Staff paper

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Project	**Business Combinations—Disclosures, Goodwill and Impairment**
Topic	**Estimating value in use**
Contacts	Vikash Kalidas (vkalidas@ifrs.org)

Purpose and structure

1. This paper includes our analysis and recommendations on the IASB's preliminary views to amend the requirements on estimating value in use (VIU) in the impairment test in IAS 36 *Impairment of Assets*. The Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment* sets out the IASB's preliminary views.

2. The structure of the paper is as follows:

   (a) the preliminary views (paragraphs 4–12);

   (b) feedback summary (paragraphs 13–17);

   (c) staff analysis and recommendations (paragraphs 18–33); and

   (d) detailed feedback (Appendix A).

3. Paragraphs 6–10 of Agenda paper 18 explain the matters considered in this paper.

Preliminary views

4. In the Discussion Paper, the International Accounting Standards Board (IASB) included preliminary views aimed at reducing the cost and complexity of the requirements for estimating VIU when measuring the recoverable amount of an asset or CGU, those include:

(a) removing the restriction on including cash flows from future restructurings, improvements or enhancements (paragraphs 6–9); and

(b) allowing the use of post-tax cash flows and discount rates (paragraphs 10–12).

5. Both preliminary views would apply not only to impairment tests of CGUs containing goodwill but to impairment tests of all assets and CGUs within the scope of IAS 36.

Future restructurings, improvements or enhancements

6. In estimating VIU, IAS 36 requires an entity to estimate cash flow projections for an asset in its current condition. IAS 36 restricts these cash flow projections—these cash flows exclude future cash flows expected to arise from a future restructuring to which the entity is not yet committed, or to arise from improving or enhancing the asset's performance. IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* provides guidance on determining when an entity is committed to a restructuring.

7. Paragraph 4.35 of the Discussion Paper explains that some stakeholders have said this requirement can cause cost and complexity because excluding such cash flows requires management to adjust its financial budgets or forecasts. For example, management can find it challenging to distinguish maintenance capital expenditure from expansionary capital expenditure in these budgets or forecasts.

8. The IASB's preliminary view was that it should develop a proposal to remove the restriction on including cash flows arising from a future restructuring to which an entity is not yet committed or from improving or enhancing an asset's performance. As explained in paragraph 4.38 of the Discussion Paper this would:

(a) reduce cost and complexity;

(b) make the impairment test less prone to error;

(c) make the impairment test easier to understand; and

(d) make the test easier to perform and could make it easier to audit and enforce.

9. The IASB considered the risk that removing the restriction on these cash flows could increase the risk that management might use inputs that are too optimistic and discussed whether to set a probability threshold or require additional qualitative disclosures for these cash flows. The IASB's preliminary view was that it was unnecessary to do so because:

    (a) the cash flows would still be subject to the same requirements that apply to all cash flows included in estimates of VIU—entities would be required to use reasonable and supportable assumptions based on the most recent financial budgets or forecasts approved by management; and

    (b) paragraphs 134(d) and 134(f) of IAS 36 require companies to disclose information about the assumptions on which management based its estimates of the recoverable amount.[1]

Post-tax cash flows and discount rates

10. In estimating VIU, IAS 36 requires an entity to estimate pre-tax cash flows and discount them using pre-tax discount rates. It also requires disclosure of the pre-tax discount rates used.

11. Paragraph 4.46 of the Discussion Paper explains that stakeholders said determining pre-tax discount rates is costly and complex. Stakeholders said a pre-tax discount rate is hard to understand, is not observable and does not provide useful information because it is generally not used for valuation purposes. In practice, valuations of assets are generally performed on a post-tax basis.

12. The IASB's preliminary view was that it should develop a proposal to:

    (a) remove the explicit requirement to use pre-tax cash flows and pre-tax discount rates in estimating VIU;

[1] Paragraph 125 of IAS 1 would also require additional information if these cash flow forecasts were a major source of estimation uncertainty.

