Staff paper

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IASB® meeting

Date	**January 2025**
Project	**Business Combinations—Disclosures, Goodwill and Impairment**
Topic	**Allocating goodwill to CGUs**
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Purpose and structure

1. As Agenda Paper 18 explains, this paper summarises feedback on the proposal to make targeted changes to IAS 36 *Impairment of Assets* to improve how entities allocate goodwill to cash-generating units (CGUs) which was included in the Exposure Draft *Business Combinations—Disclosures, Goodwill and Impairment* (Exposure Draft).

2. This paper is structured as follows:

   (a) key messages (paragraphs 3–4);

   (b) background (paragraphs 5–8);

   (c) feedback summary (paragraphs 9–21);

   (d) question for IASB; and

   (e) Appendix A—Excerpts of the proposed amendments to IAS 36.

Key messages

3. Many respondents agree that the proposal could reduce shielding, however many disagree (including almost all respondents who suggest reintroducing amortisation of goodwill) and say the change would have a limited effect on reducing shielding.

4. Many respondents who disagree, and a few who agree, suggest providing more clarity or application guidance.

Background

5. Paragraph 80 of IAS 36 (see paragraph A1) contains requirements for allocating goodwill to CGUs for impairment testing.

6. In developing the Exposure Draft, the International Accounting Standards Board (IASB) heard that entities might not always apply paragraph 80 of IAS 36 as intended. For example, feedback suggested entities might allocate goodwill to operating segments as a default and management might not specifically monitor goodwill.

7. The IASB concluded it would not be possible to provide comprehensive guidance on allocating goodwill to CGUs. However, the IASB proposed some targeted changes to paragraph 80 of IAS 36 to improve those requirements, which in turn could help reduce shielding.[1] In particular, as paragraph BC199 of the Basis for Conclusions on the Exposure Draft (Basis for Conclusions) states, the IASB proposed:

   (a) to replace the phrase 'goodwill is monitored' in paragraph 80(a) of IAS 36 with 'business associated with the goodwill is monitored':

      (i) to describe better the activity that an entity's management performs;

      (ii) to maintain the link between how goodwill is tested for impairment and how an entity is organised for internal reporting purposes; and

      (iii) to avoid an entity allocating goodwill at the operating segment level by default because its management does not monitor goodwill.

[1] In some stakeholders' view, goodwill can be shielded by, for example, the headroom of a business with which an acquired business is combined. Headroom is the amount by which a business's recoverable amount exceeds the carrying amount of its recognised net assets. This headroom can mask the impairment of acquired goodwill when an entity tests the combined business for impairment because any reduction in the recoverable amount of the combined business is first absorbed by that headroom. The shielding effect can lead to delayed recognition of impairment losses on acquired goodwill. In this paper we call this effect shielding.

(b) to clarify that an entity is required first to apply paragraph 80(a) of IAS 36 and determine the lowest level at which the business associated with the goodwill is monitored for internal management purposes and only then apply paragraph 80(b) of IAS 36, which acts as a ceiling to the level that the entity determines applying paragraph 80(a). This clarification would help avoid an entity applying paragraph 80(b) as a default.

(c) to provide limited guidance on what 'monitoring the business associated with the goodwill' means. This guidance would help an entity allocate goodwill to a level consistent with how it reports internally and manages its operations.

(d) to clarify that IAS 36 requires an entity to allocate goodwill to groups of CGUs (if goodwill cannot be allocated to individual CGUs on a non-arbitrary basis) because goodwill arises in a business combination and a business sometimes comprises groups of CGUs.

8. Appendix A reproduces excerpts from the Exposure Draft relevant to this proposal. Paragraphs BC194–BC201 of the Basis for Conclusions explain the IASB's rationale for this proposal.

Feedback summary

9. Many respondents agree with the proposal for reasons considered by the IASB—that is, the proposal will help entities allocate goodwill to CGUs for impairment testing purposes and thereby reduce shielding. For example:

(a) one preparer group says the proposal helpfully clarifies how to allocate goodwill[2]; and

(b) one accounting firm says the proposal helpfully emphasises the link between goodwill allocation and how an entity organises its operations.

