

Recommendations on Accounting for Goodwill



IOSCO

**The Board
OF THE
INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS**

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Executive summary

Since the financial crisis, the total balance of accumulated goodwill of the S&P 500 has more than doubled from USD 1.6 trillion in 2008 to USD 3.7 trillion in 2021. An increasing trend was also observed in the European Union where the total amount of goodwill reported by 1,477 listed companies increased by almost 50% - from EUR 1.1 trillion in 2013 to EUR 1.6 trillion in 2019.

In active merger and acquisition (M&A) periods, acquisition prices tend to be higher, and as a result, the balance of goodwill has grown. Under current global accounting standards goodwill is not amortized and is tested for impairment at least annually. A concern expressed by some stakeholders is that management may use optimistic assumptions in estimating the recoverable amount to reduce the instances where impairment losses negatively impact profitability. As a result, impairment losses may not always be recognized adequately or on a timely basis. In such situations, it is only when the financial performance of a company deteriorates that the company recognizes impairment losses and reduces goodwill significantly. This is referred to “too little, too late.” In other situations, the decline in performance may occur slowly over a period of time resulting in “close call” situations in advance of an impairment (i.e., the excess of the recoverable amount and the carrying amount is declining over time until there is no longer an excess thereby triggering the goodwill impairment recognition) but with a lack of transparent disclosure about the close call scenario.

The economic environment that issuers face changes continually. It is important that management carefully and objectively assesses the current economic environment so that it is faithfully reflected in the assumptions used in the goodwill impairment tests.

It is critical that the application of financial reporting standards result in fair presentation of the financial position, performance and cash flows of the company for the benefit of investors, and this includes the accounting and disclosure for goodwill.

We support the International Accounting Standards Board (IASB)’s plans to enhance disclosures so that investors receive better information to support their assessment of the performance of an acquisition and more effectively hold management to account for its acquisition decisions. We also encourage the IASB to look for opportunities to improve the impairment tests. IOSCO continues to monitor whether and how the problem of “too little, too late” could be addressed through initiatives by issuers, audit committees (or those charged with governance [TCWG]) and external auditors. It is also important for the IASB to consider how the expected changes in standards address the problem of “too little, too late”.

Chapter 1 - Introduction

Goodwill is an asset arising from a business combination when a company obtains control over a business paying an acquisition purchase price that is greater than the value assigned to the identifiable net assets of the acquired business.

Although it is recognized as an asset that represents future economic benefits arising from an acquisition, goodwill is not separable from other assets of the business unlike identifiable assets. In accordance with the model used in International Financial Reporting Standards (IFRS Accounting Standards), goodwill is not subject to amortization but is instead subject to an annual (or more frequent when there are indications of potential impairment) impairment test.

1.1. Accumulation of Goodwill

Since the financial crisis, the total balance of accumulated goodwill of the S&P 500 has more than doubled from USD 1.6 trillion in 2008¹ to USD 3.7 trillion in 2021.² A similar trend was also observed in the European Union where the total amount of goodwill reported by 1,477 listed companies increased by almost half - from EUR 1.1 trillion in 2013 to EUR 1.6 trillion in 2019.³

One of the driving forces for the accumulation of goodwill is the active merger and acquisition (M&A) market during this period. As a result of the easing of monetary policies after the financial crisis, financially strong companies were able to access funding more easily and at a less-costly amount, which in turn allowed them to finance their M&A activities and to scale up their business. Although the M&A market was disrupted by the onset of the COVID-19 pandemic, the market bounced back quickly in 2021.⁴ In active M&A periods, acquisition prices tend to be higher, and as a result, the balance of goodwill has grown. Consequently, there is a risk that goodwill balances continue to accumulate over time even when the goodwill amounts may not be economically supportable.

1.2. Issues Identified by IOSCO

Under IFRS Accounting Standards, goodwill is impaired when the recoverable amount (i.e., the higher of fair value less costs of disposal and its value in use) of a cash-generating unit (CGU) or a group of CGUs to which the goodwill is allocated is less than its carrying amount. The determination of the recoverable amount of a CGU or a group of CGUs requires the use of significant management judgements and estimates. Accordingly, it creates challenges for preparers, audit committees (or TCWG), external auditors and regulators. There is a risk that management may use optimistic assumptions in estimating the recoverable amount, which in some circumstances may be motivated by a reluctance to recognize impairment losses that will

¹ Source: <https://www.ifrs.org/news-and-events/2018/12/speech-are-we-ready-for-the-next-crisis/>.

² Source: <https://news.bloombergtax.com/financial-accounting/how-goodwill-accountings-makeover-hits-s-p-500-in-six-charts>.

³ EFRAG - Evolution of goodwill for entities listed on EU exchanges - Issues Paper 2021 - <https://www.efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FMeeting%20Documents%2F2101201620495169%2F02-03%20Issues%20paper%20on%20the%20evolution%20of%20goodwill%20on%20EU%20exchanges%20EFRAG%20Board%202021-01-26.pdf>.

⁴ Recently, there has been a general increase in interest rates as central banking authorities move to address inflationary pressures. This, along with other market uncertainties, has reduced M&A activity more recently, but these same factors also place additional pressures on management's impairment assessment for existing goodwill.

negatively impact profitability. As a result, there may be circumstances where impairment losses are not recognized adequately or on a timely basis. In such situations, it is only when the financial performance of a company deteriorates significantly (and there is no shielding due to the good performance of other components of the CGU to which goodwill is allocated) that the company recognizes impairment losses and reduces goodwill significantly, although declining expectations of future performance may have been evident in earlier years. This is referred to by some as “too little, too late.” In this sense, it is sometimes said that goodwill carries “hidden losses” that are not recognized until a dramatic decline in profitability or cash flows occurs. Additionally, there may be circumstances where a company’s performance is declining but there is still an excess of the recoverable amount over the carrying amount of a CGU or a group of CGUs – sometimes referred to as a “close call” scenario. It therefore is possible that the impairment test under the current accounting framework and/or the related disclosures are in need of improvement. The IASB is considering potential improvements to both the impairment test and disclosures about the performance of an acquisition.

1.3. Why Are We Engaging in This Issue?

It is critical that the application of financial reporting standards result in fair presentation of the financial position, performance and cash flows of the company for the benefit of investors, including that goodwill is not stated at an amount in excess of its recoverable amount,⁵ and that impairment losses are recognised in a timely manner.

The “too little, too late” issue and the adequacy of disclosures around close call scenarios may be important to investors in helping them assess the success of acquisitions by management. Indeed, transparent and timely disclosure of financial performance, including information on goodwill, is important for informed investment decisions, through which market mechanisms work well and efficient capital allocation is achieved.

Disclosure of the key assumptions underlying the impairment analysis of goodwill is also one of the top issues for securities regulators. The validity of assumptions underlying the estimated cash flows used to test goodwill for impairment emerged as the second most common issue from a survey of securities regulators.

1.4. Structure of This Report

This report is structured as follows:

- Chapter 1 – Introduction (this chapter)
- Chapter 2 – Current Status
- Chapter 3 – Results of Survey by Members
- Chapter 4 – IOSCO Consultation Feedback from Stakeholders
- Chapter 5 – IOSCO Recommendations for Stakeholders
- Chapter 6 – Conclusion

⁵ The objective of the impairment test for goodwill is to ensure that the assets including goodwill of a CGU, or a group of CGUs are carried at no more than their recoverable amount.

Chapter 2 - Current Status

2.1. Increase in Economic Uncertainty

After the financial crisis, the global economy gradually recovered. However, the COVID-19 pandemic and the conflict in Ukraine and other economic uncertainties have more recently significantly impacted the global economy. Throughout all of this, there has been a significant amount of M&A activity as stronger companies seek opportunity for growth through acquisitions.

As identified in an IOSCO public statement issued in November 2022,⁶ factors affecting economic conditions include, but are not limited to, supply chain challenges; on-going impacts of the COVID-19 pandemic; evolving impacts of the conflict in Ukraine; escalating energy supply shortages and costs; labour shortages; inflationary pressures; volatility in currency exchange rates; rising interest rates; changes in monetary and fiscal policies; and other responses from central banks and other government authorities. As economic circumstances evolve and change, it is critical for management to carefully assess the latest economic environment where issuers operate and reflect it in the assumptions used in the accounting estimates, including goodwill impairment tests.

Different industries/companies face different economic challenges and uncertainties. Accordingly, entity-specific assumptions and disclosure of underlying assumptions in goodwill impairment tests may be important for investors' understanding of management's goodwill impairment assessment and conclusion.

