suggested requiring entities to disclose this difference.	consideration in a business combination should be measured at the acquisition date. The IASB noted: 1) all forms of consideration transferred should be valued on the same date, which should also be the same date as when the assets acquired and liabilities assumed are measured; 2) parties to a business combination are likely to take into account expected changes between the agreement date and the acquisition date in the fair value of the acquirer and the market price of the acquirer's securities issued as consideration; and 3) measuring equity securities on the acquisition date avoids the complexities of dealing with situations in which the number of shares or other consideration transferred can change between the agreement date and the acquisition date. Respondents to the Discussion Paper have not highlighted new information.	
<u>Definition of goodwill</u>	Paragraph BC313 of IFRS 3 includes the IASB's discussion when developing IFRS 3 on the components of goodwill. The IASB concluded that the fair value of the going concern	We recommend not adding this topic to the Goodwill and Impairment project

Feedback	Staff analysis	Staff recommendation
A few respondents suggested reviewing the definition of goodwill and clarifying that goodwill includes both the value of going concern as well as expected synergies.	element of the acquiree's existing business and the fair value of the expected synergies are part of goodwill. We think this comment would have been relevant in considering any changes to the accounting for goodwill. However, the IASB decided in its November 2022 meeting not to consider further the subsequent accounting for goodwill.	
Breakdown of goodwill by business combination A few respondents suggested requiring entities to disclose the breakdown of goodwill by business combination, the allocation of goodwill to different segments and the age of goodwill. This was also suggested by the UK Endorsement Board at the ASAF meeting in September 2022.	We agree with a few ASAF members who highlighted in September 2022 that requiring an entity to track goodwill by business combination might be difficult and costly. For example, it might be difficult to know which business combination an impairment relates to if there are several business combinations with goodwill that are allocated to a particular CGU. However, we think it might be less costly to require entities to disclose the amount of goodwill for each reportable segment and the CGUs which contain goodwill allocated to that segment. We think such information might provide better visibility as to how goodwill is tested for impairment and allow users to use segment information to assess the reasonableness of the assumptions used in impairment testing.	We recommend considering whether requiring an entity to disclose goodwill by reportable segment could help improve the effectiveness of the impairment test by allowing users to better assess the reasonableness of the assumptions used in the impairment test. If the IASB agrees with our recommendation, we will consider this as part of our assessment on how to improve the effectiveness of the impairment test of CGUs containing goodwill.

Appendix B—Topics relating to other IFRS Accounting Standards

B1. The table below summaries the topics suggested by respondents related to other IFRS Accounting Standards and our analysis on that feedback.

IFRS Accounting Standard	Feedback	Staff analysis	Staff recommendation
IAS 1 *Presentation of Financial Statements*	The IASB should prevent entities from being able to window dress their financial results by prohibiting entities from classifying impairment losses recognised on goodwill as an unusual expense as proposed by the IASB's Primary Financial Statements project.	In September 2022 the IASB tentatively decided to not proceed with specific requirements for unusual income and expenses as part of IASB's Primary Financial Statements project.	We recommend not adding this topic to the Goodwill and Impairment project.
IAS 21 *The Effects of Changes in Foreign Exchange Rates*	The IASB should review how requirements in IAS 21 relating to the level goodwill balances are translated interact with the level at which goodwill is tested for impairment applying IAS 36.	Paragraph 47 of IAS 21 requires an entity to treat any goodwill arising on the acquisition of a foreign operation as assets of the foreign operation. We think the respondent who suggested considering the interaction between the requirements in IAS 21 and the impairment test in IAS 36 did so as a consideration for improving the effectiveness of the impairment test. In particular, that the requirements in IAS 21 might provide a way to allocate goodwill to lower level CGUs than is currently done in practice.	We recommend considering this suggestion when discussing possible improvements to the effectiveness of the impairment test.
IAS 28 *Investments in Associates and Joint Ventures*	The IASB should consider whether, and if so how, its preliminary views would apply to investments accounted for using the equity method.	The IASB's project is a response to the PIR of IFRS 3 and therefore is focused on business combinations. We think	We recommend not adding this topic to the Goodwill and Impairment project.

IFRS Accounting Standard	Feedback	Staff analysis	Staff recommendation
		considering other types of investments would be beyond the scope of this project. In particular, we think topics such as amortisation of goodwill might have been relevant if the IASB had decided to reintroduce amortisation of goodwill. We think disclosures about business combinations are of less relevance to the application of the equity method.	
IAS 36 *Impairment of Assets*	A few respondents highlighted difficulties in determining cash outflows when applying IAS 36 to CGUs containing right-of-use assets recognised applying IFRS 16 *Leases*. These difficulties include: 1) The definition of a CGU in paragraph 6 of IAS 36 does not include liabilities, and paragraph 50(a) of IAS 36 states that estimates of future cash flows should not include cash inflows or outflows from financing activities. A few respondents said preparers find it difficult to adjust management budgets to separate cash flows relating to leases that are included in the lease liability applying IFRS 16 from cash flows relating to leases that are not included in the lease liability. Some of those respondents suggested allowing entities to include lease liabilities relating to right-of-use assets in the carrying value of a	The objective of the Goodwill and Impairment project is to improve information entities provide about business combinations, at a reasonable cost. As part of this project the IASB is considering ways to simplify the application of the impairment test in IAS 36. We note that this project is not intended as a review of IAS 36 more generally and so we think the IASB should only consider simplifications that would be applicable when testing CGUs containing goodwill for impairment (for example, the changes to the calculation of value in use suggested in the Discussion Paper). The suggestion from respondents in this instance would not affect all impairment tests of CGUs containing goodwill—only those that contain a right-of-use asset.	We recommend not adding this topic to the Goodwill and Impairment project.

IFRS Accounting Standard	Feedback	Staff analysis	Staff recommendation
	CGU and cash flows related to financing liabilities when estimating value in use. 2) Paragraph 33 of IAS 36 states that when an entity estimates value in use, cash flow projections and forecasts based on budgets shall cover a maximum period of five years, unless a longer period can be justified. A few respondents suggested providing guidance for cash flows relating to right-of-use assets beyond the forecast period, including guidance for cash flows from reinvesting these assets at the end of the lease term.	We think the matter raised relates to the interaction of IFRS 16 and IAS 36. Consequently, we think the matter raised goes beyond the scope of the project.	
	The IASB should require entities to incorporate Environmental, Social, and Corporate Governance (ESG) considerations when forecasting future cash flows for impairment tests.	We think it is unnecessary to explicitly consider this matter within the scope of this project. We note that subsequent to the publication of the Discussion Paper the IASB: 1) published educational material on the Effects of climate-related matters on financial statements. That education material discusses how ESG factors are included in impairment tests. 2) added to the maintenance project pipeline a narrow-scope project on Climate-related Risks in the Financial Statements in response to feedback in the Third Agenda	We recommend not adding this topic to the Goodwill and Impairment project.

IFRS Accounting Standard	Feedback	Staff analysis	Staff recommendation
		Consultation about inconsistent application of IFRS Accoutning Standards to climate-related risks. We think any actions of the IASB, whether in this project or in the narrow-scope maintenance project, are unlikely to include developing requirements specific to ESG factors, as doing so could undermine the benefits of principle-based approach to developing IFRS Accounting Standards. As noted in Agenda Paper 18, the IASB will discuss in a future meeting the IASB's preliminary views about improving the effectiveness of the impairment test for cash-generating units containing goodwill and simplifying the impairment test. To the extent relevant, we will liaise with the staff working on the Climate-related Risks in the Financial Statements project.	