Australian Government

Australian Accounting Standards Board

AASB RESEARCH REPORT 9

PERSPECTIVES ON IAS 36: A CASE FOR STANDARD SETTING ACTIVITY

SUMMARY OF OUTREACH RESULTS

MARCH 2019

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Disclaimer

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Executive Summary

It has been widely observed that application of the existing version of IAS 36 *Impairment of Assets* is problematic in practice, causing significant issues at all stages in the financial reporting cycle. These observations are supported by the outreach completed as part of this project, as well as regulatory activity published by regulators in jurisdictions across the globe.

The IASB is currently considering a number of amendments to the existing requirements, specifically improvements to disclosures about acquisitions contained within IFRS 3 *Business Combinations*, as well as possible simplifications to the accounting for goodwill and targeted improvements to the impairment test. The ongoing application issues demonstrate consistent divergence in understanding between preparers, users, auditors and regulators as to the procedures that should be applied in ensuring that assets are carried at no more than their recoverable amount. Having considered the input from preparers, users including investors and analysts, auditors, academics and regulators during this project, the authors have concluded that IAS 36 requires holistic reconsideration rather than piecemeal changes focussed on disclosure. Accordingly, the overarching recommendation in this report is that IAS 36 be reconsidered in its entirety for issuance as a new standard.

1. *Review IAS 36 in its entirety with a view to issuing a new standard that provides principles that enable users, preparers, auditors and regulators to develop a common understanding of the practical aspects of undertaking the procedures applied to ensure that assets are carried at no more than their recoverable amount.*

Specific themes and recommendations coming out of the research were:

There is an overall lack of clarity on the purpose of the impairment test

There was wide-ranging inconsistency in respondents' opinions on the purpose of the impairment test. Participants did not agree whether the impairment test is intended to determine recoverability of a specific asset or group of assets, provide information on the subsequent results of a previous business acquisition, or give information on the overall reasonableness of the balance sheet. An incorrect or misguided interpretation of the purpose of the test results in diversity in application and lack of comparability. As a result, the following recommendation has been made:

2. *Clarify the purpose of the impairment testing requirements, and develop guidance explaining what the test is (and is not) intended to achieve.*

The application guidance does not align with internal decision-making

There is dissatisfaction with the application guidance contained in the standard, the various options and restrictions that the standard prescribes and the level at which the impairment test should be performed. Most preparers see restrictions on the prescribed Value in Use (ViU) model as limiting in practice, and inconsistent with their internal budgeting and forecasting processes. Similarly, the guidance requires an approach based on forecasting cash flows within a cash-generating unit (CGU), however preparers see the identification of CGUs as an artificial construct, and a lack of clarity in the standard renders the 'management perspective' lens applied when aggregating CGUs for goodwill testing purposes difficult to interpret. External stakeholders have speculated that this aggregating process allows entities to 'shield' impairments that otherwise ought to be taken. These factors add unnecessary complexity to the preparation and ambiguity to the disclosure of impairment information without providing additional information that is useful to internal or external decision-making. This feedback has informed the following recommendations:

3. *Develop a modified single model approach, including specific amendments to:*
   a. *remove the existing restrictions on ViU regarding future restructurings and asset enhancements and replace those restrictions with guidance on when it would be reasonable to include such cash flows in an impairment model;*
   b. *reserve the use of a Fair Value Less Costs of Disposal (FVLCD)-type model for assets expected to be disposed of within the following financial reporting period;*
   c. *allow the use of a post-tax discount rate; and*
   d. *specifically permit the use of market-based assumptions within the cash flow model such as a forward curve for commodity prices and foreign exchange rates.*
4. *Redraft the guidance as to what constitutes a CGU or group of CGUs to strengthen the linkage with how an entity's results are viewed and decisions are made internally.*

Diversity in disclosure reduces usefulness

There is diversity in the way information related to impairment testing is disclosed and the level of detail that is included. Giving consideration to this and some specific feedback received in relation to key assumptions, the following recommendations have been raised:

5. *Implement the following enhanced disclosure proposals:*
   a. *provide further guidance on the definition of a key assumption, being those to which the impairment model is most sensitive, to encourage more informative disclosure;*
   b. *revise the disclosure requirements of IAS 36 to provide more coherent disclosure principles regardless of the method chosen to determine recoverable amount; and*
   c. *incorporate an additional disclosure objective in IFRS 3 to provide information to help investors understand the subsequent performance of the acquired business, having regard to the commercially-sensitive nature of the information.*

Next steps

The AASB welcomes feedback on the content of this paper, encourages further research from academics, and looks forward to working with the ASAF and IFASS on seeking to improve the impairment testing requirements.

Introduction

1. As part of the post-implementation review (PIR) of IFRS 3 *Business Combinations*, the International Accounting Standards Board (IASB) received a substantial amount of feedback regarding the shortcomings of impairment testing under IAS 36 *Impairment of Assets*.

2. Concerns raised included:
    a. the results of the existing requirements is that impairments are being recognised 'too little and too late'; and
    b. the existing standard is unduly complicated and includes requirements that do not practically contribute to better accounting outcomes.

3. The stated purpose of IAS 36 is to verify the recoverability of assets on an entity's statement of financial position[1]. If it is widely believed that this test does not consistently achieve an appropriate accounting outcome, then this undermines the statement of financial position as a useful financial statement. Many users rely on the general purpose financial statements to satisfy their information needs, and accordingly those statements of financial position should accurately reflect the likely recoverability of the assets recorded.

4. Many preparers have observed that the standard is difficult to apply in practice, includes requirements that do not contribute to better accounting outcomes, and relies on management assumptions that are not consistent with the everyday operations of the business, rendering the result irrelevant outside of the impairment testing process. Externally, entities are under growing scrutiny from investors and other stakeholders, who are expecting increasingly sophisticated reporting and insight into the decisions made by management.

5. Regulators across the globe are consistently and frequently reporting on both financial reporting surveillance and audit quality issues in respect of the application of IAS 36. This has been seen recently across geographies such as Australia, the United Kingdom, South Africa, Europe, and Singapore. The published reports in Australia and Europe also refer to restatements[2] or enforcement decisions that have been made following their inspections. Many of these regulators have noted that entities are struggling to apply the requirements in the light of modern-day business challenges, for example how to factor in the effect of risks relating to climate change, technological advances, digital disruption and political instability. A summary of issues reported in each of these jurisdictions has been included in Appendix A.

[1] IAS 36.1
[2] 'Restatement' in this context refers to the scenario where a formal inquiry raised by the regulator results in an adjustment to a previously reported amount.

6. In preparing this research report, the authors have had significant regard to the views of the investment community. Equity markets are continually aiming to arrive at a share price that reflects the present value of a company's future earnings. Investment analysts have been able to provide interesting insight into how they use the information in financial reports, and how they form an overall picture of an entity's value to contribute to an investment decision or recommendation. The authors believe that this perspective brings additional colour to the discussion of whether the accounting requirements could be improved to better serve the needs of users.

