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Staff paper

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Accounting Standards Advisory Forum

Date	**March 2023**
Project	**Business Combinations—Disclosures, Goodwill and Impairment**
Topic	**Possible changes to the impairment test of cash-generating units containing goodwill**
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Information for ASAF members

Slides 13, 15, 17, 19, 24, 26 and 29 contain questions for ASAF members

Background

Business Combinations—Disclosures, Goodwill and Impairment – Project overview

Objective

- Improve information entities provide about their business combinations at a reasonable cost

Current focus

- A package of disclosure requirements about business combinations (decision on some key aspects made in September 2022)
- Changes to the impairment test of cash-generating units containing goodwill in IAS 36 *Impairment of Assets* (decision not to explore reintroducing amortisation of goodwill made in November 2022)

Next milestone

- Publish Exposure Draft (decision to move project to standard-setting agenda in December 2022)

Preliminary views on impairment test

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

In the Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment* the IASB set out its preliminary views regarding the impairment test, which were:

- 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
- to provide relief from the mandatory annual quantitative impairment test of CGUs containing goodwill, thereby leaving only an indicator-based test
- to allow an entity to use post-tax cash flows and post-tax discount rates in estimating value in use (VIU)
- 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

Feedback on preliminary views

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 that test

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

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

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

Agenda Papers 18B and 18D to the IASB's May 2021 meeting summarise feedback on the preliminary views

Purpose of this session

To obtain feedback on some suggestions respondents to the Discussion Paper had for changes to the impairment test of CGUs containing goodwill

This feedback will help the IASB decide whether to explore these suggestions further

Slides 13, 15, 17, 19, 24, 26 and 29 contain questions on these suggestions

We also welcome comments on our rationale for considering suggestions (slide 9) and indications of which suggestions (if any) to prioritise

Scope of discussion at this meeting

The IASB will discuss its preliminary views on slide 5 at a future IASB meeting and we are not seeking feedback on those preliminary views at this meeting

We acknowledge that your feedback on some of the suggestions to be discussed at this meeting may depend on decisions the IASB makes on its preliminary views on slide 5—for example, on whether to provide relief from the mandatory annual quantitative impairment test or whether to remove some restrictions on the cash flows included in estimates of VIU. If this is the case, we ask you to highlight such dependencies

Following the Third Agenda Consultation, the IASB added to the 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 ASAF members may be consulted on further suggestions for clarifications to IAS 36 in the context of that project

Rationale for considering suggested changes

We identified suggestions for changes to the impairment test of CGUs containing goodwill that we think warrant further consideration (see slides 10–29)[1]

A full review of IAS 36 is not in the scope of this project

In order to identify suggested changes to explore further within the scope of this project we considered:

- Suggested changes that would improve effectiveness, if the suggested change would:
  - mitigate either of the two main reasons the IASB identified for PIR feedback that impairment losses are not being recognised on a timely basis – management over-optimism and shielding; and
  - be able to be implemented at a reasonable cost
- Suggested changes that would reduce cost and complexity, if the suggested change would:
  - respond to PIR feedback that impairment tests of CGUs containing goodwill are costly and complex; and
  - be clear, simple and not significantly reduce effectiveness of the impairment test

[1] All suggested changes can be found in paragraphs 8–56 of Agenda Paper 18C to the July 2021 meeting of the IASB and paragraphs 40–42 and 55–68 of Agenda Paper 18D to the May 2021 meeting of the IASB

Suggested changes that could improve the effectiveness of the impairment test

Suggestions to reduce management over-optimism

- Comparison of past forecasts
- Reasonable and supportable assumptions
- Segments goodwill is allocated to
- Indicators of impairment

Comparison of past forecasts

Suggestion

Require entities to disclose a **comparison of cash flow forecasts used in impairment tests in prior years with actual cash flows** for a specified number of reporting periods to assess the accuracy of those cash flow forecasts (see Appendix for an illustration of this suggestion provided by one respondent to the Discussion Paper)

(see paragraphs 12–17 of Agenda Paper 18C to the July 2021 meeting of the IASB)

Initial staff comments

Could help deter over-optimistic forecasts or identify entities that are consistently over-optimistic

However, usefulness of the information is questionable given forecasts are highly judgemental and can be affected by events outside management's control

It is also questionable how costly providing this information would be. The IASB rejected a similar idea when developing IFRS 3 and one of the reasons was cost

