Staff paper

Agenda reference: 18B

IASB® meeting

Date	**January 2025**
Project	**Business Combinations—Disclosures, Goodwill and Impairment**
Topic	**Restructuring and asset enhancement cashflows**
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Purposed and structure

1. As Agenda Paper 18 explains, this paper summarises feedback on the International Accounting Standards Board (IASB)'s proposal to remove from IAS 36 *Impairment of Assets* the requirement to exclude uncommitted future restructurings and asset enhancements when calculating value in use (VIU) of an asset or a cash generating unit (CGU).

2. This paper is structured as follows:

   (a) key messages (paragraphs 3–4);

   (b) background (paragraphs 5–6);

   (c) feedback summary (paragraphs 7–31); and

   (d) question for the IASB.

Key messages

3. Many[1] respondents agree with the proposal to remove the requirement to exclude uncommitted future restructurings and asset enhancements when calculating VIU of

[1] Agenda Paper 18A of the October 2024 IASB meeting said 'most' respondents agree. Further analysis suggests 'many' is a more appropriate quantification.

an asset or a CGU (restructuring and enhancement cash flows) for reasons consistent with those considered by the IASB (see paragraph 6). Some who agree suggest providing further application guidance such as defining 'current condition' and 'current potential' of an asset or adding illustrative examples.

4. Many respondents disagree with the proposal. Many of these respondents say removing this requirement could increase the level of judgement required to calculate VIU and increase management over-optimism. Some who disagree say the proposal could worsen the problem of impairment losses on goodwill sometimes being recognised too late.

Background

5. The recoverable amount of an asset or CGU is the higher of its fair value less costs of disposal (FVLCD) and its VIU. In calculating VIU, paragraph 44 of IAS 36 requires:

> 44 Future cash flows shall be estimated for the asset in its current condition. Estimates of future cash flows shall not include estimated future cash inflows or outflows that are expected to arise from:
>
> (a) a future restructuring to which an entity is not yet committed; or
>
> (b) improving or enhancing the asset's performance.

6. The IASB proposed to remove the requirement to exclude restructuring and enhancement cash flows. Paragraph BC205 of the Basis for Conclusions on the Exposure Draft (Basis for Conclusions) states:

> The IASB proposes to remove that [requirement]. In the IASB's view, doing so would:
>
> (a) reduce cost and complexity—removing the [requirement] would reduce the need to amend management's financial budgets

or forecasts. Stakeholders said it can be challenging for management to distinguish maintenance capital expenditure from expansionary capital expenditure and identify which cash flows need to be excluded because they relate to expansionary capital expenditure.

(b) make the impairment test less prone to error because estimates of value in use would be based more closely on cash flow projections that are prepared, monitored and used internally for decision-making.

(c) make the impairment test easier to understand, perform, audit and enforce.

Feedback summary

7. This section summarises:

   (a) reasons for agreeing (paragraph 8);

   (b) increased subjectivity and judgement (paragraphs 9–15);

   (c) management over-optimism and need for additional constraints or disclosures (paragraphs 16–22);

   (d) conceptual basis (paragraphs 23–24); and

   (e) other matters (paragraphs 25–31).

Reasons for agreeing

8. Many respondents, including most preparers and accounting firms, agree with the proposal for reasons similar to those considered by the IASB (see paragraph 6) and say the proposal would result in more useful information. For example, one accounting firm says an entity acquiring a business with significant expansionary growth potential applying the existing requirements is currently unable to reflect that

potential when calculating VIU, despite the transaction price (and therefore the amount of goodwill) reflecting the growth potential. Reflecting that growth potential in VIU calculations would provide more useful information.

Increased subjectivity and judgement

9. Paragraph BC205(a) of the Basis for Conclusions (see paragraph 6) explains why the IASB considered that the proposal would reduce cost and complexity.

10. Many respondents agree and say the proposal would reduce the need to make adjustments to the most recent internal cash flow projections, which can be arbitrary, resource consuming and complex.

11. However, other respondents say the proposal would increase the subjectivity and level of judgement required in assessing which cash flows to include in a VIU calculation. This could increase cost and complexity and result in inconsistent application and reduced comparability between entities.

12. Proposed paragraph 44A(b) of IAS 36 in the Exposure Draft states estimates of future cash flows of an asset in its current condition include 'future cash flows associated with the current potential of the asset to be restructured, improved or enhanced…'.