Background

Key requirements of IAS 36

7. IAS 36 seeks to ensure that an entity's assets are not carried at more than their recoverable amount, i.e. the higher of FVLCD and ViU. 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. 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, the test may be conducted at a CGU or group of CGUs level. The impairment test involves comparing the higher of FVLCD and ViU with the carrying amount of the asset, CGU or group of CGUs to which goodwill is allocated. Where there is a deficit in carrying amount, the carrying amount is reduced to the recoverable amount.

What are the key elements of the current impairment test that cause issues?

8. The approach taken by the IASB to date has been broadly aligned with the feedback received following the PIR of IFRS 3, however it can be seen that many of the comments raised by regulators outlined in Appendix A are broader than the requirements of IFRS 3. It appears that if there had been a more widely-scoped request for feedback, further insights may have been received, which in turn may have indicated the need for a more holistic reconsideration of IAS 36. The specific aspects of the standard identified as a cause of concern in the IASB's PIR, and the more recent trends in regulatory feedback are outlined in the following table, along with a description of some of the specific issues and the broader implications.

Feedback	Example of issue	Implication	Identified through: IFRS 3 PIR	Identified through: Regulator feedback
There are delays in recognition of asset impairments, including goodwill.	Goodwill can be 'shielded' by unrecognised headroom and/or additional value generated internally through management's efforts and investments.	Specific impairments of underperforming businesses are not recorded in financial statements on a timely basis.	●	●
Impairment testing is a time-consuming and costly process with no real practical benefit to the business.	The process of allocating goodwill to CGUs requires judgement and the standards provide limited guidance.	Limited guidance leads to diversity in practice, which reduces comparability.	●	●
	Mandatory annual determination of recoverable amount is time-consuming and costly.	Entities spend time and money on a compliance process that has no alternative value to the business.	●	
	The requirements underlying the ViU model are reactive and driven by anti-avoidance concerns, which has resulted in a ViU concept that is far removed from its conceptual foundations.	Restrictions on the ViU model – including the requirements to exclude future restructurings and/or asset enhancements and use a pre-tax discount rate – do not reflect how acquirers price prospective transactions, nor necessarily the manner in which management itself views the business. As a result, the outcome of the impairment testing process does not reflect either a true business valuation or management's internal perception of value.	●	

			Identified through:	
Feedback	**Example of issue**	**Implication**	**IFRS 3 PIR**	**Regulator feedback**
	Users are confused about the differences between ViU and FVLCD, and the circumstances in which each model is most appropriately applied.	Users of the financial statements do not understand the implications of the differences between the two methods, and accordingly disclosure of the method applied does not provide meaningful information.	●	
There is limited guidance on determining and/or applying the methodology and assumptions required to calculate recoverable amount.	There is limited guidance on how an entity should factor risk into cash flow projections.	Results in differences of opinion with auditors and regulators on the outcome, especially in times of fast technological disruption and economic instability.		●
	The recoverable amount is determined using an inappropriate methodology.	The recoverable amount may be overstated, resulting in a delay in impairment recognition and overstatement of assets.		●
Impairment disclosures do not include all information that users require to make decisions.	Key assumptions underlying the impairment calculation are often omitted from the relevant disclosures.	Analysts are required to substitute with externally-available information when assessing performance, which may not accurately align with management's decisions.		●
	Disclosures are not tailored to the business' operations and/or are ambiguous.			

Response to post-implementation review of IFRS 3

9. In response to the PIR of IFRS 3, the IASB has explored various proposals for change through their 'Goodwill and Impairment' project. Since its launch the IASB has discussed:
    a. whether changes should be made to the existing impairment test for goodwill and other non-current non-financial assets;
    b. the subsequent accounting for goodwill, including the relative merits of an impairment-only approach and an amortisation and impairment approach; and
    c. whether additional disclosures assessing outcomes of a previous business combination would result in more useful information in the market.

10. The Financial Accounting Standards Board (FASB) is also actively discussing accounting for identifiable intangible assets in a business combination, goodwill and goodwill impairment in the United States. The IASB and the FASB have been following each other's progress and hold regular joint meetings to discuss project summaries and progress reports.

11. The IASB has finalised its discussion on the objectives for the next stage of this research project and has directed its staff to perform additional work to explore possible improvements to disclosures about acquisitions and possible simplifications to the accounting for goodwill and targeted improvements to the impairment test. As part of the October 2018 meeting the IASB reviewed a draft outline of a Discussion Paper and provided feedback for the staff to consider. The final discussion paper is expected to be released in the second half of 2019.

The Research Process

Research scope and focus

12. During 2018, the Australian Accounting Standards Board ('AASB' or 'the Board') oversaw the preparation of a paper by the authors summarising feedback from targeted outreach conducted with preparers and analysts in Australia regarding 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 recently considered by the IASB and the EFRAG.

13. In early 2019 this research was supplemented by public workshops in Melbourne and Sydney, attended by investment analysts, preparers, auditors and academics. At those workshops, attendees discussed their views on:
    a. The purpose of impairment testing
    b. External assessments of value
    c. Cash-generating units
    d. Disclosure
14. Subsequent to the workshops, telephone interviews were conducted with a small number of analysts who had expressed an interest in participating but were unable to attend the sessions.

15. The conclusions of this report are based on the views of relevant stakeholders who are known to apply, analyse, audit, regulate, or otherwise use the impairment testing model outlined in IAS 36. The number of participants within each of these categories is outlined in the following table:

Representative group	Total participation
Academics	1
Accounting firms	5
Analysts / Investors	15
Preparers	9
Public sector	2
Regulators	1
Valuation specialists	4
TOTAL	37

16. Throughout this report, collective terms are used with the following broad and approximate meanings:

Most	Almost all; approximately 90%
Majority	Approximately 70-80%
Many	Approximately 50-70%
Several	Three to five participants

Unless stated, use of the above terms does not necessarily indicate that the remaining respondents expressed an opposing view.

Research limitations

17. Limitations of this report primarily relate to the challenge of engaging with a sufficient number of relevant stakeholders. Response to invitations sent was relatively low, specifically from the analyst community. This has been attributed to, among other factors:
    a. the search strategy employed to identify participants was limited, being primarily based on the AASB's existing networks and relationships within Australia;
    b. the timing of the outreach sessions for early 2019 – invitations distributed in mid-December for workshops to be held in mid-January – meant that many respondents were on summer holidays when the invitations went out, when the workshops were held, or both; and
    c. limitations on time and resources meant that workshops were planned for face-to-face sessions in both Sydney and Melbourne. Despite offering teleconference facilities for both sessions, no responses were received from participants outside of these geographies.

Next Steps

18. The AASB welcomes feedback on the content of this paper, encourages further research from academics, and looks forward to working with the ASAF and IFASS on seeking to improve the impairment testing requirements.

