Australian Government
Australian Accounting Standards Board

Project:	**Goodwill and Impairment**	**Meeting:**	M165
Topic:	**Feedback from preparers and analysts**	**Agenda Item:**	8.1
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Objective of the meeting

1. The objective of this meeting is to provide the Board with an update on outreach conducted on impairment testing for goodwill and other financial assets and seek Board's direction on whether:

   a) recommendations should be made to the IASB that concerns relating to incorporating future restructuring and using post-tax discount rates in VIU calculation could be resolved by a limited scope project on IAS 36 *Impairment of Assets;*

   b) further research should be conducted into developing a new approach for testing goodwill and other non-financial assets for impairment to enable the recognition of impairment on a more timely basis; and

   c) further research should be conducted into optimal methods of goodwill allocation for the purposes of impairment testing; and

d) further research should be conducted on disclosure requirements in relation to impairment testing of goodwill and other non-financial assets.

Attachments (for board information only – not necessary to have read these attachments for the purposes of the meeting)

Agenda Paper 8.2 April 2018 ASAF Agenda Paper 5 – *Goodwill and Impairment*'

Agenda Paper 8.3 EFRAG published a discussion paper titled '*Goodwill Impairment Test: Can it be improved?*'

Introduction

2. As part of the post-implementation review of IFRS 3 *Business Combinations*, the International Accounting Standards Board (IASB) received significant feedback regarding the shortcomings of impairment testing under IAS 36 *Impairment of Assets*. As a result the IASB has discussed proposals for change, and a summary of the current status of their project can be found in paragraphs 8 and 9 of this paper.

3. This paper summarises feedback received from targeted outreach conducted with preparers and analysts in Australia on the following:
   (a) the current impairment testing requirements in IAS 36 for goodwill and other non-financial assets; and
   (b) the proposed approaches for goodwill impairment testing, which have been recently considered by the IASB and the European Financial Reporting Advisory Group ("EFRAG").

4. In gathering this feedback, the following groups were interviewed
   (a) Preparers from seven major Australian corporates
   (b) One representative of the regulator
   (c) Eight representatives of the analyst or shareholder community
   (d) One representative of a state auditor general's office.

5. The paper supplements the feedback of the AASB Business Combinations Project Advisory Panel. Minutes of a meeting held by this panel on 5 April 2018 are attached as Appendix B to this paper.

Summary of recommendations

6. The paper concludes by proposing the following:

   (a) IAS 36 be amended to permit the inclusion of cash flows from future restructurings and future enhancements in a Value in Use (ViU) calculation.

   (b) IAS 36 be amended to permit the use of a post-tax discount rate in the calculation of ViU.

   (c) Further research be conducted into:

      i. The allocation of goodwill amongst cash-generating units (CGUs) for impairment testing purposes; and

      ii. developing an approach for impairment testing to recognise impairments on a more timely basis based on the methodology analysts use to assess impairment.

   (d) Further research be conducted on disclosures related to impairment testing of goodwill and other non-financial assets.

Background

7. As part of the Post-Implementation Review of IFRS 3 in 2013, the IASB received the following feedback:

   (a) Impairments of goodwill are being ‘shielded’ by unrecognised headroom and/or additional goodwill generated internally through management’s efforts and investments.

   (b) The process of allocating goodwill to CGUs requires judgement and there is limited guidance provided. Subsequent acquisitions and restructurings may mean the actual composition is difficult to reconcile.

   (c) Mandatory determination of recoverable amount is time-consuming and costly with no real practical benefit.

   (d) There is confusion among users around the differences between ViU and fair value less costs of disposal (FVLCD), and the circumstances in which each model is most appropriately applied.

   (e) Specifically, in relation to ViU, the exclusion of future restructurings from ViU (as per the requirement of IAS 36) does not reflect how acquirers price prospective transactions, and the requirement to use pre-tax discount rates is anomalous.

(f) The separation and valuation of intangibles in an acquisition is a costly process and does not provide valuable information.

Please refer to Appendix A for summary of IAS 36 requirements and definition of key terms used in this paper.

Current status of IASB project

8. In April 2018, in response to the post-implementation issues mentioned above in paragraph 7, the IASB tabled 'April 2018 ASAF Agenda Paper 5 – *Goodwill and Impairment*' (refer to Agenda Paper 8.2) which set out a number of recommendations. In June 2017 EFRAG published a discussion paper titled '*Goodwill Impairment Test: Can it be improved?*' (refer to Agenda Paper 8.3), which debated the advantages and disadvantages of a number of other proposals put to that group. The proposals from these two bodies set out the basis of our discussions with stakeholders.

9. In a meeting on 23 May 2018, the IASB Staff recommended developing a Discussion Paper or Request For Information seeking feedback on the headroom approach (summarised in paragraph 52 of this paper and detailed in Agenda Paper 8.2), however during the meeting the Board decided not to pursue this. The Board did decide to pursue including in the ViU calculation expected cash flows from future restructuring and future performance enhancements that management is more likely than not to undertake. While it appears that the original intention of the IASB's project was to amend IAS 36 only in minor parts and leave as much as possible untouched, it has become evident that impairment testing should be reconsidered as a whole. Subsequent to the May 2018 IASB meeting, dates for publication of documents arising from the Goodwill and Impairment project were removed from the IASB's work plan. Given the concerns that impairment testing should be reconsidered as a whole the IASB decided at their May 2018 meeting not to vote on whether a Discussion Paper or Exposure Draft would be the next step. The IASB Staff will bring back the alternative solutions and a strategy to a future IASB meeting.