The information should already be available to entities (paragraph 34 of IAS 36[1]), however there could be possible incremental costs

How useful the information would be and how costly it would be to provide the information would depend on how long the comparison would be required for

[1] Paragraph 34 of IAS 36 says that management assesses the reasonableness of the assumptions on which its current cash flow projections are based by examining the causes of differences between past cash flow projections and actual cash flows and that management shall ensure that the assumptions on which its current cash flow projections are based are consistent with past actual outcomes, provided the effects of subsequent events or circumstances that did not exist when those actual cash flows were generated make this appropriate

Questions for ASAF members

1 Comparison of past forecasts

a) How useful will information from this comparison be?

b) Do you think this comparison would help to deter management over-optimism? Why or why not?

c) Would entities incur significant incremental costs if required to provide this comparison? Why? Would information on accuracy of past forecasts be commercially sensitive?

d) Is the information for this already available because of the review performed in applying paragraph 34 of IAS 36?

e) 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

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Reasonable and supportable assumptions

Suggestion

Provide additional guidance or illustrative examples on the application of paragraph 33 of IAS 36, particularly regarding the **interaction between**:

i. the requirement to base cash flow forecasts on **reasonable and supportable assumptions** (paragraph 33(a)); and

ii. the requirement to base cash flow forecasts on **the most recent financial budgets or forecasts approved by management** (paragraph 33(b)) which may, by their nature, be ambitious because they are also used to incentivise management

A few respondents suggested putting more emphasis on ‘reasonable and supportable’

(see paragraphs 29–33 of Agenda Paper 18C to July 2021 meeting of the IASB)

Initial staff comments

More clarity about these requirements might assist enforcement

The IASB could clarify that these requirements do not conflict and that cash flow projections based on the most recent financial budgets/forecasts approved by management need to be based on reasonable and supportable assumptions

For example, ‘stretch targets’ used to incentivise management might not always be reasonable and supportable and if this is the case adjustments should be made when estimating the recoverable amount

Questions for ASAF members

2	**Reasonable and supportable**	Would additional guidance or illustrative examples on the application of paragraph 33 of IAS 36 as suggested on slide 14 help the application and enforcement of that paragraph and help deter management over-optimism?

Segments goodwill is allocated to

Suggestion

IAS 36 paragraph 134(a) requires the carrying amount of goodwill allocated to CGU(s) to be disclosed (where the carrying amount of goodwill is significant in comparison with total goodwill)

Entities could be required to disclose in which reportable segments the CGU(s) containing goodwill are included

This could be required only in the year of acquisition (ie reflecting the initial allocation) or in ongoing reporting periods (ie reflecting any reorganisations)

(see Agenda Paper 18D to December 2022 meeting of the IASB)

Initial staff comments

Could help improve the effectiveness of the impairment test by allowing users of financial statements to better assess the reasonableness of the assumptions used in the impairment test in comparison to information disclosed about reportable segments

How useful the information would be might depend on the size of the CGU(s) containing goodwill relative to the size of the reportable segment

Questions for ASAF members

3 Goodwill allocated to segments

a) Do you think impairment assumptions and segment information can be compared? Why?

b) 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 (ie not just the segment the CGU(s) are included in on acquisition)? Why?

c) Do you think the additional information described on slide 16 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?

d) Do you think the additional information described on slide 16 would help to deter management over-optimism? Why or why not?

List of impairment indicators

Suggestion

Review the list of **indicators of impairment** in paragraph 12 of IAS 36[1]

Some respondents said that the list of indicators in IAS 36 may contribute to the delay in recognising impairment losses

(see paragraphs 54–56 of Agenda Paper 18C to July 2021 meeting of the IASB)

Initial staff comments

Updating the list of indicators is unlikely to have a significant benefit if the IASB decides not to provide relief from the mandatory annual quantitative impairment test.[2] This is because improved indicators are likely to only marginally accelerate the recognition of impairment losses on goodwill if an annual test continues to be required

If the IASB decides to explore this suggestion, it could consider:

i. developing a list of indicators specifically applying to goodwill

ii. developing a list of indicators that should exist to presume goodwill is not impaired

iii. amending the existing indicators to provide more prominence to internal indicators over external indicators

iv. specifying disclosure of the failure to achieve an objective or target for a business combination (as would be required under the new disclosures to be proposed) should be an impairment indicator

[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

[2] IAS 36 requires an entity to test CGUs containing goodwill annually. In the Discussion Paper the IASB's preliminary view was to remove the requirement to perform an annual quantitative impairment test of CGUs containing goodwill and require CGUs containing goodwill to be tested for impairment only if there is an indication of impairment

Questions for ASAF members

4 Indicators of impairment

a) Should the IASB explore improving the list of indicators if:

   i. it retains the requirement for an annual quantitative impairment test of CGUs containing goodwill?

   ii. it decides to provide relief from the annual quantitative impairment test of CGUs containing goodwill?