These economic conditions could either directly or indirectly affect the carrying amount of goodwill on issuers' balance sheets. IOSCO encourages issuers, audit committees (or TCWG) and external auditors to exercise heightened professional scepticism with regards to these issues. These stakeholders need to carefully consider how risks and other macroeconomic factors affect or may affect an issuer's operations, financial condition, cash flows, future prospects, and the need for transparent disclosures around these judgements and estimates.

2.2. IASB's Initiative

2.2.1. Discussion Paper

In March 2020, the IASB issued the Discussion Paper *Business Combination – Disclosures, Goodwill and Impairment* (the Discussion Paper) which outlined issues identified through the Post-Implementation Review of IFRS 3 *Business Combinations* (PIR of IFRS 3) and provided the IASB's preliminary views on how to address these issues.

Issues identified through the PIR of IFRS 3

Although stakeholders had divided views on some issues (e.g., reintroduction of goodwill amortisation), many stakeholders raised concerns in the following areas:

- Many investors said they often have difficulty assessing the subsequent performance of an acquisition.

⁶ IOSCO Statement on Financial Reporting and Disclosure during Economic Uncertainty, November 2022 <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD720.pdf>.

- Many stakeholders said there may be a time lag between when goodwill is economically impaired and recognition of an impairment loss in a company's financial statements. This could be a consequences of several factors including, but not limited to, optimistic assumptions used by management, or, alternatively, "shielding" created by other operations which generate internal goodwill that is unrecognized.
- Many stakeholders described the impairment test as complex and said it requires companies to make difficult judgements and estimates.

Preliminary views presented in the Discussion Paper

The Discussion Paper presented the IASB's preliminary views on how the IASB would address the issues identified through the PIR of IFRS 3. The IASB's preliminary views relating directly to goodwill accounting and disclosure are as follows:

- Disclosure objectives and requirements in IFRS 3 should be enhanced to improve the information provided to investors about an acquisition and its subsequent performance;
- No impairment test was identified that would be significantly more effective than the current impairment test in IAS 36 *Impairment of Assets*;
- Amortisation of goodwill should not be reintroduced; and
- Proposals would be explored to reduce complexity of the impairment test by removing the restriction on including cash flows from a future uncommitted restructuring.

2.2.2. Current IASB discussions toward exposure draft

We understand that the IASB is developing an exposure draft that would propose amendments to IFRS 3 and IAS 36.⁷ At its November 2022 meeting, the IASB tentatively decided to retain the impairment-only approach to accounting for goodwill. The IASB stated that the decision whether to retain the impairment-only model for the subsequent accounting for goodwill or to explore reintroducing amortisation of goodwill was a decision about whether evidence gathered since IFRS 3 was issued provides a compelling case for change. The IASB reported that it was not a decision about which of those models is conceptually better (and upon which there is significant disagreement among stakeholders). The IASB considered that evidence collected to date does not clearly demonstrate that one approach is "more correct" than the other. The IASB underlined that the views represent different perspectives of the nature of goodwill which, to their proponents, were valid and supported by well thought out evidence. In conclusion, the IASB concluded that there is not a compelling case to explore reintroducing amortisation of goodwill, either on its own or as an option, to improve the information provided to users about business combinations. The IASB also tentatively decided during meetings in 2022 and 2023 to explore adding disclosure requirements to IFRS 3 on an acquisition and its subsequent performance.

⁷ See <https://www.ifrs.org/projects/work-plan/goodwill-and-impairment/>.

We also understand that the exposure draft will also explore improvements to, and simplification of the impairment test as discussed by the IASB during a number of meetings in 2023.

Similar to the IASB project, the Financial Accounting Standards Board (FASB) also had its own goodwill project. The FASB voted to deprioritise and remove the project from its technical agenda because there was not a sufficient case for change in the subsequent accounting for goodwill. The tentative decision made by the IASB to retain the impairment-only model is consistent with the decision made by the FASB.

2.3. IOSCO's Work on Goodwill⁸

2.3.1. Issues in current practice

“Too little, too late” on goodwill impairment

The risk of unrecognized impairment on accumulated goodwill balances arising from business combinations as well as “close call” situations (i.e., limited headroom) where IAS 36 would not require impairment recognition are top priority issues among members of IOSCO's Committee on Accounting, Audit and Disclosure (Committee 1). From the viewpoint of investor protection, it is crucial that financial reports fairly present the financial position, performance and cash flows of an issuer. Goodwill should not be presented in excess of its recoverable amount on an issuer's statement of financial position and impairment losses should be recognised on a timely basis. Additionally, investors should receive information that allows them to better understand whether any of an issuer's goodwill is “at risk” of impairment in the near term (i.e., where there is a close call, but management has determined that goodwill is not impaired as of the financial statement date).⁹

Disclosure on goodwill impairment tests

Disclosure of the key assumptions underlying the determination of the recoverable amount of goodwill is one of the top issues for securities regulators. One of the IOSCO principles for listed companies is that there should be full, accurate, and timely disclosure of financial results, risk, and other information that is material to investors' decisions.¹⁰ We believe that there is room for improvement in the disclosure requirements for issuers and disclosure practices by issuers such as greater transparency about assumptions used and the outcomes of goodwill impairment assessments.

2.3.2. Support for the IASB's Objective

We support the IASB's objective to explore whether improvements can be made in the goodwill impairment test and disclosures around the performance of an acquisition that could provide investors with more useful information about acquisitions. This information could help

⁸ See IOSCO Comment Letter to DP/2020/1 “*Business Combinations – Disclosures, Goodwill and Impairment*”- https://www.iosco.org/library/comment_letters/pdf/IASB-112.pdf.

⁹ IAS 1.129 (a) – (d) & IAS 36.134(f)

¹⁰ See E 16 of IOSCO Principles for Issuers <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD561.pdf>.

investors to more effectively hold management to account for its acquisition decisions. In addition to achieving further transparency, the IASB could explore whether the standards can be improved in respect of the impairment test such that they are better aligned with the economic prospects of an issuer.

We broadly agreed with the IASB's preliminary views presented in the Discussion Paper and its plans for developing enhancements to IAS 36. There may also be further opportunities to enhance the standards as follows:

- Consider whether amendments to the requirement for an annual test of goodwill would respond to stakeholder concerns of “too little, too late.”
- Consider whether removing the restriction in IAS 36 that prohibits companies from including some cash flows from uncommitted restructurings or improvements of the asset's performance would respond to stakeholder concerns of “too little, too late” since there will be a significant level of judgement involved with estimating what could be identified as an uncommitted restructuring cost.
- IOSCO members are of the view that commercial sensitivity should not prevent companies from disclosing information about management's objectives for an acquisition. When a company accesses the public capital markets, it is accepting that transparency will be required to continue as a listed company.
- Many IOSCO members are concerned that management's estimation of value in use may be overly optimistic in some circumstances. Many IOSCO members considered that this is challenging from an enforcement perspective. Therefore, to enhance auditability and enforceability, we encourage the IASB to explore disclosures for “close call” situations when no impairment is recognized when an impairment test is conducted. The IASB could consider whether an entity should disclose the facts and circumstances with respect to how close it was to impairing goodwill when the entity performed an impairment test and the potential consequences of reasonably foreseeable changes in assumptions to the impairment assessment, in addition to the disclosures already required by IAS 36.

We support the IASB's tentative decision to enhance disclosures that enable investors to assess performance of an acquisition which may help more effectively hold management to account for its acquisition decisions. We emphasize that the issue of “too little, too late” goodwill impairment and the issue of insufficient disclosure on goodwill impairment tests are priority issues in financial reporting.

2.3.3. Potential Actions Available under Existing Standards

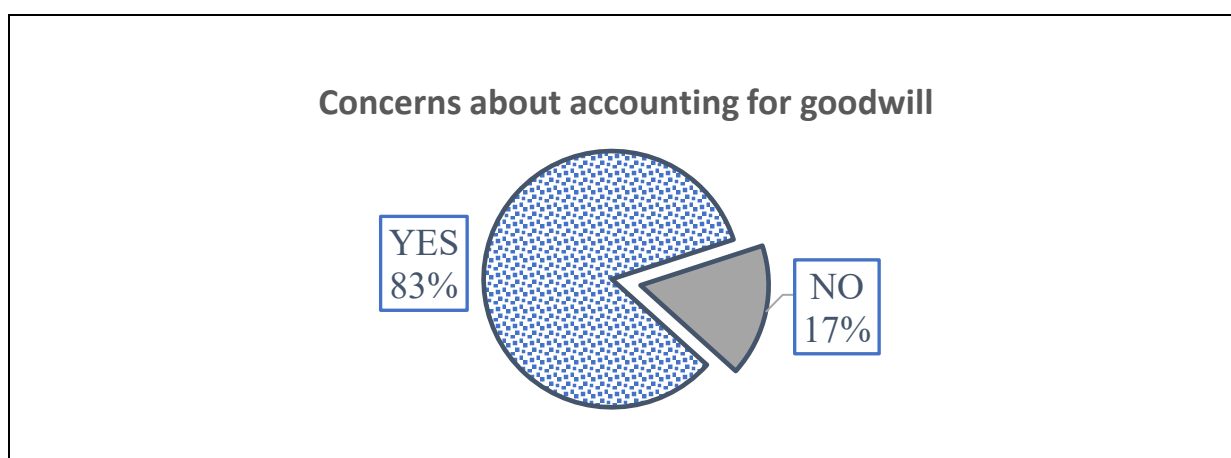
As noted earlier, we support the IASB's initiative to explore enhanced transparency on an acquisition and its subsequent performance. We also believe that issuers, audit committees (or TCWG) and external auditors can consider actions now available to address some of the issues surrounding accounting and disclosure of goodwill. The risk of unrecognised impairment on accumulated goodwill is an area of greater concern in light of the increasing economic uncertainty in the business environment. Issuers, audit committees (or TCWG) and external

auditors should scrutinize their existing processes, judgements, estimates and external communications around goodwill impairment assessments.