Summary of feedback received from targeted outreach conducted in Australia

Are impairments too little too late?

10. Generally, respondents in all categories acknowledged that impairments are recorded after the market recognises the issues and adjusts share price accordingly. Only one analyst offered an alternate view, believing that the continuous disclosure requirements in Australia adequately protect investors in ASX listed companies from the risk that impairments are disclosed to the market ‘too late’.

11. However, five respondents from both the preparer and analyst categories separately indicated that impairments – when they are recorded – are not ‘too little’ but are taken heavily, on the basis that partial impairments are rarely seen, meaning that if and when an impairment is required the full amount of goodwill will be written off, regardless of the outcome of the model. One stated that in their opinion businesses know when they have a problem and are not scared to report an impairment, likely because in recent years the market has not been seen to react negatively to such announcements, indicating that, as mentioned above, the market may have previously accounted for the impact.

12. Several analysts added more to this discussion by outlining that in years where there has been a change in leadership, organisations can be seen to ‘take a bath’ and in those cases impairments are taken more heavily than necessary. They suggest the prevalence of this phenomena reflects a combination of incumbent management safeguarding against accusations of poor decision-making in relation to past acquisitions, and new management being motivated to ‘start with a clean slate’. Impairments are also noted to be more common when an industry-wide event occurs and other entities are seen to be recording write-offs. Having said this, one analyst commented that generally, aside from ‘big bath’ years and extreme events, management’s KPIs result in motivation to delay or smooth impairments over a longer period. Others however perceived that generally management KPIs excluded ‘one-off’ or ‘non-cash’ items, and accordingly management were not genuinely held accountable for impairments. Another explained that it is much more important to get the impairment ‘right’ rather than to record it earlier, especially in cases where there is subsequently a recovery – in these cases it is better to wait.

13. Analysts in particular noted that the fact that impairments generally only go in one direction is problematic.

14. Several of the respondents acknowledged that the two issues at play appear to be that the impairment testing process needs to be simplified, and that goodwill is being impaired too late. Respondents recognised that these appear to be mutually-exclusive and it was difficult to come up with suggestions that addressed both of these concerns.

Is shielding really an issue?

15. One of the primary concerns underlying this project is that impairments of goodwill are being ‘shielded’ by unrecognised headroom (which mainly comprises internally generated goodwill) which always absorbs the first layer of decreases in the recoverable amount; thus, it ‘shields’ the acquired goodwill. Subsequent to acquisition, the concern is that this is emphasised by management’s activities and programs to build the newly-combined businesses and that these may contribute to an increase in the recoverable amount. As these activities are post-acquisition they therefore represent internally-generated goodwill that is not representative of the value that existed on acquisition, and which is conceptually the item being tested for impairment.

16. Throughout our conversations with stakeholders we received a wide spectrum of responses to this, however generally the perception was that shielding in this form is not an issue. One preparer challenged the notion that impairments are being ‘shielded’ by internally generated goodwill from management’s activities post-acquisition and questioned how management would differentiate between that and the actual synergies that the goodwill represented in the first place. Several other respondents challenged the appropriateness of recognition of an impairment in these circumstances when the overall value of the combined business or operating segment has increased.

17. Along these lines, three respondents (one preparer and two analysts) separately suggested that impairment testing should actually be required at a level other than the operating segment, which would be especially important where one business is acquired strategically to subsidise another and those businesses are in different segments. Practically, this might result in goodwill being tested for impairment at a level higher than an operating segment. Another respondent also commented on this and stated that the requirement to test the goodwill at the level which management monitors goodwill for internal reporting purposes

(IAS 36) is often vague and not applicable to how businesses run, however acknowledged that in circumstances where this does genuinely represent the way that a business is analysed internally this level of allocation should remain.

18. A number of respondents cited statistics regarding the likely ‘failure’ of a business acquisition. The rate cited varied, but the consensus was that somewhere between 50 and 90% of all business acquisitions would be considered to ‘fail’ in the five years following the transaction using standard business metrics. It was noted however, that it is not the case that acquired goodwill is impaired in 50 – 90% of cases in the five years following a transaction. Many respondents believed that businesses were being tested immediately post acquisition, and then on an ongoing basis as part of larger CGUs that have headroom, creating an instant shield for the newly acquired business in case it did not perform as expected.

19. Based on these discussions, it appears that the real issue with ‘shielding’ relates to the fact that the Standard can be interpreted in a way that allows goodwill to be allocated at the time of acquisition to the CGU with the most headroom, therefore allowing entities to ‘future-proof’ their results. This is further discussed below commencing from paragraph 46 and forms the basis of our recommendation in paragraph 69.

What is the perceived and actual value of impairment information to the market?

20. Responses to the question of the value of impairment information to the market were varied, with many believing that under the existing requirements recording an impairment was more of confirmatory value rather than providing new information to the market.

21. Analysts explained that at a high level there are two key ways of assessing results, either based on assets or available cash flow information. Most analysts interviewed use the cash flow approach along with their observations of the issues facing the industry as a whole and therefore place less value on goodwill and impairment disclosures, with one analyst labelling them ‘yesterday’s news’. The value of an acquisition is assessed based on actual cash flows compared to expected cash flows following an acquisition.