13. Respondents say assessing which cash flows reflect an asset or CGU's 'current potential' could be subjective and highly judgemental. One professional body says the proposal would introduce more variables and hypothetical scenarios into a VIU calculation. Respondents provide examples of scenarios which could be challenging and request application guidance and/or illustrative examples. For example:

    (a) whether to include cash flows from a planned future business combination or an asset acquisition, and under what conditions; and

    (b) how to assess whether a cash flow reflects the potential of a current asset (or CGU) or results in a new asset (or a different CGU).

14. Some respondents acknowledge the proposal might reduce complexity for preparers. However, they say the increased subjectivity and level of judgement that would be required could increase complexity for other stakeholders, such as auditors and regulators who could find it more challenging to audit and enforce the requirements.

15. A few respondents provide drafting suggestions to help stakeholders better understand the IASB's intentions about 'current potential'.

Management over-optimism and additional constraints or disclosures

16. In developing the Exposure Draft, the IASB heard concerns that the proposal could increase the level of management over-optimism in calculating VIU and that additional safeguards would be required if restructuring and enhancement cash flows are included in calculating VIU. Paragraphs BC208–BC211 of the Basis for Conclusions explains the IASB's consideration of these concerns and the reasons it decided to not propose additional safeguards.

17. A few respondents agree with the IASB and say the proposal would not significantly increase management over-optimism. These respondents say existing requirements in IAS 36, such as the requirement for assumptions used to be reasonable and supportable, suffice. One respondent says restructuring and enhancement cash flows do not significantly affect calculation of terminal value—a key driver of VIU—and hence the proposals will not significantly affect the VIU calculation.

18. However, some respondents say the proposal could increase management over-optimism and worsen the problem of impairment losses on goodwill sometimes being recognised too late.[2]

19. Some respondents suggest including additional constraints or criteria for restructuring and enhancement cash flows to be included in calculating VIU. These suggestions are

[2] As paragraph 12 of Agenda Paper 18A of the IASB's December 2024 meeting explains, a few respondents say the project's original intent was specifically to address feedback that impairment losses are being recognised 'too late'.

similar to those previously considered by the IASB (see paragraph BC207 of the Basis for Conclusions) and include requiring inclusion of restructuring and enhancement cash flows only if those cash flows:

(a) meet a probability or minimum level of commitment threshold. However, a few respondents disagree with this suggestion and say the existing requirement in IAS 36 for cash flow projections to be based on reasonable and supportable assumptions is sufficient.

(b) have been reviewed and/or authorised by the entity's management.

(c) are due to take place in the near future (for example the next 5 years).

(d) meet criteria similar to those in IAS 38 *Intangible Assets* for recognising an intangible asset arising from development—that is, requiring demonstration of technical feasibility and intention to complete a restructuring or enhancement.

(e) meet general recognition criteria for recognising a provision in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* (see paragraphs 26–28).

20. A few respondents suggest requiring an entity to use the expected cash flow approach (a probability-weighted approach) to calculate VIU when including restructuring and enhancement cash flows.

21. Some respondents suggest adding disclosure requirements for restructuring and enhancement cash flows included in calculating VIU. These suggestions include:

(a) disclosing quantitative information such as:

(i) restructuring and enhancement cash flows that are uncommitted; and

(ii) assumptions and judgements used in determining restructuring and enhancement cash flows; and

(b) disclosing only qualitative information such as:

(i) the nature of any uncommitted restructuring or enhancement cash flow and when those cash flows are planned to occur;

(ii) an entity's business plans that justifies including restructuring and enhancement cash flows;

(iii) the extent of restructurings and enhancements already completed; and

(iv) the entity's ability to make the future restructuring happen.

22. However, other respondents disagree with requiring entities to disclose information about restructuring or enhancement cash flows because:

(a) costs—for example, one standard-setter says entities would need to prepare calculations with and without uncommitted future restructurings and asset enhancements to meet any disclosure requirements; and

(b) legal risks—for example, one preparer says disclosing information about anticipated restructurings could expose entities to legal risks, particularly where restructuring plans affecting employees need to be discussed in advance with employee representatives.

Conceptual basis

23. Paragraphs BC211–BC214 of the Basis for Conclusions discuss the IASB's considerations of the conceptual basis for including restructuring and enhancement cash flows in calculating VIU. This included considerations about whether the proposal would be consistent with other requirements for measuring VIU, such as the requirement to estimate cash flows for an asset (or a CGU) in its current condition.

24. A few respondents disagree with the IASB's considerations and say including restructuring and enhancement cash flows contradicts other requirements in IAS 36 for measuring VIU because:

(a) restructuring and enhancement cash flows represent future, and not, current potential of an asset or CGU (a few respondents).