Chapter 3 - Results of Survey of IOSCO Committee 1 Members

In 2021, IOSCO conducted a survey among Committee 1 members to understand issues identified by members on accounting for goodwill, in relation to the activities of issuers, audit committees (or TCWG) and external auditors.¹¹

Most members (83% of the sample) expressed concerns about accounting for goodwill, in particular the recoverability of significant (and increasing) goodwill balances recognized in the financial statements. Members also highlighted examples in their respective jurisdictions where goodwill was not impaired adequately (in terms of amount) or impairment was not recognised on a timely basis (“too little, too late”).



The following section describes the findings in more detail, in relation to issuers, audit committees (or TCWG) and external auditors.

3.1. Findings Relating to Issuers

3.1.1. Concerns with recognising all identifiable intangible assets and providing the entity-specific disclosure of the factors that make up the goodwill recognized in a business combination

Members were concerned that in some cases a significant amount of the consideration paid is reflected as goodwill, which may indicate that not all separate intangible assets were properly identified and/or measured. Issuers should ensure that separately identifiable intangible assets are appropriately identified, recognized and measured in accordance with the relevant financial reporting standards. Investors need disclosure of these assets to fully understand the nature of the acquisition and to better understand the subsequent performance of the acquisition. In addition, members were concerned that issuers do not currently disclose entity-specific information about factors that make up the goodwill recognized in business combinations.¹²

¹¹ 18 C1 members responded to this survey.

¹² IFRS 3.B64(e) requires issuers to disclose “a qualitative description of the factors that make up the goodwill recognised, such as expected synergies from combining operations, intangible assets that do not qualify for separate recognition or other factors”.

3.1.2. Concerns with use of reasonable and supportable assumptions

Members were concerned that cash flow projections used in goodwill impairment analyses were not always based on reasonable and supportable assumptions. Although IFRS Accounting Standards require issuers to place greater weight on external evidence for the determination of assumptions, issuers do not necessarily have access to external evidence (e.g., industry data, peer data or investors' analysis) to support key assumptions.¹³

Members expressed concerns that issuers may not develop sufficient documentation to support the basis and reasonableness of the assumptions used in their goodwill impairment tests.¹⁴ Members also expressed concerns about the adequacy of internal controls over the goodwill impairment process. For example, in some cases management did not necessarily evaluate whether their budgets and forecasts were properly adjusted for risks.

3.1.3. Concerns with consistency between assumptions used in goodwill impairment tests and non-financial disclosures

Members identified inconsistencies between statements in the management commentary and the assumptions used in goodwill impairment tests in some cases. These inconsistencies could be in respect of assumptions about the potential effect of sustainability risk (e.g., climate risk), economic trends and uncertainties, or potential changes in regulatory requirements.

3.1.4. Concerns with disclosures of impairment tests

Members were of the view that disclosures relating to goodwill impairment tests could be improved including for example:

- How key assumptions are determined, including whether those assumptions reflect past experience or external sources of information.
- If those assumptions do not reflect past experience or external sources of information, how and why they differ from past experience or external sources of information.¹⁵
- Disclosure of information regarding the reasonably possible changes in a key assumption that could cause a subsequent impairment.¹⁶

3.2. Findings Relating to Audit Committees (or TCWG)

Many members questioned whether communication between audit committees (or TCWG) and management could be improved in relation to goodwill impairment tests. Those members also questioned whether communication between audit committees (or TCWG) and external auditors could be improved on this topic.

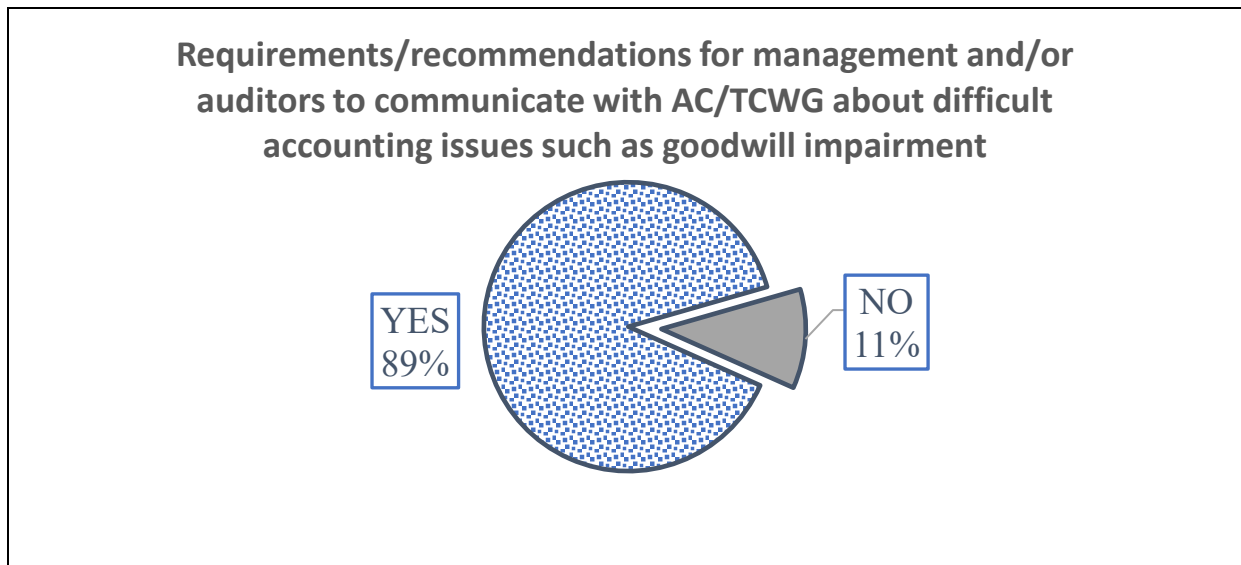
¹³ IAS 36.33(a).

¹⁴ In February 2023, New Zealand Financial Market Authority published "Guidance and expectations for keeping proper accounting records" Page 9 "Areas of significant judgements and critical accounting estimates" <https://www.fma.govt.nz/library/guidance-library/guidance-and-expectations-for-keeping-proper-accounting-records/>

¹⁵ IAS 36.134(d)(i)(ii).

¹⁶ IAS 36.134(f) and IAS 1.129.

Many members noted that their jurisdiction requires/recommends management and/or external auditors to communicate with audit committees (or TCWG) about difficult accounting judgments and estimates such as goodwill impairment tests.



3.2.1. Interaction between audit committees (or TCWG) and management

Oversight of financial reporting is one of the core responsibilities of audit committees (or TCWG). In order to fulfil the responsibility, audit committees (or TCWG) need to understand how management has performed goodwill impairment tests. However, some members found that audit committees (or TCWG) do not necessarily obtain information regarding whether management undertook proper processes or procedures on goodwill impairment tests, notwithstanding that goodwill may be material to the financial statements. As such, there may be an opportunity to improve interactions between audit committees (or TCWG) and management.

3.2.2. Interaction between audit committees (or TCWG) and external auditors

Interaction between audit committees (or TCWG) and external auditors could be also enhanced in relation to goodwill impairment tests. Members suggested that audit committees (or TCWG) could:

- Understand the time, skills and resources used by external auditors on assessing the adequacy of management's goodwill impairment tests.
- Have their own internal process to identify important issues and understand the basis for the external auditors' conclusions about whether goodwill impairment tests are conducted in a timely manner.
- Discuss critical judgements and estimates made in relation to goodwill impairment tests with the external auditor.

- Discuss with the external auditors whether there was consistency between the assumptions underlying the goodwill impairment test and those used in other accounting estimates, or with related assumptions used in other areas of the entity’s business activities, based on the auditor’s knowledge obtained in the audit.

