EFRAG Secretariat: Isabel Batista;
Raffaele Petruzzella

Improving disclosures about goodwill impairment testing

Issues Paper

Purpose of this paper

1 The purpose of this paper is to obtain EFRAG TEG members views' on the IASB tentative decisions on disclosures about goodwill impairment testing under IAS 36 *Impairment of Assets*.

Background

2 During its meetings in 2016 and 2017, the IASB considered a number of IASB Staff proposals to improve the disclosure requirements about goodwill impairment as part of its Research project on improving the effectiveness of the impairment test.

3 The IASB Staff proposals were also discussed with the IASB consultative groups namely the Capital Markets Advisory Committee (CMAC), the Global Preparers Forum (GPF) and the Advisory Standard Setters Forum (ASAF).

4 The IASB Staff proposals included the following new disclosure requirements:

(a) Disclosure on headroom - headroom in a cash-generating unit that includes goodwill or indefinite-lived intangible assets.

(b) Recoverability of goodwill - breakdown of the carrying amount of goodwill by business combination, with an explanation for each combination of why management considers that the goodwill is recoverable.

(c) Premiums - reasons for payment of a premium over and above the value of the net identifiable assets acquired in a business combination, together with key assumptions or targets supporting the purchase consideration and comparison of actual performance with those assumptions or targets.

(d) Payback period- expected payback period of the entity's investment in the business combination, (the expected time to recover the cost of the acquisition either with or without considering the effect of discounting).

(e) Reportable segments - a measure of total assets and total liabilities for each reportable segment.

5 The IASB Staff also proposed to review the current disclosure requirements in IAS 36 *Impairment of Assets* and IFRS 3 *Business Combinations* to determine whether any of those requirements should be modified or removed.

IASB tentative decisions

6 At its meeting in December 2017, the IASB tentatively decided to consider requiring the disclosures in paragraphs 4(a) - 4(c).

7 The IASB tentatively decided against pursuing the IASB Staff proposal in paragraphs 4(d) and 4(e) either because of cost/benefit reasons or because they were considered to be outside of the scope of the goodwill and impairment project.

8 The IASB tentative decisions are discussed in more detail below.

Disclosure on headroom

9 The IASB tentatively decided to require disclosure of the unrecognised headroom for a cash-generating unit (or group of cash-generating units) on an annual basis. Information about the unrecognised headroom would provide relevant information to users of financial statements to help them assess the reliability of the impairment test. This tentative decision is consistent with feedback received from some CMAC and GPF members.

10 Currently, IAS 36 requires disclosure about the headroom only when a reasonably possible change in a key assumption, on which management has based its determination of the recoverable amount, would cause the carrying amount of the cash generating unit (CGU) to exceed its recoverable amount.

11 The IASB observed that headroom information is generally available from the current impairment testing model. However, the IASB noted that there might be cases when determining the precise headroom may involve some additional costs since an entity would have to perform additional tasks to obtain a precise recoverable amount.

12 In addition, the IASB observed an interaction between 'headroom' information and other simplifications/effectiveness to impairment testing that it is currently considering:

(a) recoverable amount - the trend in the headroom is likely to become distorted if an entity switches between value in use and fair value less costs of disposal when determining recoverable amount. The tentative decision of the IASB is not to change the current requirement of a 'higher of' value in use and fair value less costs of disposal.

(b) removing restrictions on cash flow projections used to determine value in use calculation - when recoverable amount is based on value in use, the headroom might not be determined in full, because IAS 36 imposes certain restrictions on cash flows expected to arise from uncommitted future restructuring or enhancing an asset's performance.

13 Disclosing information about the headroom might help address these interactions and allow users to understand the outcome of the goodwill impairment test in a more transparent way.

Breakdown on goodwill and explanation justifying recoverability

14 The IASB tentatively decided to require a breakdown of the amount of goodwill by business combination, with an explanation for each combination, of why management considers that the amount of goodwill is recoverable. For instance, management would be required to consider evidence that justifies ongoing synergies and going concern from prior business combinations.

15 Disaggregation of goodwill by each past business combination combined with other improvements being considered by the IASB on goodwill impairment testing could help users of financial statements make their own assessment of whether goodwill is recoverable.

16 This information was suggested by members of CMAC and also by users during the outreach on the IASB's post-implementation review (PIR) of IFRS 3. The disaggregation would highlight goodwill acquired in combinations that investors consider as unsuccessful. Consequently, there may be pressure on the entity to justify why that goodwill is recoverable and to perform a more rigorous impairment test of that goodwill. However, some GPF members questioned the usefulness of this information, especially long after an acquisition. A similar requirement was proposed in EFRAG's *Discussion Paper Goodwill impairment test: can it be improved*?.

<u>Cost and benefit assessment</u>

17 IAS 36 does not require tracking of goodwill by each past business combination. For impairment testing, goodwill acquired in a business combination is allocated to a unit or group of units expected to benefit from the synergies of the combination. Consequently, if a unit (or units) contains goodwill allocated from different acquisitions, the goodwill in the unit (or units) will be regarded as a single asset for impairment testing.

18 However, IAS 21 *The Effects of Changes in Foreign Exchange Rates* requires an entity to track goodwill acquired in past business combinations of foreign operations with a functional currency that is different from the entity's presentation currency.

19 The IASB observed that in some cases it could be costly for preparers to gather evidence for prior business combinations and be able to identify and isolate the benefits arising from those combinations with post-acquisition reorganisations. However, overall the benefits to users were likely to outweigh the costs to preparers as users have repeatedly asked for this information.