(b) require use of internally consistent assumptions for cash flows and discount rates regardless of whether VIU is estimated on a pre-tax or post-tax basis; and

(c) retain the requirement to disclose the discount rates used but remove the requirement that the discount rate disclosed should be a pre-tax rate.

Feedback

13. Appendix A contains detailed feedback on both preliminary views. Paragraphs 14–17 summarise this feedback.

Future restructurings, improvements or enhancements

14. Many respondents agreed with the preliminary view. However, some disagreed. In their view, the inclusion of those cash flows could exacerbate management over-optimism and would further delay recognition of impairment losses.

15. Many respondents agreeing with the IASB's preliminary view also agreed that further discipline is unnecessary because IAS 36 already requires an entity to use reasonable and supportable assumptions. However, many said assessing whether cash flows from future restructurings or asset enhancements are reasonable and supportable could be difficult and judgemental. To ensure that the impairment test remains robust, these respondents suggested developing requirements on when to include cash flows arising from a restructuring or enhancing the asset's performance.

Post-tax cash flows and discount rates

16. Almost all respondents agreed with the preliminary view. Those who agreed generally agreed that a pre-tax discount rate is not observable and does not provide useful information because it is generally not used for valuation purposes.

17. Some accounting firms and national standard-setters suggested providing further guidance and illustrative examples to ensure consistent treatment of tax cash flows

and temporary differences, carried-forward losses and the associated deferred tax amounts.

Staff analysis and recommendations

18. Our analysis considers:

    (a) removing the restriction on including cash flows from future restructurings, improvements or enhancements (paragraphs 19–27); and

    (b) allowing the use of post-tax cash flows and discount rates (paragraphs 28–33).

Future restructurings, improvements or enhancements

Staff analysis

19. As noted in paragraph 14, many respondents agreed with the preliminary view for the reasons the IASB set out in the Discussion Paper. Stakeholders that disagreed generally did so because of concerns that removing the restriction on including these cash flows in estimations of VIU could increase management over-optimism.

20. We think feedback supports maintaining the preliminary view. However, we considered whether the IASB should include requirements on when to include cash flows arising from a restructuring or enhancing the asset's performance given many respondents that agreed said there was a need for further discipline.

21. The IASB discussed whether additional safeguards were needed when developing its preliminary view—see Agenda Paper 18E to the IASB's June 2019 meeting. The IASB considered several of the suggestions respondents provided (see paragraph A9) but decided additional safeguards were unnecessary (see paragraph 9).

22. The only suggestion from respondents in paragraph A9 not specifically discussed by the IASB when developing its preliminary view is the suggestion to require these cash

flows to be included only if they are authorised by management. Those respondents said this would help ensure that future cash flows are estimated reliably.

23. However, paragraph 33(b) of IAS 36 already requires an entity to base cash flow projections on the most recent financial budgets/forecasts approved by management.

24. In addition, paragraph 44 of IAS 36 requires an entity to estimate future cash flows for the asset (including a CGU) in its current condition. We understand the IASB is not proposing to remove this requirement and it acts as an additional safeguard because an entity would not be permitted to include cash flows from future restructurings, improvements or enhancements if the potential for those cash flows does not exist for the asset in its current condition.

25. We also disagree with respondents who said removing this restriction lacks a conceptual basis because cash flows from future restructurings or from enhancements to an asset's performance are not cash flows from the asset in its current condition. Although, paragraph BC72(a) of IAS 36 states that including the costs and benefits of future restructurings to which the entity is not yet committed would be a significant change to the concept of VIU adopted in the previous version of IAS 36, the IASB considered this when developing its preliminary views (see paragraphs 15–18 of Agenda Paper 18E to the June 2019 IASB meeting). We continue to agree with the analysis that if the asset has the current potential to generate those cash flows, conceptually they can be included in estimating VIU and are cash flows of the asset in its current condition.

26. We acknowledge there are mixed views as to whether additional safeguards are required—the IASB considered this question when developing its preliminary view, and respondents have not provided new evidence that would require the IASB to reconsider its decision not to develop safeguards.