Many members pointed out that the “IOSCO Report on Good Practices for Audit Committees in Supporting Audit Quality”¹⁷ is relevant and should be considered by audit committees (or TCWG) when they oversee goodwill impairment tests.

3.3. Findings Relating to External Auditors

The initial recognition of goodwill and subsequent impairment testing may require significant attention by external auditors. In fact, accounting for goodwill is one of the most frequently identified “key audit matters” (under International Standards on Auditing) in member jurisdictions, ranging up to 70 percent of all key audit matters reported in member jurisdictions.

3.3.1. Concerns with challenging management’s assumptions and disclosures

Many members observed that the accounting for business combinations and goodwill is one of the areas for which audit oversight bodies frequently identify audit deficiencies.

Members are concerned that some external auditors do not appropriately challenge management or obtain sufficient support about the reasonableness of assumptions used in impairment tests, or whether sufficient disclosures are made about those assumptions in the financial statements. For example, external auditors could:

- Carefully review the outcome of accounting estimates made in prior financial reporting periods¹⁸ and consider whether issuers have a history of overly optimistic cash flows and other assumptions.
- Properly identify and test management review controls (MRC) over assumptions used in goodwill impairment analysis and acquisition accounting for business combinations, including evaluating evidence about steps performed by the reviewer for the identification of outliers and resolution of identified outliers.
- Challenge the reasonableness and appropriateness of the future growth rate having regard to changing market and economic factors, and other developments or uncertainties specific to the entity, and not place undue reliance on a comparison of the future growth rate with the prior years’ actual growth rates.
- Test the accuracy and completeness of management prepared reports used in the goodwill impairment analysis and acquisition accounting for the business combination and test controls over the preparation and maintenance of the information.

¹⁷ See <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD618.pdf>.

¹⁸ International Standards on Auditing (ISA) 540 *Auditing Accounting Estimates and Related Disclosures*(Revised).14.

- Carefully assess the relevance and reliability of assumptions and other information provided by management’s expert.

Members noted that in some cases, external auditors did not exercise the appropriate level of professional scepticism. For example:

- There was insufficient evidence in some cases that:
 - (i) management projected growth in cash flows beyond five years in a value in use model was reliable and the issuer could demonstrate its ability, based on past experience, to forecast cash flows accurately over that longer period;¹⁹ and
 - (ii) the terminal growth rate exceeded the long-term average growth rate for the products, industries, or country or countries in which the issuer operates, or for the market in which the asset is used²⁰ IFRS Accounting Standards require that the terminal growth rate shall not exceed the long-term average growth rate unless a higher rate can be justified) is appropriate.
- Although external auditors recognized the contradictory evidence to the assumptions used in the forecasts, some auditors did not obtain sufficient appropriate audit evidence to resolve the known contradictory evidence when evaluating the reasonableness of forecasts and indicators of possible management bias.

Members considered that there are cases where external auditors mechanically followed a checklist approach to conclude their audit. For example, some external auditors mechanically checked that the issuers provided some disclosure required by IFRS Accounting Standards,²¹ including boilerplate disclosure, instead of assessing whether all material information was disclosed. Disclosure that is not entity-specific or unclear could result in the obscuring of material information about goodwill impairment test. This could reasonably be expected to influence decisions that investors make on the basis of the financial statements.²²

3.3.2. Concerns with transparency of audit on goodwill through key audit matters

One-third of members expressed concern that the disclosure of key audit matters relating to goodwill did not enhance the communicative value of the auditor’s report. Specifically, members expressed concern about the lack of specificities in the descriptions of key audit matters as to why the matter was one of most significant in the audit and how the matter was addressed in the audit. These members noted that key audit matters were reported in a boilerplate manner in some cases.

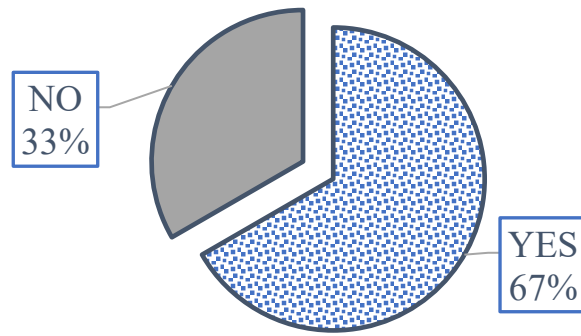
¹⁹ IAS 36.35.

²⁰ IAS 36.33(c).

²¹ IAS 36.134.

²² IAS 1 *Presentation of Financial Statements* .7.

Sufficient transparency of audit on goodwill through KAM



Chapter 4 - IOSCO Consultation Feedback from Stakeholders

In June 2023, IOSCO published its “Consultation on Goodwill” to gather stakeholders’ views in relation to accounting for goodwill. Most respondents shared the concern on the issue of “too little, too late” and pointed out that current practice on the accounting for and disclosure of goodwill and impairment testing needs to be improved. The respondents provided various suggestions in their feedback.

IOSCO received comment letters representing investors, external auditors, issuers, audit/securities regulators and other stakeholders. Most letters are from member bodies representing numerous individual members.

In summary, the following main points were noted:

- Most respondents indicated that current disclosure of the factors that make up the goodwill recognized in a business combination needs improvement. In addition, they also pointed out that goodwill may be overstated in some situations because not all identifiable intangible assets are recognized.
- Most respondents expressed concerns about whether in all instances assumptions used by management are reasonable and supportable in goodwill impairment testing.
- Respondents that commented on the consistency between assumptions used in goodwill impairment tests, other financial statement disclosures (e.g., recoverability of deferred tax assets), and non-financial disclosures indicated the need for greater consistency between financial and non-financial information.
- Most respondents indicated concerns about the quality of disclosures provided by issuers with respect goodwill impairment testing.
- Respondents indicated a need for improved communications and the interactions between audit committees (or TCWG) and management and external auditor.
- Investors expressed concerns that external auditors may not be sufficiently challenging management’s assumptions and disclosures
- Investors indicated that the disclosure of key audit matters related to impairments tests of goodwill tend to be generic and do not provide sufficient entity-specific information to users of the financial statements.
- Respondents provided some suggestions for the IASB to improve the effectiveness and the disclosure requirements of the goodwill impairment test.

The following section describes the feedback in further detail, in relation to issuers, audit committees (or TCWG), external auditors and the standard setter.

4.1. Feedback Relating to Issuers

4.1.1. Concerns with recognising all identifiable intangible assets and providing the entity-specific disclosure of the factors that make up the goodwill recognized in a business combination

Most respondents that commented on the entity-specific disclosures of the factors that make up the goodwill recognized in a business combination indicated that current disclosure practices need improvement, because sufficient entity-specific information, which enable an understanding of the factors that make up the goodwill, is rarely disclosed. In addition, they also pointed out that goodwill may be overstated because not all identifiable intangible assets are recognized.

Notably, a response from an investor association pointed to a survey²³ it conducted in 2020, where 73% of the respondents considered that goodwill is often overvalued because many other intangibles also acquired are not properly separately identified.

Another investor group was also of the view that disclosure about how the acquired business is incorporated in the existing business (and consequently how the results of performance and cash flows of the acquired business are included in each operating segment or CGU of the acquirer) would be useful information for investors. The investor group noted that many of the disclosures provided by issuers only describe general procedures applied to test goodwill for impairment and do not provide any meaningful information relating to the risk of impairment.

An integrated regulator (audit and securities regulators) observed that in many cases, the information disclosed by issuers on the initial recognition of goodwill (and about the subsequent impairment tests of goodwill) is boilerplate and does not include entity-specific information.

An issuer organisation provided the perspective that it is not possible to identify and verify items and amounts of the synergies of the combined business empirically. Moreover, this issuer organisation noted information concerning goodwill is inherently commercially sensitive, and depending on the disclosed information, competitive disadvantages could emerge if it becomes publicly available for competing companies.

4.1.2. Concerns with use of reasonable and supportable assumptions

Most respondents expressed concerns as to whether management's assumptions are in all instances reasonable and supportable in goodwill impairment testing in all cases.

Investors were of the view that management should be held more accountable when impairments are recognized in an untimely manner, due to lack of realistic assumption.

²³ <https://www.cfainstitute.org/-/media/documents/survey/cfa-goodwill-survey-without-appendices-2021.pdf>

External auditors were of the view that practice on the use of reasonable and supportable assumptions as well as documentation on the assumptions varies depending on management's experience, knowledge, the involvement of audit committees (or TCWG), the involvement of competent external expert and the maturity of the entity. Some external auditors indicated that they have observed instances where management is biased towards corroborative information and tends to be overly optimistic in their key assumptions.

