# STAFF PAPER

**July 2017**

**IASB® Meeting**

| **Project** | **Goodwill and Impairment research project** | | |
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| Paper topic | Relief from the mandatory annual quantitative impairment testing of goodwill | | |
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## Purpose

1. The Board initiated its discussions of the possible simplifications at its May 2017 meeting. No decisions were made by the Board at that meeting.

2. The purpose of this paper is to discuss the relief from the mandatory annual quantitative impairment testing of goodwill in the light of feedback from the Board's consultative groups.[1]

3. This paper does not ask the Board to make any decisions.

> Significant changes to this paper from Agenda Paper 18B of the May 2017 meeting are as follows:
>
> - using a single method as the sole basis for determining the recoverable amount, which was considered as a possible simplification, has been removed in the light of the Board's discussion (see paragraph 13 of Agenda Paper 18A of this meeting);
> - removing the restrictions imposed by IAS 36 *Impairment of Assets* on cash flow estimates used in calculation of value in use, which is another possible simplification, has been removed because this simplification is relevant within the context of using a single method for determining recoverable amount; and

[1] Any reference to impairment testing of goodwill should be read as impairment testing of a cash-generating unit (CGU) to which goodwill is allocated. References to a CGU to which goodwill is allocated should be read as references also to a group of CGUs to which goodwill is allocated.

- the analysis of the possible relief from the mandatory annual quantitative impairment testing has been expanded considering feedback from the Board and the consultative groups.

As explained in paragraph 13 of Agenda Paper 18A of this meeting, using a single method for determining the recoverable amount is being considered as a possible approach that might improve effectiveness of the impairment testing model.

## Structure of the paper

4. The paper is structured as follows:

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| (a) | objective of simplifying the impairment testing model; | paragraph 5 |
| (b) | possible approaches to simplifying the impairment testing model—relief from the mandatory annual quantitative impairment testing of goodwill; | paragraphs 6–17 |
| (c) | extracts from Topic 350-20 of FASB Codification relating to qualitative factors for goodwill impairment. | Appendix A |

## Objective of simplifying the impairment testing model

5. The objective of considering possible simplifications to the impairment testing model is to investigate whether it is possible to reduce the cost of impairment testing without making the impairment test less robust

## Possible approaches to simplifying the impairment testing model

6. The Board could consider one or more of the following possible simplifications to the impairment testing model:

(a) providing relief from the requirement to perform the annual quantitative impairment test of a CGU to which goodwill is allocated by removing the requirement for entities to test goodwill for impairment when there are no indicators of possible impairment.

(b) other less significant changes to IAS 36, such as:

  (i) easing the VIU calculation by being less specific about whether pre-tax or post-tax inputs should be used.

  (ii) providing additional guidance to assist entities in applying IAS 36.

  The staff will analyse the less significant changes for a future meeting.

7. In March 2017, the staff sought feedback from Global Preparers Forum (GPF) on possible simplifications described in paragraph 6 of this paper. In June 2017, the staff discussed the indicator-based impairment test with the joint group of members of Capital Markets Advisory Committee (CMAC) and GPF. See *Appendix C* of Agenda Paper 18A for the minutes from the two meetings. The feedback from the two meetings has been considered in the staff analysis.

## Relief from the mandatory annual quantitative impairment test

8. IAS 36 requires a CGU to which goodwill has been allocated to be tested for impairment annually, and whenever there is an indication that the CGU may be impaired, by comparing the carrying amount of the CGU, including the goodwill, with the recoverable amount of the CGU.

9. The annual quantitative impairment test may be performed at any time during an annual period, provided it is performed at the same time every year. Different CGUs may be tested for impairment at different times. However, if some or all of the goodwill allocated to a CGU was acquired in a business combination during the current annual period, that CGU must be tested for impairment before the end of the current annual period.

10. According to some feedback from the PIR of IFRS 3, removing the requirement to perform the quantitative impairment test when there are no indicators of possible

impairment may reduce complexity. This would also be consistent with the approach for finite life assets in the scope of IAS 36.

11. IAS 36 requires that an entity shall assess at the end of each reporting period whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall perform an impairment test. IAS 36 provides a list of indicators that an asset may be impaired. These indicators are not exhaustive and they are required to be considered as a minimum.