22. From a preparer’s perspective, respondents were mixed on their perception of the value that analysts place on goodwill and impairment balances and disclosures. One preparer remarked that impairment of goodwill is totally disregarded, stating that, in their experience,

analysts either exclude goodwill in the first instance or disregard impairment as a non-cash item. Interestingly, a number of analysts debunked this by saying they believe that what is sitting in impairment – and similarly amortisation – is a genuine business cost. If these adjustments imply the value is being worn out, then there is a genuine expense to the business which should be recorded in the profit or loss, and not below the Earnings Before Interest Tax and Depreciations and Amortisation (EBITDA) line. These analysts further noted that claims by management that impairments are a 'non-cash' item are not entirely accurate, as the goodwill recognised in balance sheets was in fact acquired using cash and if that goodwill is no longer supported, then there is a genuine cash outflow that has occurred in the past that has not provided the business with a commensurate benefit.

Would the reintroduction of amortisation be supported?

23. The overwhelming response to this question was 'no'. All respondents believed that this would be a retrograde step. Many analysts noted that the purpose of acquiring goodwill was to support the growth of a business and it could not reasonably be presumed that this asset wears out over time.

24. Whilst some preparers noted that if acquired goodwill *is* conceptually considered to be an asset that is being consumed and decreasing over time, then the reintroduction of goodwill amortisation should be considered, however all of them agreed that although this would make their lives easier, it does not necessarily increase the usefulness of information in the financial statements.

25. Two respondents who participated in the G100 meetings explained that this suggestion has not attracted a great deal of support in that group as the result is a hybrid of cost and value, and does not give relevant information about value. It was also suggested that other jurisdictions may support this proposal because they are already amortising goodwill for tax purposes.

What are the frustrations and limitations identified in current impairment testing?

Rules for calculating ViU are restrictive and driven by anti-abuse concerns

26. Generally, preparers' opinions were that the rules underlying the ViU model are reactive and driven by anti-abuse concerns, which has resulted in a ViU concept that is far removed from where it started. Both preparers and analysts accepted that there may be situations where the value of a certain asset is greater to a business than it is to the market which is why ViU continues to be used despite these frustrations.

EFRAG proposal: Allow consideration of cash flows from future restructurings in the ViU

27. All preparers that expressed a view on this topic, except one, supported EFRAG's suggestion as it would allow management to more easily apply its actual outlook for the business and simplify the impairment test. It was generally agreed this would allow entities to use budgets and forecasts, which are likely to include the impact of future restructurings and asset acquisitions or replacements, and that the artificial adjustments currently required to remove them are arbitrary and do not paint the full picture.

28. Analysts were more wary of this change. One believed that this information belongs in the management commentary, and another speculated that management would likely not be willing to disclose this information in the early stages of planning anyway. In general, where analysts disagreed with the proposal it was on the basis that the cash flow impact of the restructures can be unrealistically positive and the value accretive nature of restructurings is often not borne out in practice. Respondents did not suggest a methodology for assessing the likelihood of the predicted cash flows.

29. Nonetheless, all respondents were consistent in agreeing that if this proposal was adopted there should be strict safeguards, and auditors should be prepared to robustly challenge the inputs. For example, the 'highly probable' guidance in IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* paragraph 8 could be used as a basis for determining management's commitment to the restructure.

30. However, it was noted by preparers and analysts alike that terms such as 'highly probable' and 'virtually certain' have limitations in practice due to an inconsistent understanding and application of the meaning of such terms.

EFRAG proposal: Allow the use of a post-tax rate in the ViU calculation

31. We found that respondents fully supported allowing the use of a post-tax discount rate. It was generally acknowledged that this is an area in which the accounting standard has a requirement that is not able to be applied in practice (as valuation experts cannot readily derive pre-tax discount rates, because market rates do not exist in a tax-free vacuum), and accordingly preparers have been forced to develop practical solutions. It was noted that the only practical implication of the pre-tax requirement in IAS 36 is that once impairment testing has been completed using a post-tax rate, an additional exercise is completed to derive a notional pre-tax rate that is used only for disclosure purposes.

Impairment testing is not performed consistently between entities

EFRAG proposal: Allow only a single calculation approach

32. Although EFRAG has proposed that only one approach (either ViU or FVLCD) be allowed to determine the recoverable amount of an asset or CGU, the majority of respondents that expressed a view on this topic did not support having only one approach because both ViU and FVLCD are considered relevant for the calculation of the recoverable amount, and both are adopted widely meaning the removal of either one would attract significant opposition. It was also noted that the two approaches tend to be used for different situations.

33. There were a number of suggestions from analysts on the use of the two approaches, including:
    (a) At a minimum, ViU needs to be allowed where operations are ongoing and FVLCD used when disposal is planned.
    (b) ViU should not be permitted for assets in the exploration and evaluation phase.
    (c) A FVLCD approach should not be used where inputs are not sufficiently reliable.

34. Having said this, two respondents did favour removing the choice on the basis that the differences between the two methods are nuanced and difficult to explain to users, particularly when a discounted cash flows (DCF) method is used to determine FVLCD or ViU. One respondent believed that conceptually, a FVLCD approach should be the only allowable approach, and that too often in practice FVLCD is currently used to get around the restrictions in ViU, but insufficient work is performed to determine whether the output is genuinely representative of fair value.

35. However, most participants supported redefining the base principles around ViU rather than removing the approach all together.

Valuation and recognition of intangible assets in an acquisition is highly judgemental

IFRS Proposal: Allow indefinite-lived intangible assets to be included within goodwill

36. There were mixed responses to this proposal, however most respondents who had an opinion on this were supportive of retaining the current requirements of IFRS 3.