External auditors highlighted the following good practices that issuers could implement to better support the reasonability and supportability of the assumptions that they use in goodwill impairment tests:

- Clear documentation of process for performing goodwill impairment assessments.
- Implementation of robust governance processes and controls that focus on the material assumptions used in the goodwill impairment testing, including an appropriate level of involvement of the audit committee (or TCWG).
- Where possible, the use of assumptions that are corroborated by reliable external sources.
- The involvement of external experts (or third-party valuation specialists) to determine complex assumptions often results in clearer documentation of judgements taken and data considered (including corroborative and contradictory evidence).
- Close monitoring of budgeted versus actual results by management and the audit committee (or TCWG).
- Close monitoring of synergies (both revenue and cost) by management and the audit committee (or TCWG).

External auditors also indicated that management's documentation does not always adequately support the reasonableness of their assumptions and judgements. Examples of good documentation practices include:

- Detailed processes and controls, including a clear and well-executed review process.
- The rationale behind key judgements in identifying CGU or a group of CGUs.
- Identification of significant assumptions within the estimates used for impairment test.
- Consideration of estimation uncertainty (for example, via sensitivity analysis).
- Consideration of multiple data sources when determining significant assumptions.
- Clear, well supported conclusions developed by appropriately experienced individuals.

One regulator noted that entities should improve their internal policies and procedures to identify specific indicators of impairment on a more timely basis for potential impairment losses.

An issuer organisation respondent noted its belief that concerns with whether the assumptions used are reasonable and supportable is alleviated very little by the use of external experts. Other respondents (investors, external auditors and regulators) noted that management should have adequate in-house expertise or should engage independent third parties to support their impairment assessment. Respondents suggested the use of experts when the following arise:

- disclosures are complex;
- the process of obtaining information for the disclosure exceeds management's time capacity;
- specialisation or expertise in specific technical areas is required, such as fair value determinations;
- a need for determination of fair value of non-listed entities;
- qualitative information suggests that there are significant impairment triggers;
- there are significant negative changes in macro-economic factors and internal factors upon which the recoverable amount of the CGU is based on; and
- there are unobservable inputs used to determine the fair value of the assets acquired or liabilities assumed, or in calculating the impairment of goodwill.

4.1.3. Concerns with consistency between assumptions used in goodwill impairment tests and non-financial disclosures

Respondents that commented on the consistency between assumptions used in goodwill impairment tests and non-financial disclosures underlined the need for greater consistency between financial and non-financial information.

Regulators commented that they have observed instances where the information disclosed by issuers about the assumptions used in goodwill impairment testing is incomplete, or that it does not allow a reader to understand how such assumptions align with other information used by the issuer in determining its non-financial information (for example, the potential impacts of climate risk or regulatory requirements mentioned in the management report).

Some external auditors underscored that an issuer's disclosure in its other public filings should be considered as part of the overall assessment of whether goodwill impairment is present. It was suggested by these respondents that it would be helpful to include narrative disclosure in the financial statements to indicate how the assumptions used by management in testing goodwill for impairment are aligned with assumptions used to derive the non-financial disclosures. This would help financial statement users understand the connectivity between financial and non-financial information.

4.1.4. Concerns with disclosures of impairment tests

Most respondents that commented had concerns about the quality of disclosures provided by issuers with respect to goodwill impairment testing. A survey conducted by an investor group indicated that 70% of the respondents considered that the current goodwill impairment disclosures need improvement, and were not sufficient to enable as specific an analysis of goodwill impairment as some investors would like. Investors commented that disclosures did not always discuss key assumptions (or for those that did, many did not contain a sufficient level of detail that would provide meaningful information to investors). In addition, disclosures did not always contain a sensitivity analysis (or for those that did, there was a lack of consistency of the analyses provided from issuer to issuer). It was observed that in some cases, the sensitivity analysis was omitted because the recoverable amount of the cash generating unit to which goodwill was allocated significantly exceeded its carrying amount. In those cases, some investors were of the view that the excess percentage should be disclosed.

The issuer perspective differed in that it indicated that expanding the disclosure requirements related to impairment tests would not meaningfully improve the “too little too late” issue, and that the cost of increased disclosure would significantly outweigh any anticipated benefits. In addition, the information that could be disclosed without negatively impacting corporate value would be extremely limited. As such the issuer perspective was that the approach of resolving related issues with the impairment testing model by expanding disclosure would not be efficient.

Regulators noted that issuers often do not disclose sufficient quantitative information about all the relevant assumptions. Specifically, sufficient information is not often disclosed about the rationale and the description of management’s approach to determining the values assigned to each key assumption, whether the values reflect past experience, whether the assumptions are consistent with external sources of information, and if not, how and why they differ from the external sources. Regulators also commented on lack of sensitivity analysis provided even when a reasonably possible change in the key assumptions on which management based its determination of recoverable amount would cause the carrying amount to exceed the recoverable amount. In addition, regulators were of the view that sensitivity analysis disclosures should incorporate all key assumptions (beyond just the discount rate which is commonly disclosed).

4.2. Feedback Relating to Audit Committees (or TCWG)

4.2.1. Interaction between audit committees (or TCWG) and management

With respect to oversight and governance of the financial reporting process for the timely identification and recognition of goodwill impairment, the investor perspective was that the audit committee (or TCWG) should have the responsibility to ensure that management creates processes and procedures that would result in the appropriate recognition of impairment in a timely manner.

The perspective of an external auditor group was that an entity's audit committee (or TCWG) should be involved in the corporate planning and forecasting process. This process should give consideration to possible goodwill impairment as early as possible, and audit committees (or TCWG) should be proactively involved in the decision-making process over when an impairment is required. Another external auditor group also commented that audit committee members themselves must have adequate skills to understand and assess management's process, or alternatively, to consider engaging a third-party expert to assist them in their assessment of management's goodwill evaluation. Similarly, regulators commented on the need for audit committees (or TCWG) to have the appropriate level of expertise to evaluate the issuer's financial reporting processes and control systems.

In their feedback, regulators also identified the need to strengthen the internal audit and control process and institute programmes that allows for regular testing to identify and recognise of impairment of goodwill.

4.2.2. Interaction between audit committees (or TCWG) and external auditors

An investor organisation thought that the audit committee (or TCWG) should have more thorough discussions with the external auditor about the results of goodwill impairment testing and these types of in-depth discussions should occur at least annually.

4.3. Feedback Relating to External Auditors

4.3.1. Concerns with challenging management's assumptions and disclosures

Investors expressed concerns that external auditors are not sufficiently challenging management's assumptions and disclosures. Investors commented that auditors should carefully question and scrutinize the assumptions based on their knowledge of comparable asset impairments and valuations in the industry.

Some external auditors were of the view that the following work should be performed by external auditors to maintain and demonstrate professional scepticism when auditing management's estimates used in goodwill impairment tests:

- Assessing management's assumptions by comparing them to reliable external sources or benchmarks such as industry reports or economic forecasts.
- Performing stress tests based on market-based information or "shadow calculations" to corroborate or disprove management's assumptions.
- Considering and documenting contradictory evidence if it exists.
- Testing whether the forecasts used for goodwill testing are consistent with other forecasts applied by management (e.g., tax).
- Performing independent sensitivity or scenario analyses.
- Engaging with external auditors' experts to support the audit of complex assumptions.

- Involving key external audit engagement team members at the right stage.
- Comparing past projections with actual results to identify patterns of overly optimistic assumptions.
- Reporting the results of the external auditor’s procedures to the audit committee (or TCWG).

4.3.2. Concerns with transparency of audit on goodwill through key audit matters

Respondents who commented on this topic included investors and regulators. Both of these respondents were generally aligned in their view that the disclosure of key audit matters related to impairments tests of goodwill tend to be generic and do not provide sufficient entity-specific information to users of the financial statements.

The investor groups were of the view that this was in part because the related impairment disclosures in the financial statements were not sufficiently detailed. Investors felt that auditors could do more to encourage issuers to disclose more robust information in the financial statements, such that the auditor could in turn include the information in their reporting of key audit matters.

The regulator respondent also indicated that it would be useful to have more comprehensive information about the management’s approach for determining the quantitative value assigned to each key assumption and the sensitivity analysis performed on those assumptions.

4.4. Feedback Relating to Standard setter

4.4.1. IASB's tentative decisions about business combinations, particularly regarding the disclosure of the performance of business combinations after acquisition

Investors broadly agree with the IASB’s tentative decisions regarding improvements in disclosure of the performance of business combinations after acquisition. Investors are of the view that management should be principally responsible for impairment testing, and that more information should be disclosed by management to facilitate investors’ understanding and assessment of management’s accountability for a business acquisition. Investors also indicated that quantitative disclosures, such as the subsequent performance of a significant acquisition, would facilitate the analysis of management performance and of forecasts.