(b) paragraph BCZ45 of the Basis for Conclusions on IAS 36 states 'future cash inflows should be estimated for an asset in its current condition, whether or not these future cash inflows are from the asset that was initially recognised or from its subsequent enhancement or modification' (one valuation specialist). The respondent says this suggests the asset (or CGU) being evaluated is the asset in its present form. The respondent also says US GAAP uses the term 'existing service potential', which they say excludes cash flows associated with expenditures that increase the asset's service potential.

Other matters

25. Respondents also comment on other matters in relation to the proposal. These include:

    (a) interaction with IAS 37 (paragraphs 26–28);

    (b) differences between fair value and VIU (paragraph 29); and

    (c) illustrative examples (paragraphs 30–31).

Interaction with IAS 37

26. In developing the proposal, the IASB considered, but decided not to require restructuring and enhancement cash flows to meet all the criteria for recognising a restructuring provision in IAS 37 (see paragraph 72 of IAS 37) for inclusion in the calculation of VIU. Paragraphs BC209–BC210 of the Basis for Conclusions explain the IASB's rationale.

27. Many respondents comment on the difference between, and interaction of, restructuring and enhancement cash flows that would be included in VIU applying the proposals and the definition of a restructuring plan in IAS 37. Specifically:

    (a) many request clarification on the interaction between these requirements. For example:

        (i) a few preparers suggest providing guidance on how to treat restructuring cash flows in VIU calculations when a provision recognised in accordance with IAS 37 is part of the CGU being tested; and

(ii) one accounting firm suggests clarifying whether the requirements in paragraph 78 of IAS 36 (which requires deducting the carrying amount of a liability in determining both the CGU's VIU and its carrying amount) would apply to a restructuring provision in the light of proposed paragraph 44B(b) of IAS 36.[3]

(b) a few stakeholders suggest clarifying when an entity should include restructuring and enhancement cashflows in VIU and when to include those cash flows in recognising a liability applying IAS 37.

28. A few respondents provide specific examples of cash flows which would be included in VIU but not recognised as a liability applying IAS 37—for example, employee costs related to an uncommitted restructuring.

Differences between VIU and FVLCD

29. As paragraph BC213 of the Basis for Conclusions explains, applying the proposal, the measurement of VIU would be more consistent with how FVLCD is determined if an asset, or CGU, contains potential to be restructured or enhanced. Some respondents comment on the remaining differences between VIU and FVLCD as follows:

(a) most of these respondents suggest clarifying what differences remain. For example, a few respondents recommended revisiting and/or expanding the list of differences in paragraph 53A of IAS 36 or providing examples of the remaining differences. A few provide examples of remaining differences. For example, one accounting firm says management's expectations about restructuring or enhancements being incorporated in entity-specific cash flows

[3] Proposed paragraph 44B says:

When an entity becomes committed to a restructuring and a provision for restructuring is recognised in accordance with IAS 37, its calculation of value in use for an asset affected by the restructuring:

(a) continues to include estimates of future cash inflows and outflows that reflect the cost savings and other benefits from the restructuring (as long as these cash flows meet the requirements in paragraph 33); and

(b) excludes estimates of future cash outflows for the restructuring because these cash outflows are included in the restructuring provision in accordance with IAS 37.

for the VIU model might differ from a general market participant's view of restructurings or enhancements in FVLCD.

(b) some respondents say making the calculation of VIU more consistent with FVLCD would simplify impairment testing.

(c) a few respondents question whether maintaining two different methods for calculating recoverable amount remains appropriate.

(d) a few respondents say the proposed amendment is unnecessary because restructuring and enhancement cash flows are included in FVLCD and recoverable amount is the higher of the two. These respondents say entities would simply use FVLCD as the recoverable amount if restructuring or enhancement cash flows increase the resulting FVLCD.

Illustrative examples

30. The Exposure Draft proposed to delete Example 5 and Example 6 of the Illustrative Examples accompanying IAS 36. These examples illustrate the treatment of a future restructuring and future costs respectively.

31. Respondents suggested:

(a) not deleting, but updating, these examples to illustrate the inclusion of restructuring and enhancement cash flows (a few respondents);

(b) reinstating Example 5 (Treatment of a future restructuring) to illustrate how to apply paragraph 78 of IAS 36, which requires an entity to deduct the carrying amount of a liability in determining both the CGU’s VIU and its carrying amount (a few accounting firms);

(c) adding examples to illustrate how to apply the concepts of 'current condition' and 'current potential' (some respondents); and

(d) adding industry specific examples (a few respondents).

Question for the IASB
Do IASB members have any questions or comments on the feedback in this agenda paper?