Summary of feedback received

An international problem requiring wholesale reconsideration

19. **Recommendation to IASB:** Review IAS 36 in its entirety with a view to issuing a new standard that provides principles that enable users, preparers, auditors and regulators to develop a common understanding of the practical aspects of undertaking the procedures applied to ensure that assets are carried at no more than their recoverable amount.

20. To date, those working to improve the impairment testing requirements have been acting in response to the PIR of IFRS 3, which has resulted in proposals and recommendations centred on targeted issues and disclosure shortcomings, however the authors believe this standard will continue to attract user concerns and regulatory attention unless it is put on the agenda for more wholesale reconsideration.

Are impairments 'too little and too late'?

21. The perceived late recognition of impairment losses has been one of the most common issues raised as part of the PIR of IFRS 3. To understand this further, as part of the early research the authors asked both analysts and preparers for their thoughts.

22. Generally, respondents across all categories acknowledged that impairments do not trigger major market upsets, arguably indicating that analysts use methods that are able to predict impairments and can therefore update projections accordingly prior to them being detected by the financial reporting process.

23. However, several 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; if and when an impairment is required the full amount of goodwill will be written off, regardless of the outcome of the relevant model. Two factors were offered as explanation for this:
    a. impairments often have no effect on management performance indicators; and/or
    b. management would prefer to impair and explain to the market once, rather than taking a piecemeal approach.

24. In parallel to these points, it was highlighted that in years of leadership change, organisations can be seen to 'take a bath' and record impairments more heavily than necessary. They suggest the prevalence of this phenomena reflects a combination of incumbent management historically safeguarding against accusations of poor decision-making, and new management being motivated to 'start with a clean slate'. Impairments are also more common when an industry-wide event occurs and other entities are seen to be recording write-offs.

25. Several preparers and analysts similarly explained that it is often more important to get the impairment 'right' rather than to record it earlier, especially in cases where the indicators of impairment can be attributed to a timing issue and there is subsequently a recovery – in these cases it would have been better to wait.

26. From the responses to the question of whether impairments are 'too little' and/or 'too late', as well as the commentary on how management and the markets respond to impairments, the authors concluded that there was a lack of clarity as to the purpose of impairment testing that warranted further research.

What is the perceived purpose of impairment testing?

27. **Recommendation to IASB:** Clarify the purpose of the impairment testing requirements, and develop guidance explaining what the test is (and is not) intended to achieve.

28. The purpose of the impairment test is arguably the primary question underpinning the debate at an international level, albeit one that has not been explicitly discussed in much of the formal research and outreach to date.

29. On one hand, the disclosure requirements currently being considered by the IASB as a solution imply that many consider the impairment test a mechanism for assessing management's decision making in respect of past acquisitions. In contrast, others suggest that the impairment test does not and should not explicitly look at goodwill from previous individual business acquisitions, but instead it contributes to a conclusion as to whether the overall statement of financial position is recoverable. In other words, recording an impairment expense is unnecessary when the value of the asset is supportable within the statement of financial position as a whole.

30. The current impairment testing requirements fall in the middle ground between these two views. The requirement to test at a CGU level provides impairment information at a level more granular than that of the overall statement of financial position. That is, the test is aimed at determining whether a CGU's overall value is recoverable. Furthermore, where a past individual business acquisition is considered a CGU in its own right, the impairment testing of that CGU may provide information as to the outcomes from that business acquisition. However, where some of the goodwill has been allocated to other CGUs, or the business is tested within a larger CGU, the information loses its direct relationship to the economics of the underlying business acquisition.

31. Most analysts who had strong convictions on this topic broadly explained that the test should not be applied at a micro-level and used as a mechanism for assessing the relative success of an individual business acquisition. Having said that, several analysts independently explained that the statement of financial position is interpreted as the overall store of past management decisions or a historical 'scorecard' of assessing management's ability to effectively allocate

resources. In combination with tangible value, it represents an aggregation of the price paid by management for assets. The return on invested capital from these purchases is one way to measure the success of management decisions.

32. To the suggestion that impairment should instead be considered in a broader sense, as an overall reasonableness test for the entire statement of financial position, almost all participants disagreed, sharing the conviction that this method would provide too much opportunity for ineffective acquisitions to be supported by unrelated internally-generated goodwill and other, more successful, acquisitions. It appears that most users consulted on this topic believe that the optimum approach is at a level somewhere higher than an individual acquisition but lower than the whole statement of financial position.

33. When responding to the question of what the test does or should represent, participants also offered views on what the test does not or should not represent.
    a. Given that the valuation process underpinning the impairment test can only result in decrements, it cannot be used as a proxy for measuring success. Recognition of an impairment can indicate failure and absence of an impairment can indicate a business is in line with predictions made during the pricing process, however fundamentally it cannot measure success.
    b. Despite current accounting standards implying that the amount determined during an impairment testing exercise should represent an approximation of 'fair value', all preparers interviewed indicated that this is not reflective of practice. Full business valuations occur as part of business acquisitions, and in contrast, the impairment model is, at most, a determination of a recoverable amount, not a valuation exercise, and should not be treated as such.

34. While preparers of financial statements tended to assume analysts disregard impairment as a non-cash item and normalise it out of metrics such as earnings per share (EPS), many analysts discredited this concept explaining that goodwill exists because of a historical cash outflow. And on that basis, impairments – and similarly other 'non-cash items' such as depreciation and amortisation – indicate a devaluation of something 'purchased', and should be treated with sufficient gravity. The authors heard that several analysts generally agreed with the sentiment that management KPIs tend to exclude 'one-off' or 'non-cash' items such as impairment, and accordingly believe it's possible management are not being held accountable for impairments.

35. Based on the feedback received it is clear that there is wide diversity in opinion on this topic. For this reason, clarification of the purpose, and what the impairment test is and is not intended to achieve has been included as a key recommendation in this report.

36. During this part of the discussion, several participants discussed the topic of goodwill amortisation[3]. In particular, whether goodwill should be amortised or subject to impairment testing and the appropriate treatment of internally generated intangible assets has long been a controversial issue. While there is undeniably a school of preparers who support the amortisation argument, it was often noted by others 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. Furthermore, those participants who believed the asset did wear out over time were sceptical that it wears out evenly, which is arguably the implication of an amortisation process. Where preparers supported the argument, their reasons were based on conceptual arguments – for example because goodwill is replaced by internally generated goodwill over time – and/or because information provided by an impairment-only approach has limited use – rather than because of a strong conviction that amortisation with impairment would provide the market with better information than an impairment-only approach. Some analysts explained that knowing management's assessment of the useful life of goodwill might be informative.

How should the impairment test be performed?

37. **Recommendation to IASB:** Develop a modified single model approach, including specific amendments to:
    a. remove the existing restrictions on ViU regarding future restructurings and asset enhancements and replace those restrictions with guidance on when it would be reasonable to include such cash flows in an impairment model;
    b. reserve the use of a FVLCD-type model for assets expected to be disposed of within the following financial reporting period;
    c. allow the use of a post-tax discount rate; and
    d. specifically permit the use of market-based assumptions within the cash flow model such as a forward curve for commodity prices and foreign exchange rates.