Reasons for paying a premium, key assumptions or targets supporting the purchase consideration and comparison of actual performance with targets

20 The IASB learned from its post-implementation review (PIR) of IFRS 3 that the goodwill and impairment disclosures in financial statements are either limited or boilerplate repetition of phrases used in IFRS 3. Investors said that the disclosures do not provide any insight into the real economic reasons for the business combination or the key drivers that support the valuation.

21 CMAC members generally supported having more information about the acquired business. However, many GPF members expressed concerns that for those disclosures to be meaningful an entity would have to disclose commercially sensitive information. If the IASB requires those disclosures, entities are likely to disclose only boilerplate information.

22 To address the concerns expressed by users, the IASB tentatively decided to require the following disclosure:

(a) the reasons for payment of premium over and above the value of the net identifiable assets;

(b) the key performance assumptions or targets supporting the purchase price paid (and the amount of goodwill recognised); and

(c) a comparison of actual performance against the key performance targets for a number of years following the acquisition. The comparison period should be based by management when determining the key performance targets; however a minimum period, for example three years, could also be required in any case.

<u>*Key performance targets*</u>

23 Key performance targets might include, for example: a) the level of expected revenues of the acquiree (if the acquiree is not integrated); b) specified increases in revenue for an existing operating segment that benefits from the acquisition; c) specific cost savings through economies of scale.

24 The entity would also identify the period(s) over which it expects to achieve these targets (for example, an increase in revenue at 5 per cent per year for 3 years).

25 The IASB observed that information on key assumptions supporting the price would benefit users of financial statements by providing with the key drivers that justified the price paid for the acquiree and help users assess whether it is reasonable to consider the carrying amount of goodwill as recoverable. Furthermore a comparison would inform users about the subsequent performance of the business combination and whether the entity is realising any synergies that it targeted.

<u>*Cost and benefit assessment*</u>

26 The IASB observed that the information on key targets and comparison to actual performance should be readily available. This is the case in large business combinations (for which that information should be included in regulatory filings) or in cases the entities prepare management commentary, and it is common practice to disclose some or all the information described in the tentative requirement.

IASB Staff disclosure proposals the IASB tentatively decided not to pursue

Requiring new disclosure; disclosure on expected payback period

27 The IASB considered an IASB Staff proposal to disclose the expected payback period of the investment in a business combination; in other words the expected time to recover the purchase price paid for a business combination acquisition (either with or without considering the effect of discounting).

28 A few non-user respondents to the PIR of IFRS 3 supported this proposal, because it is likely to provide some indication about management views on the expected payback period of acquisitions. However, these respondents did not provide a definition of what they considered to be the payback period.

29 The IASB also had mixed opinions about what the expected period could represent; not everyone agrees that the payback period is the same as an appropriate amortisation period for goodwill.

Requiring new disclosure: a measure of total assets and total liabilities for each reportable segment

30 The IASB considered an IASB Staff proposal for disclosure of a measure of total assets and liabilities for each reportable segment, even if such amounts are not regularly provided to the chief operating decision maker. Currently, IFRS 8 *Operating Segments* requires that information only when the amounts are regularly provided to the chief operating decision maker.

31 The disclosure was suggested by some CMAC members because it would allow them to assess the returns that an entity is generating in each of the reportable segments by comparing it with the entity's average cost of capital. Furthermore, it would able to provide information on the effects of a business combination about the rates of returns of the reportable segment that includes the acquired business. However some prepares noted that such disclosure would be relevant only in certain industries.

32 However, since the IASB Staff proposal would require changes to IFRS 8, the IASB thought it was outside of the scope of research project on goodwill and impairment.

Reviewing current disclosure requirements in IAS 36 and IFRS 3

33 The PIR on IFRS 3 provided some evidence that the current disclosure requirements in IAS 36 are not being well applied. The latter was also confirmed in a review of 2011 IFRS financial statements related to impairment testing of goodwill published by European Securities and Markets Authority (ESMA) in 2013.

34 Users of financial statements have also expressed concerns about the quality of some of the information required by IAS 36 and IFRS 3, which they argue is sometimes boilerplate and of no use to investors.

35 The IASB considered whether it should review the disclosure requirements in IAS 36 and IFRS 3 more comprehensively. However, the IASB thought it would be better to target specific disclosure requirements on goodwill and impairment, instead of reopening the disclosure requirements in IAS 36 and IFRS 3. This was also consistent with feedback from CMAC and GPF members in more recent discussions.

36 Furthermore, the IASB noted that its project on the Disclosure Initiative was still in progress and that as part of that project it could decide to perform a standards-level review of disclosures.

EFRAG Secretariat observations and analysis

37 In April 2016, the EFRAG User Panel discussed IASB developments in relation to disclosure on a) the premium paid for a business combination and key performance targets; and b) the breakdown of goodwill by acquisition and the information supporting recoverability of goodwill.

38 Some members thought that the key problem was that the current impairment test was not sufficiently reliable and it was therefore not particularly helpful to improve disclosures to the current impairment test.

39 The EFRAG Secretariat notes that respondents to EFRAG's *Discussion Paper Goodwill impairment test: can it be improved*? generally support adding information on the composition of goodwill to the notes although some of respondents doubted its practical feasibility and whether additional disclosure would be helpful to users.

Questions for EFRAG TEG

40 Do you agree with the IASB's tentative decisions on disclosures about goodwill impairment testing?

41 Do you think there are other disclosures that you think would be helpful to users to assess the recoverability of goodwill?

42 Do you have any other suggestions how to improve disclosures about goodwill and impairment?