Staff recommendation

27. As a result of our analysis in paragraphs 19–26, we recommend the IASB maintain its preliminary view and propose:

    (a) removing the restriction in IAS 36 on including cash flows arising from a future restructuring to which an entity is not yet committed or from improving or enhancing an asset's performance;

    (b) retaining the requirement to assess assets or CGUs in their current condition; and

    (c) including no additional safeguards for those cash flows beyond those that already exist in IAS 36.

Question 1—Removing the restriction on including cash flows from future restructurings, improvements or enhancements.
Does the IASB agree with our recommendation in paragraph 27?

Post-tax cash flows and discount rates

Staff analysis

28. As noted in paragraphs 16–17 almost all respondents agreed with the preliminary view for the reasons the IASB described in the Discussion Paper.

29. Some respondents suggested providing further guidance and illustrative examples to ensure consistent treatment of tax cash flows and temporary differences, carried-forward losses and the associated deferred tax amounts. The Discussion Paper refers to these interactions as avoiding 'double counting'. The IASB considered providing further guidance during the development of the preliminary view. However, as noted in paragraph 4.52 of the Discussion Paper the IASB decided not to.

30. The IASB noted that in making a similar change to IAS 41 *Agriculture* the IASB deleted 'pre-tax' and did not add further guidance. Paragraph BC12(a) of IAS 41 notes that the resulting requirements are consistent with the requirements in IFRS 13

Fair Value Measurement—paragraph B14 of IFRS 13 requires only that assumptions about cash flows and discount rates be internally consistent.

31. In our view, the feedback suggests the IASB should maintain its preliminary view and allow entities to use post-tax cash flows and discount rates. Respondents did not identify additional reasons why providing illustrative examples or application guidance would be necessary, especially because:

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

    (b) the IASB observed in paragraph BC94 of IAS 36 that, conceptually, discounting post-tax cash flows at a post-tax discount rate and discounting pre-tax cash flows at a pre-tax discount rate would be expected to give the same result—as long as the pre-tax discount rate is the post-tax discount rate adjusted to reflect the specific amount and timing of future tax cash flows. Therefore, an entity using pre-tax cash flows and discount rates would make the same judgements about the tax effects but would make those adjustments to the discount rate rather than the cash flows.

32. Accordingly, we think the IASB should not provide additional guidance on how to reflect tax in estimating VIU.

Staff recommendation

33. As a result of our analysis in paragraphs 28–32, we recommend the IASB maintain its preliminary view and propose to:

(a) remove the explicit requirement to use pre-tax cash flows and pre-tax discount rates in estimating VIU;

(b) require use of internally consistent assumptions for cash flows and discount rates regardless of whether VIU is estimated on a pre-tax or post-tax basis; and

(c) retain the requirement to disclose the discount rates used but remove the requirement that the discount rate disclosed should be a pre-tax rate.

Question 2— Removing the requirement to use a pre-tax discount rate and pre-tax cash flows in estimating VIU
Does the IASB agree with our recommendation in paragraph 33?

Appendix A—Detailed feedback

A1. This appendix contains detailed feedback on the preliminary views related to simplifying estimates of VIU by:

(a) removing the restriction on including cash flows from future restructurings, improvements or enhancements; and

(b) allowing entities to use post-tax cash flows and discount rates.

A2. Paragraphs A3–A12 are similar to paragraphs 43–54 of Agenda Paper 18D to the IASB's May 2021 meeting.

Future restructurings, improvements and enhancements

A3. Most respondents across all jurisdictions commented on the IASB's preliminary view:

(a) many of the respondents agreed with removing restrictions on including some cash flows in estimations of VIU;

(b) some respondents, including some regulators and a few accounting firms, disagreed with the IASB's preliminary view; and

(c) many respondents also commented on whether it is necessary to require discipline in addition to that already required by IAS 36 for an entity to include these cash flows when estimating VIU.

