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BCDGI - Possible changes to the impairment test of cash-generating units containing goodwill

Cover Note

Objective

- 1 To obtain feedback of EFRAG FR TEG-CFSS on some suggestions respondents to the Discussion Paper had for changes to disclosure requirements and the impairment test of CGUs containing goodwill.
- 2 This feedback will be provided during the ASAF meeting and will help the IASB to consider some of the suggestions further and to decide which ones to prioritise. If the feedback on some of the suggestions may depend on decisions the IASB makes on its preliminary views, for example, on whether to provide relief from the mandatory annual quantitative impairment test, the IASB is asking to highlight such dependencies.
- 3 The IASB already discussed this topic with Global Preparers Forum on 3 March, Capital Markets Advisory Committee on 9 March, IFRS IC – on 15 March and will discuss it with ASAF on 28 March 2023.
- 4 Given the number of questions, the EFRAG Secretariat proposes to EFRAG FR TEG-CFSS members to provide us with a written input ahead of the session to the extent possible.

Background of the IASB project

- 5 The IASB issued its Discussion Paper [Business Combinations – Disclosures, Goodwill and Impairment](#) (“the DP”) in March 2020 with a comment period that ended on 31 December 2020.
- 6 The objective of the *Business Combinations—Disclosures, Goodwill and Impairment* project (the project) is to provide users of financial statements with more useful information about the business combinations entities make, at a reasonable cost. To meet this objective, the IASB is considering:
 - (a) the disclosure requirements about business combinations; and
 - (b) the subsequent accounting for goodwill—in particular, potential changes to the impairment test in IAS 36 *Impairment of Assets*.

The IASB preliminary views on impairment test

- 7 In the Post-implementation Review (PIR) of IFRS 3 *Business Combinations*, stakeholders said impairment losses on goodwill are sometimes recognised too late

and the impairment test of cash-generating units (CGUs) containing goodwill is complex, time-consuming and requires significant judgement.

- 8 In the DP the IASB set out its preliminary views regarding the impairment test, which were:
- (a) it is not feasible to design a different impairment test that is significantly more effective than the impairment test in IAS 36 at a reasonable cost;
 - (b) to provide relief from the mandatory annual quantitative impairment test of CGUs containing goodwill, thereby leaving only an indicator-based test;
 - (c) to allow an entity to use post-tax cash flows and post-tax discount rates in estimating value in use (VIU); and
 - (d) to remove restrictions on including in estimates of VIU, cash flows arising from a future restructuring to which an entity is not yet committed or, from improving or enhancing an asset's performance.

Respondents feedback on preliminary views on impairment test

- 9 Most respondents agreed that it is not feasible to design a different impairment test of CGUs containing goodwill that is significantly more effective than the impairment test in IAS 36 at a reasonable cost. However, many suggested ways to improve the application of the existing approach.
- 10 Most respondents did not support providing relief from the mandatory annual quantitative impairment test of CGUs containing goodwill. Many of them expressed concern that any cost savings would not outweigh the resulting reduction in the test's effectiveness and robustness.
- 11 Almost all respondents agreed with allowing an entity to use post-tax cash flows and post-tax discount rates in estimating VIU - a pre-tax discount rate is not observable and does not provide useful information.
- 12 Many respondents agreed with removing restrictions on including, in estimates of VIU, cash flows arising from a future restructuring to which an entity is not yet committed or from improving or enhancing an asset's performance. However, many suggested developing requirements on when these cash flows can be included in VIU estimates.

The IASB tentative decisions during its redeliberations of the DP

- 13 In November 2022, the IASB tentatively decided not to explore further reintroducing amortisation of goodwill.
- 14 In December 2022, the IASB added the project to its standard-setting work plan. The IASB expects to publish an exposure draft in 2024 to consult on its tentative decisions on the project.
- 15 The IASB has completed most of its redeliberations and tentative decisions on disclosure regarding the objectives, subsequent performance and synergies of a business combination with only some refinements to be discussed.

Next steps

- 16 The IASB will discuss the following aspects of the DP at future meetings:
- (a) clarifying other aspects of the disclosure requirements for business combinations;
 - (b) reducing the cost and complexity of applying the impairment test of cash-generating units in IAS 36 *Impairment of Assets*; and
 - (c) improving the effectiveness of the impairment test of cash-generating units containing goodwill.