   Please explain why

b) How would you suggest improving the list of indicators?

Suggestions to reduce shielding

- Allocating goodwill to CGUs
- Impairment test when entities reorganise

Allocating goodwill to CGUs for impairment testing (1)

Suggestion

Clarify the **reference to 'operating segment'** in paragraph 80(b) of IAS 36[1] **is not a default but a safeguard to prevent goodwill being tested at too high a level** (eg at an entity level)

(see paragraphs 40–42 of Agenda Paper 18C to July 2021 meeting of the IASB)

Initial staff comments

In developing its preliminary views, the IASB decided not to develop guidance on allocating goodwill to CGUs because it would be difficult to provide guidance relevant to all entities

We think the safeguard in IFRS 3 is still necessary and hence the reference to operating segment should not be removed

It is possible the wording in paragraph BC150B of the Basis for Conclusions on IAS 36 may lead to a misunderstanding of the reference to operating segment in paragraph 80(b)[2]

Explaining the rationale for the operating segment ceiling in paragraph 80(b) of IAS 36 (as a safeguard rather than a default) may encourage entities to test goodwill at a lower level and assist enforcement

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[1] 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

[2] Paragraph BC150B of the Basis for Conclusions on IAS 36 says the IASB noted that the lowest level of the entity at which management monitors goodwill as required by paragraph 80(a) is the same as the lowest level of operating segments at which the chief operating decision maker regularly reviews operating results as defined in IFRS 8

Allocating goodwill to CGUs for impairment testing (2)

Suggestion

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**

Respondents said management often does not monitor goodwill but instead monitors the overall business and in these situations, entities test goodwill for impairment at the operating segment level

A few respondents suggested replacing ‘goodwill is monitored’ with ‘the acquired business is monitored’ and a few respondents suggested clarifying what ‘monitoring’ means

(see paragraphs 40–42 of Agenda Paper 18C to July 2021 meeting of the IASB)

Initial staff comments

The IASB could replace ‘goodwill is monitored’ with ‘the business associated with goodwill is monitored’ in paragraph 80(a) of IAS 36, as suggested by respondents. Alternatively, the IASB could clarify the meaning of ‘monitoring’

More clarity might assist application of paragraph 80 of IAS 36 and encourage entities to test goodwill at a level lower than the operating segment

Allocating goodwill to CGUs for impairment testing (3)

Suggestion

In clarifying how to allocate goodwill and what 'monitoring' means (see slide 22), some respondents suggested **linking the level management monitors the business combination** when applying the preliminary views[1] on disclosures about the subsequent performance of business combinations **to the requirements in paragraph 80 of IAS 36**

(see paragraphs 40–42 of Agenda Paper 18C to July 2021 meeting of the IASB)

Initial staff comments

This suggestion could help

- identify the level goodwill should be tested for impairment
- clarify what is meant by monitoring goodwill

The IASB could also explore prohibiting goodwill being tested for impairment at a level higher than the level an entity monitors whether a business combination is achieving management's objectives for that business combination

[1] In its September 2022 meeting, 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

Questions for ASAF members

5 Allocating goodwill to CGUs

a) Would the additional guidance suggested on slides 21–23 help improve the application and enforcement of the impairment test?

b) Should the IASB clarify that the reference to ‘operating segment’ in paragraph 80 of IAS 36 is a safeguard (slide 21) and if so, how?

c) Should the IASB clarify the term ‘monitoring’ (slide 22) and if so, how?

d) Could the level goodwill should be tested for impairment be different to the level the business combination is monitored for the proposed disclosures (slide 23)?

e) 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 (slide 23)?