A4. Those who agreed with the IASB said that:

(a) the preliminary view would align information used in the impairment test with information approved and used internally, without the need of hypothetical adjustments solely for the purpose of the impairment test; and

(b) the simplification would reduce the cost and complexity of the impairment test without compromising significantly the decision usefulness of the information provided because:

(i) there are no conceptual reasons for excluding some cash flows from VIU and not from fair value less costs of disposal (FVLCD); and

(ii) the cash flows would better reflect the expected performance of the asset or CGU.

A5. Those who disagreed with the IASB's preliminary view to remove restrictions from including some cash flows in estimations of VIU said that the preliminary view would:

(a) reduce the robustness of the impairment test and make it more difficult to challenge for auditors and regulators because of the significant level of judgement involved in assessing whether assumptions are reasonable and supportable;

(b) provide limited reduction in costs because of the burden of gathering information to prove that the assumptions are reasonable and supportable;

(c) further delay the recognition of impairment losses because it would increase the risk that management may use inputs that are too optimistic; and

(d) lack a conceptual basis for the change because cash flows from future restructurings or from enhancements to an asset's performance are not cash flows from the asset in its current condition.

Need for further discipline on including some cash flows.

A6. Many respondents commented on whether there is a need for further discipline to include cash flows from a future restructuring to which an entity is not yet committed or from improving or enhancing an asset's performance in estimating VIU.

A7. Many respondents, most of which are preparers, that agreed with the IASB's preliminary view to remove restrictions on including some cash flows in estimations of VIU, said that it is not necessary to require further discipline to include those cash flows because IAS 36 already requires an entity to use reasonable and supportable assumptions.

A8. On the other hand, many other respondents, mainly regulators, accounting firms and national standard-setters, although agreeing with the IASB's preliminary view for the reasons indicated in paragraph A4, expressed concern that it would further delay recognising impairment losses due to too optimistic cash flow forecasts. They added that assessing whether cash flows from future restructurings or asset enhancements are reasonable and supportable could be difficult and judgemental.

A9. To ensure that the impairment test remains robust, these respondents suggested that the IASB should develop requirements on when cash flows arising from a restructuring or enhancing the asset's performance can be included in estimations of VIU. For example, some suggested that the IASB should:

(a) require these cash flows to be included only if authorised by management. Those respondents said that this would help ensure that the amount of future cash flows is estimated reliably.

(b) develop guidance on the evidence that might be needed to satisfy the requirement for these future cash flow estimates to be reasonable and supportable.

(c) require additional disclosure regarding management's assumptions about future cash flows from future uncommitted restructurings or asset enhancements.

(d) set a probability threshold to determine when these cash flows can be included.

A10. A European standard-setter also said that the IASB should carefully define the scope of cash flows that can be included in estimating VIU (for example excluding those that relate to future business combinations) and consider the interplay with the legal provisions existing in some jurisdictions that require an entity to inform employees before making public a restructuring plan.

Post-tax cash flows and discount rates

A11. Almost all respondents across all jurisdictions and stakeholder types, agreed with the IASB's preliminary view. Those who agreed generally concurred with the IASB's analysis that a pre-tax discount rate is not observable and does not provide useful information because it is generally not used for valuation purposes. They said that:

(a) the preliminary view would align IAS 36 with commonly used valuation methodologies.

(b) it would reduce the costs and complexity of the impairment test without compromising the decision usefulness of the information provided.

(c) in practice, entities already use post-tax cash flows and post-tax discount rates which are mechanically converted to pre-tax rates solely to meet disclosure requirements of IAS 36.

(d) if implemented, the preliminary view would make it easier for auditors to challenge impairment tests. Post-tax discount rates are more reliable because they are observable and do not require additional calculations.

A12. Some accounting firms and national standard-setters were concerned about application issues that could arise in using post-tax discount rates and post-tax cash flows. Many of these respondents suggested that the IASB provide further guidance and illustrative examples to ensure consistent treatment of tax cash flows and temporary differences, carried-forward losses and the associated deferred tax amounts. Some of these respondents also observed that the issue may be more relevant in those situations where goodwill increases as a result of measurement of deferred taxes (technical goodwill), as described in paragraph 37 of Agenda Paper 18E to the IASB's May 2021 meeting.