37. Two respondents outlined that separate recognition is a long and difficult process and results in debates with auditors, regulators and valuers. From an analyst and investor perspective, the transaction value is of most interest but the assumptions underlying the allocation to tangible and intangible assets require much judgement. While this is less-so for tangible assets, for intangibles the value to be assigned becomes speculative.

38. A number of respondents believed separate recognition is valuable for certain types of assets – referencing patents and brands – but for others, (with customer lists being the most commonly cited example) separate recognition does not provide meaningful information. One analyst suggested that the standard requires certain intangibles to be split out 'as if they mean something', with the clear implication being that in his opinion the split amongst intangible assets was not meaningful.

39. One of the analysts interviewed suggested that more disclosure should be made of the valuation techniques used to arrive at these amounts.

40. One respondent agreed with the IFRS proposal of allowing indefinite-lived intangible assets to be included within goodwill and suggested that under the current requirements, an entity that grows organically will show higher profitability than an identical organisation that grows through acquisition due to the amortisation charge on acquired intangibles.

Staff recommendations

Inclusion of future restructurings and future enhancements in ViU calculation subject to certain criteria

41. As mentioned above, almost all preparers who expressed a view on this topic supported including the cash flows related to future restructurings and future enhancements in ViU calculations because it allows a more holistic use of use management' forecasts, and aligns with the requirement in the first part of IAS 36.33(b) to base ViU 'on the most recent financial budgets/forecasts approved by management'. Preparers have indicated this will solve the issue of entities arbitrarily removing the effect of prohibited events as per IAS 36 such as restructuring.

42. Although analysts were more cautious of this change, it was due to the cash-flow impact of restructures often being unrealistically positive, and the value accretive nature of restructurings not being seen in reality.

43. Given these responses, allowing the inclusion of cash flows related to future restructuring and future enhancements into ViU calculations together with robust guidance for management would simplify the impairment testing process without compromising timeliness of impairments. Use of a threshold for when such cash flows could be included such as 'highly probable' could arm the standard in this area, with an example as follows, based on guidance in IFRS 5.8:

> *For the restructure or enhancement to be highly probable, the appropriate level of management must be committed to a plan to implement the restructure or enhancement, and an active programme to complete the plan must have been initiated.*
>
> *In addition, the restructure or enhancement should be expected to qualify for recognition under paragraph 72 of IAS 37* Provisions, Contingent Liabilities and Contingent Assets *within one year from the testing date, and actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.*
>
> *The probability of shareholders' approval (if required in the jurisdiction) should be considered as part of the assessment of whether the restructure is highly probable.*

44. This guidance should be complemented by appropriate disclosure of the change in ViU caused by the respective incremental cash flows.

Use of post-tax discount rates

45. Given that all preparers interviewed agreed that testing is performed on a post-tax discount rate basis with an additional iteration simply to derive a pre-tax rate, introduction of a choice would simplify the calculation of the ViU and reduce costs.

Questions for the Board

Q1 Does the Board consider that IAS 36 should be amended as part of a narrow scope project to incorporate the following:

a) permit the inclusion of cash flows from future restructurings and future enhancements in a Value in Use (ViU) calculation, subject to certain criteria?

b) permit the use of a post-tax discount rate in the calculation of ViU

Lack of guidance around allocation of goodwill to CGUs

EFRAG proposal: Include commentary on permissible allocation methods and how they should be applied within the body of the standard.

46. A range of views were expressed around the adequacy of the rules relating to the allocation of goodwill to CGUs. There was no obvious pattern across any of the groups interviewed. The range of views included:

(a) Existing requirements of IAS 36 are too prescriptive and do not reflect the fact that the synergies represented by goodwill can have benefits across an entire entity, and the direction of those benefits is predictable.

(b) Existing requirements of IAS 36 are appropriate and afford management a reasonable degree of flexibility around allocating goodwill that reflects how the acquired asset will be used; and

(c) Existing requirements of IAS 36 are too open to manipulation and allow management to allocate goodwill in a way that protects the entity against the recognition of impairments.

47. Several respondents welcomed additional guidance due to the structure and clarity it would provide to preparers and users on the process undertaken determining the allocation. One preparer suggested that the definition of a CGU based on ‘independent cash flows’ is subjective which results in inconsistent application and the ability to allocate on the basis

of how management monitors goodwill is too judgemental. It was also noted that it is not clear what is meant by the level 'at which goodwill is monitored', with some entities taking a view that goodwill, as an historic balancing number, is not 'monitored' (and therefore viewing this leg of the test in IAS 136.80 as irrelevant), resulting in the goodwill being tested at the operating segment level. Others take the view that if the underlying business to which the goodwill originally related is monitored then this leg of the test is relevant, which in some circumstances may result in goodwill being tested at a level lower than the operating segment.

48. Staff note that given the definition of operating segment in IFRS 8 *Operating Segments* it would be technically unlikely that this distinction would arise in practice, however we note that clarifying the meaning of the phrase the level 'at which goodwill is monitored' will improve IAS 36.

49. Alternative views were offered, which centred on management seeing value in the standards allowing entities to choose a method which aligns with their vision for the combined business going forward and that EFRAG's proposals of including permissible allocation methods seem to be a rule-based and driven by anti-abuse concerns forcing every business to fit the same mould.

50. Generally, there was support for including suggested allocation methods as part of the illustrative and non-mandatory guidance accompanying IAS 36, rather than in the body of the standard.

51. Most respondents believed that if cash-generating units were to be more tightly defined and this resulted in an increase in the number of CGUs, it would be appropriate for this to be combined with a 'step zero' type approach (refer paragraph 63 of this paper) in order to ensure that the increased number of CGUs did not result in increased work being performed on CGUs which were not likely to be impaired.