[2] References to 'goodwill allocation' or 'allocation of goodwill' throughout the rest of this paper refers to allocating goodwill to CGUs or groups of CGUs for impairment testing purposes.

10. A few users comment on the proposal and almost all agree. For example, one investor group says clarifying how to allocate goodwill coupled with a requirement to disclose reportable segments that include a CGU (see Agenda Paper 18D of this meeting) would result in more useful information.

11. However, many respondents disagree with the proposal. Many of these respondents say the proposal will not significantly change how entities allocate goodwill and thereby would have a limited effect on reducing shielding.

12. A few respondents, particularly preparers and accounting firms, say the proposal—which could result in entities allocating goodwill at a level lower than is currently the case—could result in significant costs for some entities and would contradict the objective of reducing the cost and complexity of the impairment test.

13. We have grouped feedback on the proposal as follows:

    (a) effect of the proposal (paragraphs 14–15);

    (b) level at which to allocate goodwill (paragraphs 16–18);

    (c) understandability of the proposal (paragraph 19); and

    (d) requests for further clarifications, guidance or examples (paragraphs 20–21).

Effect of the proposal

14. As paragraph 6 says, feedback suggested entities might allocate goodwill to operating segments as a default. Consistent with that feedback, a few respondents say entities might currently allocate goodwill for impairment testing at the operating segment level because there is additional rigour associated with a review by the Chief Operating Decision Maker (CODM) and the definition of CODM in IFRS 8 *Operating Segments* is well understood. However, many respondents say in applying the existing requirements, they already allocate goodwill to levels below the operating segment and the proposal would not significantly affect that allocation.

15. A few respondents ask whether the proposals are clarifications or represent substantive changes to the requirements. These respondents say characterising the changes as clarifications may diminish their effectiveness in reducing shielding—this is because entities may not view the changes as requiring changes to their existing goodwill allocations. One accounting firm says describing the proposals as clarifications means any change to how an entity allocates goodwill when implementing the proposals would indicate the entity had a prior period error.

Level at which to allocate goodwill

16. A few respondents suggest changing the requirements by introducing a rebuttable presumption that information is available to allocate goodwill at some level below the operating segment level. One of these respondents suggests requiring additional disclosures if the entity rebuts the presumption and allocates goodwill at the operating segment level.

17. A few respondents suggest removing paragraph 80(b) of IAS 36 which limits the allocation of goodwill to an operating segment. These respondents say:

    (a) doing so would make entities more carefully consider the requirements of IAS 36 when allocating goodwill to CGUs.

    (b) the requirement is unnecessary and removing it would not result in entities allocating goodwill at a level higher than an operating segment. Financial information is provided to the CODM as part of segment reporting which naturally caps the level at which an entity can allocate goodwill.

18. One respondent suggests aligning the goodwill allocation requirements in IAS 36 with those in IAS 21 *The Effects of Changes in Foreign Exchange Rates*. Paragraph 47 of IAS 21 requires goodwill arising on the acquisition of a foreign operation to be treated as an asset of the foreign operation.

Understandability of the proposals

19. Many respondents provide feedback on the proposal's understandability, specifically:

Proposal[3]	Feedback
(a) Last sentence of proposed paragraph 80A(b)	Some respondents do not understand the last sentence and ask for industry specific examples / guidance to help apply this requirement (see paragraph 20). Some respondents read the last sentence to imply that management monitors goodwill at the level at which it expects synergies from the business combination to arise. A few respondents suggest removing the last sentence. They say management may monitor the business associated with the goodwill for purposes other than impairment testing.
(b) Paragraph 80A(a)	Some respondents say the link between expected synergies from a business combination with the goodwill impairment testing requirements in IAS 36 is unclear and ask about the allocation of goodwill that arises in a business combination with no expected synergies.
(c) Paragraph 80(a)	One respondent suggests using the phrase 'synergies associated with the goodwill' instead of 'business associated with goodwill' in paragraph 80(a) because management might monitor a business at some level lower than the level at which synergies arise and it would not be possible to allocate goodwill to that lower level.

[3] Appendix A reproduces relevant excerpts of the proposed requirements.