38. Parts a. to c. of this recommendation align with ideas the IASB has previously discussed. Part d. is an original recommendation based on feedback received during this project.

Information used by analysts

39. Researchers have long noted that in many cases the share market does not respond when an impairment is announced, which arguably implies that analysts are able to anticipate impairments and adjust projections accordingly before they are recognised[4]. The authors were particularly interested in analysts' perception of this phenomenon.

[3] Goodwill amortisation was raised during the outreach sessions but not discussed in detail given the focus of this paper.
[4] *Determinants of Goodwill Impairment under IFRS: International Evidence*; Martin Glaum, Wayne R. Landsman, Sven Wyrwa; 2015.

40. Both buy side and sell side analysts are continually making judgments about the value of listed companies based on the information at hand. These judgments take into account a wide range of factors and possible asset write-downs are only one component of the many considerations that ultimately influence a company's share price.

41. The authors asked questions of how analysts complete their assessments including the inputs that are used, where they are sourced and what qualitative information is overlaid. Participants provided a wide range of responses, however the following themes emerged.

42. When assessing performance of a business, it appears that net operating cash flows and earnings before interest and tax (EBIT) or earnings before interest, tax, depreciation and amortisation (EBITDA) are favoured in the first instance and the overall valuation model can be based on the capital asset pricing model (CAPM), discounted cash flow (DCF) analysis, price/earnings (P/E) ratio or a multiple of EBITDA. For forecasting purposes, inputs can include both the entity's disclosed assumptions – such as discount rate – and the analyst's own expectations. Where an input is externally available – for example a commodity price – in the absence of convincing information to the contrary, several analysts indicated they would presume the external information more relevant than the assumption disclosed by the entity.

43. Impairment information disclosed and/or recognised in the financial statements is used by analysts as a component of the considerations that go into their assessment of value. As mentioned above, the analyst can apply their specific adjustments to management assumptions to create their own proprietary valuation for the asset. All analysts noted that generally they would expect there to be differences in the specific assumptions they use for assessing value compared with those used by management. They went on to note that where disclosed, the assumptions and methodology disclosed in the financial statements are useful at a minimum for identifying points of difference.

44. Some participants commented that from their perspective the statement of financial position is the third most important financial statement, with information from the statement of profit and loss statement and cash flow statement being considered more informative.

45. In certain industries, such as extractives, users can make their assessment at a relatively disaggregated level, such as an individual area of interest. This is facilitated by disaggregated supplementary information – often available as part of the operational reports or investors presentations. In other industries often the CGU analysis, segment disclosures, and supplementary information do not align in a meaningful or useful way, leaving it necessary for users to default to a segment-level approach in making their assessments.

46. Analysts indicated that their activities range from full quantitative style analyses – for example on specific mining projects – to more limited qualitative assessments. The activities undertaken vary according to:

a. the size of the investment house and the portfolio of investments followed;
b. the purpose (buy-side or sell-side analysis); and
c. the size of the entity under consideration.

47. The authors asked follow-up questions regarding other factors that influence the view of value taken by analysts. Several analysts articulated that there is more art than science in being able to value an impairment as quickly as it arises. In addition to quantitative calculations, a substantial amount of qualitative assessment is overlaid, including the following:
    a. discussions with management, market and other stakeholders;
    b. third-party research such as channel checking5;
    c. management's perceived credibility, which can be eroded by poor decision-making or ambiguous declarations; and
    d. directors' reputations, which can be affected by a history of unsuccessful acquisitions.

48. Although one of the goals of the research was to establish if analysts' feedback in this area could offer insight into potential amendments to IAS 36, the authors cannot immediately see how these additional qualitative factors can be pragmatically built into the accounting requirements. Analysts' assessments primarily centre on re-estimation of future cash flows and – with the exception of any qualitative overlay that is applied – any differences arising between that and the entity's own result are most commonly due to use of different assumptions, discussed further in the next section.

49. Many analysts also offered explanations as to why the assumption that the market can 'predict' impairments may be flawed.
    a. It is not always possible to assess the opposite outcome - i.e. where the market predicts an impairment that does not occur. Therefore the number of confirmatory results may be misleading.
    b. A period of share price stability after an impairment announcement should not be taken to mean that the impairment was expected. At most this should be interpreted as an event not impactful enough to affect price, in the context of all other factors.
    c. Both the impairment test and lodgement of full financial statements are only required once a year, whereas material developments, must be reported to the market under continuous disclosure obligations associated with the ASX listing rules. It therefore follows that material impairments announced in the annual report should generally be already known to the market in most cases and no meaningful reactions should be anticipated from this source when the report is released.
50. Having considered the general information supplied by analysts above, the authors have developed four specific recommendations they believe would improve the workability of the overall impairment testing requirements, which are discussed further below.

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[5] A channel check is third-party research on a company's business based on collecting information from the distribution channels of the company.

The standard could be simplified by introduction of a single-model approach

51. In practice, many companies use a discounted cash flow calculation (DCF) to determine the recoverable amount under both the FVLCD and ViU methodologies, the difference being that FVLCD uses a market participant perspective and ViU uses an internal management perspective.

52. The merits of each method were discussed widely in the workshops. FVLCD can be based on transaction prices in the market when available – enhancing its reliability – although it was acknowledged that recent transaction prices for specific CGUs are not generally accessible. Many preparers acknowledged that FVLCD is often used simply because it allows an entity to consider either the impact of a future restructuring or asset enhancement to which a preparer is not yet formally committed, which the ViU model specifically prohibits. The authors learned that FVLCD is typically used within those industries where commodity prices are in play, as there is better external information than other industries because prices are forecast out into the future. These entities also have the ability to switch assets on or off depending on the temperature of the market – which is permitted within a FVLCD model but not when using a ViU approach.

53. There was support among respondents for requiring or allowing only one method on the basis that it could simplify the impairment test. The authors learned that analysts rarely distinguish between information provided under each model and many preparers found the ViU model unnecessarily restrictive in its application. However most participants supported redefining the base principles around ViU rather than removing the ViU option all together.

54. In most respondents' views, the ViU approach should reflect management's intentions for the use of the asset over the forecast period and therefore is expected to align as much as possible with management's budgets. For this reason, the recommendation in this section centres on a modified-single model approach, essentially a rebuttable presumption that ViU is the most appropriate basis to use unless the asset is genuinely expected to be realised through sale. It is expected that together with the other recommendations made in this section, the updated ViU model will be easier and more relevant for preparers, offering substantial time and cost-savings. Entities examine budgets in detail each year so the authors see this as an appropriate starting point for the impairment test. The suite of recommendations in this section aim to allow management to align with budgets as much as possible – albeit certain items may continue to be excluded, for example where budgets are not organic i.e. factoring in a future business acquisition or non-organic growth.