Perform impairment test when goodwill is reallocated

Suggestion

Require entities to **perform an impairment test based on its previous reporting structure** before reallocating goodwill to different CGU(s)[1]

A few respondents said that entities may decide to reallocate goodwill opportunistically to avoid impairments of goodwill

(see paragraphs 43–46 of Agenda Paper 18C to July 2021 meeting of the IASB)

Initial staff comments

Requiring an entity to perform a test at the date of the reorganisation on the previous reporting structure could help limit opportunist behaviour to avoid goodwill impairments

We would need to understand:

- whether entities would be able to perform this test—would cash flow forecasts be available for the previous reporting structure?
- the interaction with the requirement for an annual quantitative impairment test (if this is retained) because this may limit the value of this suggestion (if an impairment test has been performed recently)

[1] 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

Questions for ASAF members

6 Impairment test when entities reorganise

a) Would entities have information/forecasts to perform an impairment test based on a previous reporting structure?

b) Would entities incur significant incremental costs if required to perform this impairment test? Why?

c) Conceptually, should an impairment be recognised based on the ‘old’ structure?

d) Do you think that requiring an entity to perform the impairment test on the ‘old’ reporting structure, as described in slide 25, would provide useful information? Why or why not?

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

Paragraph 99 of IAS 36

Suggestion

Clarify or amend paragraph 99 of IAS 36[1] in order to make it easier to apply

Respondents said this paragraph is used infrequently in practice because of the perceived lack of clarity on some of the criteria that must be met

Some respondents said making paragraph 99 easier to apply could reduce cost and complexity and could be an alternative to removing the requirement for an annual quantitative impairment test

(see paragraph 40 of Agenda Paper 18D to May 2021 meeting of the IASB)

Initial staff comments

The IASB could explore this suggestion further

Paragraph 99 of IAS 36 was designed to help reduce costs of applying the impairment test without compromising its integrity. Feedback suggests the requirement might not be working as intended, although there may be mixed views on this

We would need to understand what (if anything) is preventing entities from using the relief in this paragraph and whether the IASB could do anything about this

We think if the IASB were to retain its preliminary view to remove the requirement for an annual quantitative impairment test of CGUs containing goodwill, paragraph 99 would also be removed

If changes were to be made to paragraph 99 of IAS 36, we would need to consider whether similar changes should be made to paragraph 24 of IAS 36 that includes similar requirements for intangible assets with indefinite useful lives

[1] 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

Questions for ASAF members

7 **Paragraph 99 of IAS 36**

a) In your experience, is paragraph 99 of IAS 36 applied frequently?

b) If not, why not? How could (and should) the IASB make it easier to apply?

c) 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?

d) 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?

e) 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?

[1] Paragraph 136 of IAS 36 requires an entity to provide the same information for the CGU containing goodwill, for which an entity has used the most recent detailed calculation made in a preceding period of the recoverable amount, as it would do if the recoverable amount had been estimated in the current reporting period

Appendix

Illustration of comparison of past forecasts

One respondent to the Discussion Paper provided an example of the suggestion to require a comparison of past cash flow forecasts with actual cash flows (see slide 12). This is repeated here for illustrative purposes only. If the IASB were to explore this suggestion, it would need to decide the mechanics of the requirement, which could be different to those illustrated here

Assume A purchases B on 1 January 2020. A has a 31 December year-end. A pays Currency Units ('CU') 2,000 for B and recognised CU 700 of goodwill in the purchase price allocation. IAS 36 requires A to perform an impairment test of goodwill on an annual basis. Assume in this case, that A performs the test on 31 December of each year. In preparing this impairment test each year, management makes an estimate of future cash flows

As at 31 December 2024, the disclosure comparing management's estimates to actual cash flows to date can be illustrated as follows:

	2021	2022	2023	2024	Cumulative estimate	Actual to date[1]	Difference
Forecast at 31/12/2020	100	100	120	120	440	335	(105)
Forecast at 31/12/2021		90	110	115	315	245	(70)
Forecast at 31/12/2022			80	90	170	160	(10)
Forecast at 31/12/2023				85	85	80	(5)
Actual	90	85	80	80			

[1] Actual to date is calculated by summing the total actual cash flows compared to the estimate made at each period end. For example, CU 335 in 2020 is the sum of 90, 85, 80 and 80 actual cash flows from 2021-2024 and CU 245 in 2021 is the sum of 85, 80 and 80 from 2022-2024

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