Most investors indicated that impairment charges are often not recorded in a timely manner. Investors raised concerns on this point, given the overall size of goodwill has become a very significant component on the statement of financial position and is currently 30-40% of issuers’ equity on average in many developed markets.

Regarding how to address the issue of “too little too late”, views varied. Some investors believe that the introduction of additional disclosures can result in improvements to the timeliness of impairment recognition. Conversely, other investors indicated that they did not believe it is possible to significantly improve the effectiveness of impairment testing through disclosure improvements, given that the shielding effect is inevitable in impairment testing.

An investor association pointed out that the IASB should have a clearer focus on the issue of “too little too late” in its standard setting. According to the investor association, when the IASB began its review of accounting for goodwill, it initially had the perspective of addressing the “too little, too late” issue. However, this investor association asserted that this perspective gradually disappeared. The investor association indicated that the continued accumulation of goodwill without appropriate impairment could have a significant impact on the overall economy and the financial system through increased stock market volatility and procyclicality.

4.4.2. How disclosures around the goodwill impairment test in IAS 36 can be improved to address the concerns around the timely identification and recognition of an impairment charge

An investor association summarized the information needs suggested by its members as follows:

- Valuation Models and Related Estimates and Assumptions:

Investors want more information on the valuation models employed along with greater transparency on the related inputs and outputs. In addition, they indicated that mandatory disclosures should include information regarding the sensitivity to change of the significant estimates and assumptions.

- Performance of Acquisitions:

Investors made it clear that they want more quantitative information on how an acquisition performs, and they want disclosure of the key common performance metrics that management is using to monitor the performance of the acquisition. Qualitative information was not considered as high of a priority, given the concerns that qualitative information is often boilerplate.

- Board’s Assessment (or TCWG):

Investors indicated that they want more information on the board’s assessment of an acquisition. They also want hard quantitative metrics related to the impairment valuation model and the performance of the acquisition. This will allow investors to evaluate the acquisition quantitatively, as opposed to relying solely on narrative information provided by management.

Another investor association suggested that investors require the following information be disclosed in order for investors to be aware of indications of goodwill impairment:

- At the time of acquisition:

- ✧ how the acquired business is (or is not) incorporated into the existing business;
- ✧ how the results of performance and cash flows of the acquired business are included in each operating segment or CGU of the acquirer; and
- ✧ the future cash flows (including synergies), weighted average cost of capital (WACC) and growth rates for each business segment or CGU as assumed at the time of the acquisition.

- For periods subsequent to the acquisition, it would be useful to obtain the same information as outlined in the above categories, to help investors confirm the subsequent performance of the business combination and identify the indication of goodwill impairment.

The investor association considered that disclosure of the percentage by which the fair value or the value in use exceeds the carrying amount of the CGU is useful information in incorporating impairment risk into performance forecasts. At the same time, sensitivities such as assumptions and interest rates used in estimating the fair value or the value in use should be appropriately disclosed.

An issuer organisation expressed concerns that requiring additional disclosure would impose additional burden. This issuer organisation suggested that if additional disclosure requirements are set, the cost-benefit of the intended effect of the improvements from the disclosure requirements and the workload on the part of preparers and others should be thoroughly analysed and examined.

4.4.3. How the impairment test for goodwill in IAS 36 can be improved to address the concerns around the timely identification and recognition of an impairment charge

According to the survey conducted by the investor association, 74% of the respondents indicated that the accounting requirements are not transparent to investors, for when and how much goodwill impairment should be recognized.

An investor organisation pointed out that there appears to be a significant degree of judgement for companies to decide when to conduct impairment testing for a CGU or a group of CGUs. The investor pointed out that they have observed situations where restructurings of CGU or a group of CGUs seem to be designed to avoid impairments by moving previously acquired problematic units into a larger CGU. Accordingly, the investor thought that it would be helpful to have disclosure requirements for the performance of acquired units.

External auditors were of the view that the requirements for goodwill impairment testing in IAS 36 could be revised in order to address concerns around the timely identification and recognition of impairment losses. For example:

- The level at which impairment testing is performed could be reconsidered, which often defaults to the operating segment level under current requirements. Testing for impairment at a lower level would help to reduce or eliminate any shielding of goodwill from other successful business units and, in turn, improve the timeliness of impairment recognition.
- Additional guidance needs to be provided, in relation to the allocation of goodwill to CGU or a group of CGUs, as management tends to allocate more goodwill to CGU or a group of CGUs with higher pre-existing recoverable amount to shield newly acquired goodwill. For example, the following constraints could be added to clarify the relation between benefits expected from synergies due to business combinations and a CGU or a group of CGUs:

- ✧ The benefits expected at the acquisition date from synergies of combining the units.
 - ✧ The CGU(s) should represent the lowest level in which specific factors generating synergies are identified at the time of business combination.
- The existing impairment indicators in IAS 36 paragraph 12 could be revisited. For example, internal indicators should be given prominence over external indicators, which are often lagging indicators of an impairment. Enhanced indicators that are based on the performance of acquisitions might also result in more timely impairments. Some suggested that the standard could incorporate either bright line criteria or specific factors which require an assessment of the possibility of an impairment, which, if present, would mandate that an early warning be disclosed and that an impairment assessment be performed. Respondents suggested that enhanced guidelines which can facilitate an objective list of factors would, but not absolutely, create a better environment for the various stakeholders to assess, decide, report, and use the related financial statements and related disclosures around goodwill.
 - Clarification could be made for the existing requirements in IAS 36 to give greater weight to external evidence in developing forecasts
 - Clarification could be made to require an assessment of historical estimates provided by management that did not achieve the projected outcome. This could assist in preventing overly optimistic forecasting.
 - A requirement could be introduced to adjust for the risk in cash flows through the use of probability-weighted scenarios instead of through the discount rate, especially in cases of increased uncertainty or where the level of headroom is minimal.

This external auditor also noted that additional illustrative examples and educational materials for applying the guidance in IAS 36 would be useful, which could include:

- Guidance that clarifies and provides examples of triggering events and indicators of impairment.
- Guidance, good practice examples and related judgments in identifying CGU or a group of CGUs and in allocating goodwill to those CGU or a group of CGUs.
- Examples related to how climate change impacts management's assumptions and estimates.
- Illustrative examples on reviewing and assessing the assumptions applied by management in forecasting future cash flows for determining value in use.
- Guidance (for both management and external auditors) that articulates common scenarios where it is appropriate to use certain methodologies for determining discount rate, for example, when it is appropriate to use WACC.
- Illustrative models for value in use and fair value less costs of disposal assessments, and acknowledgement that models need to be specific to the entity's circumstances (there are many easily accessible examples for more straightforward modelling in other standards, for example, IFRS 2 *Share-based Payment*).

- Illustrative examples detailing what should be included in each of the value in use and fair value less costs of disposal calculations for reference by management and auditor during the audit.

Some stakeholders were of the view that it is not feasible to design a different impairment test for goodwill that is significantly more effective than the current impairment test in IAS 36. Accordingly, in order to address the “too little, too late” issue, mandatory amortization is a practical and effective approach (in their opinion).

Chapter 5 - IOSCO Recommendations for Stakeholders

IOSCO has developed the following recommendations for issuers, audit committees (or TCWG) and external auditors aimed at enhancing the reliability, faithful representation and transparency of goodwill recorded and disclosed in the financial statements. We also believe these recommendations will be useful to the IASB and other standard setters as they pursue initiatives to enhance business combination disclosures and related matters of impairment testing.

These recommendations are based on the results of the survey of IOSCO Committee 1 members, issues encountered in practice by securities regulators and feedback received from stakeholders to IOSCO's Consultation on Goodwill.

Securities regulators believe that goodwill accounting should continue to be a focus area in the coming years, in light of the current global macroeconomic environment.

5.1. Recommendations Relating to Issuers

Recommendation 1: Issuers should properly recognise all identifiable intangible assets and provide entity-specific disclosure of the factors that make up the goodwill recognised in a business combination

Issuers need to ensure that all the separately identifiable intangible assets acquired in a business combination are appropriately recognized in accordance with the relevant financial reporting standards.

In addition, issuers should ensure that they satisfy the requirement to disclose a qualitative description of the factors that make up the goodwill recognized in a business combination, such as expected synergies from combining operations, intangible assets that do not qualify for separate recognition or other factors.²⁴

In providing the above disclosure, issuers should focus on investors' needs and provide entity-specific disclosures. Investors need decision-useful information regarding the specific benefits that a company expects when it acquires a business to enable them to assess the quality of the business combination. Generic disclosure that indicates synergies are expected is not useful to investors.