Proposed goodwill impairment testing approaches

IASB proposal: Headroom approach

52. The headroom approach aims to address shielding caused by decreases in recoverable amount that are absorbed by unrecognised headroom. This approach involves comparing total headroom at the current impairment testing date with headroom at the previous testing

date. The proposal is that there would be a rebuttable presumption that a decrease in total headroom indicates an impairment.

53. Respondents generally understood how this approach would address the issue relating to timeliness of impairments and agreed that management activities post-acquisition can result in internally generated goodwill and can shield poor performance of acquirees and impairments that would otherwise be recorded. However, as noted above, opinions were varied as to whether this was necessarily problematic for acquisitions which are genuinely integrated into a CGU, as the investor has invested in the CGU as a whole. Several respondents suggested that tracking historical headroom would become complex when the entity undertakes further acquisitions or restructurings.

54. Several respondents highlighted that the approach would require complete agreement on the amount of headroom each year, an area where – in instances of ample headroom – the exact value may not currently be scrutinised or challenged. In general, although respondents understood the logic for the approach they believed it would add significant workload without necessarily significantly improving impairment testing outcomes. Many respondents including both preparers and analysts were vocal in their disagreement with the proposed model as a solution to current impairment testing rules, as such an approach goes further than addressing the carrying value of amounts on the balance sheet (which is the current purpose of impairment testing).

55. Two respondents mentioned that in the commodities market headroom can fluctuate significantly depending on pricing trends at the time. One of these respondents suggested that an appropriate compromise may be to disclose headroom and reasons for changes in it, rather than using it as a contributor to the carrying value.

56. Preparers indicated that if an impairment was recorded, under this framework companies would want to disclose that the impairment was due to the headroom approach and not because the recoverable value had fallen below the carrying value.

57. It was noted that IFRS does not permit the recognition of internally generated goodwill, meaning that when headroom is created in a CGU, the uplift cannot be recognised. However, the headroom approach would require that when the value of unrecognised headroom falls, an actual impairment loss is recorded. Concerns were raised that this treatment is asymmetrical, requiring the recognition of reductions in value, but not

permitting the recognition of increases in value. Almost all respondents that expressed a view on this suggested that if this proposal was to be adopted, subsequent reversals should be permitted to allow for corrections if and when results subsequently recover.

EFRAG proposal: Accretion approach

58. The accretion approach works to address apparent shielding caused by the consumption of and then re-creation of goodwill through management's activities and spending. Entities would annually add an accretion amount to a CGU's carrying amount or deduct it from the CGU's recoverable amount. Accretion is determined by applying a discount rate to the opening balance of goodwill.

59. Again, respondents had varying degrees of buy-in to the issue which this solution was developed to address. However, most of the respondents did not support EFRAG's goodwill accretion approach as it would only add complexity and subjectivity to the goodwill impairment model, believing the result was somewhat arbitrary, and represented pseudo-amortisation. It was also suggested that while this solution could work for large entities that have strong valuation expertise, it would be difficult for smaller entities to meaningfully implement and then explain to users. It was also acknowledged that further acquisitions and/or restructurings would make this complex.

60. Nonetheless, one respondent acknowledged the merits of this solution, and considered that the goodwill accretion approach could be a reasonable compromise to solve the issues related to internally generated goodwill and timeliness of impairments.

61. One respondent stated that this approach appeared to require a FVLCD approach and questioned whether this would make ViU redundant.

62. There was also a substantial amount of discussion relating to the most appropriate discount rate to use, and various options were put forward including the discount rate from acquisition, the company's current rate – which could be volatile – or the incremental borrowing rate. None of these were seen to be appropriate over a longer period. One respondent suggested that companies may be incentivised to use a smaller discount rate on acquisition to ensure the goodwill does not increase by more than projected growth rate.

EFRAG proposal: Introduction of 'step zero'

63. EFRAG have proposed a qualitative assessment of the likelihood of an impairment loss prior to testing, and there would be no requirement to determine recoverable amount when the likelihood of impairment is remote. This proposal is known as 'step zero'. This might operate in a manner similar to the requirements of IAS 36.12, whereby indicators of impairment are assessed in order to determine whether an impairment test must be performed. Under IAS 36.12 goodwill, intangible assets with indefinite useful lives and intangible assets not yet available for use must be assessed at least annually irrespective of whether there is any indicator of impairment. However, the current indicators test is expressed differently in that it requires an impairment test to be carried out if any indicators are present, which in practice is possibly easier to prove or disprove, than an assessment of whether or not an impairment is 'remote'.

64. Most respondents welcomed the introduction of a step zero on the basis that the IAS 36 requirements for determining recoverable amount are complex, costly and have to be performed at least annually regardless of an indication of an impairment. An analyst commented that in the ordinary course of business, if earnings are traveling in the right direction a full impairment test is unnecessary, however this gives latitude and discretion to management, so suggested strict guidelines, including a maximum period for which step-zero could be applied for example three years. Generally, this was consistent among respondents; support for this solution came with a caution that application of 'step zero' would require robust application guidance. Another respondent who agreed with the proposal said that additional disclosure around indicators considered and the results obtained would add value to step zero.

65. Two respondents noted that the exception in IAS 36.99 [1]was rarely used because of the strict conditions attached and therefore alternatively suggested expanding paragraph 99 to allow a broader and more practical application.