*Staff analysis*

12. To respond to the feedback from preparers, the Board could consider providing relief from the mandatory annual quantitative impairment testing of goodwill. There can be four possible approaches for providing that relief:

    (a) *Approach 1*—the Board could require an entity to perform the quantitative impairment testing of goodwill only when there are indicators of possible impairment;

    (b) *Approach 2*—the Board could require an entity to perform the quantitative impairment testing of goodwill for the first year after a business combination; and in the later years, perform the quantitative impairment test only when there are indicators of possible impairment;

    (c) *Approach 3*—the Board could require an entity to perform the quantitative impairment testing of goodwill at least annually (and more frequently whenever there are indicators of possible impairment) for the first few years after a business combination, perhaps 3–5 years; and in the later years, perform the quantitative impairment test only when there are indicators of possible impairment; and

    (d) *Approach 4*—the Board could require an entity to perform the quantitative testing of goodwill less frequently than annually, for example every 3 years; and in the intervening periods, perform the quantitative impairment test only when there are indicators of possible impairment.

13. The Board may consider the following factors in assessing whether the relief would meet the objective of simplifying the application of IAS 36 without making the model less robust:

(a) As explained in the Basis for Conclusions on IAS 36, the Board required an annual quantitative impairment test for intangible assets with indefinite useful life because non-amortisation of an intangible asset increases the reliance that must be placed on impairment reviews of that asset to ensure that its carrying amount does not exceed its recoverable amount. In respect of goodwill, the existence of a rigorous and operational impairment test was seen as a precondition for removing the requirement to amortise in all cases. The International Accounting Standards Committee (IASC), the predecessor of the Board, introduced the requirement to carry out an annual quantitative impairment test for goodwill and indefinite life intangible assets at the same time as it removed a previous requirement to amortise those assets. These considerations continue to be relevant.

(b) There was feedback from investors that impairment losses are often recognised too late (even with an annual quantitative impairment test). A few members of the Board's consultative groups viewed the annual quantitative impairment test as a good governance mechanism. They thought that without a mandatory annual test, concerns may arise that recognition of impairment losses could be delayed even further. This could reduce investors' confidence in the carrying amount of goodwill and increase concerns that it may be overstated. Consequently, some GPF members preferred Approach 4, which they think would be more robust than other approaches.

(c) IAS 36 requires an entity to disclose the estimates used to measure recoverable amounts of CGUs containing goodwill or intangible assets with indefinite useful life. During the PIR of IFRS 3, some investors said that some of the current disclosures are useful; these included discount rates used, long-term growth rates, profit and capital expenditure assumptions and sensitivities. If the requirement to perform the annual quantitative impairment test is removed, an entity will disclose those estimates only when the quantitative test is performed (ie when there are indicators of possible impairment triggering the quantitative impairment test).

(d) A few CMAC members supported the indicator-based impairment test, together with a disclosure of the reasons that triggered the quantitative impairment test. Currently, IAS 36 does not require disclosure of indicators that triggered the quantitative impairment test. For assets within the scope of IAS 36 other than CGUs containing goodwill or intangible assets with indefinite useful life, IAS 36 requires disclosure of the events and circumstances that led to the recognition or reversal of an impairment loss.

(e) A possible question that is likely to arise is whether performing the quantitative impairment testing of goodwill annually is truly costly. At least some of the cost of the quantitative test is in setting up the valuation model. Having set up a valuation model for a CGU to which goodwill is allocated, an entity would run the valuation model with fresh set of inputs and assumptions every year. (An entity may have to amend the valuation model when there are events such as reorganisation of CGUs or new business combinations etc. In those situations, the incremental costs incurred by an entity for performing the quantitative impairment test may not be considered significant because the entity would have undertaken a valuation exercise in the process of restructuring the CGUs or undertaking the new business combinations.)

(f) In relation to the first few years after a business combination, the Board could consider including another indicator of possible impairment—whether the actual performance is in line with key assumptions or targets supporting the purchase consideration in that business combination. See paragraphs 6–20 of Agenda Paper 18C. If the actual performance is not in line with the key assumptions or targets, this indicator would trigger a requirement to determine the recoverable amount of the CGU. The staff envisage this indicator would operate only over the first few years following a combination, for example 3 years. However, some GPF members thought that if the actual performance in the first few years is not in line with the key assumptions or targets supporting the purchase price, that does not mean that the acquired assets are impaired and entities generally take a long-term view of the benefits from the business combination.

(g) In relation to Approaches 3 and 4, GPF members thought that requiring the quantitative test for the first few years after an acquisition is not useful because there is generally no impairment of goodwill during those initial years, especially if there is no significant change in circumstances.

