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AASB Research Report: Perspectives on IAS 36: A Case for Standard Setting Activity Issues Paper

Objective

- 1 The objective of this paper is to:
 - (a) Share with EFRAG TEG and CFSS the results of the research performed by the Australian Accounting Standards Board (the AASB) on IAS 36 *Impairment of Assets* in relation to the goodwill impairment (the AASB report); and
 - (b) Obtain feedback from EFRAG TEG and EFRAG CFSS members on the AASB research findings, conclusions and its proposed recommendations to the IASB on how to improve the goodwill impairment testing requirements.

Agenda papers

- 2 In addition to this paper, the following agenda papers have been provided for the session for background only:
 - (a) 10-02 – *ASAF 13 AASB Research report – Perspectives of IAS 36*; and
 - (b) 10-03 – *ASAF 13a AASB Presentation– Perspectives of IAS 36. [This presentation is expected on 18 March 2019].*

Background information

- 3 As part of the post-implementation review of IFRS 3 *Business Combinations*, the IASB received a substantial amount of feedback regarding the shortcomings of impairment testing under IAS 36.
- 4 Concerns raised included:
 - (a) the impairments are being recognised ‘too little and too late’ (user concern); and
 - (b) the existing standard is unduly complicated and includes requirements that do not practically contribute to better accounting outcomes (preparer concern).
- 5 In developing the research project, the IASB examined ways to make the impairment test more effective in terms of timely recognition of goodwill impairment.
- 6 The IASB staff developed the headroom approach with the objective of removing the shielding effect created by internally generated goodwill. However, the approach was not supported by many stakeholders as they did not consider the approach feasible in terms of cost-benefit considerations. Consequently, the IASB decided not to consider the headroom approach further.

IASB revised project objectives

- 7 In its July 2018 meeting, the IASB tentatively decided to pursue the following three objectives:
- (a) **Objective A - Identifying disclosures** to enable investors to assess management's rationale for the business combination, and whether the post-acquisition performance of the business combination meets expectations set at the acquisition date;
 - (b) **Objective B - Simplifying the accounting for goodwill** by exploring whether to permit an indicator-only approach to determine when an impairment test is required; and/or reintroduce amortisation of goodwill; and
 - (c) **Objective C** – Simplification of the calculation of value in use by exploring whether to **remove the prohibition** on the inclusion in cash flow projections of **future enhancements** to the asset and permit **the use of post-tax inputs** in the calculation of value in use.
- 8 These objectives were discussed with CMAC and GPF in November 2018 and their feedback - at ASAF December 2018 meeting (and discussed with EFRAG TEG and EFRAG CFSS at its meeting in November 2018).
- 9 ASAF members welcomed the enhanced disclosure requirements. EFRAG also supported the disclosure objective. However other ASAF members (about half) were concerned with the feasibility and cost of implementing the proposals citing that some of the information was of a sensitive nature. More members expressed support for amortisation of goodwill than those who did not. The usual arguments for and against were put forward. EFRAG noted that preparers supporting amortisation generally preferred the approach as a simpler alternative to the impairment only model. On the other hand, those preparers opposing amortisation are concerned that it will reduce entities' equity. Objective C was supported by EFRAG TEG and EFRAG CFSS in previous discussions.

Outreach performed by the AASB

- 10 As a contribution to the work of the IASB on its goodwill and impairment project, during 2018 the AASB conducted targeted outreach with preparers and analysts in Australia to better understand the issues arising from applying the current requirements in IAS 36 for goodwill and other non-financial assets impairment testing.
- 11 The feedback received from the AASB stakeholders included four main issues:
- (a) *Delays in recognition of asset impairments including goodwill* due to 'shielding' by unrecognised headroom and/or additional value generated internally through management's efforts and investments;
 - (b) *Impairment testing is too time-consuming and costly with no real practical benefit to the business.* The following examples were given:
 - (i) The process of allocating goodwill to Cash Generating Units (CGUs) requires judgement and the standards provide limited guidance;
 - (ii) Mandatory annual determination of recoverable amount is time-consuming and costly;
 - (iii) The requirements underlying the Value in Use (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; and