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[1] IAS 36.99:

The most recent detailed calculation made in a preceding period of the recoverable amount of a cash generating unit 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;

66. Those preparers that disagreed with the step zero proposal were generally those who had a well-established impairment testing process and would perform the testing regardless, as best practice. These preparers believed that the introduction of step zero would not address the perceived delay in recognition of goodwill impairments. One analyst commented that if the guidance was sufficiently robust any business who could apply this requirement is not one that is at risk of recording impairment 'too little or too late', indicating that this would not solve the perceived problems. Another analyst suggested that annual testing is reasonable as a statutory minimum.

Staff Recommendation

67. In relation to the overall goodwill impairment testing approach, it is possible that the IASB could either choose to stay with the current impairment testing approach, or explore an entirely new approach, possibly based on how investors and analysts assess results as their methodology appears to detect likely impairments on a more timely basis.

68. The feedback received, together with the original concerns raised during the post implementation review of IFRS 3 and subsequent debates, suggests that there are some fundamental issues relating to impairment testing which could be explored further.

69. In particular, further research could be conducted to explore the following:

    (a) identifying optimal methods of goodwill allocation to CGUs that address the concerns identified in paragraphs 47 – 52 of this paper; and

    (b) developing an appropriate approach for goodwill impairment testing to recognise impairments on a more timely basis given that evidence suggests that analysts are able to accurately predict impairment well in advance of entities recognising impairment in their books.

(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 the Board

Q3 Does the Board want staff to conduct further research to identify optimal methods of goodwill allocation to CGUs that address current concerns about allocating goodwill to CGUs for impairment testing?

Q4 Does the Board want staff to conduct further research into developing an appropriate approach for goodwill impairment testing to recognise impairments on a more timely basis?

Disclosures are not meaningful to users

70. Several respondents expressed concerns that impairment disclosures are ‘boiler plate’ and in many cases based on the minimum acceptable information. In a similar vein, an analyst expressed a frustration that often when an impairment is recorded at full year, the half-year results will have suggested no such result was expected, which appears unlikely to be the case. Having said that, some preparers did explain that they offered disclosure in excess of the minimum requirements, especially in the area of impairment testing.

71. Generally, analysts were more supportive than preparers of additional disclosures, however there was still a spectrum of varied responses about the value that analysts place on goodwill and impairment disclosures. These ranged from complete disregard due to reasons outlined in the previous paragraph, to the fact that some analysts comb through prior year disclosures to reconstruct information that is not included in the one place (refer to discussion in paragraph 73).

72. Several respondents from the categories of valuation specialist, analyst and regulator, suggested more meaningful disclosure on the following topics would assist users:

    (a) The methodology used in testing a CGU and any insights identified during the testing process, especially if there are indicators of impairment but management has not recognised an impairment, or not recognised a full impairment.
    (b) Increased guidance on disclosure of impairment testing, including more specific direction about what constitutes a ‘key assumption’, with the specific observation being that the key assumptions are in fact the inputs to the statistic (i.e. why have certain growth and discount rates been chosen) rather than the statistic itself.
    (c) Information on forecasting accuracy from prior year(s).

EFRAG proposal: Track goodwill by each acquisition and disclose a reconciliation of total goodwill allocated to each CGU.

73. This proposal was not well received by preparers, who said that historically-focussed disclosures become less relevant as time passes, and that this type of disclosure would not necessarily be aligned with the business' current monitoring practices for segments and vision for the future. Many preparers did not support additional disclosures as it would be difficult and onerous to track and assess each individual component of goodwill over time. It was widely believed that the cost of maintaining this disclosure would far outweigh the benefits for users, and that it would be difficult to reconcile where restructures or rebranding occurs. It was further noted that when businesses are genuinely fully integrated into a CGU, the relevance of historic goodwill and exactly how it arose is questionable

74. Whilst some analysts were supportive of the proposal, opinions in this group were mixed. Comments included the following:

    (a) It would greatly assist with assessing return on investment in respect of particular acquisitions;

    (b) Analysts value this information and currently obtain it by reconstructing from historical disclosures, so whilst having it all in the current year financials might be convenient, it is not necessary for the purposes of informing the market;

    (c) For 'serial acquirers' the resulting disclosure would be too voluminous to be useful, and materiality should be applied in aggregating small pieces of goodwill to prevent 'noise' in the financial statements;

    (d) Uncertainty around how this presentation would work when the goodwill from one past acquisition may have decreased in value but the overall CGU is performing well, and whether such disclosures would be suggestive of an impairment which would not, under current rules, be recognised; and

    (e) Where one piece (acquisition) of a CGU is underperforming, currently that is seen as the 'entire' CGU underperforming, so more granular disclosure might allow analysts to accurately assess the size of the underperforming piece of the business, and therefore more accurately allow for this in share price recommendations.

Staff recommendations

75. Disclosure is arguably the area which divided respondents the most, with some considering it to be valuable and others advising that they disregard the impairment disclosures in their entirety. At the May 2018 IASB meeting the IASB Chairman noted that in his view disclosures alone will not be accepted by constituents as a solution if nothing is done about the impairment mechanism. Having said that re-examining the guidance around goodwill and impairment disclosures has the potential to add to the usefulness of information provided to users.

76. In particular, based on respondents' comments, further research should be conducted examining whether any or all of the following disclosures might assist in resolving the perceived information gaps:
    (a) A clearer definition of what constitutes a 'key assumption'.
    (b) A requirement to disclose the selection rationale for and inputs into the key assumptions, rather than just the numeric value attributable to those assumptions.
    (c) A requirement to disclose the value at which a change in the key assumptions would result in an impairment.
    (d) A requirement to disclose a sensitivity analysis for all assets subjected to impairment testing, rather than requiring this disclosure only for goodwill.
    (e) A requirement to disclose a look-back analysis that assesses the forecasting accuracy of the prior year modelling used for goodwill impairment purposes.