*Optional qualitative test in US GAAP*

14. In 2011, the Financial Accounting Standards Board of the US introduced an optional qualitative test in US GAAP for testing goodwill for impairment. An entity that applies US GAAP has the option to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the goodwill impairment test. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. See *Appendix A* for the extract of the qualitative factors from US GAAP.

15. The staff reviewed publicly available information and had informal discussions with the FASB staff about how the optional qualitative assessment is being applied in practice. Publicly available survey reports indicate that there is a steady increase in the number of public companies that are electing to use the qualitative test as a first step. The percentage of public companies applying the qualitative test increased from 29 percent in 2012 to 59 percent in 2016.

16. Based on informal discussions with the FASB staff, we understand that many companies did not immediately use the qualitative test because the macro-economic environment in the US when the qualitative test was introduced possibly made it difficult for companies to pass the more-likely-than-not threshold. The accumulation of evidence needed for a robust application of the qualitative test was probably more complex than performing the quantitative test. However, with the macro-economic environment improving, the application of the

qualitative test is possibly becoming less complex, which is evidenced by more public companies using the qualitative test.

17. If the Board considers pursuing Approach 1, the staff think that the audit and enforcement framework in a jurisdiction affects the robustness of application of the indicator-based impairment testing.

## Questions for the Board

1. Do you have any questions or comments on the analysis and any other factors that the staff should consider?
2. Do you need any further information in developing your views about the indicator-based impairment testing?

## Appendix A
## Extracts from Topic 350-20 of FASB Codification relating to qualitative factors for goodwill impairment

**35-3C** In evaluating whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount, an entity shall assess relevant events and circumstances. Examples of such events and circumstances include the following:

a. Macroeconomic conditions such as a deterioration in general economic conditions, limitations on accessing capital, fluctuations in foreign exchange rates, or other developments in equity and credit markets

b. Industry and market considerations such as a deterioration in the environment in which an entity operates, an increased competitive environment, a decline in market-dependent multiples or metrics (consider in both absolute terms and relative to peers), a change in the market for an entity's products or services, or a regulatory or political development

c. Cost factors such as increases in raw materials, labor, or other costs that have a negative effect on earnings and cash flows

d. Overall financial performance such as negative or declining cash flows or a decline in actual or planned revenue or earnings compared with actual and projected results of relevant prior periods

e. Other relevant entity-specific events such as changes in management, key personnel, strategy, or customers; contemplation of bankruptcy; or litigation

f. Events affecting a reporting unit such as a change in the composition or carrying amount of its net assets, a more-likely-than-not expectation of selling or disposing of all, or a portion, of a reporting unit, the testing for recoverability of a significant asset group within a reporting unit, or recognition of a goodwill impairment loss in the financial statements of a subsidiary that is a component of a reporting unit

g. If applicable, a sustained decrease in share price (consider in both absolute terms and relative to peers).

…

**35-3F**[2] The examples included in paragraph 350-20-35-3C(a) through (g) are not all-inclusive, and an entity shall consider other relevant events and circumstances that affect the fair value or carrying amount of a reporting unit in determining whether to perform the quantitative goodwill impairment test. An entity shall consider the extent to which each of the adverse events and circumstances identified could affect the comparison of a reporting unit's fair value with its carrying amount. An entity should place more weight on the events and circumstances that most affect a reporting unit's fair value or the carrying amount of its net assets. An entity also should consider positive and mitigating events and circumstances that may affect its determination of whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If an entity has a recent fair value calculation for a reporting unit, it also should include as a factor in its consideration the difference between the fair value and the carrying amount in reaching its conclusion about whether to perform the quantitative goodwill impairment test.

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[2] ASU 2017-04 (referred to in paragraph A24 of Agenda Paper 18A of his meeting) amended paragraphs 350-20-35-3F and 350-20-35-3G. The text reproduced in this Appendix is the amended text.

**35-3G**[3] An entity shall evaluate, on the basis of the weight of evidence, the significance of all identified events and circumstances in the context of determining whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. None of the individual examples of events and circumstances included in paragraph 350-20-35-3C(a) through (g) are intended to represent standalone events or circumstances that necessarily require an entity to perform the quantitative goodwill impairment test. Also, the existence of positive and mitigating events and circumstances is not intended to represent a rebuttable presumption that an entity should not perform the quantitative goodwill impairment test.

[3] ASU 2017-04 (referred to in paragraph A24 of Agenda Paper 18A of his meeting) amended paragraphs 350-20-35-3F and 350-20-35-3G. The text reproduced in this Appendix is the amended text.