- 17 Following the Third Agenda Consultation, the IASB added to its maintenance project pipeline a narrow-scope project on *Climate-related Risks in the Financial Statements*. As part of that project, the IASB might consider whether and, if so, what narrow-scope actions might be needed to improve the application of IAS 36 in relation to such risks. Hence, it is possible that at a future meeting EFRAG FR TEG-CFSS members may be consulted on further suggestions for clarifications to IAS 36 in the context of that project.
- 18 Once the IASB has made tentative decisions on all aspects of the project, it will consider whether the package of decisions meets the project objective and whether to publish an exposure draft setting out its proposals.

Key discussion points for the session

- 19 The IASB classified the suggested changes to the impairment test as:
- (a) Changes that can improve the effectiveness of the impairment test. For this purpose, the IASB considered changes that would:
 - (i) mitigate either of the two main reasons that impairment losses are not being recognised on a timely basis – management over-optimism and shielding; and
 - (ii) be able to be implemented at a reasonable cost.
 - (b) Changes that would reduce cost and complexity. For this purpose, the IASB considered changes that would:
 - (i) respond to PIR feedback that impairment tests of CGUs containing goodwill are costly and complex; and
 - (ii) be clear, simple and not significantly reduce effectiveness of the impairment test.
- 20 The IASB proposed the below four suggestions to reduce management over-optimism, two to address the shielding effect and two to reduce cost and complexity of the impairment test.

Changes that can improve the effectiveness of the impairment test

Suggestions to reduce management over-optimism

Suggestion 1: To disclose a comparison of cash flow forecasts used in impairment tests in prior years with actual cash flows.

Suggestion 2: To provide additional guidance or illustrative examples on the application of paragraph 33 of IAS 36 about reasonable and supportable assumptions and the most recent financial budgets or forecasts approved by management used in cash flow forecasts.

Suggestion 3: To disclose in which reportable segments the CGU(s) containing goodwill are included in the year of acquisition and/or in the subsequent periods.

Suggestion 4: To review the list of indicators of impairment in paragraph 12 of IAS 36¹.

¹ Paragraph 12 of IAS 36 includes a list of internal and external sources of information an entity should consider in assessing whether there is an indication that an asset may be impaired

Questions for EFRAG FR TEG-CFSS

Suggestion 1:

- 21 How useful will information from this comparison be?
- 22 Do you think this comparison would help to deter management over-optimism? Why or why not?
- 23 Would entities incur significant incremental costs if required to provide this comparison? Why? Would information on accuracy of past forecasts be commercially sensitive?
- 24 Is the information for this already available because of the review performed in applying paragraph 34 of IAS 36?
- 25 How long would you recommend requiring entities to provide this comparison? In your answer, take into consideration how long the comparison needs to be so that it is meaningful and the cost of providing the comparison?

Suggestion 2:

- 26 Would additional guidance or illustrative examples on the application of paragraph 33 of IAS 36 help the application and enforcement of that paragraph and help deter management over-optimism?

Suggestion 3:

- 27 Do you think impairment assumptions and segment information can be compared? Why?
- 28 Would entities incur significant incremental costs if required to disclose the reportable segments that CGU(s) containing goodwill are included in on a continuing basis (i.e., not just the segment the CGU(s) are included in on acquisition)? Why?
- 29 Do you think the additional information described in **Suggestion 3** would help users to better assess the reasonableness of the assumptions used in impairment tests of CGUs containing goodwill because of the ability to compare to information disclosed about reportable segments? Why or why not?
- 30 Do you think the additional information described in **Suggestion 3** would help to deter management over-optimism? Why or why not?

Suggestion 4:

- 31 Should the IASB explore improving the list of indicators if:
 - (a) it retains the requirement for an annual quantitative impairment test of CGUs containing goodwill?
 - (b) it decides to provide relief from the annual quantitative impairment test of CGUs containing goodwill? Please explain why.
- 32 How would you suggest improving the list of indicators?