- (iv) Users are confused about the differences between ViU and Fair Value Less Costs of Disposal (FVLCD), and the circumstances in which each model is most appropriately applied.
 - (c) *Limited guidance on determining and/or applying the methodology and assumptions required to calculate recoverable amount*, for example:
 - (i) How to factor risk into cash flow projections; and
 - (ii) Inappropriate methodology used to determine the recoverable amount.
 - (d) *Impairment disclosures do not include all information required by users*, such as:
 - (i) Key assumptions underlying the impairment calculation; and
 - (ii) Disclosures are not tailored to the business' operations and/or are ambiguous.
- 12 Some of the above findings are not due to the lack of requirements in the IFRS Standards but rather due to the lack compliance with these requirements.

The AASB recommendations

- 13 Based on the above feedback the AASB **drafted five recommendations to the IASB** covering the various aspects of the current impairment testing requirements.
- 14 These recommendations together with the EFRAG's recommendations (if any) laid down in its Discussion Papers published in 2014 and 2017¹ are summarised in the table below.

Problem	The AASB Recommendation	EFRAG Recommendation
The standard is difficult to apply in practice, unduly complicated and does not contribute to better accounting outcomes.	<p><i>Recommendation 1</i></p> <p>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.</p>	
An overall lack of clarity on the purpose of the impairment test.	<p><i>Recommendation 2</i></p> <p>Clarify the purpose of the impairment testing requirements, and develop guidance explaining what the test</p>	

¹ 2014 EFRAG/ASBJ/FASF Research Paper *Should Goodwill still not be Amortised?* and 2017 EFRAG Discussion Paper *Goodwill Impairment Test: can it be Improved?*

Problem	The AASB Recommendation	EFRAG Recommendation
	is (and is not) intended to achieve.	
<p>The application guidance not aligned with internal decision-making (single model approach).</p>	<p><i>Recommendation 3</i></p> <p>Develop a modified single model approach, including specific amendments to:</p> <p>(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;</p> <p>(b) reserve the use of a FVLCD type model for assets expected to be disposed of within the following financial reporting period;</p> <p>(c) allow the use of a post-tax discount rate; and</p> <p>(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.</p>	<p>Allow only one method, either ViU or FVLCD.</p> <p>Allow considerations of cash flows from future restructurings in the ViU.</p> <p><i>This was discussed in the development of the EFRAG DP, and eventually not retained.</i></p> <p>Allow to perform the impairment calculation on a post-tax basis.</p>
<p>The application guidance not aligned with internal decision-making (CGUs).</p>	<p><i>Recommendation 4</i></p> <p>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.</p>	<p>Include specific guidance how to allocate goodwill to CGUs.</p>
<p>Diversity in disclosure reduces usefulness.</p>	<p><i>Recommendation 5</i></p> <p>Implement the following enhanced disclosure proposals:</p> <p>(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;</p>	<p>Require disclosure of the composition of goodwill. Track goodwill by each acquisition and provide a reconciliation of total goodwill allocated to each CGU.</p>

Problem	The AASB Recommendation	EFRAG Recommendation
	<p>(b) revise the disclosure requirements of IAS 36 to provide more coherent disclosure principles regardless of the method chosen to determine recoverable amount; and</p> <p>(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.</p>	

EFRAG Secretariat observations

- 15 The EFRAG Secretariat notes that the AASB recommendations 3 (a-c) and 5 are in line with the proposals being considered by the IASB and discussed with ASAF in December 2018 and with EFRAG TEG and EFRAG CFSS at its November 2018 meeting (see paragraphs 7- 9).
- 16 The EFRAG Secretariat is not sure whether the recommendation to review IAS 36 in its entirety is an alternative to the proposed targeted improvements to the existing requirements (Recommendations 2-5).

Questions for EFRAG TEG-CFSS

- 17 What are your views on improving IAS 36 more broadly than the targeted improvements currently identified in the IASB’s Goodwill and Impairment project?
- 18 What are your views on the findings and recommendations of the AASB Research Report?