55. Further, the argument was put forward that if output from the ViU model results in an impairment, but management intended to continue using the asset regardless, why should the entity be permitted to use the benefit of a higher FVLCD to avoid recording an impairment? The use of ViU reflects the value expected to arise from continuing use of an asset and from its disposal in the future and not the value expected to arise from an hypothetical immediate sale which management does not intend to make.

56. The authors believe that removal of the restriction on restructurings will assist with preparer acceptance of the removal of the FVLCD option from the standard for ongoing operations. This is particularly for those entities that have specifically used the FVLCD model in the past because the ViU model did not serve their needs. The author's objective in this section is to promote an approach to impairment that is more budget-aligned to ensure entities are not disadvantaged by removing the FVLCD option for assets that will continue to be used in the organisation.

Remove the restriction on future restructurings when using Value in Use

57. Many preparers asserted that the requirements underlying the ViU model are reactive and driven by anti-avoidance concerns, which has resulted in a ViU concept that is far removed from its conceptual foundations. Further, the standard includes guidance on using management-approved budgets, separate to the suggestion that added weighting must be given to external evidence and a holistic reading of the standard is required to fully understand both points. Both preparers and analysts recognised 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. These comments aligned with a proposal published by the EFRAG in 2018 that suggested removal of the restriction on including effects of future restructurings within the ViU calculation.

58. In general, where analysts disagreed with this 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. One analyst noted that in practice, while impairments are factored into their view of value earlier than they occur, the opposite is true for restructurings. That is, the positive cash flows attributable to a 'cost-out' project are only considered by analysts when they have been proven in practice, rather than when they are announced.

59. Nonetheless, all respondents agreed that adoption of this proposal would require strict safeguards. 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, as follows:

> *For the restructure to be highly probable, the appropriate level of management must be committed to a plan to implement the restructure, and an active programme to complete the plan must have been initiated. In addition, the restructure should be expected to qualify for recognition under para 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.*

60. Both preparers and analysts alike warned 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.

61. During the workshops the authors learned that the most analysts place no information value on the disclosure of management's distinction between ViU and FVLCD when making their assessments. Similarly, in each session the analysts were also asked if they themselves make a distinction between 'current use' and 'highest and best use' when making their external assessments. Several analysts gave examples of scenarios where this can be relevant, for example a retailer with modest revenue located in a prime real estate position, but no intention to realise the value in the property. This has become increasingly relevant following the recent explosion of online retailing, however analysts consistently explained that unless they can identify a catalyst for this alternative 'highest and best use' value to be unlocked within the investment holding period – generally 3-5 years – it will not be factored in to their assessment of value.

Allow the use of a post-tax discount rate in the ViU calculation

62. Respondents fully supported allowing the use of a post-tax discount rate. It was widely acknowledged that the existing requirement cannot be applied in practice – primarily because valuation experts cannot readily derive pre-tax discount rates and accordingly preparers have been forced to develop practical work-arounds to address the requirement. Respondents explained that the only practical application of the pre-tax requirement in IAS 36 is to complete the test on a post-tax basis and then derive a notional pre-tax rate to be used only for disclosure purposes.

Use of market-based assumptions for cash flow projections

63. The authors learned that in most cases the effect of items such as commodity prices and foreign exchange rates in forecasted cash flows will be considered by analysts having regard to their forward rates. We note there is confusion amongst preparers as to whether an analogy should be drawn to IAS 36.54[6] in deriving inputs into the cash flow model given that the standard is silent on this matter, or whether standard valuation principles of assessing market forward curves should prevail. When dealing with this problem, preparers have been known to interpret the requirement to use spot rate as also applicable to the translation of forecasted cash flows within the model, which is not only inconsistent with how management would forecast internally, but also results in output inconsistent with information that analysts use to perform their analysis. The authors believe that if the standard were amended to specifically allow the use of forward curves in developing the cash flow model itself, this source of debate would be removed.

64. In response to this, a key recommendation in this section is to specifically permit the use of market-based assumptions for forecasted cash flows within the relevant cash flow model, such as the forward curve for commodity prices and foreign exchange rates.

[6] IAS 36.54 "… An entity translates the present value using the spot exchange rate at the date of the value in use calculation."

65. The early research in this project also considered the 'headroom' and 'accretion' approaches considered by the Accounting Standards Advisory Forum and the European Financial Reporting Advisory Group in early 2018. Our discussions and findings were consistent with those heard by the two bodies and support the IASB's decision not to progress these alternatives. Accordingly, these have not been considered further throughout this report.

At what level of aggregation should the test be performed?

66. **Recommendation to the IASB:** Redraft the guidance as to what constitutes a CGU or group of CGUs to strengthen the linkage with how an entity's results are viewed and decisions are made internally.

67. The IASB has previously explored adding guidance on identifying CGUs and allocating goodwill to CGUs, however decided not to pursue possible amendments further on the basis that providing guidance that could apply to all entities would be difficult. This was most recently discussed in December 2017.

The concept of shielding

68. Goodwill recognised in a business combination represents the future economic benefits – or 'synergies' – arising from other assets acquired that are not otherwise identified and separately recognised. By nature, goodwill does not generate independent cash flows, therefore, it will always be tested for impairment as part of the CGU or group of CGUs that are expected to benefit from the synergies identified at the time of acquisition. The standard requires that goodwill be allocated at the lowest level within the entity at which it is monitored for internal management purposes, and not be larger than an operating segment determined in accordance with IFRS 8 *Operating Segments*.

69. A universal discussion point in the goodwill and impairment debate relates to the question of whether the current guidance within the standard permits entities to allocate goodwill in such a way that has the effect of 'shielding' against impairments that ought to be taken. When discussing this issue a number of respondents cited statistics regarding the likely 'failure' of a business acquisition. The citation varied, but the consensus was that between 50 and 90% of all business acquisitions would 'fail' in the five years following the transaction using standard business metrics. However, there is no similarly high rate of impairments in the five years following a transaction. Many respondents agreed with the perception, suggesting that individual businesses were being tested immediately after the acquisition, and then on an ongoing basis as part of larger CGUs with headroom, creating an instant 'shield' for the newly acquired business in case it did not perform as expected.

70. Throughout the project responses to this have been mixed; some respondents acknowledged this view, offering the perspective that 'aggregation can cover a multitude of sins', while others asserted that shielding becomes irrelevant in a truly integrated business. One preparer

challenged the notion that impairments are being 'shielded' by internally generated goodwill from management's activities after the acquisition and questioned how management would differentiate between that and the actual synergies that the goodwill represented in the first place. Although analysts have access to information at the segment level rather than detailed CGU-level, the market often appears able to anticipate impairments despite the information discrepancy.

71. The authors note that whilst this issue is most prevalent as a matter of judgment for entities with goodwill, the principles applied in identifying individual CGUs apply equally to entities without goodwill. That is, it is only the rules around aggregation to an operating segment level that are specific to goodwill, in all other respects the guidance on identifying a CGU is identical, and potentially problematic.