Suggestions to reduce shielding

Suggestion 5: Allocating goodwill to CGUs for impairment testing

- (a) To clarify the reference to ‘operating segment’ in paragraph 80(b) of IAS 36² is not a default but a safeguard to prevent goodwill being tested at too high a level (e.g., at an entity level);
- (b) To clarify the requirement in paragraph 80(a) of IAS 36 to allocate goodwill to the lowest level within the entity at which goodwill is monitored for internal management purposes;
- (c) When clarifying how to allocate goodwill and what ‘monitoring’ means in point (b) above, to link the level management monitors the business combination, applying the IASB preliminary views³, to the requirements in paragraph 80 of IAS 36.

Suggestion 6: To perform an impairment test based on its previous reporting structure before reallocating goodwill to different CGU(s)⁴.

Questions for EFRAG FR TEG-CFSS

Suggestion 5:

- 33 Would the additional guidance in **Suggestion 5** help improve the application and enforcement of the impairment test?
- 34 Should the IASB clarify that the reference to ‘operating segment’ in paragraph 80 of IAS 36 is a safeguard and if so, how?
- 35 Should the IASB clarify the term ‘monitoring’ (**Suggestion 5(b)**) and if so, how?
- 36 Could the level goodwill should be tested for impairment be different to the level the business combination is monitored for the proposed disclosures (**Suggestion 5(c)**)?
- 37 Do you think the IASB should explicitly prohibit goodwill being tested for impairment at a level higher than the level the business combination is monitored for the proposed disclosures (**Suggestion 5(c)**)?

Suggestion 6:

- 38 Would entities have information/forecasts to perform an impairment test based on a previous reporting structure?
- 39 Would entities incur significant incremental costs if required to perform this impairment test? Why?
- 40 Conceptually, should an impairment be recognised based on the ‘old’ structure?
- 41 Do you think that requiring an entity to perform the impairment test on the ‘old’ reporting structure would provide useful information? Why or why not?

² Paragraph 80 of IAS 36 says that each unit or group of units to which the goodwill is allocated shall: (a) represent the lowest level within the entity at which the goodwill is monitored for internal management purposes; and (b) not be larger than an operating segment as defined by paragraph 5 of IFRS 8 *Operating Segments* before aggregation.

³ In September 2022, the IASB tentatively decided to propose adding to IFRS 3 a requirement for an entity to disclose, for ‘strategically important’ business combinations, information about (i) management’s objectives for the business combination; (ii) the metrics and targets management will use to monitor whether those objectives are being met; and (iii) in subsequent periods, the extent to which management’s objectives are being met, using those metrics, for as long as management monitors the business combination against its objectives.

⁴ Paragraph 87 of IAS 36 says that if an entity reorganises its reporting structure in a way that changes the composition of one or more CGUs to which goodwill has been allocated, the goodwill shall be reallocated to the units affected.

Suggested changes that could reduce cost and complexity of the impairment test

- 42 **Suggestion 7:** Clarify or amend paragraph 99 of IAS 36⁵ in order to make it easier to apply.

Questions for EFRAG FR TEG-CFSS

Suggestion 7:

- 43 In your experience, is paragraph 99 of IAS 36 applied frequently?
- 44 If not, why not? How could (and should) the IASB make it easier to apply?
- 45 Would paragraph 99 of IAS 36 (if applied) significantly reduce cost and complexity of the impairment test of CGUs containing goodwill, without reducing its effectiveness?
- 46 Do you think that when an entity applies paragraph 99 of IAS 36 it should be required to disclose additional information to that already required by IAS 36?¹ If so, what additional information do you think would be useful?
- 47 If the IASB were to clarify or amend paragraph 99 of IAS 36, should similar clarifications or amendments be made for intangible assets with indefinite useful lives (paragraph 24 of IAS 36)? Why or why not?

Agenda Papers

- 48 In addition to this cover note, agenda paper 09-02 – *IASB Agenda Paper AP7 BCDGI - Possible changes to the impairment test* – has been provided for the session.

⁵ Paragraph 99 of IAS 36 says that the most recent detailed calculation made in a preceding period of the recoverable amount of a CGU to which goodwill has been allocated may be used in the impairment test of that unit in the current period provided all of the following criteria are met: (a) the assets and liabilities making up the unit have not changed significantly since the most recent recoverable amount calculation; (b) the most recent recoverable amount calculation resulted in an amount that exceeded the carrying amount of the unit by a substantial margin; and (c) based on an analysis of events that have occurred and circumstances that have changed since the most recent recoverable amount calculation, the likelihood that a current recoverable amount determination would be less than the current carrying amount of the unit is remote.