Recommendation 2: Issuers should obtain sufficient evidence to demonstrate that assumptions are reasonable and supportable

Issuers are required to use reasonable and supportable assumptions in impairment tests that represent management's best estimate of the range of economic conditions over the remaining useful life of the asset.²⁵ Neutrality is an important characteristic of faithful representation in financial reporting, and a neutral depiction is without bias in the selection or presentation of financial information. The assumptions used in impairment testing should adhere to this

²⁴ IFRS 3.B64(e).

²⁵ IAS 36.33(a).

important principle. In addition, .²⁶ Issuers should maximize the use of external evidence to support and corroborate their assumptions.²⁷

Issuers should ensure that the assumptions are supported by sufficient internal documentation that demonstrates that appropriate judgements and estimates were made by management.²⁸ Issuers should also design and implement appropriate internal controls which are relevant for goodwill impairment tests including appropriate internal controls and procedures for determining and evaluating significant judgements and estimates.

Issuers should conduct a thorough review of internal and external sources of information to support judgments made in determining whether impairment indicators exist at the end of each reporting period.²⁹ If the issuer determines impairment indicators exist, significant care and attention should be made in determining assumptions used in impairment calculations.

Issuers should assess whether they have sufficient experience and expertise to conduct complex impairment tests of goodwill. In situations where an issuer determines it needs to engage or employ the use of an expert, the issuer should ensure appropriate controls are designed and implemented to evaluate the work of management’s expert.

Recommendation 3: Issuers should ensure the consistency between assumptions used in goodwill impairment tests and non-financial disclosures

Issuers should ensure that the assumptions used in goodwill impairment tests are aligned with its non-financial disclosures (e.g., sustainability-related transition plan), and if inconsistencies exist, then disclosure of the reasons for such inconsistencies should be provided. Furthermore, issuers should ensure the assumptions used in goodwill impairment tests are based on the most recent budget/forecast information and, the value in use does not reflect the effect from future restructurings or improvement or enhancement of the asset’s performance.

Issuers should carefully assess the effect of sustainability risks, including climate-related matters on the assumptions used in estimates when conducting goodwill impairment tests. Sustainability risk including climate-related matters may give rise to indicators of impairment of goodwill, especially when the goodwill pertains to the acquisition of a business more likely to be affected by climate-related risks.

Sensitivity analysis disclosure should incorporate the effect of sustainability risks, including climate-related risk on the assumptions used, when the issuers’ impairment tests are affected by the sustainability risks including climate risks.

Recommendation 4: Issuers should clearly disclose impairment tests of goodwill

Issuers should clearly disclose impairment tests of a CGU or a group of CGUs to which goodwill is allocated, including how key assumptions are determined. This disclosure should

²⁶ Conceptual Framework 2.13, and 2.15.

²⁷ According to IAS 36.33(a) “Greater weight shall be given to external evidence”. When the recoverable amount is based on fair value according to IFRS 13.3 “When a price for an identical asset or liability is not observable, an entity measures fair value using another valuation technique that maximises the use of relevant observable inputs and minimises the use of unobservable inputs. Because fair value is a market-based measurement, it is measured using the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk”.

²⁸ In February 2023, New Zealand Financial Market Authority published “Guidance and expectations for keeping proper accounting records”, which provides guidance on internal documentation for significant judgements and critical accounting estimates (page 9). <https://www.fma.govt.nz/library/guidance-library/guidance-and-expectations-for-keeping-proper-accounting-records/>.

²⁹ IAS 36.9 and IAS 36.12.

describe the issuer’s past experience, external sources of information, market and economic factors, and other developments or uncertainties specific to the entity. If those assumptions do not reflect past experience or external sources of information, issuers should disclose how and why they differ from past experience or external sources of information.³⁰

In providing such disclosure, issuers should avoid boilerplate disclosure and should describe the key assumptions reflecting the current macroeconomic scenario.

Issuers should disclose the sensitivity analysis in relation to key assumptions to which the CGU’s or a group of CGUs’ recoverable amount is most sensitive.

A **good practice** would be to disclose the percentage by which the fair value or the value in use exceeds the carrying amount of a CGU or a group of CGUs, because this information provides relevant information for users to understand the uncertainty involved in the goodwill impairment test.³¹ This disclosure is particularly important when there is a significant risk of a material adjustment to the carrying amounts of goodwill within the next financial year.³²

Another **good practice** would be to provide a discussion of the degree of uncertainty associated with the key assumptions. The discussion regarding uncertainty should provide entity-specific considerations and conditions to the greatest extent possible (e.g., uncertainty regarding assumptions within a valuation model that may involve future expectations for economic recovery from a business downturn that may have uncertain time horizons).

Another **good practice** would be to describe potential events and/or changes in circumstances that could reasonably be expected to negatively affect the key assumptions.

5.2. Recommendations Relating to Audit Committees (or TCWG)

Recommendation 5: Audit Committees (or TCWG) should exercise effective governance over goodwill impairment tests by using IOSCO Report on Good Practices for Audit Committees³³

Audit committees (or TCWG) should exercise effective governance over goodwill impairment tests, by implementing practices in the IOSCO Report on Good Practices for Audit Committees in Supporting Audit Quality.

In relation to the recognition, measurement and disclosure of goodwill, including impairment assessment, audit committees (or TCWG) should pay special attention to the following chapters of IOSCO Report on Good Practices for Audit Committees:

Chapters on the IOSCO report	Relevant good practice from the report
2.8 What are the Responsibilities of the Directors and Audit Committees in	The audit committee should assist the board by reviewing significant financial reporting issues and judgements made in connection with the preparation of the company’s financial statements (including having regard to matters communicated to

³⁰ IAS 36.134(d)(i)(ii).

³¹ IAS 1.112(c).

³² IAS1.125 and IAS 1.129.

³³ IOSCO, January 2019 <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD618.pdf>.

Overseeing Management on Financial Reporting as Relevant to Audit Quality?	it by the auditor). This includes considering whether management has adopted appropriate accounting policies, made appropriate estimates and judgements, and made appropriate disclosures.
3.2 Features of Audit Committees that Support Audit Quality	<p>3. At least one member of the audit committee, preferably the chair, should have a good knowledge of financial reporting and/or audit (including accounting, auditing and auditor independence requirements).</p> <p>7. Audit committee members should maintain professional scepticism and a questioning attitude toward the information received from management and in considering the quality of the audit.</p>
3.6 Facilitating the Audit Process	<p>The audit committee should consider the extent to which:</p> <p>46. The audit committee seeks explanations and advice supporting the accounting treatments chosen and, where appropriate, challenges the accounting estimates and treatments applied in the financial report. The audit committee should particularly seek external professional advice where a treatment does not reflect their understanding of the substance of an arrangement.</p> <p>The audit committee should take reasonable steps to ensure that:</p> <p>50. Management has produced all information, records, and explanations that may be relevant to the financial report and audit in a timely manner. Information should be supported by appropriate analysis and documentation, particularly for key accounting estimates and judgements.</p>
3.8 Communicating with the Auditor	<p>The audit committee should ensure that:</p> <p>73. The audit committee meets with the auditor without management present on a regular and frequent basis and discusses with the auditor any contentious issues that have arisen with management during the course of the audit and whether they have been resolved to the auditor's satisfaction.</p>
3.9 Assessing Audit Quality	<p>The audit committee should consider the extent to which:</p> <p>77. The auditor appears to exhibit sufficient professional scepticism in challenging, rather than rationalising, estimates and accounting policy choices.</p>
4.1 Audit Committee Reporting	To the extent not already required by law or regulation, audit committees might wish to consider whether to publicly voluntarily comment on the role of the audit committee in supporting audit quality, either in documents accompanying the financial report or another document (e.g., a statement on the company's website).

This list is not meant to be exhaustive. Please refer to the original report.

Please see Appendix A for sample questions from audit committees (or TCWG) to management/external auditors. The questions would help the communications between audit committees (or TCWG) and management/external auditors.

5.3. Recommendations Relating to External Auditors

Recommendation 6: External auditors should challenge management’s assumptions and disclosures

External auditors should adequately challenge management on their determination of reasonable and supportable assumptions used in impairment tests³⁴ in accordance with the applicable financial reporting standards.

The external auditor should carefully evaluate whether all material information was disclosed, and the overall disclosure are in accordance with the applicable financial reporting framework, instead of mechanically following checking the box approach. Disclosure that is not entity-specific or unclear could result in the obscuring of material information about goodwill impairment test.