72. Whilst respondents across all categories have acknowledged the mathematical concept of ‘shielding’ on impairment calculations, those who took this view also recognised that ‘shielding’ is a by-product of the integration process especially where businesses are acquired for strategic purposes and subsidised by another group of assets. As an outcome of this it is expected that one business in isolation may be considered a poor performer, however in the absence of other factors it is generally considered an acceptable by-product of owning a portfolio of businesses, and would not individually influence an investor’s decision to buy or sell.

What is the best approach?

73. In response to questions raised, the authors learned that participants across all categories were generally supportive of the current level of allocation required by IAS 36. Their reasons were that a more aggregated view – for example at the reportable segment level – would likely emphasise the perceived shielding effect outlined above and result in less useful information in the market. On the other hand, a more detailed view – for example, to force testing at the more-disaggregated individual CGU level – would be burdensome to complete and potentially require arbitrary allocations to some business units that genuinely rely on others to derive results. Although this was the general consensus, one analyst offered an interesting perspective – that if an impairment is reported within a certain CGU it is likely to reflect poorly on the wider segment, so assessment at a more disaggregated level may allow users to ‘filter out the bad’ rather than have users assume the whole segment is underperforming.

74. Interestingly, respondents’ grievances with the current standard lie not necessarily in the methodology but in the application. It was widely agreed that the ‘level that reflects the way an entity manages its operations and with which the goodwill would naturally be associated’ – as currently prescribed by IAS 36.82 – is conceptually the most effective level for testing. However, these comments were accompanied by a consensus that lack of clarity in the standard renders this requirement difficult to interpret and implement, requiring a high degree of subjectivity and resulting in diversity in application. It was offered that the guidance is so ambiguous and difficult to apply that entities may default to the segment level to avoid the specific requirement to

properly determine 'the level at which goodwill is monitored'. Further, the concept of a 'cash-generating unit' is considered an artificial construct and participants argued that the operating-segment-level-ceiling imposed by the standard is an anti-avoidance mechanism which forces a result that may not be truly aligned with how the business is managed. This is despite the guidance permitting completion of the test at a 'group of CGUs' level, fundamentally intended to align with management's internal reporting.

75. It was noted that more recently issued standards such as IFRS 8 contain useful guidance on aligning financial reporting outcomes with management's perspective. The IASB explained as part of its February 2019 *Responses to Exposure Draft: Improvements to IFRS 8 Operating Segments (ED/2017/02)*, that IFRS 8 is based on the management approach and was designed to enable users of financial statements to see an entity's operations through the eyes of management. In addition, the Board observed that IFRS 8 should reduce the cost to preparers of providing disaggregated information because it requires the disclosure of segment information already generated for management's use.

76. It appears there is potential benefit in further research regarding the specific source of the grievances outlined previously, to understand where the application of the standard results in a divergence from internal reporting, and on that basis, consideration of how the guidance could be re-drafted to support this intention. If there was a clearer linkage between management approach – as discussed in IFRS 8 – and the CGU at all levels rather than only at the aggregation level for goodwill testing, preparers may have more clarity in applying the requirements. The standard could be both improved and simplified by fully aligning impairment testing with the level at which an entity's results are viewed and decisions made internally, and redrafting the existing guidance regarding CGUs to emphasise this objective – the key recommendation within this section. Participants agreed that the main driver to allocate goodwill should be internal decision-making, which would be bespoke for each entity.

Disclosure

77. **Recommendation to IASB:** Implement the following enhanced disclosure proposals:
    a. provide further guidance on the definition of a key assumption, being those to which the impairment model is most sensitive, to encourage more informative disclosure; and
    b. revise the disclosure requirements of IAS 36 to provide more coherent disclosure principles regardless of the method chosen to determine recoverable amount;
    c. incorporate an additional disclosure objective in IFRS 3 to provide information to help investors understand the subsequent performance of the acquired business, having regard to the commercially-sensitive nature of the information.

78. The latter of these is consistent with a recommendation currently being considered by the IASB.

Disclosure of 'key assumptions'

79. Almost all analysts explained that there is a consistent gap between their expectations and those 'key assumptions' that are actually disclosed. While discount rate and revenue growth rate are often disclosed – likely because those are specifically cited within the standard – the following were also offered by analysts as being considered 'key assumptions' that are not always disclosed, where applicable:
    a. EBITDA margin
    b. Interest paid
    c. Expected life
    d. Cost profile

80. While analysts offered these as common omissions it was with the caveat that these may not be 'key assumptions' in all cases. Key assumptions are considered those to which the CGU or group of CGUs' recoverable amount is most sensitive. On this basis an input may not be 'key' because it is not relevant for the industry, or because it does not have a material impact on the impairment outcome across a large range. Further, the practice of identifying a few inputs and disclosing the impact in isolation, regardless of whether they are relevant, or not is rarely helpful. It appears there are some common assumptions that are described as 'key' across financial statements, despite those assumptions not having a significant impact on impairment testing outcomes in many cases, It is clear that preparers require further guidance to assist in determining what their key assumptions are, and to encourage more informative disclosure.

81. The authors also note that the recently issued auditing standard ISA 540 (Revised) Auditing Accounting Estimates and Related Disclosures uses the term 'significant assumption'. The authors believe it would be helpful if revised IAS 36 disclosure requirements used terminology consistent with ISA 540.

82. Interestingly, on the subject of requiring commentary as to why a particular value was chosen and how it was derived, the majority of analysts were less inclined to see the value. Again, it is clear that users will take any incremental information offered, however there was general consensus that to give real insight on complex inputs the level of disclosure would be significant and likely would contain commercially sensitive information.

83. Respondents generally considered that the existing requirement to provide information as to whether an input was based on internal or external data was useful, although not widely adopted. They further noted that it would be particularly useful if entities disclosed any differences between their inputs and publicly available data – for example, estimates of commodity prices. The authors understand that this disclosure is also intended by IAS 36.134(d)(ii), however is not commonly disclosed in financial statements.

84. Key assumption sensitivity analysis is a current requirement for goodwill impairment testing. Under the requirements, if a reasonably possible change in a key assumption would cause the CGUs or group of CGUs' carrying amount to exceed its recoverable amount, an entity is required to disclose[7]:
    a. the amount by which the recoverable amount exceeds the carrying amount;
    b. the value assigned to the key assumption; and
    c. the amount by which the value assigned to the key assumption must change, after incorporating any consequential effects of that change on the other variables used to measure recoverable amount, in order for the recoverable amount to be equal to its carrying amount.

85. In practice, many entities will fulfil this requirement by simply disclosing that there is sufficient headroom such that a reasonably possible change in assumption would not lead to an impairment. However it should be acknowledged that the term 'reasonably possible change' is highly subjective and difficult for a user to predict and/or interpret, and in practice, a source of much debate with regulators. It was consistently agreed that, combined with the skeletal approach to disclosing key inputs, the disclosure is poorly presented and lacking any real analytical value.