Questions for the Board

Q4 Does the Board want staff to conduct further research whether any or all of the following disclosures in paragraph 76 above on impairment testing of goodwill and other non-financial assets would be useful?

Appendix A - Summary of requirements of IAS 36

77. IAS 36 seeks to ensure that an entity's assets are not carried at more than their recoverable amount (i.e. the higher of fair value less costs of disposal and value in use). For goodwill and certain intangible assets an annual impairment test is required, and in other cases entities are required to conduct impairment tests where there is an indication of impairment of an asset. This test may be conducted for a CGU where an asset does not generate cash inflows that are largely independent of those from other assets, which is inherently the case for goodwill balances.

Definition of key terms used throughout this paper:

78. Allocation of goodwill

The process of attributing goodwill to the cash generating units (CGUs) or groups of CGUs expected to benefit from the business combination.

79. Cash Generating Unit (CGU)

The smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.

80. Fair Value Less Costs of Disposal (FVLCD)

The price that would be received on sale of the asset or cash generating unit in an arm’s length transaction, less incremental costs directly attributable to the disposal.

81. Recoverable amount

The higher of an asset's fair value less costs of disposal (FVLCD) and its value in use. FVLCD is sometimes called net selling price, and was previously known as fair value less costs to sell.

82. Value *in Use (ViU)*

The future cash flows expected to be derived from an asset or cash-generating unit, discounted to present value based on the time-value of money. The requirements relating to ViU contains specific guidance for particular issues, such as the requirement to use a pre-tax discount rate, and to exclude cash flows expected to arise from future restructurings or from improving or enhancing the asset’s performance.

Appendix B: AASB Business Combinations Panel discussion in April 2018 on IASB's Paper on Goodwill and Impairment

ASAF discussions	• AASB staff provided panel members, 'Agenda Paper 5 on Goodwill and Impairment' from the upcoming April Accounting Standards Advisory Forum (ASAF) meeting for their consideration and discussion.
• ***Comments on Boards tentative decisions on topics 2, 3 and 4***	• *Topic 2 – Can impairment testing model be simplified without making it less robust?* *Comments or feedback (slides 6-8)* o No specific comments on how to simplify it without making it less robust. • *Topic 3 - Can the quality of information provided to the users of financial statements be improved without imposing costs for preparers that outweigh benefits?* *Comments or feedback (slides 6-8)* o One panellist whilst supporting impairment approach suggested improved disclosures around 'justification' for the goodwill carrying amount. This is based on the fact that businesses often take a long time to book impairment, yet based on the entity's performance the market would have adjusted the share price a long time before the impairment is booked. For example, when Woolworths bought Masters they ended up recognising $3 billion impairment loss in books much later than the market, which had already taken the full $3 billion off market capitalisation. • *Topic 4 Are there any new conceptual arguments or new information in support of amortising goodwill?* *Comments or feedback (slides 6-8)* o Generally, the panel was not in support of the reinstatement of the amortisation method. o It was suggested that the impairment model is sensible, rather than creating an arbitrary amortisation period of 20 years as per the previous requirement. It was also noted that analysts previously excluded amortisation of goodwill when assessing the entity's performance. o A couple of panellists mentioned that the amortisation method is simpler and takes away many of the issues related to impairment.
Topic 1 • ***Improving effectiveness of impairment testing of goodwill***	***Overall comments on the headroom approach*** o Panel members did not support the headroom approach, mostly as they believed the outcomes of the model will be onerous and difficult to explain, adding to cost and not significantly contributing to better outcomes for users. The following concerns were raised: ▪ **Complexity when applying it when there is rapid integration of acquisitions with existing CGUs:** Most panellists mentioned that acquisitions are fairly quickly integrated into the existing businesses,

ASAF discussions	• AASB staff provided panel members, 'Agenda Paper 5 on Goodwill and Impairment' from the upcoming April Accounting Standards Advisory Forum (ASAF) meeting for their consideration and discussion.
using headroom approach	which means that they (the acquired businesses) are not monitored separately. This makes it difficult to assess impairment using the headroom approach suggested as impairment is not tested at the acquisition level instead it's tested at the 'integrated' CGU level, where goodwill it attributed. Each integrated CGU would be made up of a combination of multiple acquisitions and comprise of both internally generated goodwill and acquired goodwill. ▪ **Difficulty attributing goodwill to internally generated versus purchased goodwill:** Further to the comments above, it's quite common for entities to have goodwill attached to a CGU which comprises of multiple acquisitions. Thus, panel members agreed that it is not clear from the model how to attribute the headroom to either the internally generated goodwill or the acquired goodwill in more complex cases (i.e. the example provided by the IASB is too simplistic and does not deal with these issues). ▪ **Difficulty applying the method when there are disposals:** Many large corporates are continually acquiring, integrating but also disposing of parts of their business. This too has not been examined in the example provided. ▪ **The method ignores increases in the headroom:** Panellists disagreed with the fact that the method ignores increases in the headroom while the decreases in the headroom impact impairment. Related to this point, one panellist noted that in year 1 for example, there may be an increase in headroom which is ignored, in year 2, there may be other developments in the business which may result in a temporary reduction in the headroom (i.e. not specifically related to the goodwill which has been attributed to a CGU). Because this model has ignored the increased headroom in year 1, and requires impairment in year 2, the link between performance of synergies and goodwill impairment has been broken. ▪ **Could mean the value in use model is redundant:** One panellist mentioned concern over how to determine the 'day1' business unit recoverable amount. For example, would it be based on value in use or fair value? This is because the acquisition which would have created this new goodwill would be done on a fair value basis. So if the IASB chooses to go down this path then the panellist questions whether value in use would be required. ▪ **No longer be able to use the short-cut approach:** One panel member highlighted that if this approach went ahead then entities will not be able to use short-cut approach which is allowed in IAS 36 (for cases where there has not been a significant movement in the headroom as compared to the previous year). ▪ **This doesn't appear to fix the core issue with impairment testing:** Given panellists see complexity in impairment testing as the key issue