External auditors should exercise an appropriate level of professional scepticism. The importance of professional scepticism increases when accounting estimates are subject to a greater degree of estimation uncertainty, complexity, subjectivity or management bias.³⁵

As a **good practice**, following work would be performed to maintain and demonstrate professional scepticism when auditing management's estimates used in goodwill impairment tests:

- Assessing management’s assumptions by comparing them to reliable external sources or benchmarks such as industry reports or economic forecasts.
- Comparing past projections with actual results to identify patterns of overly optimistic assumptions.
- Testing whether the forecasts used for goodwill testing are consistent with other forecasts applied by management (e.g., tax).
- Performing stress tests based on market-based information or auditor’s estimate to corroborate or disprove management’s assumptions.
- Performing independent sensitivity or scenario analyses.
- Engaging with external auditors’ experts to support the audit of complex assumptions.
- Involving key audit engagement team members at the right stage.
- Specifically considering and documenting contradictory evidence if it exists.

³⁴ ISA 540 *Auditing Accounting Estimates and Related Disclosures* (Revised). 24, 34, 35.

³⁵ ISA 540. 22, 31, 8.

Recommendation 7: External auditors should achieve transparency of audit on goodwill through key audit matters (KAM)

External auditors should determine whether there is sufficient transparency in their communications in the auditor’s report when the goodwill impairment assessment is identified as a key audit matter.

Language used in the description of a key audit matter should reflect the specific circumstances of the entity and avoid generic or standardized language. For the key audit matter relating to the impairment tests of goodwill, an auditor should consider whether to draw attention to the disclosure of key assumptions, the disclosure of the range of possible outcomes, and other qualitative and quantitative disclosures relating to key sources of estimation uncertainty or critical accounting estimates, as part of addressing why the matter was one of most significance in the audit and how the matter was addressed in the audit.³⁶

³⁶ ISA701 *Communicating Key Audit Matters in the Independent Auditor’s Report*.13, A47, A41.

Chapter 6 - Conclusion

IOSCO is carefully monitoring the current economic environment and its impact on financial reporting including aspects relating to goodwill as discussed in this report. As the economic environment continues to change, it is critical for management to carefully assess current economic and business conditions and reflect these considerations in the assumptions used for goodwill impairment testing and related disclosures.

In the current economic environment, different industries/companies face different economic challenges and uncertainties. Accordingly, entity-specific disclosure of underlying assumptions used in goodwill impairment tests is especially important for investors.

From the viewpoint of investor protection, it is crucial that the application of financial reporting standards results in the fair presentation of the financial position, performance and cash flows of the company. This includes ensuring that goodwill is not stated in excess of its recoverable amount, and that impairment losses are recognised in a timely manner. In addition, it is also critical that disclosure provides necessary information to investors about the assumptions an issuer makes about the future, and other major sources of estimation uncertainties³⁷.

We support the IASB's initiative to enhance disclosures that provide investors with better information about the performance of an acquisition and more effectively hold management to a greater level of accountability for its acquisition decisions. We also support the IASB's initiative to improve the impairment tests to the extent the revision is expected to address the "too little, too late" issue. We think it is important for the IASB to consider how the expected changes, in disclosures and impairment tests, address the issue of "too little, too late". We refer the IASB to consider "*Chapter 4 IOSCO Consultation Feedback from Stakeholder 4.4 Feedback Relating to Standard setter*" to understand stakeholders' views received by IOSCO on this topic.

We recommend that issuers, audit committees (or TCWG) and external auditors take decisive action to address the issues surrounding goodwill impairment and disclosure. The risk of unrecognised impairment on accumulated goodwill is becoming an area of greater concern in light of the increasing economic uncertainty in the current business environment. We ask issuers, audit committees (or TCWG) and external auditors to carefully review the recommendations in Chapter 5 and implement the recommendations.

Securities regulators believe that goodwill accounting should continue to be a focus in the coming years, in light of the current global macroeconomic environment.

³⁷ IAS 1.125

Appendix A Sample questions from audit committees (or TCWG) to management/external auditors³⁸

Sample questions from audit committees (or TCWG) to management

Matter to consider	Questions to consider
Management's assessment of indicators of impairment	<p>Has management undertaken a review of the company's business and the environment in which it operates?</p> <p>Has management assessed impairment indicators and the need for impairment testing?</p> <p>Has management provided information to the board with its assessment of indicators of impairment? Is the analysis by management and the conclusions reached consistent with your knowledge of the business?</p>
Source information and assumptions	<p>Is the source information (e.g., historical cash flows) properly extracted and tested for reliability?</p> <p>Are there strong internal controls over the extraction of source information and the impairment testing process?</p> <p>Have key assumptions been tested by appropriate benchmarking against industry and competitor information or other appropriate sources?</p>
Adequate documentation	<p>Is there adequate documentation of the source data used, and the impairment calculations and their review – whether performed by internal staff or external experts?</p> <p>Is the basis for future cash flows and key assumptions and the testing of these assumptions adequately documented?</p> <p>Is the documentation of a suitable standard for independent audit?</p>
Forecasting cash flows	<p>Are cash flow forecasts reasonable and supportable?</p> <p>If cash flows are predicted to increase significantly after year end, is there a strong basis for this prediction? Have any risks been considered? Is the</p>

³⁸ The questions were created in reference to the *ASIC Information Sheet 203: Impairment of non-financial assets: Materials for directors*.
<https://asic.gov.au/regulatory-resources/financial-reporting-and-audit/directors-and-financial-reporting/impairment-of-non-financial-assets-materials-for-directors/>.

	<p>growth consistent with past growth achieved and is it sustainable? Have predictions been met in the months since year end to the completion of the financial report?</p> <p>If cash flows are based on an internal budget, is the budget realistic or based on stretch goals?</p> <p>Have past cash flow forecasts been met? If not:</p> <ul style="list-style-type: none"> • Has careful consideration been given to whether current forecasts and assumptions are reasonable and supportable? • Have the reasons been analysed and addressed in current forecasts and assumptions? <p>Are management's forecasted cash flows consistent with your understanding of the business and its future prospects?</p> <p>Has the cyclical nature of a business over time been properly recognised, rather than assuming cash flows at the top of a cycle will continue?</p> <p>Are nominal cash flows discounted using discount rates that include the effect of inflation?</p>
Key assumptions	<p>Have key assumptions such as growth or discount rates been adequately supported?</p> <p>Is the discount rate appropriate, having regard to funding costs, and an appropriate weighted average cost of capital or other appropriate rate?</p> <p>Is there a reasonable and supportable basis for use of different or similar discount rates for different CGUs?</p> <p>Has the impact of risks associated with matters such as market changes, climate change, technological change, or possible changes in business models due to digital initiatives of the company or its competitors, been considered?</p>
Disclosures	<p>Have key assumptions used in the impairment calculations for each CGU been disclosed in the financial report, including whether the assumptions reflect past experience?</p> <p>Where a reasonably possible change in a key assumption could lead to an impairment loss, has this been adequately disclosed in accordance with IAS 36?</p> <p>Have disclosures necessary for investors and others been made as appropriate beyond the minimum prescribed in IAS 36?</p>

Consistency with other information	<p>Are forecast cash flows and other assumptions consistent with other information, such as:</p> <ul style="list-style-type: none"> • realistic budgets and sales predictions • the operating and financial review, market announcements, and presentations to investors and analysts • commentary in other board papers and reports, and • external commentary on, and your understanding of, the market and economy? <p>Has the impairment test in IAS36 for exploration and evaluation assets been applied after technical feasibility and commercial viability have been demonstrated?</p>
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This list is not meant to be exhaustive.

Sample questions from audit committees (or TCWG) to external auditors

Matter to consider	Questions to consider
Concerns of the auditor	<p>Does the auditor have any concerns about the value of non-financial assets?</p> <p>Has the auditor raised any matters in their current or recent past management letters or reports to the audit committee (or TCWG) relating to impairment, or with the company’s process for testing for impairment?</p> <p>Have any concerns of the auditor been adequately addressed on a timely basis?</p> <p>Have you raised any concerns that you have with impairment testing with the auditor?</p>
Quality of the audit	<p>Does the auditor have appropriate experience and expertise to review the impairment work?</p> <p>Has the auditor devoted sufficient resources and time to the review of the impairment testing?</p> <p>Is impairment work made available on a timely basis to ensure that the auditor has sufficient time to undertake their review?</p> <p>Is impairment work adequately performed and documented to facilitate the audit?</p>

	<p>Have asset values and impairment calculations been made available to, and assessed by, the auditor well before the reporting deadline?</p> <p>Has the auditor demonstrated a sufficient understanding of the business, operations and risk areas relevant to the financial report, and have they responded appropriately to assessed risks of impairment?</p> <p>Has the auditor exhibited sufficient professional scepticism in challenging, rather than rationalising, cash flows and assumptions used in asset values and the resulting values?</p> <p>Has the auditor addressed any risks or concerns identified by the directors and the audit committee (or TCWG)?</p> <p>Has the auditor used their own experts to review the work of experts engaged by management?</p>
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This list is not meant to be exhaustive.