86. The standard's definition of a key assumption refers to its sensitivity in the context of the calculation performed. Therefore, a quality disclosure in this area would involve a preliminary exercise to determine the inputs that fall within this definition and then disclosure of information explaining the amount by which each would need to change to effect an impairment. This should give consideration to the flow-on effect of any individual change, for example, a sustained change in interest rates will affect the risk-free rate built into a discount rate and is also expected to have a commensurate effect on the price index which might underpin the growth rate used. Most analysts conceded that in order for this information to be truly useful, a fully dynamic impairment model would be required, which is often not practical. However this view was challenged by one analyst who suggested that the impact of isolated changes to key assumptions would be useful to obtain, subject to a suitable level of materiality. This analyst acknowledged that key assumptions may be correlated in an economic sense and changes in one key assumption may be accompanied by changes to other assumptions in more complete scenario estimates. Nonetheless, information on the impact of isolated changes to key assumptions was thought to provide valuable information to analysts who utilise the valuations under changing market and economic circumstances, and also to assess the uncertainties within the valuations themselves.

87. Several analysts explained that where included, the disclosures give a high-level sense of the 'safe' range of each input and whether the outcome would be 'better or worse' were a particular result to eventuate. However, when the question is 'by how much' the authors learned that

[7] IAS 36.134(f)

analysts expect investors to turn to them for an assessment of the quantitative effect of that information, rather than relying on the limited information available from the financial statements.

Disclosure requirements not readily applicable when using alternative calculation methods

88. In compiling the research the authors noted that the existing disclosure requirements are readily applicable to a situation where management has prepared the impairment model using a five-year forecast and terminal value for a CGU containing goodwill. However it was noted from the feedback received that where alternative methodologies are used or where goodwill is not present, compliance with the existing disclosure requirements does not adequately explain the impairment testing story. The authors consider that if the disclosure requirements were redrafted in a principles-based manner as is common with newer accounting standards, rather than using the rules-based approach that exists in the current standard, they would more readily apply to the range of methodologies applied and range of items being tested for impairment.

Information to help users understand subsequent performance of an acquired business

89. According to the IASB's published work plan, the current focus of the goodwill and impairment project appears to lie in divorcing the impairment test from assessment of the perceived 'success' of an acquisition by exploring ways to improve disclosure requirements and enable investors to separately assess whether after the acquisition the acquired business is performing as predicted.

90. The IASB staff have noted – most recently in the October 2018 meeting – that in applying the current disclosure requirements of IFRS 3, insufficient information is provided to help users understand the subsequent performance of the acquired business and whether the main targets and expected synergies of the acquisition are being achieved. The disclosures provided do not provide sufficient information for investors to properly understand the effect of the acquisition on the reporting entity. For example, the qualitative description of the factors that make up the acquired goodwill is often generic and tends not to provide useful information.

91. In response to this, the staff suggested the IASB make targeted improvements to the related disclosure requirements, including incorporation of a new disclosure objective to IFRS 3, specifically:

   A requirement to disclose, in the year in which a business combination occurs, the reasons for:

   a. *paying a premium that exceeds the fair value of the net identifiable assets acquired in the business combination, together with key assumptions or targets supporting the purchase consideration; and*
   b. *subsequently each year, a comparison between the actual performance and those assumptions or targets.*

92. In response to this, several preparers suggested if this approach was adopted, the information may be most appropriately contained in the management commentary rather than in the notes to the financial statements. It is also evident that there will be no 'one-size-fits-all' approach and

entities may appreciate flexibility to present the information in a range of different ways depending on the facts and circumstances of different acquisitions. From a users' perspective, this information would be considered valuable as it would assist with assessing the assessing the subsequent performance of a business combination, clarify understanding assumptions and projections that formed the basis for the valuation and hence support the goodwill figure, and provide a basis for assessing the accountability of management.

93. While these suggestions were met with openness from analysts, there was a consistent response that although more disclosure is always appreciated, it's not clear what effect these disclosures will have on the impairment test and whether it would result in a noticeable shift in behaviour or more timely recognition in the financial statements. The belief of respondents is that management would be just as reluctant to disclose negative results in the look-back analyses as they are currently about recording an impairment. Consistent with feedback from the ASAF as noted in the October IASB staff paper, the following concerns were also offered specifically in relation to the look-back analysis:

a. commercial sensitivity, leading to a propensity to disclose generic information only;
b. the need to achieve agreement with auditors on expected synergies, where disclosures will be based on these in the future;
c. practicality of tracking acquisitions after a period of time, specifically where genuine integration has occurred; and
d. relevance of information, particularly where the entity operates in a fast-paced industry, or is likely to be affected by digital disruption – there is little value in holding companies accountable to ventures they have already stepped away from.

94. One preparer was conscious that existing disclosure requirements are significant and the cost of compliance has increased exponentially in recent years. One preparer acknowledged that users crave more and more disclosure, however explained the cash investment required to address new application and disclosure requirements, and argued that if investors knew the actual cash cost of implementing such requirements, they might prefer the cash be reinvested into the business or distributed as dividends instead. There is a strong feeling that any increase in disclosures would need to be offset by simplification in the impairment test overall, which it was acknowledged could be achieved by the other recommendations made throughout this document.

95. Considering the views presented above, it appears that while most analysts are supportive of the disclosure requirements currently being considered by the IASB, they do note a number of practical limitations, particularly the commercially-sensitive nature of information both at the date of acquisition and subsequently. The authors therefore recommend that in drafting the proposed requirements, the IASB have regard to how these concerns might be appropriately addressed.

96. Having considered all of the input from contributors, the authors consider disclosure to be the final piece of the puzzle. Were the impairment testing requirements to be improved in respect of their other shortcomings, clearly articulated disclosure principles would likely have real value in improving the information available to market participants. However, good disclosure is not an appropriate substitute for timely recognition of impairment losses, and accordingly the authors believe that amending disclosure requirements in isolation is unlikely to make a significant contribution to reducing the issues encountered with applying IAS 36 in practice.

Appendix A: International corporate reporting enforcement focus areas and audit quality issues

Financial reporting surveillance focus areas and results

Australia

In December 2018 the Australian Securities and Investments Commission (ASIC, the Australian regulator) released its Focus Areas for the December 2018 reporting season. Consistent with prior years, impairment of non-current assets was high on this list. The report stated "directors and auditors should ensure the methodology and assumptions used for determining the recoverable amount are appropriate", and urged particular attention in the current environment, specifically citing digital disruption, technological advancement, climate change and international political instability. It is clear that these environmental factors may render recorded assets obsolete and historical business models – and therefore historical goodwill balances – irrelevant, and the regulator is concerned that the current approach taken by entities is not sufficiently dealing with these situations. This notion was mirrored within this outreach, with one respondent pointing out that there is limited guidance on how an entity should factor risk into cash flow projections, which is likely to contribute to differences of opinion with auditors and regulators on the outcome. It is not surprising that the Australian regulator has impairment high on its areas of focus, given that 18 of the previous 60 publicly-reported restatements[8] as a result of the bi-annual inspection program related to impairment of non-financial assets and/or goodwill.