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	with the impairment approach, they did not believe the headroom approach has adequately addressed the core issue (i.e. it's just as complex to calculate and explanations of outcomes are likely to be even more difficult than the current methodology). ▪ **Is this detailed information relevant to address users' needs?** the panel were asked whether they believe analysts actually look beyond the operating segment level when analysing performance? Specifically, if performance is good at the operating segment level, then do the analysts drill down to understand whether an individual acquisition has been successful. It was suggested that analysts are interested in the cash generating capacity of the business and ensuring management is accountable for investment spending (including acquisitions and capital spends). That being said, this method does not appear to be useful in trying to explain how successful individual acquisitions are because in reality the identification of how well synergies attributable to an individual acquisition is almost impossible to separate from the underlying earnings of the CGU or CGUs to which that acquired business has been integrated. Therefore, pragmatically, analysts observe the overall earnings performance of the business post acquisition to see whether the acquisition was a good or bad spend. It was also agreed that users would be much more interested in a comprehensive listing of the assumptions of impairment rather than the complex outcomes anticipated using this approach. 1) *Could you highlight the nature and extent of costs that entities may have to incur in applying the headroom approach (Headroom approach on slides 13-19)* o Whilst some panellists didn't think the testing component of performing the headroom approach would result in increased costs, others suggested that increased costs are likely to incur because • preparation costs will increase as additional time will be spent trying to explain the complex outcomes from applying the method; and • there will be additional costs incurred going back and forth between clients, valuation specialists and auditors over assumptions, calculations and explanations when applying this method. 2) *Do you think disclosure of the basis used for attributing the decrease in headroom would provide useful information to users of financial statements?(slides 19-21)* o Overall the panel didn't think it would be useful to users (refer to general comments above on what panellists did think would be useful). o It was also suggested that management's time will be spent managing the messaging rather than doing more important things in managing the business.

ASAF discussions	• AASB staff provided panel members, 'Agenda Paper 5 on Goodwill and Impairment' from the upcoming April Accounting Standards Advisory Forum (ASAF) meeting for their consideration and discussion.
Panel discussion – ASAF agenda item 5 Goodwill and Impairment • ***Separate recognition of identifiable intangible assets acquired in a business combination***	1) *Do you think separate recognition of all identifiable intangible assets acquired in a business combination provides useful information? If not, why not?* *(Feedback from PIR IFRS 3 slide 24)* ○ Some panel members believed that intangible assets such as customer contracts that have a definite life should be amortised and recognised separately from goodwill. However, intangible assets such as relationships with indefinite lives appear to be more like goodwill in nature and thus identifying these separately is unnecessary. Based on this, some panel members were inclined towards Approach D. ○ It was suggested that when separation becomes arbitrary it is less useful and therefore in those cases the assets should be combined with goodwill. ○ Some panel members mentioned that recognition of intangible assets separate from goodwill is important as, for example in the case of customer contracts, where there is a contractual arrangement, as the amount of future cash flows expected to bring to the business can be estimated and these are potentially good indicators for some aspects of the acquisition. 2) *Do you agree with the feedback that valuing brands and customer relationships is costly and complex? Are you aware of any other intangible assets that are difficult to value? (Feedback from PIR IFRS 3 slide 24)* ○ It was suggested that valuation of contractual assets is not a costly process because there are established valuation models that can be applied. However, it can be more costly to value non-contractual assets such as relationships and there are additional difficulties experienced (leading to additional costs) where there are interrelationships between different kinds of assets (such as brands, licenses and a trademarks) because currently it is necessary to split these into the different asset types even though they are contributing towards the same cash flows. Therefore, the suggestion was made to group interrelated assets to reduce the cost. ○ Related to the above point, another panellist suggested that some companies might prefer to split out identifiable assets such as brands and customer lists from goodwill even if was by way of an arbitrary allocation as that minimises goodwill to show that the company did not pay too much for the acquisition. Therefore from a practical perspective if allocations are arbitrary, they do not help users understand whether it was a good or bad deal.

ASAF discussions	• AASB staff provided panel members, 'Agenda Paper 5 on Goodwill and Impairment' from the upcoming April Accounting Standards Advisory Forum (ASAF) meeting for their consideration and discussion.
	3) Do you have any comments or feedback on each of the possible approaches that the IASB staff have identified for the Board's consideration? (refer to slides 26-32) o Some panellists leant towards Approach D but had concerns over judgement. o It was suggested that there could be a slight modification to Approach D to make it more useful for users. Specifically, instead of what was suggested, the distinction could be around contractual versus non-contractual arrangements. For example contractual intangible assets e.g. trademarks could be separated while the non-contractual intangible assets such as customer relationships could be subsumed within goodwill. o Another panellist pointed out that Approach D would require a lot of judgement to make a distinction between a wasting asset and an organically replaced asset.