Requests for further clarifications, guidance and examples

20. Many respondents (including those who agree and disagree with the proposal) suggest providing more guidance and examples illustrating how to apply the proposed requirements. For example:

    (a) one national standard-setter suggests providing an example illustrating how management might apply proposed paragraphs 80–80B of IAS 36 in periods subsequent to a business combination, showing how the level at which management monitors the business associated with goodwill may change as the acquired business gets integrated into existing operations.

    (b) a few respondents suggest clarifying how to allocate goodwill when synergies arise across multiple CGUs or when businesses are highly integrated. One national standard-setter provides an example of a retail store chain acquiring a store, with a strategic rationale of generating synergies between the new branch and existing branches. They say testing goodwill at the acquired branch level would not reflect synergies with other branches. One respondent suggests amending paragraph IE4 of the Illustrative Examples accompanying IAS 36[4] to illustrate whether, in a retail store chain context, the appropriate CGU would be an individual store or the chain.

    (c) a few respondents request industry-specific examples.

21. Some respondents suggest further clarifying existing requirements in IAS 36 by:

    (a) defining 'management' in paragraph 80(a) and proposed paragraph 80A of IAS 36[5] and explaining its relation to key management personnel, used in the IFRS 3 proposals (some respondents). Respondents say identifying the appropriate level of management for applying IAS 36 requirements is difficult when entities have multiple levels of management. One accounting firm

[4] Paragraph IE4 is part of Example 1 which illustrates the identification of CGUs for a retail store chain.

[5] Reproduced in Appendix A.

suggests providing an example, or additional guidance to reduce the risk of entities defaulting to a higher level of management than intended.

(b) defining ‘monitoring’ in paragraph 80(a) and proposed paragraph 80A of IAS 36. For example, by explaining what information management need to receive and/or review to be monitoring (a few respondents).

(c) clarifying whether the term ‘business’ proposed to be added to paragraph 80 of IAS 36 in the Exposure Draft has the same meaning as defined in IFRS 3[6]. They also ask whether the term refers only to acquired businesses or also to existing/ organically grown businesses (some respondents).

(d) providing examples of factors to consider when identifying CGUs, such as revenue and asset separation or guidance on how to determine whether groups of assets have largely independent cash inflows (a few respondents).

(e) providing examples of how to reallocate goodwill in the event of a reorganisation that affects goodwill allocation, including guidance on methods other than relative value approach referred to in paragraph 87 of IAS 36 that an entity can use when it reorganises its reporting structure in a way that affects goodwill allocation (a few respondents).

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

[6] IFRS 3 defines a business as an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing goods or services to customers, generating investment income (such as dividends or interest) or generating other income from ordinary activities.

Appendix A—Excerpts of the proposed amendments to IAS 36

A1. The Exposure Draft proposed (underlined text is proposed to be added):

> **80 For the purpose of impairment testing, goodwill acquired in a business combination shall, from the acquisition date, be allocated to each of the acquirer's cash-generating units, or groups of cash-generating units, that is expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units or groups of units. Each unit or group of units to which the goodwill is so allocated shall:**
>
> **(a)represent the lowest level within the entity at which the <u>business associated with the</u> goodwill is monitored for internal management purposes; and**
>
> **(b)not be larger than an operating segment as defined by paragraph 5 of IFRS 8 *Operating Segments* before aggregation.**
>
> <u>80A In applying paragraph 80, an entity first applies paragraph 80(a) to determine the lowest level at which the business associated with the goodwill is monitored for internal management purposes. Applying paragraph 80(a) requires an entity:</u>
>
> <u>(a) to identify the cash-generating units or groups of cash-generating units (see paragraph 81) expected to benefit from the synergies of the combination; and</u>
>
> <u>(b) to then determine the lowest level for which there is financial information about the cash-generating units identified in paragraph 80A(a) that management regularly uses to monitor the business associated with the goodwill. That financial information</u>

reflects how the benefits expected from the synergies of the combination are managed.

80B The requirement in paragraph 80(b) sets the highest level at which an entity is permitted to allocate goodwill for the purpose of applying paragraph 80(a) and is therefore applied only after paragraph 80(a) has been applied.