United Kingdom

The Financial Reporting Council (FRC), in their Annual Review of Corporate Governance and Reporting 2017/2018, warned that a lack of transparency and objectivity, particularly on key assumptions, estimation uncertainty and underlying performance, undermines users' trust. The report goes on to outline that impairment of non-financial assets was in the top ten (10) issues raised each year for the previous three years.

South Africa

In its February 2019 Proactive Monitoring Report, the Johannesburg Stock Exchange (JSE) reported IAS 36 as being its second most common source of concerns around inadequate disclosures. This was following detailed discussion in the 2017 report spotlighting overall ambiguity and a lack of specificity in impairment information provided in financial statements within its jurisdiction.

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[8] Data since August 2014.

Europe

The European Securities and Markets Authority (ESMA) publishes extracts from its database of decisions taken by European national enforcers. The most recent batch of extracts, published in April 2018 included information about a number of enforcement decisions relating to application of IAS 36, specifically the disclosure of key assumptions, identification of cash-generating units, application of the value in use methodology, and risk premium applied.

Singapore

Most recently, on 1 February 2019 the Accounting and Corporate Regulatory Authority published its annual Areas of Review Focus under its Financial Reporting Surveillance Program, outlining its top five areas of focus for the upcoming surveillance season. Of these five issues, impairment assessment and valuation was number two, second only to the new financial reporting standards on Revenue Recognition, Leases and Financial Instruments. Consistent with reports in other jurisdictions, inputs to the valuation models used were highlighted as a key area of focus, specifically whether the inputs used are appropriate and realistic given the current level of operations and wider industry environment in the jurisdiction. The authority urged specific attention to the increasing level of technological advancement and business disruption, and whether external inputs can be used to benchmark management's assumptions.

Global audit quality issues

Australia

ASIC monitors audit quality in the Australian landscape, and in January 2019 released the results of its audit inspection program for the 18-month period to December 2018. Consistent with prior years, impairment featured heavily in that a total of 347 areas were selected for review (2016: 390), of which 78 or 23% related to impairment of non-financial assets (2016: 78 or 20%), indicating that the regulator expected this to be a problematic area. As a result of the review, 85 findings were raised (2016: 97), of which 20 or 26% related to impairment (2016: 29 or 37%), indicating that the regulator's attention was not unwarranted. Specifically, the report calls out:

a. consideration of the appropriateness and reasonableness of forecast cash flows and key assumptions used in discounted cash flow models; and
b. cross-checking of the reasonableness of assumptions and outputs to external inputs such as comparable companies' disclosures and industry multiples.

United Kingdom

In the 2018 UK Audit Quality Inspection commentary, a number of audit firms were reported for issues with impairment considerations including scepticism and corroboration of management's inputs, including revenue projections.

Canada

Similarly in October 2018 The Canadian Public Accountability Board (CPAB) released its Fall Inspections Report, listing impairment as one of the top three areas where audit quality deficiencies were found, alongside Business Combinations, and Revenue Recognition. The Board highlighted that these three areas together comprised more than half of the total number of findings raised.

South Africa

The Independent Regulatory Board for Auditors (IRBA) in 2018 reported impairment of goodwill as an area where deficiencies were noted in that jurisdiction. In a similar vein to the Singaporean and Australian surveillance programs outlined above, specific reference was made to increased attention as a result of the evolving economic environment. Specific comments were made as follows:

a. goodwill was tested at an inappropriate level, giving consideration to the use of CGUs;
b. insufficient scepticism and verification of inputs used in the relevant impairment model;
c. insufficiency in disclosures; and
d. a lack of clarity on the composition of historical goodwill and whether the original acquisition to which that goodwill relates is still relevant to the business in its current state.

Appendix B: Extract of questions provided to participants in January 2019 workshops

Purpose of goodwill impairment testing

The fundamental purpose of goodwill testing has been the source of recent discussion at both a local and international level. It has been said that goodwill impairment testing should be separated from assessing the success of an acquisition, and that the impairment test should not explicitly look at goodwill from previous individual business acquisitions, but instead consider whether the overall balance sheet is reasonable.

1. Do you agree with the above statement?
2. Do you believe separating the impairment test from assessment of the success of a particular acquisition could result in more useful information in the market? Note: Potential disclosures will be discussed below at question 12.

External assessments of value

In many cases, the share market does not respond when an impairment is announced, which implies that analysts are able to anticipate impairments and adjust projections accordingly before they are recognised.

3. Do you agree with the above statement? If so, in your opinion, how does this occur?
4. What recommendations can we make about improving the impairment testing process through incorporation of some of these strategies? Are there external factors used that could be incorporated into a standard?
5. Do you make a distinction between highest and best use when making value assessments? Would you apply different assumptions depending on whether an asset is valued for continuing use or sale?
6. Do you see value in any or all of the following suggested updates to IAS 36?
    a. A single, discounted cash flow methodology for both ViU and FVLCD
    b. Inclusion of cash flows from future restructuring and enhancements, but with management assumptions for ViU and market-participant assumptions for FVLCD
    c. Use and disclosure of the post-tax discount rate rather than the pre-tax discount rate.

Cash-generating units

A common theme in the international debate is the question of whether testing for impairment at a CGU-level has the effect of 'shielding' companies from impairments that ought to be taken. In the earlier phase of our research, responses to this were mixed, with some taking this view and others believing that once the business is fully integrated the 'shielding' effect from other parts of the business is not relevant to investment decisions. To further our understanding of the different viewpoints we would be interested in your opinion on:

7. The granularity of the current impairment testing requirements.
8. Whether moving to a segment level would be a simplification to the process. Do you believe it would result in fewer impairments? If so, what compensating information would be required?
9. Possible impediments to testing at higher level than a CGU.
10. Whether impairments (or lack thereof) are driven by CGU identification or the underlying assumptions used?
11. Whether there is value in undertaking further research on optimal methods of goodwill allocation to CGUs that could address current concerns.

Disclosure

Following on from questions 1 and 2: The IASB Board has recently directed its staff to explore possible improvements to disclosures aimed at enabling investors to assess whether a business combination was a good investment decision and whether, after the acquisition, the acquired business is performing as was expected at the time of the acquisition.

12. Do you believe this could be addressed through:
    a. Disclosure of key metrics; and/or
    b. A look-back analysis on those synergies expected at acquisition date in respect of individual acquisitions.

In June 2018 as part of the AASB Board's response to the first phase of this project, the Board specifically considered additional disclosure requirements for the method used to determine ViU or FVLCD, such as a sensitivity analysis for all impairment tests and look-back analysis to assess forecasting accuracy.

13. Do you believe any or all of the following disclosures would be useful to the market?
    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. Sensitivity analysis considering the point at which a change in key assumptions would cause impairment.
    d. Sensitivity analysis for all assets subjected to impairment testing, rather than only for goodwill.